ADMINISTRATIVE BURDENS ADVISORY BOARD

Better Tax For Better Business

Rt Hon Andrew Tyrie MP
Chairman of the Treasury Committee
House of Commons
Committee Office
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Dear Andrew

Making Tax Digital

In your letter of 23 March you asked ABAB for an independent view of the analyses supplied by HMRC and the FSB on their view of the likely costs of HMRC's Making Tax Digital (MTD) proposals. As you appreciate, we do not have the resource to carry out detailed technical analysis of these papers but by drawing on the experience and knowledge of our members feel we are in a position to make a valid critique of them.

Both papers have merits and we welcome (as will all those involved with MTD) these fuller analyses. Enclosed with this letter is an annex setting out some points we would make on the two approaches. In summary we would comment:

- The two papers approach the issue from different starting points. HMRC have done an internal analysis using their SCM approach to estimate costs and have done so in careful stages. The FSB have surveyed members and asked for views on current costs from those who will have to do the compliance and who are currently doing the necessary compliance under the current system. Both approaches are in principle valid.
- Any estimates of MTD costs at this stage will suffer from the facts that there are no products yet available to really use in modelling or testing and that the exact requirements for filing are not yet set. Thus any cost estimates are to a degree 'shooting in the dark' and are necessarily based on the estimator's expectations of what products will do when available.
- HMRC's costings assume that products will be available as planned; that they will operate in such a way as to require no or minimal intervention from businesses or advisers. The FSB implicitly challenge this (we have some sympathy with this: ABAB remain to be convinced that this will be the effect) and so expect considerably more human intervention.
- HMRC rightly assume that producing four updates a year – the core of MTD – will not each require similar effort to that currently expended on tax returns. Here, we think, the FSB has overestimated the costs (even though they have used a multiplier of three rather than four).
- However, we do think that HMRC has underestimated the amount of checking that business will want to do – either themselves or through their agents – for the MTD submissions. This will probably tail off once businesses become familiar with MTD and become more confident in the system but will be a part of the transitional costs at least.
- We wonder if either paper has given sufficient consideration to the fifth submission (the 'end of period return', required by TMA 1970 sch1A para 8). It will be a challenge to reduce the time for this as HMRC envisage; we also note that a sixth submission

(the 'final declaration', which could be a sort of residual annual tax return, required by new TMA 1970 sch1A para 8(7)) will be needed; this should be a simple procedure but will still take time.

- We note that HMRC think that there are over 100 obligations connected with the tax return process and that over 80 will either '…remove, reduce otherwise [be] affect[ed]…'.. This is impressive and laudable but we do not have the detail of these advances.

In short we cannot say that either of the papers represents the true picture of MTD costs. Nor would you expect us to. Whilst we believe that HMRC's analysis is more scientific and structured than that of the FSB, we would urge them to apply more granularity to the numbers thereby placing less reliance on the SCM model which we believe results in too much optimism.

We have in our analysis given an indication of our concerns but one point to make is that any pronouncement on costings from any organisation needs to make it clear that any figures are estimates and that at this stage much is uncertain.

However, our overall conclusion is that HMRC, in setting out these figures, have given themselves a target to deliver against. They and the FSB should commit to monitoring the costs as MTD is implemented and the Government should commit to a full post-implementation review (PIR) of MTD in the light of the first couple of years' experience. As ABAB have said before, such PIRs are too rare with changes to the UK's tax system and need to become routine so that proper lessons are learned and, if necessary, adjustments made.

Yours sincerely

Teresa Graham
Chair, Administrative Burdens Advisory Board

Annex

Commentary on the HMRC and FSB approaches and methodology

HMRC

1. The HMRC approach to analysing the transitional and ongoing costs for small businesses is very scientific. The figures are detailed and seem credible. HMRC has analysed the various steps needed to comply with annual tax obligations and costed these using their standard cost model (SCM). They have then looked at the steps post MTD using the same approach and thus arrived at an average cost or saving as a result of the change.

2. We appreciate that HMRC try to keep the SCM methodology up to date (indeed ABAB had a presentation last year on updating the model) but we are not convinced it is fully reflective of the sorts of costs incurred in today's environment. But we accept it has been applied consistently and so is valid for comparative figures.

3. One point we would make is that the SCM looks at three categories of business – "small", "medium" and "large" – separately. The population sizes are very disparate – there are 3.4 million small businesses, 40,000 medium and 10,000 large. However, the "small" business population is very widely spread, and probably predominantly micro businesses and the sole traders, which are less likely to be digitally engaged (taking the population as a whole) and have lower bookkeeping skills. So although the work done has been approached on a scientific basis, the average still may not fairly represent the costs to many very small businesses.[1]

4. Inevitably one problem with the SCM approach is that it deals in averages. It has estimated costs across the population but there are many separate sectors of the 3.4 million population. This masks the fact that for an appreciable number of businesses the costs will be understated – while overstating the costs for others.

5. While not arguing that the SCM is inappropriate per se, because it looks at costs across a very wide range of businesses, it frequently produces results that do not 'feel right' to businesses and their representatives. This is evident in the costings produced for MTD, as HMRC's methodology indicates that they assume a (small) proportion of small businesses will have to purchase computer equipment in addition to software in order to comply with their responsibilities under MTD. Because this is not applicable to the entire 3.4 million population, averaging this out across the population produces an artificial figure which seems too low to those who will have to incur the expense. It might be more appropriate for HMRC to give a range of costs and the assumptions underlying them along the lines of:

    a. Businesses which need to acquire equipment and software to comply with MTD are likely to incur costs of £X; we estimate this to be y% of the small business population.
    b. Businesses which already have the appropriate equipment but need to upgrade software are likely to incur costs of £A; we estimate this to be b% of the small business population

[1] The HMRC costings correctly focus on unincorporated businesses as they are the ones first going into MTD; we are not sure that the FSB have excluded companies from their calculations.

c. The remainder of the small business population is likely to incur costs of the order of £H.

6. Without knowing what time factors were used to determine the transaction processing times and savings it is difficult to comment on that aspect of HMRC's costings. The experience of ABAB members suggests that HMRC may have underestimated the time taken to familiarise with software and the new methods. There remains a significant issue around businesses who routinely use Excel and similar methods and how well software will enable their use to continue. Those businesses not currently registered for VAT will have a particular issue in becoming familiar with quarterly returns (though of course there is a one-year deferral for such businesses as a result of the Budget announcement, something we welcome and think is sensible).

7. We also think that businesses will want their agents to do more checking of data submissions than HMRC anticipate, as least in the early stages of MTD. The best response to this would be to examine a control group of small businesses during transition and collate the actual time spent on these activities. HMRC's comments on page 5 about the frequency of returns meaning lower use of agents rather misses the point that much depends on what is required in those returns: for example, those relating to payroll would normally fall out of payroll software so would not usually involve an agent – unless of course an agent is doing the payroll. And whatever the software does in terms of facilitating MTD updates, we do not yet see that it will obviate the need for work on allowable/disallowable analyses and such things as capital allowance claims. At the same time as saying all this, we are alive to HMRC's vision that MTD will simplify systems such that businesses will make **less** use of agents.

8. We are impressed by HMRC's comments from their customer journeys analyses that as a result of MTD 80 or over 100 separate obligations may either '...remove, reduce or otherwise affect...'. It would be interesting to see the details of these listings. Whilst we have no reason to doubt HMRC's analysis, we have to note that 'or otherwise affect' seems to imply increasing the tasks involved; inevitable the admin burden changes are not all one way.

9. There may be other costs which HMRC has overlooked – to the extent that businesses decide to use a bank feed for accounting (which would produce a potentially significant time saving), it is usual for banks to charge a fee for providing this data feed. Although over time this may diminish, at present businesses will incur an additional £5 to £10 per month for this service, in addition to monthly ongoing software costs. HMRC have probably expected that all businesses which qualify for free software will make use of it, minimising the cost to them of acquiring software. To the extent that agents are encouraging clients to adopt digital record keeping now, to give time to prepare adequately, businesses will not be using free software as there is not any available at this time. This will, of course increase costs to those businesses.

10. We also wonder about the costs of the end-or-year returns. These seem to us to be underestimated. In this context, we are naturally pleased that partners will no longer have to complete a return in many circumstances (page 9): we would just note that this is a reform that should be happening irrespective of MTD, to reduce the inherent duplications of information currently provided.

FSB

1. Turning to the figures prepared by the FSB, it is true to say that they are based on 'real' businesses. The costs of complying with tax legislation and completing the various accounting and filing requirements have been collated by surveying members. This is an appropriate approach for a membership organisation to take, and provides some 'real life' estimates of current time taken to comply. It may be challengeable as subjective, but it is based on the judgements of those who have to do the work.

2. One immediate point we would make in respect of this approach is that genuinely very small businesses – micros etc. – do not tend to be members of FSB, as they are unwilling or unable to support the cost of membership.[2] The costs identified as current costs do not, potentially, represent this sector of the business population, which one might argue is the sector of greatest concern. Many, for example, will not be VAT registered and, as we have noted in the context of the HMRC analyses, face significant change to their reporting routines.

3. Possible variations in the time taken to comply presently, as a result of the above, include the fact that larger businesses may have a bookkeeper, that there may be other requirements such as VAT or company accounts that they need to comply with, so it is not clear that the 'current state' adequately represents the same measure as HMRC have used as their start point. Segmenting the estimate as described above might aid understanding, rather than using an average cost.

4. However, when it comes to the post implementation estimate of costs incurred, we feel that the FSB's figures are flawed. Rather than break down what is needed under the new rules and cost this out, they have simply multiplied the current annual cost by a factor of three, observing that as there are four filing obligations a year, there may be some time saving overall, so instead of using a multiplier of four, they have used a factor of three.

5. The justification for this approach is likely to be that the FSB 'does not yet know exactly what is required under MTD', which has been a particular issue expressed by the body and has some validity. However, sufficient is known to make a more appropriate estimate of compliance costs than a simple multiplier, which may misunderstand the processes involved at the simplest level.

6. The following chart indicates at the most basic level where the additional time will be needed compared to steady state (this analysis does of course have resonances for the HMRC analyses):

Task	Now	MTD	Notes
Prepare accounting records for the full financial period	Yes	Yes	1
Use digital tools to prepare accounting records	No	Yes	2
Submit to HMRC the totals in the accounting records on a quarterly basis	No	Yes	3
Prepare or have prepared final accounts for the whole period including taxable profit	Yes	Yes	4
File an annual return showing taxable profit	Yes	Yes	5

[2] One ABAB member notes that she has worked with these very small businesses for 30 years, and none of her clients has ever been a member of FSB. This is a view subscribed to by other members of the Board.

Notes

i. There is no difference in the amount of record keeping required before and after MTD. Accounting records need to be prepared covering the full period. In terms of tasking the increase or decrease time taken will be related to item 2. It certainly will not be a multiplier in steady state.

ii. This is the main area where extra cost and time are likely to be incurred by the smallest businesses, particularly those who are not confident with technology. Although modern business apps will make this as easy as possible, with potentially very little bookkeeping knowledge needed, many businesses will spend quite a considerable time familiarising themselves with the routine tasks that they need to perform. Some businesses are likely to prefer to pay an accountant to do this for them, in which case the existence of free software is of minimal help because the accountant will use paid for software, the cost of which will be borne by the client – whether specifically billed or not.

iii. This is a new responsibility, but provided the records are kept up to date at least quarterly, the update itself will take minimal time. If a business wishes to ask an accountant or bookkeeper to perform some basic checking at this point, that could be viewed as an additional expense, but it is likely that the same checks would be carried out at the year end point, so in fact this is not really an additional task. A small allocation of time cost could therefore be attributed to this extra step.

iv. The preparation of final accounts and a taxable profit figure is unchanged. However, HMRC's view is that this is likely to be easier than undertaking an entire year's accounting records at one go, significantly later when much of the information has to be searched for. It is certainly true that preparing the final accounts will take no longer under MTD, and it is very likely that this will be a quicker task.

v. Although the business will no longer file a tax return under MTD, there is a requirement to complete the year by filing the annual confirmation of final profit. I have thus equated the two. The fact that if prepared by the business this is likely to come direct from the software is a good reason to regard this task as easier under MTD than currently; it is sufficient to argue that there is no increase in time and cost here.

7. In summary, the approach of the FSB in applying a simple multiplier of 3 is unlikely to provide a proper estimate of the additional costs incurred, because the basis of this is demonstrably incorrect, as shown by the analysis above. At the same time, their costs do not include the costs of hardware, software or additional accountancy expenses, which would inflate the figure further.