ICAEW Tax Faculty welcomes the opportunity to submit evidence on HMRC powers and making tax digital in response to the call for evidence on Finance (No.3) Bill 2017-19 published on 21 September 2018 by the House of Lords Economic Affairs Committee Finance Bill Sub-committee

This submission of 1 October 2018 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW’s membership. The Tax Faculty’s work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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A. HMRC POWERS

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

1. The Review of Powers, Deterrents and Safeguards (the Powers Review), which ran from 2005 to 2012, established a clear set of principles for developing HMRC’s powers. These principles were agreed in consultation with stakeholders including ICAEW. They remain just as valid today and should underlie the design of HMRC’s powers. We refer to these principles in this document and reproduce them in full in an Appendix for the Committee’s reference.

2. Particularly relevant to this inquiry is the principle that HMRC’s powers should be proportionate. This means they must be appropriate to the mischief they are seeking to address.

3. Powers and sanctions must also be proportionate in relation to the taxpayers who may be subject to them. ICAEW does not condone tax avoidance or evasion and is fully supportive of HMRC having the necessary powers to tackle these. However, for those who have made innocent or careless errors, or have simply fallen foul of the UK’s very complex tax system, the compliance system should support them in getting back on track but not penalise them disproportionally. In applying its powers, HMRC must recognise that the majority of UK taxpayers seek to be compliant.

4. These principles are also specifically stated in two of the taxpayer rights set out in the Your charter. HMRC will:

   - respect you and treat you as honest;
   - tackle those who bend or break the rules.

5. ‘Your charter’ is the UK’s taxpayer charter, developed out of the work on safeguards which formed part of the Powers Review.

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

6. The same principles should apply as those established by the Powers Review. The fact that HMRC’s powers are being developed in the context of global information exchange and the move to digital methods does not alter the relevance of the principles themselves. It may, of course, raise new issues as to how the principles and safeguards can be effectively applied in the modern age.

7. The move to digital raises an important question about safeguards for the digitally excluded. ICAEW fully supports the introduction of digital methods to facilitate the operation of the tax system. If implemented effectively, digital methods will bring benefits for many taxpayers and assist HMRC in efficient compliance activities. However, many people are unable to use digital methods (eg, because of disability, financial constraints, or lack of adequate broadband), and others are unwilling to do so (eg, because of concerns about data security). Such individuals should not be disadvantaged in the move to digital.

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.
8. The Powers Review aimed to develop a set of powers (enacted in the most part in Finance Acts 2007, 2008 and 2009) which was consistent, aligned as far as possible across different taxes and situations, and in which powers were balanced by taxpayer safeguards.

9. Since then we have seen more powers ‘bolted on’ to the framework, particularly on offshore-related non-compliance, which do not follow the principles of balance. Examples are the increased time limits for overseas matters (see below) and increasing use of ‘strict liability’ rules where there is no criminal intent, as in the ‘requirement to correct’ (RTC) rules in Finance (No 2) Act 2017.

Compliance in practice

10. There is evidence from our members that HMRC is not deploying its compliance powers fairly or correctly. Some brief examples (on which we can provide more details) are:

   - When HMRC opens a self-assessment enquiry it is required by its own guidance to explain the risks or concerns which have prompted this. Often this does not happen and the officer is reluctant to give the relevant details.
   - HMRC often writes to taxpayers requesting a meeting. In fact HMRC has no power to require a meeting or to enter premises, but does not make this clear.
   - HMRC has a power to inspect premises but no power to conduct a search. Officers have been found going beyond their power in this respect.
   - HMRC has information powers under Schedule 36, Finance Act 2008 to request information reasonably required to check a tax position. On occasion officers fail to confine their requests to what is reasonably required or to a specific tax year.
   - HMRC has a power to make a discovery assessment, but it must have grounds for the discovery, and this is not a power to open an enquiry. We have seen HMRC officers refer to a ‘discovery enquiry’ when they do not have the requisite evidence.
   - In recent months HMRC has sent letters (known as ‘nudge letters’) to people who might have undisclosed tax liabilities in relating to offshore matters and who could be caught by the RTC rules. The strong wording of these letters has caused considerable concern among taxpayers. The letters also attach a certificate for recipients to complete, which HMRC presents as though it were an official requirement – but in fact has no statutory basis.
   - Recent letters sent to tax agents from HMRC, headed ‘Data Protection Act’ or GDPR, imply that data protection rules give HMRC power to request information. In fact these rules are relevant to whether agents can supply information but they are not an HMRC information power.
   - HMRC often seeks to apply a penalty for tax return errors for careless or deliberate behaviour, but fails to explain (or apparently to understand) that the burden of proof is on HMRC to show that the behaviour was careless or deliberate.
   - Anecdotal evidence from members is that in a tax enquiry HMRC does not consider whether its approach is proportionate or likely to prove fruitful, but continues in the hope that they may find something. This is not helpful or cost-effective for anyone.

11. We are not able to explain why these problems are occurring. One reason may be lack of training for HMRC staff on the legislation which underpins their work. Lack of HMRC resources and pressure to reduce the tax gap may be other factors.

Powers and sanctions as a deterrent
12. The main purpose of penalties and other sanctions should be to act as a deterrent, to prevent non-compliance in the first place, rather than to penalise people after the event. However, penalties and sanctions only work as a deterrent if taxpayers are aware of them and understand what is required in terms of compliance. HMRC must do more to make sure taxpayers understand the UK tax rules and their obligations, and that they are aware of the sanctions.

13. Constraints on HMRC resources have meant that in recent years it has done little national advertising of compliance matters. Often is has relied on other bodies to disseminate the message. A recent example is the lack of advertising of the Worldwide Disclosure Facility, viewed by HMRC as a last chance to correct offshore-related non-compliance, presumably on the grounds that taxpayers should have been aware of the need for disclosure following various previous campaigns and offshore disclosure opportunities. However, the reality is that many taxpayers were completely unaware of the issue and (with no intent to be non-compliant) had little understanding of the requirement to correct or of how offshore income or gains are taxed.

**Taxpayer charter**

14. The requirement for a charter setting out the responsibilities and obligations of HMRC and taxpayers is in s16A, Commissioners for Revenue and Customs Act 2005. This lays down that the charter must “include standards of behaviour and values to which [HMRC] will aspire when dealing with people in the exercise of their functions”. It also requires HMRC to provide an annual report of how it has demonstrated charter values.

15. However, this safeguard is not as robust as might at first appear, as the charter rights themselves are not in legislation. In practice taxpayers have no legal route to enforce these rights, although they can (for example) include reference to them in complaints to HMRC or the Adjudicator.

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

16. Please see reply to previous question.

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

17. Please see reply to question before last.

*Is there sufficient oversight of HMRC powers, and safeguards against their abuse or misuse? Does the oversight and governance of the powers need to be improved? If so, how?*

18. In practice, the oversight of tax powers and safeguards is carried out by HMRC itself.

19. Various bodies, including the National Audit Office and the parliamentary Treasury Committee, House of Lords Committee and Public Accounts Committee, review HMRC’s reports and activities.

20. The committee which reviews the operation of ‘Your charter’ has external members but is nonetheless a direct sub-committee of the HMRC Board.

21. We would strongly recommend that an independent body should have oversight of how HMRC deploys its powers and exercises the relevant safeguards.
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?

22. With regards to ss33-34 of the draft Finance Bill, we do not consider that this change incorporates the principles of proportionality or balance noted above. HMRC will now be able go back 12 years to make assessments (regardless of whether taxpayers have the relevant records) but taxpayers can still only go back four years to make claims.

23. We do not think it is right that the distinction between innocent and careless errors is being removed by the new legislation. The distinction between innocent and careless errors was arrived at after considerable debate and discussion and it remains equally valid now. It follows that the reduced assessment period for innocent errors should remain.

B. MAKING TAX DIGITAL FOR VAT

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?

24. The Committee will be aware of the significant change to the timetable for implementing Making Tax Digital for Business which was announced by the government on 13 July 2017. This change was widely welcomed. It has meant that the focus of attention has shifted to MTD for VAT. Although the MTD for income tax pilot is now in public beta, only four software products have been made publicly available. Only a small number of businesses are participating in the pilot and most software companies have put development of MTD for income tax on hold (as few as 20 are involved which contrasts with more than 150 for MTD for VAT).

25. The rest of our response below covers MTD for VAT only.

26. One consequence is that a business will now be selecting accounting software for MTD for VAT from a wide range available, but without knowing whether the same provider will also be offering an income tax or corporation tax product to suit their business in due course. A business needs to use the same accounts to fulfil all its tax reporting obligations.

27. The legislative framework for MTD for VAT was completed when the MTD for VAT Notice 700/22: Making Tax Digital for VAT was published on 13 July 2018. It was only at this point that there was any certainty over the detailed requirements and even now there are some aspects where further clarity and additional HMRC guidance is required.

28. The MTD for VAT pilot started in April 2018. HMRC has been exercising very tight control over who is allowed into the pilot and the eligibility criteria have remained very tight. This has meant that until now, the pilot has included a very small number of the simplest businesses; we have asked HMRC to share information on the number of businesses in the pilot, but this information has not been provided.

29. ICAEW is very concerned that until the system has been tested by significant numbers and all types of businesses, it is not possible to have confidence that it will work well. The eligibility criteria are now beginning to be relaxed but there are still very significant categories of business which cannot join the pilot, for example partnerships. This needs to be addressed as soon as possible. The date for the pilot to be extended to more businesses (what is known as opening it up to public beta) was to have been in the summer; this deadline was then moved to late summer/early autumn and has been delayed again to ‘before the end of 2018’. HMRC has not shared a timetable for relaxing the remaining eligibility criteria.
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? The Sub-Committee would be interested in hearing about the experiences of individual businesses preparing for implementation, as well as more holistic responses.

ICAEW research on business preparations

30. Research by ICAEW has revealed that over 40% of businesses about to be affected by Making Tax Digital (MTD) for VAT are not yet aware of it. Overall, 38% of all UK businesses now use accounting software for keeping their accounting records, a significant increase since 2016. This increase seems to have come from businesses which had previously been using a mixture of electronic and paper-based systems.

31. Only 54% of VAT registered businesses currently use accounting software. The proportion of all businesses relying on paper-based records alone remains unchanged at 25%, and this includes 13% of those businesses that will need to implement MTD for VAT.*

32. Of those businesses we surveyed, 34% will be relying on their accountant or tax adviser to deal with the changes for them, 20% will be buying new accounting software and 15% have done so already. However, 20% of businesses that will need to implement MTD for VAT have not yet made any preparations for it.

33. This lack of awareness is perhaps understandable as HMRC has not yet taken any steps to communicate directly with businesses affected. To date HMRC has communicated with software providers and professional bodies and other intermediaries but not directly with businesses.

34. It will take businesses some time to choose software and implement the necessary changes and ICAEW is concerned that there is insufficient time for businesses to implement the necessary changes and for accountants in practice to support their clients through this change process.

Software industry

35. ICAEW’s understanding is that the software industry is well advanced in developing products that will meet the requirements of MTD. However, due to the very restrictive eligibility criteria they have not been able to put significant numbers of their customers into the pilot and so have not been able to test scalability.

HMRC

36. As well as developing the APIs (Application Program Interfaces) that the software industry needs to develop their products, HMRC also needs to complete work on its internal systems. This includes a project to move all VAT records across on to a new ETMP (Enterprise Tax Management Programme) platform. We understand that this work is ongoing but HMRC has not shared a timetable for the completion of this significant piece of work.

37. Another important aspect of HMRC preparations is to ensure that its customer service offering is ready. We are not aware of HMRC’s plans to ensure that their staff are trained and ready for April 2019.

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.

38. Only a small number of businesses are involved in the pilot of MTD for VAT and most of these will have submitted one VAT return at most, so there is little real data available. The main cost is the cost of software. There appears to be significant interest in software
products that enable businesses to file their VAT returns from spreadsheets. This interest is across all sizes of business; the smallest ones may use spreadsheets to record all their transactions, larger and more complex businesses will use them to consolidate information held in several different systems and to make a variety of adjustments (such as partial exemption calculations) that are required to arrive at the final figures for the VAT return. We have seen suggestions that the price of such products may be around £250 per annum plus VAT, but others are considerably cheaper. We are aware that some software companies are upgrading their cloud-based software products to meet the MTD for VAT requirements but are not upgrading their older products. This change can mean significant additional costs for businesses that have made a one-off purchase of software as they will be required to move to a subscription-based service.

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

39. We support the new VAT penalty and interest regimes proposed in the draft Finance Bill but our concern is the transition to the new regimes. ICAEW is concerned about the uncertainty over the penalty regime that will apply in the first year of mandatory MTD for VAT filing in 2019/20. Paragraph 20, Schedule 11 gives HMRC the power to make regulations to provide a period of grace (familiarisation period) during which points and penalties for a late return would not be incurred when a new or amended return obligation is introduced. It appears that there is no such period of grace for the current default surcharge regime for VAT which will apply in 2019/20, the first year of the new MTD for VAT obligations.

40. The practical application of the old and new penalty rules needs careful managing, with clear communication to businesses. Many VAT registered businesses do not use a professional adviser for what has previously been seen as a simple administrative task. In particular the withdrawal of the seven-day period of grace for submitting a return should be explained.

_What are the implications of having different penalty regimes for different taxes?_

41. ICAEW welcomes the decision to introduce the new penalty measure separately for each tax regime and that the introduction of a single penalty regime covering all of a taxpayer’s filing obligations has been put aside for future consideration.
APPENDIX

Principles established by the Review of Powers, Deterrents and Safeguards

“To be both effective and respected, powers and the statutory obligations they impose need to be:

- set within a clear statutory framework;
- easily understood – by taxpayers, their agents and HMRC staff;
- straightforward to comply with;
- proportionate to what HMRC needs to discharge its responsibilities or to protect the Exchequer from the risk assessed;
- used consistently; and
- effective in providing the information HMRC needs to assess risk and discover and deal with non-compliance.

“Sanctions for non-compliance must be:

- set in statute;
- clear and publicised;
- proportionate to the offence;
- used consistently; and
- effective in deterring non-compliance and returning the non-compliant to compliance.

“Safeguards for citizens and businesses must be:

- clear, publicised and accessible;
- effective; and
- responsive to the nature and purpose of particular powers and sanctions.”

[Source: Modernising powers, deterrents and safeguards: A consultation on the developing programme of work, March 2006. These principles are repeated in all subsequent consultations which formed part of the Powers Review.]

Full details of the Powers Review can be found online in the national archives at: http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/about/powers-appeal.htm
KEY POINTS

HEADING 2

Heading 3

Heading 4

42. Numbered text
   • Bullet text
     - Bullet 2 text

ANSWERS TO SPECIFIC QUESTIONS

Question 1

Heading 3

Heading 4

43. Numbered text
   • Bullet text
     - Bullet 2 text