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Submission to be found under Federation of Small Businesses and Association of Independent Professionals and the Self-Employed (IPSE) – Oral evidence (70-76) (FBBOE0004).
House of Lords Select Committee on Economic Affairs:
Finance Bill Sub-Committee

IPSE Evidence Submission February 2016
About IPSE:

- The Association of Independent Professionals and the Self Employed (IPSE) represents the estimated 4.6 million individuals working for themselves in the UK.

- Often referred to as freelancers, contractors, consultants and nano-businesses, independent professionals are highly skilled specialists supplying their expertise on a flexible basis to a variety of businesses - from large companies to SMEs.

- IPSE has 22,000 members, 96% of which work through their own limited companies ('limited company contractors’ or ‘personal service companies’). IPSE also represents sole traders and freelancers who operate in partnerships or via ‘umbrella’ structures. It therefore represents the very smallest enterprises in the UK.

- Research has shown that freelancers allow businesses to promote innovation, maximise performance across peaks and troughs in demand, and create jobs by increasing the level of innovation and efficiency in the economy.

IPSE’s submission to the Finance Bill Sub-Committee:

- This document constitutes IPSE’s written evidence submission to the Committee.

- We have provided answers to the questions outlined in the “Notes to Witnesses” supplied to IPSE prior to the evidence session of 3rd February 2016.

- Should further information be required on any information supplied below, please contact:

Andrew Chamberlain

Deputy Director of Policy and External Affairs IPSE
The Association of Independent Professionals and the Self Employed (IPSE) – Written evidence (FBB0012)

Answers to questions posed by the Committee

1. Major reforms are proposed to the taxation of dividends. Do you agree that these changes will “modernise, reform and simplify dividend taxation” as the Government suggests? Or is the dividend allowance an example of the proliferation of tax reliefs already in the UK system that adds complexity for personal taxpayers?

IPSE believes the primary motivation behind the change to dividend taxation is to increase tax receipts, not to simplify the system.

However the introduction of the £5000 allowance does replace the ‘dividend tax credit’ which we believe was confusing as it was ‘notional’. The tax credit could not be reclaimed in hard cash. Instead the dividend was treated as having a tax credit in the hands of the shareholder which meant basic rate payers didn’t need to pay any extra tax. IPSE believes the new system will be easier to explain to the taxpayer and therefore could be considered a simplification.

2. One purpose of the changes to dividend taxation was to address the situation where private companies (including personal service companies) paid less tax and national insurance contributions by structuring payments as dividends rather than salary. The change would bring their tax rates closer to those paid by taxpayers operating through an unincorporated structure. What are the implications for your members? How are they likely to manage any impact on their business?

IPSE estimates a business turning over £80,000, and paying its sole director mainly in dividends, will pay around £3,500 more in tax per year once the new rules come in. The exact figure will vary depending on the level of salary they pay and the costs incurred by the business.

Businesses will either attempt to pass this cost on to their clients (possibly via the agency) or will absorb the costs themselves.

Passing the costs on to the agency / client will undoubtedly put a strain on the commercial relationship so many businesses will have to ‘take the hit’.

Although the change might bring the total tax paid by incorporated entities closer to that of sole traders (unincorporated businesses), very few IPSE members will have the option to ‘unincorporate’. This is because their agency and clients typically insist on the limited company structure as it removes liability for tax and limits employment status claims.

For this reason IPSE believes the Government has overestimated the impact of tax motivated incorporation (TMI) which it claims will be reduced by £500m a year as a result of this measure (page 45 of the Summer Budget Report). Businesses have to incorporate as engagers insist on it – changes to the taxation of dividends will not have a significant effect.

IPSE believes in fairness and consistency in the tax system. Although this tax rise will be unwelcome to those affected (including our members) it is being applied to all shareholders equally, so it is not considered unfair. Many IPSE members see the change
The Association of Independent Professionals and the Self Employed (IPSE) – Written evidence (FBB0012)

simply as part of the cost of doing business in the UK.

There is concern though that the rate of taxation (initially set at 7.5% above current levels) could be easily changed in the future. Businesses need certainty on their tax affairs. They would not relish waiting to find out what each year’s dividend tax rate will be on Budget day.

3. Clause 71 introduces a new power for HMRC to assess individual tax liabilities using information supplied by third parties such as pension providers or banks. At first glance this change looks like it will make it much easier for those with relatively simple tax affairs to manage them. Do you agree? Will they have the ability and information to check and, if necessary, dispute HMRC’s tax bills?

This initiative appears to be part of a suite of initiatives (like Accelerated Payment Notices) designed to allow HMRC to access more quickly the tax it believes is due.

HMRC will be able to see where taxable income has been received and contact the taxpayer to request payment straight away, rather than waiting for the tax return which may not be due for 21 months.

On the face of it, this approach doesn’t seem unreasonable; however, is HMRC in possession of all the facts? Have any legal or professional fees incurred in generating the income been accounted for? Will the income generated be off set against losses made by the taxpayer in the same year?

While IPSE can see the logic in accelerating tax receipts, it would be interesting to understand how HMRC believe Simple Assessment would work in practice. Would the sale or taxable event trigger contact from HMRC? Would it require the individual to make a return to HMRC (but not register for SA)? What happens if HMRC or the taxpayer get it wrong? How are the parties protected? Would there be a penalty regime for taxpayer error?

IPSE is therefore not necessarily opposed to this measure but we do have some concerns about how this initiative would work in practice.

4. Simple assessments have been presented as first step on a path that leads to the eventual replacement of tax returns by ‘digital tax accounts’. We understand that FSB members are particularly concerned about the proposed requirement for small businesses to provide HMRC with information quarterly rather than annually as at present? Do IPSE members share those concerns?

IPSE has serious concerns about the ‘Making Tax Digital’ initiative which includes the shift to quarterly returns. The change will require business owners to update their books and report to HMRC four times per year, instead of just once. IPSE believes this represents a straightforward increase in the amount of red tape businesses have to deal with.

Many of the smallest UK businesses do not keep digital business records - everything is kept on paper, so the change in working practices they are being asked to make is significant.

In addition, not all data is available quarterly. For example, banks supply an annual
The Association of Independent Professionals and the Self Employed (IPSE) – Written evidence (FBB0012)

interest statement. Will they now be required to supply this information quarterly?

More reporting provides more opportunities for mistakes and more deadlines to miss, so unless the sanctions for mistakes are significantly lower than at present, businesses are likely to be hit with additional penalties.

Businesses will need to engage their accountants more frequently which will increase costs. Some estimate accountancy bills will increase significantly.

Government has not adequately explained how businesses without a decent broadband connection will be able to meet this requirement.

5. *The FBSC has commented that “The push towards digital must be introduced alongside tax simplification, with businesses able to choose the best tax reporting process appropriate for them.”* What specific simplifying changes did you have in mind? How would they make the introduction of digital tax accounts easier?

The aspiration to make the tax system simpler for tax payers is universally shared, including by IPSE.

In the last Parliament the Government introduced a ‘simpler income tax for the simplest small businesses’ initiative which IPSE supported. The scheme was designed to be made available to unincorporated businesses, under the VAT threshold. It enabled businesses to operate on a cash accounting basis for tax purposes. Where possible, IPSE would welcome similar initiatives for incorporated businesses too.

IPSE agrees that simplifications would smooth the transition to quarterly, digital reporting. Requiring businesses to report less information would ease the burden of requiring them to report it more frequently. IPSE believes that the quarterly system should initially be introduced on a voluntary basis.

6. *IPSE’s website states that “IPSE believes the Office of Tax Simplification has the potential to be a positive force in suggesting future tax policy and has been working with the body to develop a simpler tax system.” Would Mr Chamberlain please briefly outline IPSE’s experience of working with the OTS? Does the draft legislation establishing the OTS and its functions in statute go far enough in promoting simplification of the UK tax system?*

IPSE has worked with the OTS since it was set up in 2010. We have sat on its Consultative Committees, conducted research on its behalf amongst our members and responded to its calls for evidence. In addition we have arranged face to face meetings with our members and OTS staff to inform its work.

Most recently IPSE has contributed a paper to the OTS’s review of Small Business Taxation on a new type of limited company structure tailored to the needs of freelancers.

Under the leadership of John Whiting the OTS has tackled some of the most complex areas of the UK tax system and made a significant contribution to the simplification agenda.
The Association of Independent Professionals and the Self Employed (IPSE) – Written evidence (FBB0012)

IPSE fully supports the work of the OTS and welcomes its establishment in statute as a very positive step in the right direction. However, the Government must be bold and take up the recommendations of the OTS if real simplification is to be achieved.

2 February 2016
EVIDENCE FOR THE FINANCE BILL SUB-COMMITTEE
ON
CLAUSE 1 OF THE DRAFT FINANCE BILL 2016:
SAVINGS ALLOWANCE, AND SAVINGS NIL RATE ETC
Response by the Association of Taxation Technicians

1  Introduction

1.1  The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the Finance Bill Sub-Committee’s call for evidence on Savings allowance, and savings nil rate etc (Clause 1) published by HMRC and HM Treasury on 9 December with a view to inclusion in Finance Bill 2016.

1.2  We provide our comments on draft S12A and S12B at section 2.1 and 2.2 below. We also provide some more general commentary at section 2.3.

2  Our comments

2.1  S12A: Savings income charged at the savings nil rate

2.1.1  Subsection (1) of S12A states: “This section applies in relation to an individual who has savings income above the starting rate limit for savings”. We find the use of the word “above” potentially misleading as, if this statement was taken literally, someone who had savings income of below £5,000 (the current starting rate limit) might think that S12A does not apply to them. There are many situations where the level of other income is such that the starting rate limit does not apply but the savings income is below £5,000, for example, employment income of £30,000 and savings income of £2,000. We believe that there needs to be some consideration given to altering the wording of subsection (1) so that it is much clearer.

2.1.2  Indeed, we find that the draft legislation contained in S12A subsections (1) – (6) is generally more complex than it needs to be by making reference to ‘the excess’
(£X) being ‘so much of the individual’s income above the starting rate limit for savings as is savings income’ (subsection 2) and then having to compare £X to £A (the amount of individual’s savings allowance). It appears that the legislation has been written so as to deal with the very few cases where the starting rate limit and the savings allowance would both apply – e.g. Other income of £10,500 and savings income of £6,000. In reality, we would expect that there would be very few taxpayers where both would apply as people on very low incomes are not very often likely to have savings income in excess of £5,000. We believe that it would be more appropriate to draft the legislation in relation to the savings allowance and savings nil rate without reference to the starting rate limit for savings, and to instead have included one line within S12A with words to the effect that if the starting rate band should apply to the taxpayers circumstances then the legislation in respect of that takes precedence. This approach would have the added benefit that if the starting rate band is ever removed only one line of this legislation would need adjusting as opposed to the whole of S12A needing to be rewritten.

2.2 **S12B: Individual’s entitlement to a savings allowance**

2.2.1 Subsection (8)(b)(ii) includes the following statement: *Each of the following is “higher-rate income (ii) income on which income tax would be charged at the higher rate but for section 12A (income charged at the savings nil rate)”*. This is obviously designed to prevent someone having just £1,000 of savings income falling into the higher-rate band, but saying that it is exempted by a £1,000 savings allowance so nothing is chargeable at the higher-rate. The income is looked at before applying the savings allowance so a savings allowance of just £500 would be due, leaving £500 of savings income chargeable to tax at the usual rates.

2.2.2 However, subsection (8)(a), which defines *additional-rate income*, does not include a similar restriction so what is to prevent someone from having just £500 of savings income falling into the additional-rate band but saying that after applying the £500 savings allowance there is no income chargeable to the additional rate? We would not expect this to be the intention - that there should be differing treatment between what is defined as higher-rate or additional-rate income and the ability to claim a savings rate allowance if only £500 of savings income falls into the additional rate band - but it would seem like a possibility without a similar provision to (8)(b)(ii).

2.3 **General points about the legislation**

2.3.1 There is no mention of how the savings allowance applies to trust income. We would expect that for bare trusts and trusts where the beneficiary is entitled to
the income (interest-in-possession trusts) that the savings allowance ought to be available to the individual beneficiary in the usual way as the trust income is assessed directly on them. However, there is no confirmation of this included within the draft legislation and we think there should be.

2.3.2 We presume that discretionary trustees are not entitled to the savings allowance against trust income as all income is assessable at the additional (trust) rate, although this is again not confirmed in the legislation. At the very least both of our above points should be confirmed in guidance.

2.3.3 We are concerned about the complexity being added to the tax system by the fact that the savings allowance is being introduced at the same time as the dividend allowance. Whilst on the face of it both would appear to operate in similar ways, when one delves into the detail of the legislation they operate quite differently with the savings allowance being notably more complicated by the decision to have it as a two-stage allowance, so the allowance reduces if you are a higher-rate taxpayer and is nil if you are an additional-rate taxpayer. By contrast, the dividend allowance allows a straight £5,000 allowance across the board, regardless of a person’s highest rate of tax. We feel the legislation on the dividend allowance works much better because of this and is less discriminating. The same allowance is available to all by reference to just the dividend income whilst the amount of allowance available on the savings income is affected by what other sources of income a taxpayer has received. We believe that a full £1,000 savings allowance to all taxpayers would work better and provide legislation that was more straightforward and easy to follow.

2.3.4 We have concerns about how easy it will be to determine how much the savings allowance should be - £1000, £500 or NIL. This can only really be determined after the end of the tax year, when the full amount of the taxable income is known. So, how will relief for the allowance be given within the relevant tax year (especially important with the proposed move to ‘real-time’ reporting and payment) or will the savings allowance always have to be given at the end of a tax year? Or if it is given in-year, will it need to be adjusted at the end of the tax year? We appreciate that these are practical points rather than comments on the draft legislation but these issues will need clarification in guidance notes unless addressed within the legislation itself.

3 Summary

3.1 We trust that the points raised in this response provide useful evidence to the Finance Bill sub-committee. A copy of this response has also been forwarded to HMRC.

Yours sincerely
4.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible. Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia. The Association has over 7,900 members and Fellows together with over 5,800 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.

28 January 2016
1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the Finance Bill Sub-Committee’s call for evidence on the draft Dividend nil rate (Clause 2) provisions published by HMRC and HM Treasury on 9 December with a view to inclusion in Finance Bill 2016.

1.2 We provide our comments on new S13A at section 2.1, on the implications for trustees and personal representatives at section 2.2 and finally on the more general practical issues at section 2.3.

2 Our comments

2.1 S13A: Income charged at the dividend nil rate – Steps 1, 2 & 3

2.1.1 The Step approach adopted in draft S13A is very helpful, especially where dividend income straddles rate bands.

2.1.2 However, we believe there needs to be a small addition to Step 1, in subsection (2). Rule 1C considers the outcome if D (the amount of an individual’s income which would, ignoring S13A, be charged at the dividend ordinary rate) is less than £5,000 but more than nil. However, there is no mention of the possibility that D could be nil, as other income has pushed the dividend income straight into the higher rate or additional rate bands. We understand that the intended action is to follow the instructions at Step 2, but we believe that the legislation should explicitly state this for the avoidance of doubt as everything in Step 1 has so far ignored the possibility that D could equal nil.

2.1.3 Similarly, we believe that there needs to be an addition to the beginning of Step 2. Where the legislation currently says: “if D is less than £5,000, identify the amount of (‘U’) of the individual’s income which would, ignoring this section, be charged at the dividend upper rate”, we believe that after ‘£5,000’ the words ‘or is nil’ should be included for the avoidance of doubt.

2.1.4 In addition, at the end of Rule 2C, it should be made clear that if the total of D and U equals nil (as the dividend income takes the individual straight into the additional rate band) then Step 3 should be followed.

2.1.5 Similarly, in the first paragraph of Step 3, before the explanation of Rule 3A, the words ‘or is nil’ should be added after ‘if the total of D and U is less than £5,000’.

2.1.6 The comments in sections 2.1.2 – 2.1.5 may seem like minor drafting points, but we believe that, as the legislation has been specific in certain sections in referring...
to D (and the total of D and U) as being less than £5,000 but more than nil, the comprehensive design of the legislation would be completed by the inclusion of the rules to follow when D is nil.

2.2 **Implications for Trustees and Personal Representatives**

2.2.1 The legislation at S13A(1) refers to the dividend nil rate applying to a UK resident individual’s income. We would be grateful for clarity on the position of a UK resident who is a beneficiary of a bare trust or an interest-in-possession trust (with entitlement to income). Will this beneficiary be able to claim the dividend allowance against any dividend income arising from such a trust as the income will be directly assessable on the beneficiary? Confirmation of this in the legislation would be very helpful. As a second-best alternative, the point should be covered in guidance.

2.2.2 Moving onto discretionary trusts, the trustees of such trusts will not be able to claim the dividend allowance against any dividend income the trust receives. This is despite the fact that the tax credit on dividends will have been removed for trustees as well as individuals and so they will face an increased liability on dividend income. There will be an increased burden on trusts and we question why they have been excluded from being eligible for this allowance.

2.2.3 We are concerned that similar issues could exist for Personal Representatives as a result of being excluded from claiming this allowance. We believe the removal of the 10% dividend tax credit could result in many more estates having a tax liability to settle. Currently, the informal settlement procedure can apply where the tax liability is less than £10,000. This limit may need to be reviewed and potentially increased. Otherwise, we believe there is the possibility for an increase in the number of estates where tax returns are required purely due to the removal of the 10% dividend tax credit and the unavailability of the dividend allowance.

2.3 **General practical points**

2.3.1 For anyone who has dividend income slightly above £5,000 but within the basic rate band, currently there may not be a tax liability to report (depending on the level of any other income) due to the 10% dividend tax credit being available. However, from April 2016, individuals with dividend income in this range will now need to calculate whether they have any tax to pay. HMRC has said that this tax liability will be automatically collected through PAYE tax codes in most cases. As this legislation was only published for the first time on 9 December, it has left very little time for HMRC to do anything regarding a publicity campaign to raise awareness amongst taxpayers of the implications of both Clause 2 and the accompanying Clause 3 (the abolition of the dividend tax credit). Therefore, it is unlikely that many (if any) taxpayers in this position will have the excess dividend income above £5,000 included in their tax code from the start of the 2016/17 tax year. HMRC will have to work hard in the next few months to make sure affected taxpayers are aware of their obligations to report any liability. However, we are concerned that, due to the timing of the legislation, opportunities to get this right from the start of the 2016/17 tax year have been lost and we anticipate there will have to be many reconciliations of tax positions carried out after 5 April 2017 to ensure that dividend income is correctly taxed.
3 Summary
3.1 We trust that the points raised in this response provide useful evidence to the Finance Bill Sub-Committee. A copy of this response has also been forwarded to HMRC.

Yours sincerely

Michael Steed
Co –Chair of ATT Technical Steering Group

4 Note
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Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 7,900 members and Fellows together with over 5,800 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.

29 January 2016
Introduction

The British Bankers’ Association (BBA) welcomes the opportunity to make this written submission in response to the call for evidence issued on 18 January 2016 by the House of Lords Economic Affairs Committee’s Sub-Committee into the Finance Bill 2016.

We do not have any comments on the call for evidence on the Office of Tax Simplification (OTS) and have focused on the proposed changes to the taxation of savings and dividends and on simple assessments. We would like to thank the Committee for considering our submission.

The BBA is the leading trade association for the UK banking sector with 200 member banks headquartered in over 50 countries with operations in 180 jurisdictions worldwide. Eighty per cent of global systemically important banks are members of the BBA. As the representative of the world’s largest international banking cluster the BBA is the voice of UK banking.

We have the largest and most comprehensive policy resources for banks in the UK and represent our members domestically, in Europe and on the global stage. Our network also includes over 80 of the world’s leading financial and professional services organisations. Our members manage more than £7 trillion in UK banking assets, employ nearly half a million individuals nationally, contribute over £60 billion to the UK economy each year and lend over £150 billion to UK businesses.

Background

Overall, the industry has been supportive of changes introduced or proposed by HM Treasury and HMRC in recent years. However, there is growing concern that the pace and scope of reforms are, at least in the short term, adding additional complexity for customers. In particular, the ongoing pace of changes may lead to an increase in uncertainty around tax rules which apply to savers.

Consumers have seen a significant level of tax-led change across the majority of deposit products held with their bank and it is important that there is time for those changes to settle and be understood by customers before any further changes are made.
In the past 18 months, banking customers will have been affected by tax changes to many of the products they hold or are actively considering, including:

- retail customers will see changes to ordinary savings accounts which no longer suffer tax at source under the Tax Deduction Scheme for Interest (TDSI); 
- changes to the Personal Savings Allowance which encourages savings by removing the first £1,000 of interest from the charge to tax (£500 for higher rate tax payers); and 
- changes to the types of ISAs available (including Help to Buy ISAs) and to the rules affecting ISAs more generally, which include introduction of flexibility, new rules for deceased investors and new rules on the assets which can be held in an ISA.
At the same time, the role of banks in relation to customers’ tax affairs is changing. The introduction of Automatic Exchange of Information requirements under Foreign Account Tax Compliance Act (FATCA), Crown Dependencies and Overseas Territories (CDOT) and Common Reporting Standard (CRS) regimes, has meant that banks will be asking for new information from customers and sharing more information with tax authorities. The result of those changes is that since the start of this year, every customer opening a new bank account will be asked about their tax residency – a step which could cause confusion and complaints in the first few years.

In addition the decision to move to digital tax accounts by 2020 and the introduction of new Direct Recovery of Debts powers more visibly places banks as an intermediary between the customer and HMRC.

Many of these changes are positive for customers and for the UK as a whole. However, the scale and pace of change has added complexity for all customers from those opening bank accounts for the first time to long-term savers who will find that changes are made to both regular savings accounts and ISAs.

**Proposed changes to the taxation of savings and dividends –** the Bill proposes to end the Tax Deduction System for Interest under which banks and building societies deduct tax from the interest they pay on deposits. A new Personal Savings Allowance will also be introduced. The draft clauses also substantially reform the taxation of dividends.

**Consequences for taxpayers**

TDSI has been a feature of the UK tax landscape for a long time. For many UK savers, the deduction of tax at 20% from interest payments will have always applied to them.

The ending of the TDSI regime will affect all UK savers - many savers will be placed in a better position, with both basic and higher rate tax payers up to £200 a year better off as a result of personal savings allowance.

However, tax payers who earn more than £1,000 in interest per year (£500 for higher rate tax payers) will now find themselves in a position where additional tax is owed. A saver who receives more than £1,000/£500 respectively in interest would be required to declare and pay additional tax if they already file a tax return.

Where the saver does not already file a tax return, we understand that the additional tax may be collected through changes to the taxpayer’s annual coding and collected through PAYE. However, this will not be suitable in all cases, for example where a saver is self-employed and there is no employer to deduct the tax on their behalf.

There is a risk that as consequence of the proposed reforms to TDSI, the position becomes less clear for some taxpayers. For example, customers could be in a situation where they
receive both gross interest and net non-TDSI interest. Research undertaken for HMRC\(^1\) in May 2015 suggested that customers do not currently have a clear awareness or understanding of taxation of savings interest, despite these rules having been in place for a number of years. Creating further confusion for many customers might increase the risk that the customers/taxpayers become inadvertently non-compliant and fail to pay the right tax. In addition, increased taxpayer confusion could increase the burden on HMRC through handling of queries and chasing unpaid/incorrectly paid tax.

We believe that the Government should consider revisiting the rules relating to non-TDSI interest payments, as the current proposals could lead to either inequity between savers or a substantial increase in the number of tax returns required to be filed. We understand that HMRC already have a view of the scale of these changes, and the likely impact on taxpayers and we look forward to continued engagement with the HMRC team on these issues.

It should also be noted that the rules for deduction of tax are only changing for interest payments on accounts within the scope of TDSI. A number of payments which would are not subject to tax under the Personal Savings Allowance are still subject to the deduction of tax at source (referred to as non-TDSI payments within the HMRC consultation paper). This includes both compensation interest paid by banks, as well as payments on other investments such as certain authorised investment funds (commonly referred to as bond funds). Although the majority of savers will not receive these payments, some will do. One possible outcome is that taxpayers forego tax refunds as they are unaware of the possibility of a reclaim.

**Summary**

The critical issue for the successful implementation of these changes is customer/taxpayer understanding. The Government needs to ensure that savers understand the tax implications of their savings and whether they need to complete self-assessment tax returns.

We would encourage HM Treasury to avoid further changes affecting customers beyond those already enacted or announced within the life of this Parliament. This will allow time for those changes to settle and be understood by all customers and maximise the opportunity for savers to take advantage of the new opportunities available to them.

As an exception to the above, the full removal of non-TDSI withholding obligations as part of an effective implementation of the Personal Savings Allowance would be welcome.

A settled tax landscape will also allow the banks time to make sure that appropriate processes and procedures are in place, along with training for customer-facing staff, to ensure that the best experience is provided to all users of banking services.

We would also encourage a higher profile role for HMRC in communicating the changing landscape for bank customers, savers and taxpayers.

Simple Assessments – This introduces a new power allowing HMRC to access an individual’s tax liability without a tax return being submitted. This is part of the Government’s strategy to introduce digital tax accounts to eventually replace the annual tax return. The Committee is interested in views on the administration of Simple Assessments.

We understand that the key role for banks as part of the digital tax account strategy will be the provision of information to HMRC on income received by customers to be used as part of the simple assessment. We have restricted our comments to this role.

Overall, simplifying tax affairs for the majority of customers is a welcome development which, if successfully delivered, will minimise the administrative burden on taxpayers whilst also helping customers to pay the right tax.

Banks are currently required to provide a substantial amount of information to HMRC to facilitate the tax collection process, in particular Bank and Building Society Interest returns (formerly known as Section/Type 17 returns) or Other Income returns (formerly known as Section/Type 18 returns), require institutions to provide details of all UK individuals who have received interest payments in the previous tax year. These returns are provided annually in an electronic format to HMRC.

Implementation experience suggests that whenever existing data is used for new purposes, it should not be assumed that the implementation will be simple. There are a number of risks in the implementation including:

1. data mapping, ensuring that information flows correctly from the bank to HMRC to the taxpayer,
2. appropriate testing cycles, including pilot schemes, to ensure that any issues are identified and corrected prior to go live, and
3. data security, which will be a critical part of a new system holding banking, tax and financial data for all UK taxpayers.

With that in mind, we would encourage early engagement between HMRC and all data providers to allow adequate time to implement and test changes. The scale and nature of these changes means that, to the extent that bank systems changes are required, early visibility of requirements would be beneficial.

As with the changes to the Personal Savings Allowance, communication with tax payers will be critical to the successful delivery of a new system, with clear timelines and targets established alongside profile raising activities by HMRC.

British Bankers’ Association
29 January 2016
Executive Summary

This inquiry response outlines the views of the Building Societies Association, representing its members in relation to the draft Finance Bill 2016.

In essence we welcome the removal of the majority of customers from savings income tax; outline the likely costs for building societies and highlight the importance of customer communications as the new regime is due to begin.

Building Societies

The Building Societies Association (BSA) fulfils two key roles. We provide our members, all 44 building societies and two credit unions, with information to help them run their businesses. We also represent their interests to audiences including regulators, the Government and Parliament, the Bank of England, the media and the general public.

Although building societies compete with banks in the cash savings and residential mortgage markets, they do so with a very different fundamental purpose. As customer-owned mutuals, building societies have a social purpose by providing a safe home for savings and finance for home ownership, working in the interests of their customers, not seeking to maximise profits for the benefit of external shareholders.

Our members have total assets of over £330 billion, and account for approximately 20% of both UK mortgage and savings balances. It is estimated that over 20 million consumers has a financial services relationship with a building society. Between 2012 and the end of September 2015, building societies provided £56 billion new mortgage lending net of redemptions (80% of the total) out of a total of £70 billion net by the mortgage lending sector as a whole.

Building societies range in size from the Nationwide with over 14 million members, around 17,000 staff, £190 billion assets to our smallest society with 61,400 members, 18 staff and assets of £93 million.

General Comments

We note that these proposed changes will take effect at the start of the tax year. This is helpful for our members, as it requires one set of changes at a fixed point in the year when change is always required, rather than numerous changes spread throughout the year.

Proposed changes to the taxation of savings and dividends

On the matter of the new personal savings allowance, which will result in the first £1000 of interest each year being tax free for basic rate taxpayers and the first £500 for higher rate taxpayers, the removal of 95% of customers from savings income tax is clearly welcome both for building society customers and for the general economy in which the sector operates.
Impact on building societies

The estimated cost to implement the TDSI changes range from around £3-£3.5 million for each of the larger societies down to tens of thousands for each of the smaller members. These cost estimates include both system changes and customer communications.

The removal of the R85 and R105 schemes is welcome and over time is expected to reduce operational costs by around £150,000-£180,000 a year for the larger societies down to tens of thousands for the smaller societies.

The continuation of the payment of non-TDSI interest as net is a disappointment since this reduces some of the simplicity of the new approach. Our members would like to see the decision re-considered.

Customer Communications

The onus should not be only rest with financial institutions to communicate these changes to customers. Instead there should be a broader awareness campaign that lets those who exceed their PSA know what will happen.

Our members are concerned that they may receive a high volume of inquiries from customers asking how they need to report interest above the PSA threshold to HMRC and then how to pay the appropriate level of tax. Our members do not provide tax advice and would like HMRC to provide a leaflet – not all customers have internet access - with this information clearly included covering the three main categories of customer:

- those customers whose tax is paid under PAYE.
- those customers who are required to complete a self-assessment tax form.
- those customers whose tax is not paid under PAYE and are not currently required to complete a self-assessment tax form.

Simple Assessments

We have no comment on this issue. Making tax digital

We have concerns about HMRC’s ability to deliver this fundamental change. Office of Tax Simplification

We have no comment on this issue.

4 February 2016
Chartered Institute of Taxation; Institute of Chartered Accountants in England and Wales and Association of Certified Chartered Accountants – Oral evidence (QQ 1-14) (FBBOE0001)

Chartered Institute of Taxation; Institute of Chartered Accountants in England and Wales and Association of Certified Chartered Accountants – Oral evidence (QQ 1-14) (FBBOE0001)

Submission to be found under Institute of Chartered Accountants in England and Wales; Chartered Institute of Taxation; and Association of Certified Chartered Accountants – Oral evidence (QQ 1-14) (FBBOE0001).
Finance Bill Sub-Committee’s inquiry into the draft Finance Bill 2016
Response by the Chartered Institute of Taxation

5 Introduction

5.1 The Chartered Institute of Taxation is pleased to set out its comments in relation to the Finance Bill Sub-Committee’s inquiry into the draft Finance Bill 2016.

5.2 The FBSC will this year concentrate its inquiry on the extent to which the measures proposed in the draft Bill contribute to the simplification of the personal tax system and their impact on the compliance burdens of individual taxpayers.

5.3 The FBSC invited evidence on these cross-cutting issues with particular reference to the following three topics:

i) Proposed changes to the taxation of savings and dividends (clauses 1 - 4 of the draft Bill and the accompanying schedules).

ii) Simple Assessments (clause 71).

iii) Office of Tax Simplification (clauses 83-88).

5.4 During oral evidence given on Monday 25 January, the FBSC also asked for comment on three other factors.

iv) Other countries’ experience of digitalisation

v) Examples of high effective marginal rate calculations caused by the savings allowance and dividend allowance changes

vi) Information on HMRC service levels

5.5 Because of the limited time available to address the three other factors, our comments are relatively brief and included at the end of this submission, and in the appendix.

6 Executive summary

6.1 Taxation of savings and dividends
6.2 The introduction of the savings allowance, combined with the cessation of the Tax Deduction Scheme for Interest (TDSI), and the replacement of the dividend tax credit with the new dividend allowance, will represent a small tax reduction for the majority of taxpayers who have small amounts of investment income, and there will be a compliance saving for a number of taxpayers - but there will be exceptions.

6.3 For instance, HMRC’s own estimate is that 1.4 million taxpayers will still be paying tax on some of their savings income after the measure is introduced, and 200,000 more individuals will pay tax on their dividend income as a result of these changes, meaning that 2 million taxpayers will be paying tax on their dividend income after the measure is introduced.

6.4 We have concerns about the way the savings allowance has been designed, which will lead to ‘cliff-edge’ tax liabilities for taxpayers whose income levels fall just over the higher-rate threshold. These cliff-edges are illustrated in the main body of our submission.

6.5 The new allowances are also complex:

- There are two different savings allowances depending upon whether a taxpayer is a basic rate or higher rate taxpayer (or three if you include the fact that the allowance is not available to additional rate taxpayers).

- Despite their name, the savings allowance and dividend allowance are not actually a tax free ‘allowance’; savings and dividend income that is within the ‘allowance’ will still count towards an individual’s basic and higher rate limits, and will therefore affect allowances and charges which are dependent on whether an individual’s income crosses a particular threshold (for example, the High Income Child Benefit Charge (£50,000)). We suggest that they should be renamed to make it clearer that it is not an allowance in the widely understood sense of the word.

- The starting tax rate for savings is retained, and will operate alongside the savings allowance. This is likely to be confusing for those who will continue to pay tax on their savings income after the savings allowance is introduced.

6.6 HMRC must ensure that appropriate and clear guidance is published in advance of 6 April 2016, to help taxpayers understand how the new regimes will affect them. The guidance must provide clear explanations and worked examples of how the savings allowance interacts with the new ‘dividend allowance’.

6.7 Simple Assessments

6.8 We have limited comments to make on this area. In principle the measures appear sensible and avoids the need to put taxpayers into self-assessment, enabling HMRC to assess a person’s tax liability on the basis of information held by it, for example where it is not possible to collect the whole of a person’s annual Income Tax liability.
6.9 **Office of Tax Simplification**

6.10 We welcome the measures to put the OTS on a permanent, statutory footing.

6.11 We suggest that the legislation clearly ensures that the OTS has sufficient resources and funding, not only to undertake the projects it is instructed to undertake by the Chancellor of the Exchequer, but also those which it itself wishes to undertake on a proactive basis.

6.12 We consider that the OTS should not only be required to report annually on its own performance, but that it should also report upon the complexity of the tax system and increases or decreases in complexity year-on-year; helping identify a ‘direction of travel’ in the tax system.

6.13 We recommend that the OTS should be sufficiently resourced to enable it to scrutinise selective proposed legislation, so that it can provide commentary from a complexity perspective.

6.14 We also recommend that senior personnel at the OTS, particularly the Chair and the Tax Director, are adequately remunerated for the work they undertake for the OTS.

7 **Taxation of savings and dividends - detailed comments**

7.1 **Introduction**

7.2 We have broadly welcomed the introduction of measures to seek to simplify the taxation of savings and dividend income. We consider that, the introduction of the allowances, combined with the cessation of the TDSI, will represent a small tax reduction for the majority of taxpayers who have small amounts of investment income. We also recognise that those on lower incomes will benefit from the full amount of the investment income they receive (within the allowances), when previously that would have been paid under deduction of tax. However, there was a lack of consultation on the principle behind this change, and we consider that this lack of consultation, together with how the changes are being introduced, will create complexity and cliff-edges.

7.3 When HMRC did consult on the proposals in July 2015, and when we responded in September 2015, HMRC had not announced how the saving allowance would work, so we were unclear about whether it would be a tax free allowance or whether it would operate within the basic rate and higher rate bands. Ideally the consultation would have identified how the allowance would work, and we could have explained the unnecessary complexity and demonstrated the ‘cliff-edge’ tax liabilities for taxpayers whose income levels fall just over the higher-rate threshold - we return to
7.4 **Complexity**

7.5 Our overall concern is that we already have complex legislation (e.g., assorted thresholds that are not logical, different rates of tax for different types of income etc.) and when further complex legislation is introduced (e.g., the savings allowance and dividend allowance), we end up with interactions that create even more complexity.

7.6 The savings allowance is complex because there are two different savings allowances depending upon whether a taxpayer is a basic rate or higher rate taxpayer (in fact there are three ‘allowances’ if you include the fact that the allowance is not available to additional rate taxpayers i.e. a nil allowance).

7.7 Both allowances are, despite their names, not actually a tax free ‘allowance’. It is unfortunate that the terminology used has the potential to lead to confusion about how the new savings allowance and dividend allowance operates. Rather than being a tax free allowance, like the main personal allowance, it is in fact a nil-rate band that does not extend the basic or higher rate bands.

7.8 Neither allowance will reduce ‘total income’ for tax purposes (as defined in section 23 ITA 2007). Savings and dividend income that is within the ‘allowance’ will still count towards an individual’s basic and higher rate limits. The income will also flow through to ‘net income’, ‘adjusted net income’ and all other derivatives from total income. Therefore it will still affect allowances and charges which are dependent on whether an individual’s income crosses a particular threshold. For example, the High Income Child Benefit Charge (£50,000), the personal allowance income limit (£100,000), and pension tapering (threshold income of £110,000; adjusted income of £150,000).

7.9 Our suggestion is that the savings allowance and dividend allowance should be renamed in the legislation to make it clearer that it is not an allowance in the widely understood sense of the word.

7.10 In addition, the starting rate for savings is to be retained and will operate alongside the savings allowance. It is likely that this will be very confusing for the 1.4 million taxpayers who will still be paying tax on their savings income after the measure is introduced.

7.11 Further, some basic rate taxpayers with dividend income in excess of £5,000 and below £10,000 will be required to complete a self-assessment tax return for the first time, since the removal of the dividend tax credit means that they will have an income tax liability on the excess. We assume that such taxpayers (estimated by HMRC to be in the region of 8,500 individuals) will need to notify HMRC under section 7 Taxes Management Act 1970 (i.e., by 5 October 2017) that they have a new source of taxable income for the tax year 2016-17.
7.12 Small limited companies, who pay their shareholder/directors with a mixture of salary and dividends will need to review their remuneration strategy from 6 April 2016.

7.13 The savings allowance cliff-edge

7.14 Draft clause 1 introduces the amendments to ITA 2007. New s.12B determines which level of savings allowance applies.

7.15 The rule [ss.(3)] is:

‘If –
(a) any of the individual’s income for the year is higher-rate income, and
(b) none of the individual’s income for the year is additional-rate income,

the individual’s savings allowance for the year is £500.’

7.16 By contrast, ‘If none of the individual’s income ... is higher-rate income’ the £1,000 savings allowance applies [ss.(4)]. There is a cliff-edge effect of reducing the allowance as the taxpayer moves from one income band to another.

7.17 EXAMPLE:

Becky has earned income and £1,000 of savings income. Her total income equals the basic rate limit, so she is entitled to a £1,000 savings allowance. Her savings income is taxed:

\[
\begin{array}{c|c|c|c}
\text{£1,000} & \times & 0\% & = \text{£0.00}
\end{array}
\]

Anne has earned income and £1,000 of savings income. However, Anne’s total income is £1 above the basic rate limit, so she is only entitled to a £500 savings allowance. Her savings income is therefore taxed:

\[
\begin{array}{c|c|c|c}
\text{£500} & \times & 0\% & = \text{£0.00} \\
\text{£499} & \times & 20\% & = \text{£99.80} \\
\text{£1} & \times & 40\% & = \text{£0.40}
\end{array}
\]

\[
\text{£100.20}
\]

7.18 For Anne, a £1 increase in income produces a dramatic £100.20 tax charge, so Anne is in fact £99.20 worse off than Becky. This is clearly unfair under any measurement. One of the consequences with any cliff-edge is that taxpayers will try to avoid it.

7.19 We note that the dividend allowance works with relative simplicity compared to the way that the new savings allowance operates. Unlike the savings allowance which has three rates, the dividend allowance is one £5,000 nil rate band applying to any dividend income wherever it falls in the income-banding computation. It is
unfortunate that the savings allowance has not been drafted along similar principles.

7.20 A second-best approach would be to temper the cliff-edge effect of the current design, but at the cost of some additional complexity. The £500 and £1,000 allowances could remain, but in each case, when the higher-rate or basic-rate threshold is breached, the savings allowance is tapered back by £1 for each £2 in excess (a well-established formula from the old age-allowance and the current withdrawal of the personal allowance) until the lower level is reached.

7.21 Other impacts on individuals

7.22 In some cases the ending of TDSI will cause problems which will need to be addressed by HMRC to ensure that taxpayers pay the right amount of tax on their interest income where their interest income is in excess of the savings allowance. We understand that there is already low awareness among PAYE higher rate taxpayers of the need to notify HMRC about savings income. The changes being made will lead to some basic rate taxpayers and higher rate taxpayers, who are not issued with a notice requiring a tax return, being required to notify HMRC about savings income. HMRC need to carry out work to raise awareness of taxpayer duties in relation to tax on interest income (see also simple assessments below).

7.23 There will be an impact on some individual taxpayers who make charitable donations, as the combined effect of the savings allowance, the dividend allowance, and the removal of the requirement for banks and building societies to deduct basic rate income tax at source from interest payments, may mean that they no longer pay sufficient tax to cover the tax attributable to their gift aid donations, and would be liable for the shortfall.

7.24 Due to the complexity of the operation of the saving allowance, it is essential that guidance (including tools such as calculators) is produced by HMRC, so that taxpayers can understand:

- whether they are eligible for the savings allowance;
- whether that allowance is £1,000 or £500 or £0;
- what type of income is eligible for the savings allowance;
- how much of their savings income falls within the savings allowance and how much is liable to tax;
- how much tax they have already paid on their savings income and how to calculate any additional tax liability;
- how to pay more tax if necessary; and
- how to claim a tax refund if appropriate.

7.25 In addition, it is vital that the guidance and tools provide clear explanations and worked examples of how the savings allowance interacts with the dividend allowance, the various tax bands and the starting rate for savings. Taxpayers need to be able to understand it so they can make informed decisions about their financial affairs.
7.26 **Compliance Burden on Trusts and Personal Representatives**

7.27 Trustees and personal representatives do not receive either the savings allowance or the dividend allowance and will remain liable to the trustee or standard rates applicable in full on the relevant category of income. However the abolition of the dividend tax credit, and the removal of the requirement for banks and building societies to deduct basic rate income tax at source from interest payments, applies regardless of the status of the recipient.

7.28 Savings income of trustees and personal representatives will be liable to the appropriate rates on such income. These persons will face an increased compliance burden in cases where a return would not have been required previously because interest was received after deduction of 20% tax (examples include a discretionary trust with income within the £1,000 standard rate band, an interest in possession trust where the trustees' liability is satisfied by the 20% deduction, or an estate in the course of administration where the personal representatives’ liability would be similarly satisfied).

7.29 In relation to dividends we understand that it has been confirmed in correspondence between the Trust Discussion Forum sponsored by STEP, and HMRC, that the dividend trust rate will continue to mirror the dividend additional rate, so will increase to 38.1% from 6 April 2016. It would be helpful if further guidance on the changes to dividend taxation in relation to trusts and estates could be published as soon as possible. In principle we think that the full 38.1% should go into the tax pool (not just the excess over 7.5%); but it would be very helpful if HMRC would provide confirmation of the rates and the effect on the tax pool.

7.30 All trustees and personal representatives will face an increased compliance burden in cases where a return would not have been required previously because the 10% dividend tax credit satisfied all liability in respect of the dividend income. From 6 April 2016, even in Estate and Interest in Possession trust cases, there will be 7.5% payable on dividend income.

7.31 Currently, HMRC Trusts and Estates do not require completion of a return for estates in the course of administration where, inter alia, the tax liability for the administration period does not exceed £10,000; in such cases an informal computation and payment of tax is accepted. Given that personal representatives will now have a tax liability in respect of dividends (see comments in our submission on the new dividend allowance), and many liabilities in respect of interest will no longer be satisfied by deduction of tax at source, there is strong argument for raising the figure for informal settlement, so as to minimise compliance costs.

7.32 **Comments on the draft legislation**

7.33 In relation to the savings allowance there seems to be a difference in method for the transition from higher rate to additional rate, when compared to the transition from
the basic rate to the higher rate; instead of losing the £500 savings allowance completely when a taxpayer’s income is £1 over the higher rate threshold, that loss occurs at a greater level – being the higher rate threshold plus up to £500 when moving from the higher rate band to the additional rate band. This seems to be what draft clause 12B(8) (as currently drafted) is indicating since clause 12B(8)(a) does not contain a sub-clause similar to clause 12B(8)(b)(ii). We think this will only affect a very small minority of taxpayers that would otherwise be additional rate taxpayers, ie those with no taxable income above £150,500, and no dividend income, but this does seem to be an added complication. The reason for the difference is unclear.

7.34 The interaction with the starting rate is difficult to understand as drafted. Draft clause 12A (1) states: ‘This section applies in relation to an individual who has savings income above the starting rate limit for savings’, which indicates that a taxpayer with savings income of less than £5,000 would not be eligible for the savings allowance. We assume that it is the intention that a taxpayer with savings income below £5,000 who is not entitled to the starting rate for savings will be eligible for the savings allowance. Our suggestion would be to rephrase clause 12A (1) as follows: ‘This section applies in relation to an individual who has savings income that does not fall within the starting rate limit for savings’.

7.35 We have no other specific comments on the draft legislation, beyond the general comment already made that we believe that the introduction of the savings allowance and dividend allowances in their current form has resulted in some unnecessarily complex legislation and attendant complications to the structure of the income tax computation.

8 Simple Assessments

8.1 Under the current self-assessment regime the taxpayer’s main responsibilities for notifying chargeability to tax, and preparing tax returns. can be summarised as follows:

a) If HMRC have issued the taxpayer with a notice to make a return for a year of assessment, then it is the taxpayer’s responsibility to complete the return to the best of his or her knowledge and belief, and submit it by the filing deadline (31 January after the end of the year of assessment if submitted electronically).

b) If HMRC have not issued the taxpayer with a return for the year of assessment, but the taxpayer is chargeable to income tax or capital gains tax for the year, then the taxpayer must notify chargeability to HMRC within 6 months of the end of the tax year of assessment. There are some very important exceptions to this, however, including taxpayers whose income is
all taken into account in the operation of PAYE. However, these exceptions
do not include taxpayers who have chargeable gains, interest income which
would be taxed at higher or additional rates of tax, or are liable to the high
income child benefit charge – those taxpayers who have not received a
notice requiring a tax return must notify chargeability.

8.2 The introduction of simple assessment will change this for some taxpayers.

8.3 In summary, a) and b) above will continue, however:

a. A taxpayer who would otherwise be liable to notify chargeability
to tax is not so liable if he or she is notified of a simple assessment
by HMRC, unless he or she is chargeable to income tax or capital
gains tax on income or gains not included in the simple
assessment.

b. HMRC may withdraw a notice to make a return and issue a simple
assessment instead. The taxpayer’s responsibility to check this
does not appear to be set out in statute. Clearly the taxpayer
should notify to HMRC chargeability in respect of any items not
included, and indeed common sense suggests the taxpayer should
check the simple assessment to the best of his or her ability and
let HMRC know of any errors; the taxpayer does of course have a
right to appeal. However a possible concern is that many
taxpayers will just assume HMRC has got the simple assessment
right and will not check it thoroughly.

8.4 If a taxpayer disagrees with the simple assessment, we consider that paragraph 7 of
clause 71 gives the taxpayer a right in new s31AA TMA 1970 to notify HMRC within
30 days that they believe the simple assessment is incorrect, and HMRC may then
suspend the simple assessment. Although this is a statutory right, it appears to be
relatively informal, and so may mean that disputes can be resolved quickly through
this means. There is a formal right of appeal under s31(1)(d) TMA 1970 given by
paragraph 6 of clause 71 which would take its normal course.

8.5 On the proviso that HMRC use simple assessments where they already hold the
correct information, and as set out in their policy statement, then few errors should
be made by HMRC. Of course, the taxpayer might have income of which HMRC is
unaware and hence which has not been included in the simple assessment, and at
this stage it is unclear to what extent errors on the pre-population of data by HMRC
will arise.

8.6 That said, taxpayers will be able to check the information on their Digital Tax
Account as and when these become available. This should be straightforward if the
taxpayer can use computers or smartphones etc and has reliable internet access, but
taxpayers would be wise to check any amounts included in their simple assessment
from usual sources such as P60s and bank certificates.
9 Office of Tax Simplification

9.1 We welcome the measures to put the OTS on a permanent, statutory footing, but we consider that the measures should go further.

9.2 Treasury control

9.3 Paragraphs 7 and 11 of the Schedule state that the Treasury may provide the OTS with resources, funding etc, that the Treasury considers appropriate for the performance of OTS functions. The Treasury, therefore, holds the ‘purse strings’ for the OTS.

9.4 The OTS has a wide ranging remit, ie:

• Provide advice to the Chancellor of the Exchequer, on request or as the OTS considers appropriate, on the simplification of the tax system (draft clause 84(1)); and

• The OTS may do anything that appears to it to be necessary or appropriate for the purpose of, or in connection with, the performance of its functions (paragraph 10 of the Schedule).

9.5 We understand that the word may is likely to have been used as a replacement for shall, as it is the Office of the Parliamentary Counsel’s policy to normally not use the word shall. However, we remain concerned, on a strict reading of the legislation, that the OTS might find itself constrained to undertake only the projects it is instructed to do so by the Chancellor of the Exchequer, pursuant to draft clause 85, if it is not provided with sufficient resourcing to enable it to undertake projects which the OTS itself considers necessary.

9.6 On this basis (and in addition to our comments on reporting, below) we would suggest a combination of measures, to include:

• An ability for the OTS to apply for additional project funding, where it can demonstrate the need for a review, or it has been encouraged to do so by a sufficient number of interested parties (such as professional bodies).

• That the OTS’ Annual Report (required in accordance with draft clause 86) sets out the projects which have been undertaken, and identifies those which it was instructed to undertake by the Chancellor of the Exchequer and those which it instigated itself.

• That the OTS’ Annual Report Provides commentary upon the level of resources it has been allocated, and whether the OTS considers those...
resources to be sufficient to enable it to properly perform its functions.

9.7 We would also request that the senior personnel at the OTS, in particular the Chair and Tax Director, are adequately remunerated for the time they spend in undertaking their non-Board-duties; as opposed to the relatively nominal sums which are paid at present.

9.8 Reporting by the OTS

9.9 In addition to the comments set out above, we consider that the OTS’ Annual Report should not be limited to reporting on its own performance, but it should also report on the increase or decrease in complexity of the tax system which has occurred during the year. The extent of that reporting should be left to the OTS to determine.

9.10 Indeed, not requiring the OTS to report in this way could call into question the Government’s commitment to reducing complexity in the tax system at all. If the OTS is not required to report on the level or direction of complexity year-on-year (even worse because its activities have been restricted to those instructed by the Chancellor of the Exchequer and resourced only to that extent by the Treasury), then the OTS becomes little more than the Treasury paying lip service to the subject of simplification.

9.11 Proposed legislation

9.12 The vast majority of the OTS’ focus to date has been on legislation which is already on the statute book, and there is a distinct feeling that the OTS is swimming against the tide, as more and more complex legislation is proposed and implemented at a much speedier rate than that which is being simplified.

9.13 Whilst the OTS is likely to have insufficient resource to review all legislation which is proposed, we would like to see some provision which ensures that the OTS has sufficient resources to scrutinise the new legislation which it chooses to review, and to comment upon whether and to what extent it increases or reduces complexity.

10 Other countries’ experience of digitalisation

10.1 We have attached as Appendix A a summary of use of IT by tax administrations, as published by the Confédération Fiscale Européenne (CFE), following its November conference.

10.2 The CFE recognises that this is limited data, and we have also been informed that:

- Malta - Corporate tax returns are predominantly submitted online, but very little information is pre-populated. Online submission of other tax returns is currently very low.
- Slovenia – Personal tax and VAT returns are submitted online, with personal tax returns being pre-populated. Corporate tax returns are not submitted online.

- Romania – Electronic submission of tax returns is optional, and there is no pre-population.

- Czech Republic - digital filing of tax returns is now obligatory, but there is no pre-population.

- Slovakia – VAT returns are submitted electronically, and the digital submission of other tax returns is optional. There is no pre-population of returns.

- Finland – Personal, corporate and VAT returns can be submitted online, and personal tax returns are pre-populated.

- Latvia – Companies appear to be required to communicate only electronically with the tax authority, with this being optional for individuals.

- Switzerland - Electronic submission of tax returns is optional, and there is no pre-population.

- Russia - there appears to be a system of on-line accounts on the tax administration’s website, with different features for legal persons, natural persons and SMEs and sole traders.

- Austria - Electronic filing of tax returns has been common in Austria for some time, and the vast majority are filed online. There is no pre-population of returns.

- Luxembourg – Electronic filing is mandatory for VAT returns, optional for personal tax, but not yet available for corporate tax.

- Ireland – The majority of corporate and personal tax payers must file electronically, with some pre-population of the personal tax returns.

- Italy – Compulsory electronic filing exists for personal, corporate and VAT returns, with pre-population for some of the personal tax returns.

10.3 Please note that this information has been provided by third parties, and has not been checked by the CIOT.

11 Examples of high effective marginal rate calculations caused by the savings allowance and dividend allowance changes
11.1 We have included in section 3 an example of the most significant cliff-edge, caused by the savings allowance.

11.2 Examples of the dividend allowance are provided in HMRC’s factsheet dated 17 August 2015, and HMRC sought to provide some examples on the savings allowance in their factsheet dated 18 March 2015; although at that point the legislation was not available, and the cliff-edge and inconsistencies noted above were not therefore identified.

12 HMRC service standards

12.1 Much has already been said in relation to HMRC’s service standards, and so we make limited observations again here.

12.2 By way of brief examples, we had been gathering from our members some statistics around telephone answering times. Whilst we recognise this is a relatively limited sample:

- The average waiting time for a response was 21 minutes, but could be as much as an hour.
- 26% of the calls were disconnected by HMRC before they were answered. This happened on the VAT helpline and the Self-Assessment Agent Dedicated Line in particular.
- More than 25% of the calls were abandoned by the caller. An example was when the caller heard a message saying that there would be a 35 minute wait.
- When callers did get through to an HMRC adviser, only one in five was satisfied with the response. In particular there were complaints of advisers who were rigidly following scripts, as well as difficulty in arranging call-backs.

12.3 These figures would appear to correspond with those published in the 2015, showing that HMRC only answered around 50% of their calls. It is clear that HMRC are aware of the concerns over service standards, and are seeking to improve service levels, and concentrate resource where it is needed most.

12.4 We are concerned, however, that this frequently involves re-deploying staff from one area in HMRC to another; which inevitably leaves the area releasing those staff short of resources. Whilst we note that HMRC are recruiting and training additional staff to deal with telephone enquiries, those individuals simply cannot have the technical knowledge to deal with anything but run-of-the-mill queries. With the complexity of legislation (some of which is actually supposed to bring about simplification – see above), we are concerned that these one-off investments in staffing will not bring the
level of benefit needed.

12.5 We also wonder whether HMRC’s longer-term strategy in relation to customer service will be effective. This appears to focus on ‘self-help’ rather than HMRC help, and for that HMRC help to become increasing digitalised (YouTube videos, online chat etc), which might leave those who are uncomfortable with this type of communication, or the digitally excluded, being unable to easily find help.

13 Acknowledgement of submission

13.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the process is published.

14 The Chartered Institute of Taxation

14.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT’s 17,500 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation
29 January 2016
Appendix A

Extract from CFE paper - Use of IT by tax administrations, selected aspects

Percentage of pre-filled tax returns

Source: OECD Report Tax Administration 2015; data from 2013

European countries that offer on-line taxpayer user accounts

Source: CFE PAC Committee, probably not exhaustive

- Belgium
- Czech Republic
- Finland
- Ireland
- Italy
- Romania
- Sweden
- United Kingdom
Crunch Accounting – Written evidence (FBB0001)

Submission to the House of Lords Economic Affairs Committee: Finance Bill Subcommittee - Finance Bill 2016
from Crunch


1. On behalf of the 45,000 micro-businesses in our community, we are submitting this evidence for FBSC’s consideration. We would be delighted to discuss any matters raised before the committee.

2. We use the BIS and ONS definition of a micro-business:- Micro-businesses are defined as companies with zero to nine employees.
   
   i) Proposed changes to the taxation of savings and dividends

3. We have no concerns over the changes to taxation of savings, we believe the proposals will simplify tax returns for many of our community.

4. We do have very significant concerns about the proposed changes to dividend tax....

5. We accept the overall principle that the gap between PAYE/Sole trader taxation and company director taxation should be somewhat narrowed to minimise the incentives to incorporate for tax purposes only. However there are still risks and costs associated with running an incorporated business which means a differential should remain in favour of the limited companies. Such a differential, though diminished, does remain after the dividend tax changes in the Finance Bill 2016.

6. However the transition from the current dividend tax system to the new dividend tax rates hits lower earning micro-businesses hardest, especially given the short timescale proposed for implementation. The leap from an effective rate of 0% to 7.5% for basic rate dividend tax particularly hits lower earning company directors hardest.
7. **Example**

*A limited company director paying themselves primarily through dividends would be paying £1,528 more tax a year when their pre-tax profits are £48,000, whereas a director with £78,000 pre-tax profits will only be paying £1,343 more tax.*

8. These changes are essentially funding the cuts in corporation tax on the backs of those who depend on dividend income - in particular the UK’s 5.2 million micro-businesses who employ 8.4 million people. Micro-business owners tend to pay themselves small monthly salaries and withdraw profit from their business only as and when cashflow allows.

9. The very smallest businesses tend to be the newest and have the least reserves, so their owners will find it hardest to cope with sudden increases in tax.

10. The Government’s impact analysis of the dividend tax changes fails to consider the transitional impact on lower earners and on micro-businesses as a sector. Our modelling\(^2\) shows that, despite the £5,000 allowance and other proposed changes to the tax regime in coming years, the transition from 2015/16 to 2016/17 will be particularly tough for lower earning micro-business company directors.

11. For example a company director on £48k profits before tax and salary would end up paying £1,528 more tax in 2016/17 compared to 2015/16. Yet a director with £58k profits before tax and salary would only pay £143 more tax in 16/17.

12. We have illustrated the impact of this transition with the graph below:

\(^2\) Full modelling can be viewed in this spreadsheet

https://docs.google.com/spreadsheets/d/1e1pbxarUrSYmclAHwNxe8WdBGVlYynnIXYVz92g4Q/edit#gid=1517148033
13. There is a clearly disproportionate impact for lower earning company directors who are having to prepare for this change with little notice. We believe analysis on the impacts of this transition for lower earners and the micro-business sector must be done by government. To give smaller businesses, who tend to have the least resilience, time to prepare for changes we propose a three year transitional credit for lower earning businesses to insulate them from the dividend tax increase.

14. Ministers have claimed that planned future reductions in the corporation tax rate, an increased personal tax allowance and increases in the Employment Allowance will offset the additional burdens of the dividend tax. We disagree: Firstly many of these changes will not come in force at the same time as the dividend tax increase, and even when they do later in the Parliament, they will not offset the full additional costs of the dividend tax rise. Furthermore some of the measures cited by ministers, including Employment Allowance and Annual Investment Allowance, are rarely available to micro-businesses who are owner-operated and have little capital investment requirement. Thus in the financial year 16/17 micro-businesses will face the full weight of the dividend tax increase whereas larger business owners may be able to offset the pressures through use of these new and increased allowances.

15. In relation to implementation our understanding from discussions with Parliamentarians is that the Finance Bill 2016, should it be agreed by Parliament, is not likely to receive Royal Assent before June or July 2016. Thus we are concerned about the level of certainty with which businesses can take action given that these

[Graph showing the change in income after tax for a Limited Company micro-business from 15/16 to 16/17.]

Source: https://docs.google.com/spreadsheets/d/1e1tpbxarUvSYmoH1mXbWdR6v1yYmnTXYVvc92g4H/edit
measures are planned to come in force from 6th April 2016. Should accounting software be updated from 6th April 2016 to reflect the new dividend tax rates even if the Finance Bill 2016 has not yet cleared all stages in both Houses? The simplest solution would be to defer the start date for this measure to April 2017.

ii) Simple Assessments

16. While in principle we welcome plans to simplify and digitise the tax system, especially for those on lower incomes unable to afford professional accounting support, there are risks. In particular we would want to be assured of the processes put in place to deal with the inevitable data errors that will arise.

17. For example we have observed employers making manual errors in the monthly RTI salary return to HMRC which has caused a tax office to record much higher pay than actually was received. These have often proved difficult problems to unpick especially at a time when HMRC has been found to be very hard to contact by telephone.

18. HMRC will need to design not just a simple assessment system, but also simple processes for correcting problems spotted by taxpayers using this new system.

iii) Office of Tax Simplification

19. We strongly support the principle of, and proposals for the Office of Tax Simplification as set out in the draft clauses.

20. About Crunch
Launched in 2009, Crunch provide online accountancy services for over 8,000 clients who are freelancers, contractors and micro-businesses. Through our online advice and guides we have built a community of 45,000 micro-businesses. Crunch has twice been named the UK’s fastest growing accountancy firm and is in the Sunday Times Tech Track 100 for fast growing businesses. We employ 160 people in Hove to serve our customers who bill their clients over £1.8 million a month through our systems. Our turnover is over £5 million per annum and growing.

22 January 2016
Dear Sirs

Draft Finance Bill 2016 – call for evidence

We welcome the opportunity to provide evidence for the House of Lords Finance Bill Sub-Committee considering the above.

1. Proposed changes to the taxation of savings and dividends

   1.1. Overall, whilst the new provisions will result in lower tax liabilities for many taxpayers, the changes will add considerable complexity to the already complex tax system for individuals. There are no fewer than seven different income tax rates for individuals and it is becoming increasingly difficult for taxpayers to understand how the rules will affect them.

Dividend tax allowance

   1.2. The Dividend Tax Allowance of £5,000 to be introduced from 6 April 2016 is coupled with the ending of the notional tax credit which applied to dividend income, and, in most cases, a 7.5% increase in the tax rate on the net income on income in excess of the £5,000 allowance. Although introduced in the 2015 Summer Budget as a reform and simplification, it is hard to see the changes as a simplification, as they merely replace three of the seven rates above with three different rates.

   1.3. The allowance was originally referred to as a £5,000 exemption but in fact the £5,000 uses up the relevant income tax band, potentially pushing any remaining taxable amount into higher rates. Thus a taxpayer with say salary of say £39,000 and dividends of £7,000 might expect that £5,000 of the dividends would be exempt and the balance of £2,000 would be taxed at 7.5% as they fall into the remaining basic rate band of £4,000. (The higher rate threshold for 2016/17 is £43,000 made up of a personal allowance of £11,000 and a basic rate band of £32,000). Instead they will be taxed at the higher rate of 32.5%, as although the £5,000 is taxed at 0% it uses
up all of the remaining basic rate band of £4,000, so that the £2,000 falls into the higher rate band.

1.4. Many individuals have incorporated their businesses in recent years, particularly so in the early 2000’s when the starting rate of corporation tax was 10% then falling to 0%. Having decided, in conformance with existing legislation, the most appropriate way in which to operate their business, they are now in the unfortunate position of having to re-consider this, due to the DTA changes.

*Personal savings allowance (PSA)*

1.5. This allowance enables basic rate and higher rate taxpayers to receive up to £1,000 or £500, of ‘savings income’ (broadly interest and interest-like returns as well as gains on life assurance contracts) respectively, tax-free from 2016/17. Additional rate taxpayers are not entitled to the allowance. Arguably this is even more complex than the DTA which is the same amount (£5,000) whatever rate of tax is payable. The level of allowance given is determined based on whether the individual would hypothetically pay tax at higher or additional rate, ignoring the personal savings allowance and dividend allowance. In working out the relevant tax rate basic rate band extensions such as gift aid or personal pension contributions are taken into account.

1.6. Like the DTA the relief is given by taxing the interest that would have fallen in the basic or higher rate bands at 0%. Income falling within the allowance therefore uses up part of the band that it is in and may have an effect on the rate of tax suffered on the remainder.

1.7. Because the allowance is based on the rate of tax paid, there will be a cliff edge effect. For example consider an individual with earnings of £42,000 who receives bank interest of £1,000 in 2016/17. His total income for the purposes of calculating the allowance is £43,000 so he would get an allowance of £1,000 and all his savings income would be tax-free. However, were he to receive £1,100 of bank interest, his total income would be £43,100 and he would be a higher rate taxpayer, and therefore receive only a £500 PSA. The remaining £600 would give rise to a tax liability of £140 (£500 @20% and £100 @ 40%), giving a tax rate on the additional £100 of income of 140%.

*Abolition of the Tax Deduction Scheme for Interest (TDSI)*

1.8. As the introduction of the PSA will mean that the majority of those receiving interest income from deposit-takers, building societies and NS&I will not be liable for tax on it, the Tax deduction scheme for interest (TDSI) which applies to the payers of such income, will cease on 5 April 2016 and interest will be paid gross on such income from that date. This is helpful as it reduces the need for individuals to file tax returns to reclaim the tax deducted, but it does mean that those who receive more than the allowance and thus continue to have a tax liability will potentially need to file a tax return in order to pay this liability, and budget to meet the payment from the higher interest receipts. Many of these individuals will be higher
rate taxpayers who are already filing a return, but others (for example pensioners) may not have been filing and will now need to do so. Unless this position is widely publicised there is likely to be a compliance issue amongst this population, many of whom are likely to be pensioners. Whilst the tax can be collected on such income by coding it out against a PAYE liability, (and HMRC refer to this in the TIIN relating to the new legislation) this will not work in all cases, and will require at least an initial tax return to report the income.

This may be partly alleviated by the use of simple assessments in the short term and digital tax accounts in the longer term, but the success of these approaches cannot be measured yet.

1.9. It is also worth noting that other income eligible for the allowance (for example interest income from authorised unit trusts and open-ended investment companies) is also currently paid net of basic rate tax. A consultation into whether the requirement to deduct basic rate tax from these types of income should also be abolished has not finally concluded, with the result that from 6 April 2016 two sources of income which a taxpayer might consider to be similar will have different withholding obligations, thus leading to confusion amongst taxpayers.

Non-UK domiciles

1.10. Interest that is taxed on the remittance basis is not savings income to which the PSA can apply and is therefore fully taxable at non-savings rates. It appears that remittance basis claimants and non-residents are entitled to the allowance (although it could normally only be utilised by UK interest). Where the remittance basis charge is payable, however, the notional income that is factored into the computation to create the charge may make the individual an additional rate taxpayer, and therefore ineligible for the allowance.

1.11. Similarly, the DTA does not apply to dividends that are taxed on the remittance basis

1.12. Many non-UK domiciles who do not claim the remittance basis are nevertheless on the remittance basis automatically, and often without their knowledge, if they remit all or most of their foreign sources of income and gains. The remittance basis applies automatically where the unremitted amounts for the year are less than £2,000. If a non-UK domicile’s only source of foreign income or gains in the year is a dividend of £1,000 and this is paid directly into his UK bank account, the full amount is automatically taxed on the remittance basis. This is not eligible for the DTA and is taxable at non-savings rates. A basic rate non-UK domiciled taxpayer would therefore suffer £200 of tax, whereas a UK domiciled taxpayer in the same circumstances would have received it tax-free. The non-UK domiciled taxpayer can make an election to disapply the remittance basis, but this can currently only be done via a Self-Assessment tax return

Interaction of PSA and DTA with other allowances which are based on income
1.13. A number of allowances and restrictions in the tax legislation depend on an income definition, which will be affected by the PSA and DTA.

1.14. The restriction of the personal allowance and the high income child benefit charge are based on whether adjusted net income exceeds £100,000 or £50,000 respectively. Although income within the PSA and DTA might be thought to be exempt from tax, both such elements of income will count towards the definition of adjusted net income set out in s58 ITA 2007. The new restrictions for annual pension contributions which scale available relief from £40,000 to £10,000 for those with income over £150,000 are based on ‘adjusted income for pensions’ (Section 228ZA(4) FA 2004) and a ‘threshold income for pensions’ (Section 228ZA(5) FA 2004). Whilst these are slightly different definitions to the adjusted net income above, income covered by the PSA and the DTA will still be included. In all cases the inclusion of the income somewhat dilutes the effect of what was introduced as an exemption, but also adds considerable complexity to the affairs of those who are affected. This will be particularly relevant for those in receipt of child benefit who need to consider whether or not to claim it and how to hold interest bearing accounts between a couple.

1.15. The proposed Tax free childcare scheme, now due to be introduced in 2017 also uses a definition of income, in that if ‘expected income’ is over a limit, taxpayers are not eligible to join the scheme. This scheme will enable taxpayers to claim up to £2,000 of Government support towards childcare costs. The expected income limit will be £100,000 (rather than the £150,000 originally proposed) and although the details are not available it is likely that income covered by the PSA and the DTA will count towards the limit. Unless this is widely understood parents will not be able to make an informed choice between the options available to them, which may include remaining in an Employer Supported Childcare Scheme.

2. Simple assessments

2.1. The proposed legislation regarding simple assessments, (Clause 71 of the draft 2016 Finance Bill) will enable HMRC to issue a Simple Assessment to certain individuals who would otherwise be in the Self-Assessment regime.

2.2. The procedure will allow HMRC to withdraw the notice to file a Self-Assessment return (given under s8 TMA 1970) and replace this with the Simple Assessment, which will use information already available to HMRC, such as details of employment income and savings income provided by banks. This Simple Assessment will replace the Self-Assessment normally provided by the taxpayer, and the tax under it will be payable by 31 January following the year of assessment, as for Self-Assessment tax generally.

2.3. If the taxpayer does not agree with the Simple Assessment an appeal must be made to HMRC within 30 days, and part or all of the assessment will be suspended pending agreement of the figures.
2.4. At present HMRC receive information only in respect of employment and pension income, and some investment income, so this initiative is likely to benefit mainly pensioners and employees for the time being. In many cases taxpayers in this category are dealt with under PAYE with investment income dealt with through their tax code. The new simple assessment process will benefit those whose PAYE income is too low to make this work, particularly pensioners. As savings income will be paid gross from 6 April 2016 there will be an increasing number of people in this category.

2.5. Whilst this legislation is welcome in that it should simplify the tax affairs of those who are issued with simple assessments, there are a number of areas of concern, mainly centering on the need for clear communication to affected taxpayers. Taxpayers must be made aware that the tax calculation in a Simple Assessment will be a legally enforceable demand for payment, which they will need to check carefully and take the necessary action within the 30 day time frame if they believe it to be incorrect.

2.6. Whilst HMRC expect to hold more and more accurate records of taxpayer income under the digital tax system, we are not yet there, and it is possible that there will be inaccuracies in Simple Assessments, particularly in the short term. Similar inaccuracies in P800 calculations (see below) as regards bank and building society interest have not generally affected the tax liability of basic rate taxpayers up to now, but with the abolition of the tax deduction at source on this income, inaccuracies will have a tax effect for those receiving such income in excess of the Personal Savings Allowance and Dividend Tax Allowance. Given the complexity of the income tax system following the introduction of the Personal Savings Allowance and Dividend Tax Allowance, most people will struggle to check the accuracy of the calculation itself.

2.7. If a taxpayer has received income or gains which are not included on the Simple Assessment, the requirement to notify HMRC of these remains, and again this will need to be communicated to taxpayers.

2.8. Many taxpayers are likely to confuse this assessment with the annual reconciliation frequently issued to those taxed under PAYE, (P800) where typically any underpayment is recovered by changing the taxpayer’s PAYE code. Indeed it is not clear from the proposals whether P800s will continue to be issued, or whether they will be replaced by Simple Assessments, and again, clarity for taxpayers around exactly how their tax affairs will be dealt with would be helpful.

2.9. There may also be confusion with what it to be required from taxpayers under the new digital tax system, particularly as this is evolving quickly.

2.10. It appears from the legislation that HMRC may either issue a Simple Assessment instead of a notice to file a self-assessment return, or may withdraw a notice to file which has already been issued, and then issue a Simple Assessment. The notice to file may be withdrawn up to 2 years from the end of the relevant year of assessment. Taxpayers may be confused if a notice to file is withdrawn and a
Simple Assessment issued instead, particularly as it seems that more than one Simple Assessment can be issued for a particular tax year.

Yours sincerely

W J I Dodwell
Deloitte LLP

29 January 2016
Ernst & Young and Office of Tax Simplification – Oral evidence (QQ 60-69) (FBB0004)

Submission to be found under Office of Tax Simplification and Ernst & Young – Oral evidence (QQ 60-69) (FBB0004).
Dear Ms Waller,

Economic Affairs Committee: Finance Bill Sub-Committee
Call for evidence: Finance Bill 2016

Thank you for the opportunity to provide evidence in person to the House of Lords’ Economic Affairs Committee’s Finance Bill Sub-Committee (FBSC) on Wednesday 3 February 2016 in its deliberations on whether the measures proposed in the draft Bill contribute to the simplification of the personal tax system and their impact on the compliance burdens of individual taxpayers. In advance of the meeting I would like to set out a number of key points.

Simplification as a concept

Before commenting on the measures themselves, I would like to address the concept of simplification in aggregate. To date, the approach has been to start with the tax system as it exists today and seek to simplify elements of it, hoping that this will lead to a simplification of the whole. I believe that this is a forlorn effort and doomed to failure, as every new Finance Bill expands the statute book. However, more importantly, this approach risks missing the point of simplification, which is to make the life of the taxpayer simpler, rather than to create a simpler tax regime for its own sake. I therefore suggest that we should be looking instead at the experience of the ‘customer’, as HM Revenue & Customs (“HMRC”) likes to call the taxpayer.

In my evidence to the Committee on a previous occasion, I suggested that the government could instead focus on the different types of taxpayer (i.e. employees, businesses etc.), rather than the technical form of tax. Ultimately, the compliant taxpayer wants to pay the right amount of tax, with the least amount of effort and is relatively indifferent about the form of any tax payment. (They will want to make sure that the amount they pay feels fair, compared to that of others, but, in practice, are likely to be ambivalent about whether the total tax bill they are paying is made up of, for example, Income Tax or National Insurance.) We should, therefore, look at tax simplification from a taxpayer perspective.

Hence I believe we need a bolder approach on tax simplification. Rather than seeking to simplify elements of existing tax law, we should adopt a broader taxpayer perspective – and focus on enabling different categories of taxpayer to pay the right amount of tax with the least amount of effort.

Putting this aside, I would make the following comments on the proposed changes in the draft Finance Bill.

1. Office of Tax Simplification
In relation to the functions of the Office of Tax Simplification, I would draw the Committee’s attention to the findings of the Forum of Tax Professionals in our fourth report, published by the Treasury on 17 December 2015. This report noted the increasing role played by the OTS in consultation but lamented on the fact that this was not set out clearly within the consultation framework.

Lesson 3 requested that the government should “clearly define the role of the Office of Tax Simplification (“OTS”) in the consultation and policy development process”. The report then noted:

“The OTS now has an official mandate with an expanded role and capacity, and, as a result, it should be formally embedded in the policy development process. A clear procedure needs to be established to both define the role of the OTS within the policy development process for the Government, and to define its role to stakeholders and industry representations. A clear guideline needs to be set to determine when consultation involves the OTS.”

It has been argued that the OTS is in some areas undertaking reviews that would otherwise have been undertaken by HM Treasury or HMRC themselves. In these cases, there can be confusion over the scope of the review, not least because the role of the OTS is not set out in the Government’s Consultation Framework. To address this, the Government should consider revising the Consultation Framework to explicitly deal with reviews that start with the OTS and whose recommendations are then accepted by the Government. In such cases, does the acceptance by the Government of the recommendations obviate the need for the Government to undertake the first two stages of the consultation process? This would appear to be an appropriate conclusion, unless the Government disagrees with the OTS recommendation (but nevertheless wants to reform).

Additionally, the absence of the OTS from the active design of new tax policy seems unfortunate. There should be an opportunity for the OTS to utilise the experience obtained from reviewing the current tax system to help Government avoid repeating the same mistakes. Given the benefit of maintaining the independent status of the OTS (and its limited resources) this might be best achieved through including input from the OTS at particular stages in the consultation process, rather than as part of the internal workings of the Chancellor’s departments.

2. Proposed changes to the taxation of savings and dividends

- **Taxation of savings**

  The Savings Allowance will reduce the need for some individuals to file a tax return, notably those who are within the Personal Allowance and would otherwise be claiming back tax withheld. Those currently within the basic rate band (and outside the Savings Allowance) would need to pay the 20% that would previously have been withheld, but it is assumed that this would be delivered through the PAYE coding system. In practice, this could lead to those people needing to submit a tax return if the difference is material.
Finally, the introduction of a new Savings Allowance may distort the current incentives for some forms of saving, since this will reduce the benefit of holding cash in a Cash ISA. For example, a 1.75% Post Office cash ISA would require a basic rate tax payer to have over £57,000 in cash before there was any tax benefit. Given the additional costs of ISAs, this may further reduce the take up of Cash ISAs by this portion of the population.

- **The system of dividend taxation**

According to the Summer Budget Red Book, the purpose of the new dividend regime was to “simplify the system of dividend taxation” and to “start to reduce the incentive to incorporate and remunerate through dividends rather than through wages to reduce tax liabilities.”

The tax regime for dividends was made more complex when the Labour Government reduced the tax credit that was attributable to dividends from 20% to 10%. This change benefited the UK by reducing the amount of tax credit which was paid to overseas taxpayers under some of the UK’s double tax treaties, but, in order to keep the tax burden on individuals the same, necessitated the introduction of a different tax rate for dividends as for other forms of income. This resulted in the tax rates on dividends being reduced from the marginal tax rates of 20% and 40%, to 10% and 32.5% respectively.

<table>
<thead>
<tr>
<th>Old system with 20% credit and 40% tax</th>
<th>Revised system with 10% credit and 32.5% tax</th>
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<tbody>
<tr>
<td>Net 80</td>
<td>Net 80.00</td>
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<tr>
<td>Credit 20</td>
<td>Credit 8.89</td>
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<tr>
<td>Gross 100</td>
<td>Gross 88.89</td>
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<tr>
<td>40% Tax 40</td>
<td>32.5% Tax 28.89</td>
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<tr>
<td>Less credit (£20)</td>
<td>Less credit (£8.89)</td>
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<tr>
<td>Net tax 20</td>
<td>Net tax 20.00</td>
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</table>

Effective rate

(= net tax/net dividend) 25%  (= net tax/net dividend) 25%

Abolishing the remnants of the dividend tax credit removes the need to gross up the dividend, but continues to require dividends to be taxed at a different marginal tax rates if the tax burden is to be maintained.

Given that the Government has chosen to increase the burden on dividends, a simpler approach might have been for the Government to have aligned the tax rates and thresholds for taxed dividends with those of Income Tax (ie. 20%, 40% and 45%) and retained the tax credit at 10%. This would have resulted in a higher increase in the burden of taxation for those within the basic rate band than those in the other bands (ie. a 10 percentage point increase for those on the basic rate, 7.5% for those on higher rate and additional rate). However, this could be offset by appropriately setting the Dividend Allowance, in a similar way to that proposed.
The complexity of the retention of the gross up calculation could be seen a better compromise than retaining different rates of Dividend Tax.

A further move towards simplicity could have been to allow dividends to qualify for the Savings Allowance (potentially at a higher level), rather than having a separate allowance, or through a general increase in the Personal Allowance. Furthermore, a different level of Savings Allowance to Dividend Allowance adds an extra level of complexity.

- **Reducing the incentive to incorporate**

As noted above, any increase above the 25% effective tax rate for a higher rate taxpayer represents a greater burden on income received in the form of dividends. Hence the 7.5 percentage point increase in the tax rates represents a distortion compared to other income, with the £5,000 Dividend Allowance representing a distortion in the opposite direction.

The Government has justified this as a means of tackling tax motivated incorporation that does not impact portfolio shareholders holding less than “very large shareholdings (typically more than £140,000)” . This is presumably on the basis that the average return on equities is approximately 3.2%. If this were indeed the rationale for the £5,000 Dividend Allowance, then the Allowance would need to be tied to a capital level and the Dividend Allowance would need to increase as the rate of return on equities increased. Instead, it might be more appropriate to position the level of the Dividend Allowance based on a long term average return on equity (e.g. 5% as used in pension projections).

As an alternative, the Government could have applied the supplement only to the type of companies that are likely to be the source of the risk (namely close companies).

3. **Simple Assessments**

A key concern for taxpayers will be how to identify and resolve calculations based on incorrect, insufficient or incomplete information, all of which may lead to an inaccurate assessment. The requirement for the taxpayer to check their tax position, and to notify HMRC within the 30 days if the amount they are being requested to pay is not correct, will require the taxpayer to have a basic understanding of the tax calculation and the different rates that apply (including proposed changes to the taxation of savings and dividends). This will be particularly important for Capital Gains Tax liabilities, as it is unlikely that HMRC would have access to the information required to be able to accurately assess a person's liability to Capital Gains Tax.

In many ways, the introduction of the Simple Assessment seems to be a return to the pre-Self-Assessment era whereby HMRC issued an estimate of the person’s tax and expected the taxpayer to confirm the correct amount. There will be an inevitable expectation that HMRC’s assessment is correct and it will be important that the basis for HMRC’s assessment is clearly identified.
Furthermore, there needs to be a clear appeals and complaints procedure to counter the powerful position of HMRC compared to individual tax payers who may not have a clear understanding of how the tax law is applied.

Hence, whilst the adoption of “Simple Assessments” can be used to simplify compliance with the tax system, the precise implementation of the regime will determine whether the use of this new power results in simplification or instead leads to multiple changes and confusion.

I appreciate the opportunity to provide comments on this crucial topic.

If you have any questions on any of the responses, please do not hesitate to contact me.

Yours sincerely

Christopher Sanger
Head of Tax Policy
Ernst & Young LLP
United Kingdom

2 February 2016
Finance Bill Sub-Committee

Inquiry on

DRAFT FINANCE BILL 2016

Evidence Session No. 4 Heard in Public Questions 70 - 76

WEDNESDAY 3 FEBRUARY 2016
3.35 pm

Examination of Witnesses

Mike Cherry, Director, Federation of Small Businesses, and Andrew Chamberlain, Deputy Director of Policy, Association of Independent Professionals and the Self-Employed

Q70 The Chairman: Mr Cherry, Mr Chamberlain, welcome. Thank you very much for joining us this afternoon. You heard the end of the previous session, so you have the drift of the nature and concern of our inquiry. Major reforms are proposed to the taxation on dividends. Do you agree with the Government’s assertion that this will “modernise, reform and simplify dividend taxation”, or is the dividend allowance an example of the proliferation of tax reliefs already in the UK system that adds complexity for personal taxpayers?

Andrew Chamberlain: The current system—we might begin to call it the old system in a few months—had a complication to it, because a notional tax credit was applied to dividends that came from a corporate structure. The point of that was to prevent what might be seen as double taxation, because it has already had corporation tax. I have often struggled with the idea of notional tax credit, not being an absolute expert in some of these areas of taxation, which could not be traded in or swapped for actual money, as some tax credits, such as working tax credits, can be.

The proposed new scheme, where there is going to be an allowance that will be a tax relief, is easier to understand. From where I stand, it could be considered to be a simplification.
Mike Cherry: Our problem is with the way the announcement came through. There has been no consultation by the Government on this significant change, and our members see it as double taxation. Equally, we have many members who are very, very concerned, because whilst this may indeed be a sledgehammer to crack a nut, and it may close one of the opportunities to legally avoid tax by paying yourself dividends instead of paying yourself a salary, at the very smallest end of those businesses it is the only method by which they can pay themselves and continue to run their businesses. If I may, I will quote from one member, who clearly says, “We have not had a pay rise for many years. We are paying it in dividends if we have enough money at the end of a tax year, in order to keep employing our small workforce”. That is one out of many who have a similar view on this.

The lack of consultation on all the other bits and pieces that are now being announced on the digital tax agenda is certainly not helpful. It is seen as tinkering around the edges, when we actually need fundamental tax simplification and policy reform in this whole area. It is too complex. In our surveys, the majority of our members clearly report that they have to use outside accountants or tax advisers, and we are told that the average cost is around £3,600. It is complex. It is costly. We need to achieve something that is far simpler, far easier, and ensures greater compliance.

The Chairman: I am sure that in your interactions with the Treasury and HMRC you have made clear your view that there should be a degree of consultation. You must have done that on a number of occasions, not only in relation to these changes. What has been the response?

Mike Cherry: We do indeed have regular consultations with Ministers in the Treasury and other senior Ministers. Part of this is another of the problems that is coming down the track to face many of our members. One of the biggest causes of consternation at the moment is this very disconcerting idea that you have quarterly tax reporting. We have had several discussions with Ministers and a meeting with the officials who are responsible for driving this forward in HMRC. We have always been supportive of moving to a digital economy and a voluntary system that businesses can use if it suits their businesses. Our biggest problem with this whole agenda is the mandating of quarterly tax reporting. Apparently, that has already been decided. The consultation that is ongoing is simply about how we implement that mandate. We hear that it could be through net profit, or net taxable profit. If you have to do that, I question whether that is reporting or whether you need to do a full tax return.

Moving that further forward, you heard at the very end of the last session the idea that pre-populating means that the business does not have to do very much work. In fact, it means significantly more work, because the business will not only have to provide its own information but have to check the information that has already been pre-populated.

The Chairman: Sticking to the question of consultation, you must have made representations over the years that you would prefer to have a relationship with the Treasury and HMRC where you were going to be involved in a consultation so that you could express the views of your members on potential changes. That has not happened, has it?

Mike Cherry: That has not happened on this occasion.
Federation of Small Businesses and Association of Independent Professionals and the Self-Employed (IPSE) – Oral evidence (QQ70-76) (FBBOE0004)

**The Chairman**: That must be a matter of some frustration.

**Mike Cherry**: It is a matter of considerable frustration. If we are able to have these discussions at the outset, even before proposals are put forward, hopefully we can be constructive, we can point out where the pitfalls may be, and come to something that may be workable in the interests of small businesses more generally as well as our members.

**The Chairman**: When you make these points to the Treasury and Ministers, what is their response?

**Mike Cherry**: It depends on the department.

**The Chairman**: Do you mean that some are more in favour of consultation than others?

**Mike Cherry**: Some are more in favour. Sometimes it depends on the single issue that may be being discussed at that time.

**The Chairman**: So you get warm words, but not a lot of action.

**Mike Cherry**: Our problem with this in particular, of course, is that we understand that there has been no impact assessment, so that is totally unknown. That can only add to complexity. It is not the way businesses work. It is certainly not the way software works at the moment. You can use an iPad for personal use, or indeed for business use, or even do a VAT quarterly return, but that does not mean that your software, or the way you work your business and accounts in your business, can move to quarterly tax reporting even in the simplest form if it is going to be mandated. This does not have to come by 2020; it starts in 2018. There is a whole raft of issues there, not least because there has been no impact assessment. We do not have the infrastructure, broadband in particular, or indeed mobile connectivity, to be able to do this. Alongside the huge issue of cybersecurity, it raises far too many questions and far too much uncertainty, and leads to more complexity. I cannot see at the moment, on all the information that we have and the discussions that we have had with officials and Ministers, how on earth this can be simpler and less burdensome and reduce the regulatory business on small businesses.

**Baroness Wheatcroft**: In what situations do you believe the Government do not have to provide an impact assessment?

**Mike Cherry**: As far as we understand, tax falls outside any need for a formal impact assessment. It does not go through the Regulatory Policy Committee. We are unclear about the scrutiny, especially with regards to the Administrative Burdens Advisory Board. Again, there is a lot of uncertainty about how this decision to mandate has been arrived at and where the consultation can actually go, given the problems that I have already alluded to.

**Q71 Baroness Wheatcroft**: It is an area that perhaps we ought to look at a little more. It has impact. Moving on, HMRC is going to have a new power to provide assessments for individuals based on information from banks, or wherever. There is some concern that not every individual will be in a position to challenge those assessments. What are your views on that? Do you foresee problems with people paying too much rather than too little tax perhaps?
Federation of Small Businesses and Association of Independent Professionals and the Self-Employed (IPSE) – Oral evidence (QQ70-76) (FBB0E0004)

Mike Cherry: I already mentioned the concern that an individual or a small business is going to have to check that for its accuracy—invariably that will be an outside individual, a tax expert or accountant—to make sure that it is correct before they can be satisfied that they are paying the right tax, be that under or over. Having a voluntary system, making tax simpler and being able to make sure you can make it work for your business is surely the easier and simpler way forward. Eventually it will ensure less cost for HMRC, make it easier for businesses, and reduce the administrative burden for businesses. If it was that simple now, businesses and individuals would have already adopted it.

Baroness Wheatcroft: Thank you. Mr Chamberlain, presumably by the very nature of your organisation your members are one-man bands on the whole.

Andrew Chamberlain: On the whole that is correct; they are usually working through their own limited company.

Baroness Wheatcroft: How are they going to cope with this change?

Andrew Chamberlain: There are some concerns about the simpler assessments power. As we understand it, it will give HMRC the ability to obtain information from a third party when some income has been generated for an individual, and apply a tax charge to that, which is quite understandable because it may save a lot of time and bother and help it to get the tax more quickly than it does at the moment. We understand that. We are not clear what might happen if, in the process of generating that income, you have incurred some sort of costs, some professional fees. Will that become apparent to HMRC when it looks this up? That is one of the things that is not clear.

Baroness Wheatcroft: It is hard to see how it could become apparent.

Andrew Chamberlain: I have had one example explained to me in relation to the Land Registry and the sale of an investment property. If an individual has made income in that way there will be a capital gains charge to that, but that individual may have incurred some costs in the sale of that property that would not necessarily come through in the Land Registry figure. Presumably HMRC will have to get back in touch with the taxpayer to check that. They have been doing that anyway through self-assessment. This brings us back to how much this is going to help that process. As you pointed out, there could be an inability for someone to challenge the calculation that has been made, either because they are not quite sure how to do it, or, as Mr Cherry has said, because they might have to incur a fee to get professional help to do that, which they may not want to do. It throws open the possibility that a miscalculation could slip through the net.

Q72 Lord Teverson: Perhaps we could come on to digital tax accounts, which you have mentioned to some degree already, Mr Cherry. We are told that this is a step towards that strategically. I understand that your members are particularly concerned about the proposed requirement for small businesses to provide this. I think you were saying that you want a voluntary system perhaps rather than a mandatory one. As a Committee, we have tried to explore quite strongly the area of quarterly reporting and how difficult that is particularly for small or one-person enterprises. Perhaps I could first ask Mr Chamberlain whether he has similar concerns about this area.
Andrew Chamberlain: We share many of the concerns that the FSB has. The primary one is that it appears that this will be more burdensome. You have to do more reporting every quarter rather than every year. I understand that it is for a lesser period of time, but overall it appears to be more burdensome. The business does not seem to be getting very much back in return for this extra burden. That is one of our first concerns.

The other issue is that there are businesses for whom this will be a huge shift, because they will have to move from keeping paper records to digital records. There are those who will not have the skills to do that. There are those who may not have a particularly strong broadband connection, so that is an issue. There are those who do not want to do that. We would much prefer to see a voluntary system brought in, especially at first, and then a longer rollout period to get people more used to the idea. That would be our preferred approach by the Government. We do, however, see it as a laudable aim. Moving everyone towards digital reporting makes some sense, but there are concerns in the short term.

Lord Teverson: It seems to me that if someone has earnings that are automatically captured it is a great win, but for the single-person enterprise in particular, or the unincorporated business, would you say that it is like doing a tax return four times a year in effect to make sure that this information is correct?

Andrew Chamberlain: We are not sure yet how it will actually look, and we understand that there is going to be a consultation later this year, but that is the fear. When people first hear about it, I think that is what goes through their mind. We may end up with your having to make an annual year-end adjustment anyway, because you will want to make sure that everything you have put in through the year ticks up at the end. If it works, which I believe is the plan, essentially HMRC will take the information that you have inputted every quarter and then supply you with a calculation at the end, and you will want to do a year end adjustment, which is effectively like doing a tax return, to check that it has done that correctly, or you will ask your accountant to do it. Indeed, you will be asking your accountant to help you do the quarterly returns too, which is a cost. There is a big cost implication here for small businesses. Most of our members use accountants and see this as another opportunity for accountants to bill them some more money. So there is certainly a cost impact here.

Lord Teverson: Do you wish to add anything, Mr Cherry?

Mike Cherry: There is one further point that needs to be very clearly understood. From a recent survey that we conducted, for around 34% of our members it is either the individual owner themselves or an employee in their business who does a manual tax calculation at the moment. That often seems to be missed by various parts of the Government: that there are still many companies, many individuals, who do things manually and are not even using software packages or simple spreadsheets.

Lord Bilimoria: According to the FSB, I believe that members already spend an average of £3,600. You are saying that having to do it quarterly would add to this cost. Microbusinesses are using accountants as well. Would this figure of £3,600 be what they spend?

Andrew Chamberlain: That is not far off. We surveyed our members a couple of years ago.
Lord Bilimoria: There was an e-petition, which was debated in the other place on 25 January, with over 100,000 signatures. Did your organisations take part in this?

Mike Cherry: Individual members would have taken part in that.

Lord Bilimoria: Have you seen the discussions, and do you agree?

Mike Cherry: I have read through all the discussions, and I found some very interesting and pertinent points. The one thing that was not mentioned so much was impact assessment. The decision to mandate has already been made. There has been no consultation on that. The whole discussion—apart from one Member of the other House—only briefly mentioned the cyber issues and how government is not very good at holding on to data in the first place. Aside from that, the problems that we all face with cyber moving on from today into the future can only get worse.

Andrew Chamberlain: I watched the debate on the live feed. It was very interesting to follow that, and some good points were raised. It did show that there was concern across the House of Commons among different parties on this issue. Clearly, a lot of those MPs have had constituents’ correspondence on this. We know that some of our members have been in touch with their MPs.

The point I took from it was that it appears from the Government side that this is coming. That does not seem to be up for debate. That is where the consultation point comes in. We would urge a voluntary approach and to try to allay some of the concerns that are clearly felt. Over 100,000 signatures to the e-petition were needed to get that debate going, so there is obviously quite a bit of concern out there.

Lord Bilimoria: Is this an example of your members who are running businesses that make up 99% of this country’s businesses, the backbone of our economy, and you have somebody sitting in an ivory tower who comes up with this four times a year without even consulting your members? How could this have happened?

Mike Cherry: Clearly it has happened. The decision has been made. We are trying to overturn that decision and help the Government to understand how businesses do their accounts, and the fact that there should be a voluntary system to test, to prove, to make it worthwhile for businesses. There is no nudge on this either. From the information that we have seen so far, there appears to be a significant cost saving to HMRC of around £652 million. Inevitably, that cost seems to be from placing extra cost burdens on small businesses, aside from the extra administrative burdens. Let us not forget that for micro and small businesses in particular, it is the time spent on administrative duties that takes them away from doing their business and producing profit, hopefully, but certainly away from contributing more to the wider economy in the first place.

Lord Bilimoria: Have you done a cost-benefit analysis of the savings the Revenue thinks it is making compared with the additional costs to these businesses and to the economy?

Mike Cherry: It would be extremely difficult for us. We do not have the resource to do that full cost-benefit analysis at the moment, because quite frankly we do not know what is in the detail yet. That is the only part that has been consulted on. Nobody knows exactly what
this idea of reporting is going to mean, how the pre-population is going to be checked and what the time spent on all that is going to be for the business.

**Baroness Noakes:** Do not businesses at the moment have to submit their VAT returns electronically, and if they employ anybody they have to use the RTI system for PAYE, which is digital? Even if they have manual records, they already have to do digital interfaces with HMRC for these other taxes. What is so difficult about sending in information about your business results?

**Mike Cherry:** With all due respect, that is a totally different area compared to either using an iPad simply for business purposes or, indeed, filling in a quarterly VAT return. You can do that relatively simply, and you may do it online—indeed, you mentioned PAYE and RTI now being done online. Those are fairly simple bits of software—if you use software, or your advisers use software—that enable that to happen without too much difficulty. To ensure that you have the right details for full quarterly reporting is far more difficult, even with the existing software, and it is not necessarily how a business works. Various reliefs would have to be taken into account, currently at the year end. Most businesses do not do management accounts either monthly or quarterly, which I suspect would also be necessary in order to do proper quarterly reporting. That detail is missing at the moment. We are consulting with government on this.

**Andrew Chamberlain:** Many small businesses will use a payroll company to operate the RTI system for them. That comes at a cost to them, but it is relatively simple. If they had to do something similar on a quarterly basis for all their income and expenditure, and factor all that in with the various tax reliefs, as Mr Cherry has said that is going to increase the cost quite a lot. A lot of this will be pushed on to the accountants, but that will come at a cost.

**Q73 Baroness Drake:** Mr Cherry, the FSB has commented: “The push towards digital must be introduced alongside tax simplification, with businesses able to choose the best tax reporting process appropriate for them”. What simplifying changes did you have in mind when that comment was made? How would they make the changes that you have in mind to make the introduction of digital tax accounts easier?

**Mike Cherry:** We have already put forward proposals to certain parts of the Government in work that we have done with Ernst & Young to ensure that, where possible, the whole area of tax simplification makes it cheaper and easier for businesses to comply. It gives everybody greater certainty of the tax liabilities of businesses. You have more effective tax incentivisation. It is easier and cheaper for HMRC. I have a copy of that report, which I am very happy to share with the Committee.

**Baroness Drake:** That would be helpful. Could you give us one significant example?

**Mike Cherry:** If I may, I will refer to the document and quote certain parts, if you will forgive me. Basically, it centres on a taxpayer-centred approach to simplification and looks at how it can best support the current review within the OTS so that it is aware of the proposals. It comes up with the idea that you segment it for taxpayers, and those taxpayers should be split so that you can have a taxpayer-centric approach that identifies the differences between start-ups, steady growers, lifestyle businesses, high-growth businesses or, indeed,
family businesses or contractors, which is obviously Mr Chamberlain’s prime area of concern. There is a lot of detail in this paper. As I say, we have shared it with parts of Government and we are happy to share it with the Committee.

**Baroness Drake:** What response did you get to your submission?

**Mike Cherry:** We have not had those discussions yet.

**Q74 Baroness Drake:** Mr Chamberlain, the IPSE’s website states: “IPSE believes the Office of Tax Simplification has the potential to be a positive force in suggesting future tax policy and has been working with the body to develop a simpler tax system”. Could you outline the IPSE’s experience in working with the OTS? In your view, does the draft legislation establishing the OTS and its functions go far enough in promoting simplification? What is your experience of engaging with it. and does what the draft Bill proposes go far enough?

**Andrew Chamberlain:** We have worked with the OTS on quite a number of its reviews over the last five years or so, since it was formed. One of the first reviews was into small business taxation, including IR35, which is an area of taxation that is particularly troublesome for our members. We worked closely with it on that issue. We have also fed into the current review into small business taxation and its employment status report. We have sat on its consultative committees. We have arranged face-to-face meetings with our own members and staff from the OTS so that they can understand what they are thinking. We have submitted responses to its papers. We have worked quite closely with it.

We fully support the decision to put it on a more statutory footing. We think that the OTS has made a really significant contribution to the simplification agenda. It is a body that sits in between the business community and the government machinery. The business community finds it very approachable and we can have a conversation which can then feed in. It provides a useful conduit for those conversations on what I think everyone agrees we want, which is simplification of the tax system. Yes, in short, we are very supportive of the decision to put it on a statutory footing.

**Baroness Drake:** Regarding the points of view that you gave to it, how do you feel it responded to them and absorbed them? Was it a positive experience? Do you feel that you still have a long way to go before it sees your point of view?

**Andrew Chamberlain:** Broadly speaking, it is very positive. There are times when it is quite challenging. You had John Whiting, the director of the OTS, in before us. He is a very bright man and sometimes you have to win him over. It will challenge you on your point of view, but it is a very healthy process because it helps you hone your own arguments. Where you think you can genuinely deliver a simplification, it will listen to that. So overall I am very positive.

**Q75 The Chairman:** Mr Cherry, the fastest growing part of the labour force is the self-employed. Do they see you as the organisation that represents them, or is that small businesses as opposed to single self-employed people?

**Mike Cherry:** We are predominantly self-employed and small businesses combined.
The Chairman: Self-employed people who traditionally have been able to fill in a tax return once a year on a relatively straightforward basis are now going to be required to do it four times a year. That is going to incur some additional costs, because they would not have had to go to an accountant before, whereas now they might have to do that. Is there a separate and rather largely populated sub-category that for the first time will have to incur costs in making their tax return?

Mike Cherry: Again, that is a possibility. Many of them will still continue, as an individual would, to submit their own returns. Equally, as I mentioned a moment ago, we do not know what this reporting is going to mean in detail. Also, it does not seem to take into account the variance at the moment with seasonal fluctuations, which applies equally to the self-employed as it would to any business where you are very much reliant on the seasonability of your sales. You could have a rural business where the majority of its sales could be in the summer, but equally you could have some retailers whose majority of sales will be over the Christmas period. It is how you even out those interactions between that seasonability and the reporting, and when you may get the reliefs and either make the payments to HMRC or indeed get any payments back.

The Chairman: So the incidence, i.e. four times a year rather than once a year, will bring some added complexity to those people who have, as you say, seasonal variations.

Mike Cherry: Yes.

The Chairman: Have you been making those points to the Treasury and to HMRC?

Mike Cherry: We are continuing to make these points as clearly as we can to Ministers and officials.

The Chairman: Can you give us an idea of how many self-employed people you represent who you have as part of your membership?

Mike Cherry: Our membership is around 200,000. Around a quarter of those have at least two businesses. That is a significant number right across self-employed, micro, small, and indeed some medium-sized, businesses.

Q76 Lord Teverson: Can I put one argument that I have tried before, not with great success? One of the things about information is that it allows you to manage better. One of the biggest reasons for business failure is that people do not keep up to date with what is going on. Obviously in a smaller business you would expect that. Is there an argument that there may be a raft of people who are not particularly adept at keeping control of their businesses and that this might prompt them to be more successful and see the problems coming somewhat earlier? Does it force a bit more rigour that might make your members more successful?

Mike Cherry: I do not think anybody would dispute the argument or rhetoric behind that. In practical terms, that is not how the majority of those businesses work. As I said at the very beginning, if it was that simple and easy they would have already adopted it.

The Chairman: Thank you very much indeed.
Dear Lord Hollick,

The Federation of Small Businesses (FSB) welcomes the opportunity to submit written evidence to Finance Bill Sub-Committee’s (FBSC) inquiry into the draft Finance Bill 2016, specifically on changes to the tax treatment of dividends and tax simplification.

FSB is the UK’s leading business organisation. It exists to protect and promote the interests of the self-employed and all those who run their own business. FSB is non-party political, and with around 200,000 members, it is also the largest organisation representing small and medium sized businesses in the UK. Small businesses make up 99.3% of all businesses in the UK. They make a huge contribution to the UK economy. They contribute 51% of the UK’s GDP and employ 58% of the private sector workforce.

Proposed changes to the taxation of savings and dividends

FSB welcomes the opportunity to provide our specific views on the measures which include the abolition of dividend tax credits and the introduction of new dividend tax rates. While we can understand the rationale for addressing the long recognised imbalance in the tax system due to the tax treatment of dividends - a major driver behind our desire to see tax simplification but on a holistic not piecemeal basis as in this approach - this has caused substantial disquiet amongst FSB members. This is especially acute from members on modest incomes who, unlike their employed counterparts, will now see a rise in their tax liabilities. Despite these impacts, FSB is yet to see the distributional analysis work and we understand that unlike with previous Budgets, this information will not be released.

The real life, practical reality of these changes is seen in the numerous communications we have already received from FSB members who are extremely concerned about the impact on their businesses, specifically with regards to staffing and growth. For the Committee’s interest, I have enclosed some of this feedback, which has already been sent to officials at HMRC and HM Treasury.

We appreciate that the employment allowance was increased by the Government by 50% to £3000, in an effort to dampen these effects. The reality however is that for many of these businesses, the increase will be of no additional benefit and will not offset the impact of the changes to dividend taxation, for the simple reason their employer NICs liability is less than £2000.

We would therefore urge the Committee to consider whether these effects could be mitigated for those on modest incomes, for example whether there is any flexibility with the proposed £5,000 dividend tax allowance threshold. We also welcome scrutiny as to how and why the £5,000 figure was reached by HM Treasury, as we are yet to receive clarity on this issue from officials.

Office of Tax simplification

FSB welcomes the opportunity to provide our view on the extent to which an Office for Tax Simplification (OTS) is likely to promote the future development of a simplified tax system.
Despite the laudable efforts of the OTS (and others such as the Administrative Burdens Advisory Board), tax continues to pose significant administrative burdens on businesses of all sizes, but particularly the UK economy’s smallest businesses. We see neither the flow of new legislation abating, nor are we convinced that the administrative impact of tax measures undergo the same level of scrutiny as regulation more generally.

In last year’s Budget, the Chancellor announced the OTS review of small company taxation, with the primary aim of simplifying the system and increasing certainty and reducing administrative burdens caused by the tax system. Alongside this, the Government also announced plans to “make tax digital”. FSB has prepared a paper – enclosed with this submission - which sets out a number of initial proposals for how simplification might be achieved and articulates the benefits it could bring, particularly towards boosting productivity and lowering costs for businesses.

FSB believes tax needs to be considered as an integral part of the work to rebalance the economy. We support the OTS Review of Small Company Taxation and urge the Government to take a bolder approach and implement a simpler and more taxpayer-centred system. This would involve looking beyond simplifying elements of existing taxes within the current architecture of the UK tax system. Instead, the OTS should examine the broader approach required to reduce the overall burden on the tax payer.

A taxpayer-centric approach would involve a radical change of the focus of the tax system. It should be cost effective and clearly identify the different types of taxpayer (i.e. employees, businesses etc.). Taxpayers are not a uniform group and therefore any tax system that seeks to treat all taxpayers alike will necessarily result in complicated rules that only apply to a subset of the taxpayers. In contrast simplification based on the taxpayer can be suitably tailored. FSB’s perception is that compliance costs faced by companies differ at different stages of their life cycle and this must be factored in to any proposals for reform.

The accuracy of tax data is fundamental to the Government’s ‘Making Tax Digital’ agenda and lowering costs for taxpayers and business. Digital reporting is a mechanism that will only provide useful reports if the tax data is accurate. Therefore this agenda needs to be developed in conjunction with a simplified tax system that enables businesses to be confident they have provided the right information. Combined, these two measures would provide a cohesive solution that genuinely reduces the administrative burden on smaller business.

**Mandatory quarterly tax reporting**

Pursuing the digital agenda without simplifying the tax system will and already is causing consternation across the small business community, especially among those who are not able to complete tax returns online. It is for this reason that FSB is extremely concerned about proposals to introduce mandatory quarterly tax reporting for small businesses and the self-employed. While we support the voluntary use of digital reporting, we believe that quarterly reporting must not be mandatory for all businesses. Instead, it should be adopted as a matter of choice by firms that can benefit from real-time reporting as an effective management tool.
For many businesses, mandatory quarterly tax reporting would be disproportionately burdensome. It could also act as a potential barrier towards the creation of more start-up businesses as well as creating further tax compliance challenges for existing firms. Together with other planned burdens and costs such as changes to dividends taxation, there is a real risk that many small business owners may opt to sell or close down their business. FSB therefore calls for the proposed exemption on mandatory reporting for individuals in employment and some pensioners to be extended to smaller businesses.

The enclosed submission contains our paper on tax simplification, FSB member feedback on changes to the tax treatment of dividends as well as feedback on quarterly tax reporting. I look forward to discussing these issues with you in more detail at our upcoming oral evidence session on the 3rd February.

With best wishes,

Mike Cherry LIWSc FRSA

Policy Director
FSB options: A new approach to simplifying taxation for smaller businesses

December 2015

A paper informed with substantive input from EY and FSB members
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Executive summary

Simplification of the tax system has been, and continues to be, an ongoing challenge for the government. The Office for Tax Simplification (OTS) was set up in 2010 with the express aim of addressing this issue for both businesses and individual tax payers. For small businesses, the burdens associated with meeting tax obligations are particularly high, often incurring unnecessary costs.

This is a significant challenge, where simplification through incremental change is unlikely to produce the level of improvements required. The review of small company taxation provides the ideal opportunity to consider new ways to address this increasing tax burden on small businesses.

This paper recommends that the Government takes a bolder approach to tax simplification through a taxpayer-centred approach. Crucially, this calls on the OTS to look beyond simplifying elements of existing taxes within the current architecture of the UK tax system. Instead, the OTS would examine the broader approach required to reduce the overall burden on the tax payer; designing a tax system around the taxpayer as opposed to merely simplifying the taxes themselves.

This paper sets out several options for small business taxation reform. These would be regimes into which the taxpayer could elect, and that would:

- **Reduce complexity for small businesses** by providing an alternative to the full tax system through abolishing existing taxes, or replacing elements of the current tax system.

- **Reform the tax system to make it less complicated and burdensome** which would reduce error and mean businesses can spend more time running their business. This will have benefits not only for businesses and the economy but also for Government through minimising loss of revenue and compliance.

- **Help small businesses to understand their tax position**, have greater certainty and reduce the cost and time involved in complying.

- **Complement HMRC’s other policy priorities** such as the introduction of a digital tax account through the Making Tax Digital and tackling avoidance and evasion.

- **Provide a simplified option for the majority of small business** which would maximise the benefits of simplification for both business and Government.

Options for reform include:

- **Option 1**: Providing a simplified small business regime, which could replace many taxes with one, based on sector analysis already developed by HMRC.

- **Option 2**: Introducing a tax transparent corporation, mimicking the benefits of the Limited Liability Partnership, but without the requirement of a second person.

- **Option 3**: Replacing corporation tax with a distribution tax that applies only when distributions are made out from the company.
The FSB would welcome the opportunity to discuss these options further.

1. **Introduction**

The Summer Budget 2015 announced the Office for Tax Simplification (OTS) review of small company taxation. The aim of the review is to develop recommendations for the Chancellor and Financial Secretary to the Treasury on how to simplify the system, increase certainty and reduce administrative burdens caused by the tax system. The project will report to the Chancellor ahead of the 2016 Budget.

Alongside the OTS small company taxation review, the Government has announced plans to Make Tax Digital. This programme aims to transform tax administration so it is more effective, efficient and easier for taxpayers, providing access to a personalised digital tax account for five million businesses and ten million individuals by early 2016, increasing to more than 50 million individuals and businesses by 2020. Introducing reforms now to simplify the tax regime will complement the digitisation of tax administration by improving the accuracy of the data reported and reducing the number of enquiries that HMRC will receive as a result of the change to digital reporting.

The purpose of this paper is to set out a number of initial proposals for how simplification might be achieved and articulate the benefits it could bring. This paper will form the basis of a discussion between the Federation of Small Business (FSB) and the OTS. This should support further detailed analysis and discussion of how any solution would operate and which solutions warrant further work. As such these options should not be viewed as definitive proposals.

1.1 **The impact of a complex tax system on small business**

Simplification of the tax system is an issue that has been considered over many years and in numerous reviews. The OTS was created in 2010 with the express aim of identifying areas where complexities in the tax system for both businesses and individual taxpayers can be reduced.

The benefits of tax simplification are broad ranging – from cost savings for small businesses at the micro level to the stimulation of growth in the economy at a more macro level. Streamlining current processes for meeting tax obligations benefits both business and government: it reduces time and resources spent by HMRC on policing tax affairs; and in turn stimulates small business growth and competitiveness by enabling businesses to spend less time fulfilling tax obligations instead of running their business. A tax system that is simple to understand is also likely to result in greater accuracy and compliance by taxpayers, reduce the need for tax agent advice, and enable businesses to use simpler and less expensive business software. The benefits of reduced error and greater accuracy will flow through to HMRC revenue.
According to the Brookings Institution\(^3\) the positive impacts of a simplified system of taxation are numerous and include:

- Reduced taxpayers’ overall burden of complying with the system in terms of time, money, and mental anguish.
- Greater effectiveness of incentives since tax provisions that are more simplistic are more likely to be used (e.g. provisions aimed at encouraging certain activities are more likely to be utilised if they are easy for the taxpayer to understand and apply).
- Increased compliance, since clarifying and simplifying tax laws can only work to enhance taxpayers’ understanding of the purpose and application of the law, and will likely make it easier to enforce as well.
- Greater public support, which should be an essential part of any effort to improve the delivery of government services.

1.2 Aim of simplification

When looking at a preferred solution and combination of options for reform, FSB identified the following benefits that they wanted simplification to bring:

- **Cheaper/easier compliance**: Make it cheaper and easier for small business to comply with the tax system.
- **Certainty of tax liability**: Create an environment where there is greater certainty for small business and they know what will be their tax liability – enabling businesses in their planning, for example, of growth or retirement.
- **More effective tax incentives**: Improve information and simplify processes to make it easier to claim tax reliefs and deliver the economic benefits the Government intended.
- **Easy to predict tax payments**: Allow small business greater flexibility in the tax system to enable small businesses to better manage cash flow challenges.
- **Simpler relationship with HMRC**: Create more effective working relationships with HMRC.
- **Alignment with other policy changes**: Be compatible with wider HMRC reforms such as the Making Tax Easier reforms.

In addition the tax system should be stable over time to avoid businesses having to regularly learn new rules, incurring costs and increasing business uncertainty.

The initial proposals contained in this report are based on the above approach of considering the system as a whole, focusing on the experience of the taxpayer rather than its component

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\(^3\) “Tax Simplification: Issues and Options”, based on testimony submitted to Congress of the United States and House of Representatives, (17 July 2011)
parts. This paper uses the benefits listed above as the basis for evaluating a number of initial proposals.

2. **A new approach to simplification**

2.1 **A taxpayer centred approach to simplification**

The current scope of the OTS review looks at simplifying the administration and differing requirements imposed by the tax system on small businesses. The OTS review affords the opportunity take a much broader approach to the issues and pave the way for radical change to the system. Taking a taxpayer-centred approach would focus on the day to day complexity and experiences that confront taxpayers in their dealings with the system rather than seeking to reduce complexity by changing each of the many sections of the tax system with which businesses must interact. Incremental simplification of each of the separate existing taxes will not result in truly significant simplification to the system. The OTS should be concerned with how the design of the tax system impacts business, HMRC operational practice as well as tax legislation.

2.2 **Segmentation of taxpayers**

A taxpayer-centric approach would involve a radical change of the focus of the tax system. It should be cost effective and clearly identify the different types of taxpayer (i.e. employees, businesses etc.). Ultimately, the compliant taxpayer wants certainty that he/she is paying the right amount of tax, with the least amount of effort and hence in theory is relatively indifferent about the form that that tax payment takes.

Taxpayers are not a uniform group and therefore any tax system that seeks to treat all taxpayers alike will necessarily result in complicated rules that only apply to a subset of the taxpayers. In contrast simplification based on the taxpayer can be suitably tailored. Concerns are different for businesses with different models and at different stages - some example categories are shown below:

| Start ups | Steady growers/lifestyle | High growth | Family | Contractors |

Each of these taxpayer groups above have different characteristics and concerns that need to be considered when designing a simplified regime. FSB’s perception is that compliance costs faced by companies differ at different stages of their life cycle. Contractors and start-ups are often hit with a high compliance costs in the first few years of operation as they set up their reporting and compliance processes. Once these processes are in place, established firms tend to face continued costs over time, with new investments and economic conditions changing year on year. Other problems faced by businesses include cash flow when investing in the growth of the company.
This paper sets out options for a simplified tax system that would particularly apply to businesses in a constant state such as the steady growers/lifestyle/ and family businesses. Importantly, this would cover the majority of smaller businesses.

### 2.3 The benefit of bespoke regimes

The development of a bespoke regime for particular taxpayers should provide a simplified regime for that particular taxpayer at that particular time. It has been argued however that this provides a choice to the taxpayer that will inherently increase the complexity of the tax system, as the taxpayer needs to understand both systems at the time the choice is made. To date, this has deterred the government from pursuing this option.

However, where the choice of an alternative regime is simple, transparent and will last for the foreseeable future, the investment made by the taxpayer in understanding the alternative is both small and long-lasting. Hence the small additional complexity of considering and opting into an alternative tax system is outweighed by the considerable simplification offered, the savings in time and cost to be made in the future, and the peace of mind of being tax compliant.

Furthermore, a generic single tax regime will have inherent difficulties in trying to cover all taxpayers, compared to one based on the particular characteristics of the taxpayer population.

### 2.4 The need for optionality

Given the different characteristics of different types of business model, small businesses should be able to choose whether to enter a simplified tax system. In designing any tax simplification solution, mechanisms can be used to tailor/constrain a new system to accommodate the varying concerns and characteristics of different business models and to ensure the system meets the requirements of the Government.

Providing a simplified tax system as an option empowers businesses to choose a system that works for them and will provide the optimal solution to suit their business needs, without imposing compliance requirements that are less relevant or complex on others. For instance it would be inappropriate to force a high growth start up into a simplified tax system only for it to go through additional burden of then transitioning to the normal regime shortly thereafter as it exceeds any threshold rules.

HMRC will be able to safeguard revenues by setting appropriate rates and thresholds designed to prevent opportunistic and short term use of a simplified system. The design of the entry, transition and exit mechanisms will be important in ensuring that the new regime does not cause unintended consequences either for businesses or in terms of HMRC revenues.

### 2.5 Interaction with Making Tax Digital
The review of small company taxation comes at a critical time in the journey of the UK tax system to a digital environment. The proposals in Making Tax Digital point to the abolition of the annual tax return and a more regular engagement between the taxpayer and the tax authority. The digital tax account can be expected to make the process of submitting a tax return easier. However, the digital tax account can only be as good as the data used to populate it. In such an environment, it is important that the tax system is simple enough for businesses to readily understand the tax implications of the activities that they undertake. Today, for many, tax remains too difficult to understand and a burden that is completed with the associated cost of a tax agent.

Simplification is necessary for the digitisation of tax to be effective for HMRC and meaningful for smaller businesses.

3. Potential options for reform

This section will set out some specific options for change and assess the different potential options against the framework above. These options are aimed at the majority of smaller businesses, i.e. those that have steady growth, such as life-style or family businesses.

3.1 Option 1: A simplified small business regime

This provides a proxy of a business’s tax liability, replacing the complexity of applying a number of different taxes. The business would calculate its overall tax liability by applying a flat tax rate (provided by HMRC, determined for each sector) to numbers drawn from the businesses accounts. This builds on the existing Flat Rate Scheme (FRS) that is applied for Value Added Tax (VAT) which is well established, having been in use for over a decade.

To simplify the tax regime and increase the accuracy of tax returns, only limited, easily verifiable and obtainable information would be required to calculate the tax liability and the tax payment would cover many tax obligations of the business. The aim of a new Small Business Simplified Regime would be to provide the basis for a business to calculate its overall tax liability using only:

- Sales it makes to its customers.
- Payroll total.
- Interest payments made.

With just these three pieces of information, and the correct categorisation of business, industry or sector, tax could be calculated. The following taxes seem appropriate for inclusion within the single payment (that is, settled by the new simplified payment):

- Corporation tax of the business.
- Employers’ National Insurance Contributions.
- Value Added Tax (based on the flat rate scheme already in existence).
This option could be further extended. Work undertaken by the FSB\(^4\) has shown that Non-Domestic Rates (Business Rates) could be replaced by a 1% tax on the turnover of a small business. Based on this analysis, Business Rates could be included in the amount applied to the turnover of the business, thereby removing yet another burden on the small business.

Even if only applied to corporation tax and VAT, this would avoid significant complexity.

**How would the model work?**

The first stage would be to categorise the business. This is critical because the categorisation aims to ensure that all those businesses in that category are very similar, allowing the use of simplifying assumptions about costs as a percentage of turnover. This approach is already adopted in the VAT (FRS) which, by assuming the ratio of VATable expenses to VAT-inclusive sales, provides a single flat rate that can be applied to the gross turnover to generate broadly the same amount of net VAT that the business would suffer if it operated the full system. The premise for this new Small Business Simplified Regime (SBSR) is that the flat rate scheme operates effectively and that the groups are categorised appropriately.

To ensure that the FRS reflects the actual VAT that the business would pay, the rates applied to different sectors vary, reflecting the differences in margin between the different types of businesses. These run from 4% for food retailing and newspapers (where expenses are a large proportion of sales) to 14.5% for legal services (where there are low costs excluding salaries and funding costs).

In determining the FRS rate, the tax system assumes a level of expenses, as is shown in the examples below. This means that for these types of business, HMRC has an estimate of the profits after VATable expenses. All that is needed to estimate the profits for corporation tax is therefore an estimate of the other expenses.

**Step 1**

The examples below show profit and loss accounts for businesses in a 10% FRS band and a 6.7% band. The existence of a Flat Rate for VAT means that there is an estimate of income less VATable expenses (shown below as profit before employment costs). All that is necessary after that is to estimate the non-VATable expenses to identify the taxable profits.

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\(^4\) Based on a study "Proposals for reform of the non-domestic rating system" conducted by the Centre for Economics and Business Research, commissioned by FSB.
Federation of Small Businesses – Written evidence (FBB0007)

Case A - A business has turnover 100,000, employment costs of 20,000 and other costs of 40,000

<table>
<thead>
<tr>
<th></th>
<th>VAT</th>
<th>Flat rate %</th>
<th>Imputed Profits Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales ex VAT</td>
<td>100,000</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td>Costs</td>
<td>(40,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit before emp. costs</td>
<td>60,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment costs</td>
<td>(20,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable profits</td>
<td>40,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Under the normal VAT rules, VAT of 12,000 would be due (VAT at 20% on turnover, less input VAT on costs).
To achieve a fiscally neutral outcome under the flat rate VAT scheme the flat rate would need to be 10% to collect VAT of 12,000.

<table>
<thead>
<tr>
<th></th>
<th>VAT</th>
<th>Flat rate %</th>
<th>Imputed Profits Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales inc VAT</td>
<td>120,000</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td>Cost inc VAT</td>
<td>(48,000)</td>
<td>(8,000)</td>
<td>12,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>50 %</td>
</tr>
</tbody>
</table>

Case B - For a business with higher VATable costs

Under the normal VAT rules, VAT of 8,000 would be due (VAT at 20% on turnover, less input VAT on costs).
To achieve a fiscally neutral outcome under the flat rate VAT scheme the flat rate would need to be 6.7 to collect VAT of 8,000.

<table>
<thead>
<tr>
<th></th>
<th>VAT</th>
<th>Flat rate %</th>
<th>Imputed Profits Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales ex VAT</td>
<td>100,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Costs</td>
<td>(60,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit before emp. costs</td>
<td>40,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment costs</td>
<td>(20,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable profits</td>
<td>20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales inc VAT</td>
<td>120,000</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td>Costs inc VAT</td>
<td>(72,000)</td>
<td>(12,000)</td>
<td>120,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>6.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>33 %</td>
</tr>
</tbody>
</table>

Whilst the profit before employment costs can be calculated from the single flat rate number, in practice it is expected that HMRC would publish both a Flat Rate for VAT and the percentage of the sales that represent the profits before employment costs (called the Imputed Profits Rate or IPR).

**Step 2**

The next step is to take from the imputed profits any non-VATable expenses. The biggest of these will be employee costs. Since it is assumed that the obligation to run a payroll is retained due to real time information requirements, this will be known to the business. The formula would be:

\[
\text{Simplified Taxable Profit} = (\text{IPR} \times \text{Turnover}) - \text{employment costs}
\]

**Step 3**
Federation of Small Businesses – Written evidence (FBB0007)

It would be possible to develop variants of this model to take account of other non-VATable costs faced by business. Another key cost could be interest paid to banks. In this case the formula becomes:

Simplified Taxable Profit = (IPR x Turnover) – employment costs – interest

Comparing the outcome under the simplified system with those delivered by the current regime it can be seen that the simplified system need not reduce the overall tax take.

<table>
<thead>
<tr>
<th>Current regime</th>
<th>Sales ex VAT</th>
<th>Costs</th>
<th>Profit before emp. cost:</th>
<th>Employment costs</th>
<th>Taxable profit</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case A</td>
<td>100,000</td>
<td>(40,000)</td>
<td>60,000</td>
<td>(20,000)</td>
<td>40,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Case B</td>
<td>100,000</td>
<td>(60,000)</td>
<td>40,000</td>
<td>(20,000)</td>
<td>20,000</td>
<td>4,000</td>
</tr>
</tbody>
</table>

The same results are delivered by the simplified system, but without the burdens and cost imposed on the small business by the current regime.

<table>
<thead>
<tr>
<th>Simplified system</th>
<th>IRP</th>
<th>Turnover</th>
<th>Emp Costs</th>
<th>Simplified profit</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Case A</td>
<td>50</td>
<td>120,000</td>
<td>20,000</td>
<td>40,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Case B</td>
<td>33</td>
<td>120,000</td>
<td>20,000</td>
<td>20,000</td>
<td>4,000</td>
</tr>
</tbody>
</table>

**Extending the regime to Employers NIC**

A further simplification could be achieved in the calculation of Employers’ NICs. Given that most, if not all, of the employees in these businesses are earning below the upper NICs threshold, it would be possible to estimate the level of employer NICs by reference to the level of employee NIC without the need for detailed employer NICs calculations.

Rather than calculating the actual Employers’ NIC, the tax could be calculated as:

Estimated Employer NIC = Employee NIC paid x (Employer NIC rate/Employee NIC rate)

= Employee NIC paid x 1.15

**Combining this all together**
It would be possible to pay an estimate of corporation tax, VAT, and Employer NIC using only the categorisation of the business (which provides the relevant rate) and the following information from the business:

- Sales to customers.
- Employment costs (and interest paid).
- Employee NICs paid.

**Thresholds and entry/exit**

The expansion of the Flat Rate Scheme to encompass more taxes would necessitate a review of the qualifying criteria for entry. This would include consideration of the turnover threshold and the time within which a company must remain in the system. The intention is to provide a simple system that the company chooses to adopt rather than an opportunity for a company to flip between different options depending on which results in less tax in a particular year.

**Who would the scheme be suitable for?**

In essence, the system is designed for businesses with a relatively constant net margin before employment costs over time (so may vary within a year but relatively constant over the longer term) and that the margin of the business is close to that which is estimated by HMRC. Hence this scheme would be suitable for the majority of smaller businesses which are steady-growth businesses, for which the sales margin could be expected to be relatively constant over a year.

The simplified small business regime is not a pure turnover tax as employee costs are deducted from the imputed profits before the tax rate is applied. Consequently, the regime does not suffer the criticism applied to turnover taxes that a shortfall of sales, resulting in a loss, would nevertheless give rise to a tax liability. Under this regime, such a shortfall would give rise to a loss that could be carried forward or backward as usual.

**Assessment against framework**

The scheme has the potential to deliver the following benefits:

- **Cheaper/easier compliance:** The scheme means that businesses need only a few pieces of information to work out their tax liability. It removes the need for them to spend time and money on tax agents and expensive software. Instead they could invest in the growth of their businesses, providing longer term economic benefits.

- **Certainty of tax liability:** The scheme eliminates the need for a detailed profit and loss account by allowing firms to calculate their tax liability using a limited amount of information. This provides reassurance to firms they are paying the right tax at the right time.

- **Easy to predict tax payments/Simpler relationship with HMRC/aligned with other policy changes:** In making the tax burden far more predictable, the scheme would enable smaller businesses to be better informed for their business planning. The use of available and understandable information would make it easier for smaller businesses to maintain
accurate tax information. The accuracy of tax information would complement the easier reporting processes proposed through the Government’s Making Tax Digital reform agenda.

3.2 Option 2: A tax transparent corporation

This option would allow a company to elect to be treated as a tax transparent vehicle. Similar to a partnership, this would mean that a business could elect into the system and its income/expenses would then be considered to be earned directly by shareholders who would report it on their individual Income Tax returns. For example, if you hold 60 percent of the stock in a corporation and the company has a taxable profit (computed under income tax rules) of £50,000, you are responsible for reporting £30,000 of that as income and would pay tax on it, based on the owner’s marginal tax rate. The entity would submit a yearly tax return.

The entity would, however, still retain corporate characteristics for all purposes other than tax, such as limited liability and the ability to contract. The company would have a rigid profit and loss allocation; profits and losses would automatically flow to the owners based strictly on the percentage of ownership.

How would the model work?

Although this would be a corporate body, for tax purposes the vehicle would operate in a similar manner to an LLP for tax purposes. The shareholders would be deemed to have undertaken a proportion of the activities of the company. Profits distributed to shareholders would not be taxable income since they would already have been taxed due to the tax transparency. This system could be designed as an addition to the current system, creating a new solution to tax-motivated incorporation.

Addressing Governments concerns around compliance

Again, this option would be designed to be a long-term option rather than one that allows companies to choose annually. The transition from tax opaque to tax transparent could be covered by the existing disincorporation rules and the opposite by the incorporation rules. The protections applying to the misuse of LLPs should equally protect the Exchequer from abuse in this situation.

International comparisons

Companies in the US are currently able to submit a tax return as an ‘S-corp’. They are then treated as a tax transparent vehicle in US with the following restrictions:

- A limit of 100 shareholders.
- Only one class of stock, although it can have both voting and non-voting shares.
- Foreign ownership is prohibited, as is ownership by certain types of trusts and other entities.

Benefits reported by companies in the US include, flow through of loss, taxation at the individual level and avoidance of double taxation.
Assessment against the framework

The scheme has the potential to deliver the following benefits set out as priorities in the evaluative framework:

- **Cheaper and easier to comply/easy to predict tax payments**: Pass-through taxation means that owners report their share of profit and loss on their individual tax returns.

- **Double taxation elimination**: Income is not taxed twice (as corporate income and again as dividend income).

- **Simpler relationship with HMRC/aligned with other policy changes**: Shareholders would provide their IT returns via online account as per the MTE reforms. HMRC has the ability to audit returns on a quarterly basis.

Who is this option suitable for?

This option would suit all types of small business, in particular sole traders and contractors who have as yet been deterred from moving to corporate form due to the tax complexities. It would also benefit those who are currently incorporated who would choose disincorporation but for the loss of limited liability.

3.3 Option 3: A distributed profit tax

This option removes the need for a company to pay corporation tax and instead taxes distributions out from the company. A company would operate its accounts in the normal manner; however tax would only apply to distributions. The distribution tax would be set at a higher rate to substitute for corporation tax.

How would the tax work?

- A standard (say, 25%) distribution tax rate would be set payable by shareholders based on the profits distributed by the company to them.

- This tax would replace corporation tax.

- To prevent untaxed income being indefinitely deferred and held by the entity, a distribution threshold would apply (for example the company must distribute at least, say, 50% of profits to shareholders annually).

- The threshold for eligibility could be based on turnover (for example companies with an annual turnover of £3m or less), beyond which companies would revert to being subject to the existing tax system. However any threshold would need to be carefully set to avoid adverse behaviour at the margin.

Addressing Government’s compliance concerns

Requirements could be imposed in terms of minimum distributions or maximum cash/investment holdings.

International comparisons
The cost-based Estonian tax system with a flat rate of 21% corporate income tax is considered to be one of the most competitive and simple tax regimes in the world. Deferral of taxation shifts the time of taxation from the moment of earning the profits to that of their distribution. Therefore, undistributed profits are not subject to income tax. Instead taxation on the profit earned by resident companies, actual and deemed profit distributions (usually in the form of dividends) are taxed at the rate of 21% on the gross amount of the distribution.

**Assessment against the framework**

The scheme has the potential to deliver the following benefits set out as priorities in the evaluative framework:

- **Cheaper/easier to comply**: The system introduces a simple flat rate distribution on profits, therefore removing the need to apply tax at the company and shareholder level (double taxation). The system removes significant compliance costs of working out employer liability for corporation tax and NICs.

- **Certainty of tax liability/easy to predict tax payments**: the tax is set at a standard 25% on distributions, no other taxes on the company are due.

- **Aligned with other policy changes**: would replace the dividend tax and corporation tax for a company. Could be administered online, in line with the Making Tax Easier reforms.

**Who is this option suitable for?**

This option would be suitable for all small business, particularly those that are growing and reinvesting profits into the business.

**Conclusion**

Further work will be needed to develop the detailed design of any solution. This stage will need to further consider the risks and benefits of each option, for industry as well as Government (for example administrative costs, increase or loss of tax revenue through greater compliance or avoidance, and political risks of the policy). An evaluation of the options, as discussed in this paper, is shown in Diagram 1 below:

**Diagram 1: Evaluative Framework**

<table>
<thead>
<tr>
<th>Industry/Government aims</th>
<th>Cheaper / easier to comply</th>
<th>Certainty of tax liability</th>
<th>Easier to claim reliefs</th>
<th>Easy to predict tax payments</th>
<th>Simpler or the same level of relationship with HMRC</th>
<th>Directly aligned with other current policy</th>
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<table>
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<tr>
<th>Areas of change</th>
<th>changes</th>
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A combination of the above options could be used to address the concerns of different business models across their life cycle.
Comments from FSB members on the impact that quarterly online tax reporting will have on their business

15-17 December 2015

For me, quarterly online tax reporting sounds like a massive additional admin burden for already stretched and bullied (by HMRC) small businesses and I for one, object to it as strongly as possible!

Instead of making the lives of small business owners as possible, HMRC should be pursuing the large businesses that do so very well out of not paying the taxes they are due!

This is my worst nightmare come true. I am going to be spending more time filling out tax returns than actually running the business. I fear it may be the straw that breaks the camel's back. This is Tory greed and stupidity gone completely out of control. Someone's got to do something about this. Otherwise. Thousands of small businesses will go down the drain. Then they are going to pick up a massive benefits bill. Just watch and see.

Sounds like it's good for accountants, bad for small business.

I've not seen any benefit to government or business clearly articulated. So far, it's just been fluffy nonsense. If they can't explain any benefits clearly, it's obvious that there are none.

This is going to be a nightmare. I'm a small accountancy practise and have trouble getting information from my clients once a year never mind 4times a year. I think HMRC think that as VAT returns are done quarterly then it follows that quarterly accounts can be also prepared. They do not realise the difference between simply reporting "ins and outs" and preparing actual accounts. They also have not considered all of the small businesses who are not VAT registered and perhaps are not using any commercial software and would therefore require help in reporting so often. This would add a substantial cost to the businesses with a possible quadrupling of their accounting bills. I also don't think accountants will be rubbing their hands either as this is just more bureaucracy to contend with. What happened to simplification........

I, for one, want to understand why the Government is driving this and their reasons for doing so. Initially it would seem that they could command a more regular share of our hard earned profits in Corp Tax and would give them a steady income stream. The downsides appear huge, more costs and more valuable time to prepare and clearly that just is NOT fair on the SME's that are the backbone of this country. We have already made ourselves 'lean' and we do not have the wherewithall to cope with this. We should demand that they go after the bigger businesses who don't pay taxes that should be due. Are there other countries out there who demand quarterly returns?

As a sole trader who already does his own self assessment once a year I see this as a major waste of my time.

Perhaps I'm not typical, but my accounting system mainly comprises boxes of invoices, drawers full of files and a hundred or so pages of bank statements which once a year have to be beaten into shape. This usually involves me forsaking family life for two to three days in January, clearing a large area around me in which to spread papers, and arming myself with a
constant feed of coffee and paracetamol until I reach that eureka moment when the numbers make sense and the return has been filed online.

If I have to do this four times a year, it will take me perhaps not two or three days each time, but certainly at least an entire day each time, which I really can't afford to lose. It will also mean that I have to have the tax money available four times a year presumably rather than saving towards at the end of the year. I also fear that four times a year will lead to simply a further three more chances to make a mistake.

Having made a mistake in the figures some years ago, amounting to only about £50, and then having to spend days dealing with the tax office, submitting bank statements etc. trying to explain that it was simply an addition error, not an attempt to defraud the inland revenue of this vast sum of money, the prospect of being able to make a mistake four times a year, rather than just one, is a bit daunting.

As far as I can see, all it will reasonably achieve, is to create four times as much work for HMRC, an already inefficient and overworked department, and whilst it may create more jobs for them, it will no doubt also mean more mistakes at their end too.

Will it raise more revenue? Of course not. It will cost more to administer as more civil servants will be required to wade through the returns, and if every person on self assessment has to submit four returns each year, it stands to reason that either, as in my case, I will earn less and therefore pay less tax because I'm busy filing returns instead of working, or people will have to pay their accountants more for filing the multiple returns, an expense which is tax deductible as far as I can see.

I simply can't see any winners here, unless you are an unemployed tax inspector....in which case you may soon have a new job.

What another pointless waste of time as we already have to report wages monthly it's more red tape gone mad

I have not heard anything about this?

I thought the government were trying to decrease red tape for small business. Reporting quarterly seems like a ridiculous idea that I would not welcome but not just for small business but also for HMRC in administration. Haven't they got better things to concentrate on?

I totally disagree with your comment that "it's good for accountants"

As a professional accountant nagging those late clients to bring in their records and other information to beat the January deadline, having to do this now 4 times a year would be our worst nightmare come true. It would be January four times a year with no doubt penalties and interest for those that are late in filing the quarterly returns.

It would also be bad for both ourselves and the client in an age where we are trying to keep fees down for our clients it would mean raising fees and possibly losing clients to back street "accountants" who have no overheads to talk of, no PI insurance and bad advice being given.
From a purely practical point of view I am totally against this proposal - and what would the Government gain from this? Surely if the object of this proposal is to get more money in quickly, instead of the payments on account being paid twice yearly, make these payments on a quarterly basis. I may be wrong but it appears this proposal will only apply to the unincorporated businesses. Is this another "George Brown" idea to force sole traders etc to become an Ltd to overcome this idea to somehow to overcome a perceived Black Economy?

Let's all unite to block this proposal

I already file my VAT return quarterly so I am used to making sure all my accounts are in order every 3 months (but then again I am super organised).

My accountant files my VAT returns for me quarterly and Corporation Tax and Self Assessment Tax returns annually.

This would add extra time and cost for myself and my accountant and I would envisage lots more 'paperwork' and admin time,

I could see how some businesses would benefit from doing this quarterly as it would encourage them to be on top of their paperwork more often. If the calculations and payments are also due every 3 months, this could also help with spreading the cost of payments for tax, rather than having to do it once a year.

I have mixed feelings about this, and would prefer to see this being brought in, as a phased approach, where businesses are not given penalties for not filing/paying on time in the first 2 years of the scheme.

In my opinion this proposed change to the Law will have several impacts upon businesses none of which will be supportive or good.

The first is that by making the payment of tax quarterly it will seriously impact the cashflow of business at a time when Banks are not lending to businesses unless it is to a strong business with a good track record and strong business plan. This cashflow impact will hit seasonal businesses worst of all since they rely on generating cash in their busiest periods and holding onto that cash to see them through the lean times. For seasonal businesses having to pay quarterly will probably result in them collapsing because they will be paying tax on their high profits earlier and will not have the funds left to see them through the lean times.

The second point relates to the administrative cost of generating quarterly figures and to submit a tax return. The Government have said that they are committed to reducing the administrative burden on businesses yet by introducing this legislation they will in one fell swoop have increased that burden by a factor of four.

The third point I would make is that for Sole Traders and Partnerships the accounting year can end at any point in the year. It does not have to match the tax year. In my experience most sole traders and partnerships where they have an accounts year other than the tax year have enough difficulty in understanding their tax position so to make the payments quarterly will confuse them even more.
The decision to implement this change will hit businesses worse than the credit crunch of 2007-08 and it will be a serious drag on business growth as well as deter people from starting their own business in this Country. This change will simply move debt from the Government onto small businesses who will not be able to fund it. Therefore I predict that we will see more business bankruptcy's and liquidations than at any other time in history.

I wonder if that is the legacy that this Government and Chancellor want to be remembered for?

I'm pretty well organised when it comes to day-to-day accounting, and it would be no great burden to report income and expenditure quarterly - even monthly. But stocktaking takes me six weeks every year, it would be a killer to have to do it more often.

I take the view that if this is to proceed at all, it should be only to much larger companies, as in gender based reporting. Quarterly VAT returns are filed, and the tax on income (whether in companies or individuals) should be once a year. Otherwise it involves an otherwise unnecessary multiplication of year end work, to four times a year. So much for a red tape challenge to reduce paperwork! This would have quite the opposite effect and increase overheads on SMEs.

For us quarterly tax returns would create a massive admin overload. We are already in undated with onerous paperwork and this would just create another strain on the business.

We would strongly oppose any move to bring this into force

The first assumption is that all self employed and small businesses are online. I thought our research indicated that at least 25% are not.

Reporting quarterly means another three lots of workings to submit in addition to the annual figures. Is everyone on a cash basis? If not then debtors, creditors, stock and work in progress will need working out quarterly. Life is hard enough for the small man in business and this will certainly not make it any easier.

Having just sold a business which these proposed changes would have had a big impact on.

I have now started a smaller business and to file accounts quarterly is not going to help when I need to concentrate growing my business not doing more paperwork.

This sounds to me like it’s more for HMRC's benefit rather than the businesses.

I'm atypical of many "one man bands" in that my accounts are up to date using a cloud based accounting system and I have an accountant to take care of the reporting for me, so from an admin point of view it wouldn't make too much odds to me. However, the extra cost of the accounting and the effect on my cashflow of the more frequent tax payments would probably push me from a currently precarious position into outright failure.

I did not know that this was coming in. From the comments above it seems unclear as to whether this is going to apply to sole traders only or also to limited companies. I run a small limited company and totally agree with everyone else that this seems to be a potentially massive increase in admin for businesses, accountants and HMRC, who already struggle to get things correct. If the purpose is to get a steadier stream of income for the government then
these changes should be aimed at large companies only. This government, unfortunately, continues to show a total disregard and lack of understanding towards small businesses.

This will be bad enough for me (smallish business - 6 employees), mainly in terms of increased accountancy costs, but will be an absolute nightmare for one-man-bands such as my gardener, who struggles with annual returns! Whilst an excellent idea for LARGE companies to improve government cash flow - there should be a threshold - based on turnover rather than CT payable to avoid further incentive to cheat than downwards for Amazon etc. Perhaps 10 million a year?

This is simply another piece of proof that the government hates small business, and want us all to fold into the big corporate world... Maybe because they are all shareholders of said big corporations, and thus are losing out on profits?

I also cannot see any benefits for the SME, nor for HMRC, with workload quadrupled for both sides, so this is really one of the dumbest ideas ever! What's next? Quarterly self assessments?

This could very well be the straw that breaks the camel’s back for me. We already reconcile and pay VAT quarterly for which we are unpaid tax collectors, PAYE monthly which is fair enough, we are in the construction sector so there is a very bureaucratic and time consuming monthly CIS (Construction Industry Scheme) return to prepare and submit and of course the most annoying of all - Corporation Tax - where my micro business pays more each year than many of these massive corporations and where is the justice and fairness of that.

In the past two years, we have had to learn to make all our returns and submissions on line and it is not user friendly or straightforward. If you phone any of the HMRC help lines, it takes eons to get through and most often you are forwarded on to another person or office. Whenever we receive documents from HMRC they seem to be laced with threats of fines for this and that rather than having any humanity in their communications.

At present, we spend the best part of a week preparing and gathering together all our documentation to present to our Accountant to file our Annual Tax Return. In amongst all this, we are trying to run a business but despite noises from the politicians about the reduction in rules and regulations, we have only seen a huge increase in legislation pertaining to our industry, particularly in the last 12 months.

I have no problem with paying my taxes as long as everyone else does as well but the burden seems to be falling on the little guys who cannot fight back or employ legions of tax accountants and lawyers to wriggle out of them. The Politicians of all persuasions seem to be inept at putting this right.

I am looking hard to find any incentive to running my own business at the moment and if we have to pay for our Accountants to prepare 4 sets of accounts per year then that might just be the point at which I say 'Sod it - I have enough'.

Yes, it will take a little more time and therefore additional cost, but as I use one of the many online accounting systems I don't see it as being a particularly big deal for me. I would like to see a justification for it however...
So much for small government eh? Every tax change I see complicates things even more - what idiots are sitting there coming up with ideas like this? Clearly they have never spent a day in the real world. RTI is already a nightmare - and I still don't know why we have to do it.

We need to grow a pair and just say no, we're not doing it. We need to create the culture where they have to justify these things to us not just demand them.

This will make extra work for the accounts department and, I suspect, more income for our accountants.

I really cannot restrict my answer to what the impact will be on my business - the issue around this is much broader.

Like, I guess, every other small business owner believes this will add yet another layer of cost / administration. If I had any idea as to who will benefit from this, other than the cash flow for UK PLC, then it may be easier to understand but as I see it the only potential winner will be the accountants who will have a justifiable reason to charge extra for undertaking more work - but realistically do they have the time to undertake this additional work load?

From what I see the HMRC are already understaffed and overloaded so can they cope with it? Will it mean an added layer of staff recruitment and cost for them - which someone will have to pay for? I wonder who that will be?

Sorry, I cannot find any way in which to support such a scheme. The impact is very negative all round.

This will have very little effect on our business.

I think the tax system has broken down. Fancy a government that can't even collect taxes!!!

No. This will be awful. The current software has errors in it anyway.

We will have to see the 'everyone has 10M broadband' strategy finalised and fully working at all point of the compass first as all this Brave New World will be done on-line to save costs.

I live about 2 miles as the crow flies from the telephone exchange trying to get an https: fails about 3 out of 4. A condition that often lasts more than a day.

Joined up thinking needed is the message

As a practising accountant I could be expected to welcome this approach as a way of generating more business. However I do feel that this is just the first step towards forcing 'small businesses' into conglomerates, or opting for incorporated status. Either way the key has to be the chancellor wishes to speed up the collection of his taxes.

I really can't see the point of this, it's just extra workload for everyone concerned and for what possible reason? - absolute stupidity from a government that continually puts burden on small businesses while allowing big business to get away with...

If this relates only to income tax (PAYE), it will not affect my business as we have only self-employed assistants working part-time and thus no requirement to report. I have to offer a
return on my own income and expenses, surely that negates Self-Assessment and tax returns at year end? We need more details on the proposals, and how they may work once ratified.

Much of how I feel has been said above. If HMRC want to pay for the additional costs that will be incurred then that’s fine. Somehow I don’t see that happening. So much for government cutting back on red tape.

Have HMRC thought about how this will affect their cash flow especially where seasonal businesses are concerned? There will undoubtedly be many businesses reclaiming tax because of this. Just extra work for both the collector and the payer.

Collectively we have to say to government 'on your bike’!

When I got wind of this a few days ago, I was horrified. Once again central Government seems to have no idea of the challenges of running a small business. Don’t get me started on CIS (Guilty until proven innocent). For a government who said it was the party of small business and was going to have a bonfire of red tape, it seems to be doing the opposite.

My initial reaction was that it is yet another piece of legislation written by high street professionals to get more fees i.e. accountants + lawyers. However, reading some of the comments below it is going to be as bad for them as it would be for us. We are a lean business and spend the whole year working long hours and working flat out most of the time. Trying to keep clients happy whilst preparing accounts annually often means coming in over weekends or a bank holiday so that I don’t get interrupted and can concentrate on the figures. To escalate this to quarterly will just make this worse. It will increase our costs because an accountant will have to be paid quarterly rather than once a year and the quarterly fees will be greater than an exact quarter of the current whole.

What has also not been recognised is that as a projects company, our projects span many months with the result that profitability comes in waves.

Furthermore, on some projects we have to accept 60 days terms which causes cash flow issues when invoicing large sums in the last month of a VAT quarter. If this then produced an inflated Corporation Tax bill at the same time as a large VAT bill then I could imagine that some companies would go under, given an aggressive tax collection regime. My requests to Government to be able to name and shame 30 days + payers to the VAT office and delay a VAT payment have been totally ignored.

A quarterly report for annual corporation tax is just too short a period to truly reflect what is going on in our business. If they need to produce a better cash flow from tax take, then how about payments on account calculated from the previous return with ability to adjust up or down as per PAYE, surely this would be simpler?

Also, isn’t it about time the Government had the guts to take on big business, many (but not all) of whom see it as their divine right to kick small businesses around. After all, which sector produces the most employment and often the most innovation? How much longer will we be forced to let them divide us and conquer? FSB you have to make these feelings felt in the strongest way.

This idea will stop business like mine growing.
Federation of Small Businesses – Written evidence (FBB0007)

In our business we turnover c.£250k per annum and deal with no cash. Because we work with cloud based real time accounts/bookkeeping software we can at any time run a Profit and Loss statement showing our current position. So the requirement to post quarterly tax returns is not a massive issue although it will add costs to our admin as we will most certainly outsource this to our accountant who will I’m sure make it as complex as possible to ensure the advice given is worthy of the bill.

The proposal is still unacceptable to me because our business in cyclical, the profit we build up in the first three quarters is needed in the last quarter to carry us through the holiday period where we invoice little work. The additional admin and perhaps an expectation to take tax payments on profits over just a matter of 12-14 weeks where the annual picture could be less profit or even a loss is utter madness. (I wonder how quick HMRC can repay over-payments?)

I pay my bills on time, sometimes I am asked to pay in advance for goods which we do not buy on a regular basis, if Tax was added to that list of bills I have to pay in advance of the annual position I would most certainly run out of money or have to delay invoicing customers to avoid peak periods. This would add admin to our business resulting in errors that cost jobs - imagine I paid the tax on Q1 profit and in Q2 made a loss and could not pay my staff, I would have to let them go.

I know it is attractive to want to collect your debt in early and it is a common sense debate that originates from exploring changes to help the economy but I would not spend any more time or money exploring this until evidence has been put forward to show this would not cause small businesses like mine to run out of money.

As a micro-business, quarterly reporting will be a disaster for me, for the following reasons:

(1) as a professional I issue relatively few, relatively large invoices to a small client base, resulting in an uneven cash-flow. Quarterly reporting is likely to result in a tax liability which seesaws wildly

(2) my accountant provides good value for money - once a year. But if my accountancy bill quadruples it will become my largest single overhead

(3) if I have read the reports correctly the proposals involve a new IT system. Public sector large IT projects NEVER work first time, and sometimes don't work at all. Chaos is entirely and depressingly predictable.

In addition, what will HMRC do with the extra information? They can't handle my annual return effectively, taking 5 months to deal with a tax refund after submitting on-line at the earliest practicable date.

This will be another straw towards giving up my business. My quarterly income fluctuates wildly as I am driven by contracts and a gap of several months is not unusual during which time I make a loss. There is no way I can estimate annual corporation tax in advance.

Yet another increase in cost and time for a small business for what would seem like little, if any, gain.
I run a single-handed business, making enough to survive but no more. I pay my accountant annually and, presumably, would now have to pay him quarterly. As others have written in previous comments, it seems that HMRC are hell-bent on increasing the workload for small businesses while doing little to tackle bigger issues.

I really don't see the point in this proposal but I guess we will just have to try and make it work.

I can recognise the benefit to HMG/HMRC in collecting money earlier but am unable to see any benefit to small businesses. The adverse impact on cash flow and the additional admin and accountancy costs will yet again increase the burden on most businesses. We should oppose the change.

This will be too time consuming and EXPENSIVE in accountancy costs and my time compiling the details every quarter.

Why do they not go after the large companies who have departments to compile and add the details for this.

Personally I have a terrible time doing the VAT every quarter. That alone makes me ill and takes me days to work out. This will be impossible for me and will probably mean I will have to cease trading after over 35 years.

This to me is typical of this Tory government who are determined to make it difficult for small business’ to continue and at the same time giving an easy ride to their rich friends

Will probably close my business as just too much hassle and cost

Additional cost and wasted time

There's just too much administration being added by the Government.

We've got quarterly VAT reporting; we've had to add Real Time PAYE Reporting; we're in the process of going through the additional administration for the workers' pensions and now they're wanting to add this! Do the Government not know that they're taking micro business people away all the time from the main money making activity, that they are restricting growth to the next level.

We don't have administration departments, that's us; we don't have HR departments, that's us too; we don't have accounts departments, that's us again and we don't have 'shop' or 'workshop' or other operations managers, guess what? ... that's us yet again. I'm working hard to grow my business, on one of the North's dying high streets, I work every waking hour, I work through weekends, and I've always worked through Christmas.

Come on guys, it's time to stop just adding and adding to the barriers you're putting up to small businesses, Britain needs its small businesses, the Governmental administrative burden needs streamlining and thinning out rather than just stacking higher and higher.

I will have to pay more to an accountant, and it will also mean that I will have to do another spread sheet on the computer which to me is hell. Paying an accountant four times a year for work will be at a guess, about £500 minimum in expense. This will be untenable. My profit
margin is low (as a small or micro business this is deliberate as people come to me because I do keep prices low.) Making a higher mark up to incorporate the extra expense will be the end.

It will be impossible for me

I expect the FSB to prevent this happening for small businesses, because that is what we pay our subscriptions for.

My alternative is to close the business before I am required to meet the additional expense. The government's time would be better spend introducing a 15% sales tax, payable on the "at the door" price on those companies currently not any paying tax because they operate from an off shore address.

I expect a largely negative effect for everyone except HMRC, who'll collect many more penalties for late/incorrect submissions. This won't help small businesses. As accountants, we anticipate that many of our small self-employed clients for whom we only prepare annual tax returns, will want us to handle this for them. Unfortunately, this will be 4x the current work & 4x the costs. They are unlikely to welcome or possibly be able to afford this. We may well need more staff to handle the increased work load, so our costs will rise. Suitably qualified staff are hard to find at present & that situation will become much worse. Competition for recruitment will probably also drive up wages so staff may become more mobile. This will cause further problems. Some clients, unable to afford substantial extra costs, may try to do their own Returns. However, often clients come to us after finding the current online Tax Return form too confusing, or because they have made mistakes doing it themselves.

Why - what's the point. Just another added time/financial burden for one man businesses. This must be stopped

Like many other small business we do not know our overall profit and loss until we finish our financial period and carry out our annual stock take.

I am not inclined to do this a further 3 times during the year.

We are a small retail business with 2 shops employing 6 staff. With the increase in minimum wage levels with the introduction of the Living Wage next April and the ending of the business rates concession (we cannot claim the small business rates relief with 2 shops) I am beginning to wonder what is the point of continuing once our leases expire next year. As owners we are struggling to make any reasonable profit as is and I am not at all confident going forward.

I run a small accountancy practice, specialising in support and compliance for very small businesses. It's hard enough now for these taxpayers - not "customers of HMRC", please - to meet their reporting requirements. The effect on my business would be to quadruple my workload, which would be impossible. The effect on my clients defies polite description. I have yet to see any justification for quarterly reporting by SMEs and micro businesses, and the whole proposition is laughably unworkable. It underlines the fact that HMT and HMRC simply do not understand what it means to operate a small business, nor the role of tax agents in keeping the tax flowing in. There needs to be a realistic de minimis limit for quarterly reporting, and this is where the FSB should concentrate its lobbying.
I thought red tape was going to be reduced. This is about as big as it gets.

Quarterly reporting would increase our workload and hence cost us money, but would have no impact on the amount of tax we hand over to HMRC.....

i.e. Quarterly reporting = extra red tape with no benefit for anyone

Well it is obviously a completely unwelcome increase in administrative overhead added by a government which says it is committed to reducing the burden of red tape, but we do already cope with doing quarterly VAT returns. With a well set up accounting system it ought to be possible to make it a push of the button job, except for complex adjustments like capital allowances, which one might hope could still be handled as a year end adjustment.

As per other replies, the problem is the additional administrative burden of doing something 4 times a year instead of once of year. I can understand that HMRC wish to speed up payment but the relatively small amount of tax collected from Small Businesses (in particular Micro Businesses) outweighs the 4x higher administrative cost. As a Micro Business, this regulation should not be imposed on us. I would suggest a limit based on turnover - but the FSB are better placed than I am to suggest such a threshold.

Huge added cost. I pay a book-keeper to do my accounts quarterly and to finalise the VAT. But I only send everything to the accountant once a year. I would need my accountant to approve the quarterly accounts and I reckon that would mean three times the price of sending it just once a year.

It is easy to do as we do monthly accounts, but we would still have to send them to accountants to ensure we are making correct claims for capital allowances etc and they will charge extra for this service. Instead of saving us money it will cost us more. Government need to simplify the tax regime first.

Short answer? Emigration!

After decades of failed promises to reduce red tape, is this really the best that our "omnishambles" Chancellor can offer?

Any short-term cash flow benefits that the Treasury expects to gain could be lost in the noise if a significant proportion of the 4 million micro-businesses, led by those operating on-line, decide that enough is enough and move to a less punitive environment. The issue is time, as much as money. This could be the tipping point. Except this one - unlike the "pastie tax" - will be a lot harder to fix.

It's such an idiotic idea that it makes you wonder if it might be another EU directive?

This will add to my administration costs as well as taking up time for me. Also of course my accountant’s fees will increase as a result of quarterly reporting.

This yet again shows how out of touch with the practical issues of running a small business the Chancellor is, despite protestations to the contrary. I only hope that people remember this when he puts his formal bid in to take over from Cameron. Other than evening out his tax
stream this will do nothing to assist businesses that are already struggling with the increasing burdens of Bureaucracy despite another hollow government pledge to get rid of red tape.

There will be cash inflows and outflows as HMRC have to deal with businesses that make seasonal profits/losses and judging by the appalling standard of HMRC's attention to detail this will also prove a mess with fines being scattered around like confetti.

Bearing in mind the 1.8 million calls which went unanswered last year I don't see how they can handle at least 4 times that amount unless they increase the staffing levels at HMRC. This wouldn't surprise me either bearing in mind the current governments continuing inability to tackle a burgeoning Public Sector which is crippling the economy. Cynically it wouldn't surprise me (as no details have been announced as far as I am aware) that this is just a hare started to get people frightened, only for a slightly less draconian proposal to come in elsewhere to demonstrate that they have 'listened to the people' After all he has form on the matter - pasty tax etc. Almost makes Corbyn-onics an attractive alternative!

This is unreasonable and excessive. For us it would mean 4 times the Accountants fees and 4 times reconciling their figures- as, for example, we don't do things like in-house depreciation - and so on. It's time consuming enough doing this once a year. Does the government really have that little understanding of this process from the business end? It would also mean employing another person - or is this one of the hidden agendas? We can't afford it and being so small we have nowhere to put them - and can't expand for a variety of reasons. I have advised the Director to plan for his retirement before that year.

This will have a very large impact on most small businesses, one that we can ill afford.

Maybe the government will be happy when they have closed down most businesses but then how will they

As I do my accounts each week, administratively there is little extra time for quarterly reporting but with a fluctuating income during the year (as do many others) this proposal leads to many questions regarding calculation and payment of tax, more investigations as figures do not fit the tax mans schedules due to these fluctuations. There are too many unanswered questions at the moment to make a firm decision.

I'm with colleagues on this one. Like [--] we'd need to go to our accountant to deal with depreciation and the like. Being the wrong side of 60 I was already toying with the idea of winding up our business (rather than it becoming a vehicle for my son's IT consultancy work). We just couldn't afford more accountant's fees so I'd pack up. I’m still trying to deal with the fiasco of auto enrolment. We've had conflicting advice from our accountant and IFA (because they have had conflicting advice!) and my letter to the Regulator has had two responses, one saying we will not be covered and the other indicating we will be. This all looks like policy making on the hoof, with little or no detailed consideration given to the practical implications.

So much for reducing the burden on business. This increased red tape will add to my administrative workload, and quadruple the amount I pay to my accountant each year. I run a one-woman business and I really cannot see any benefit to the government in spending 4x the effort and expense in processing my relatively small tax return.
As a micro business (sole trader), quarterly tax reporting will create a ridiculous amount of extra, and un-necessary paperwork.

My business is quite straight forward, and offering a professional service means that I don’t create much accountancy work in terms of buying and selling goods.

My annual tax return is, therefore, quite simple. Yet I still pay my accountant to take care of it for me, as this enables me to carry on running my business efficiently, whilst resting assured that the tax return is filled out correctly and that I have taken the correct advice in so doing.

I am a designer and not an accountant, and tax forms etc. fill me with dread. Not only will quarterly reporting cost me additional time and money, but for a business my size, surely it must also be costing the tax office more in time and money?

This will certainly increase my costs (and increase my accountant's income) with very little benefit to me or to my business.

I have no problem with online reporting but making this quarterly seems completely unnecessary.

So much for a government promise to cut red tape! Perhaps they can tell us what equivalent bureaucratic nightmare they will scrap to meet their promise of “one in, one out”?

This appears to be a measure to accelerate the rate at which they can extract tax revenues (probably 4 payments a year, all on account and taken straight from our accounts by Direct Debit with no right of appeal). Perhaps they stupidly think that real time accounting is even possible..... or perhaps they regard it as a way to quadruple the opportunities to inflict penalties.

As other posters have made clear, submitting full (or even abbreviated) accounts is significantly different to doing VAT returns. Just working out accruals and pre-payments would become immensely more complex and time consuming. We are a small business doing a large number of low-value E-Commerce transactions, through multiple sales channels, which makes accountancy fees quite high for our size of business. The effect of this measure would be to quadruple our accountancy fees, and make it likely that we would have to take on a part-time person (effectively, non-productive in terms of delivering revenue to the business) to ensure the paperwork is kept in order, stock checks done more frequently etc.

As a rough estimate, I would expect this to increase our costs by around £10,000 per annum, which is a significant slice to take straight off the bottom line.

Our margins are already tight and under significant pressure, and while this sum isn’t enough to push us into making a loss, it would reduce the profit to the point where it would become impossible to fund further growth and make me question whether the business remains viable.

One other thought - if it quadruples the amount of work we pass our accountants, won’t this create an instant national shortage of accountants (and an effective price increase), or is there some secret government plan to bring in accountants from the EU or overseas to fill the gap?
Another harebrained idea from Whitehall, which seems to be completely disconnected from real life.

Having to submit tax returns every quarter will not only create more red tape as well as take up more staff and time, to me as a sole trader [--] with little control over work coming in and even less of a head for numbers, it will also mean massive extra pressure at times when I may be pushed to my utter limits in terms of work already.

This is another promise broken – how many have there been in the past umpteen years since the Tories took over from Labour? – and needs to be rejected completely and immediately.

I have two businesses, one a private limited company and the other a 'Sole Trader'; if I am going to be obliged to report quarterly on BOTH businesses it will increase my admin costs enormously. I thought the government was going to reduce admin costs not increase them? What is going on?

Going to make it more difficult all round. Uses up valuable time, more book-keeping, form filling and accountancy fees.

Would be another pain in the **se to most small sole traders. The new landlord tax initiative is bad enough!

I am a sole practitioner Chartered Accountant. There are comments being raised about the increase in accountants' fees - this will happen because my workload from such clients will massively increase as will the pressure of obtaining the data from clients on a timely basis to complete the reports.

However, I have been in practice all my professional career and for the last 25 years in my own firm and have always striven to provide added value for the fees I charge. This will now change fundamentally as there will be no benefit at all for those clients who will have to comply with this ridiculous idea. No doubt it appears very sensible to those employed in large bureaucracies who have never had to earn a living but merely taken a salary from their allocated budget, funded by other people’s hard earned taxes.

How on Earth can such a measure help an important sector of the economy to grow and be more profitable and efficient.

We are a small limited company and use an accountancy practice to do our tax returns, although I do all the book-keeping and bank reconciliations as we go along. We use Sage, which means our accountants can just take reports out from there, so hopefully this will not mean too much extra work for us - although it might play havoc with planning holidays if we have to take into account preparing figures and doing stock takes every 3 months as there are only 2 of us here to do it all - and of course it will mean a lot more for our accountants.

Inevitably this will mean that we will have to pay more accountancy fees - directly from the profit line, so that will reduce the Corporation Tax that we pay, so the government will receive less and we will have less profit to grow the business, but if you are training to be an accountant it has to be good news: There will be a lot of jobs available! Sadly we might end up with too many bean counters and not enough people making the beans....

This proposal would be a complete nightmare for businesses like ours.
We are a husband-and-wife partnership with a small shop. Like other small businesses, we already report quarterly through our VAT returns. I file a partnership return manually (HMRC still don't have an electronic form) and 2 personal returns electronically. Our Year End is 30th April, so all our figures are based on the previous year's business.

To make quarterly reporting work, significant changes would have to be made. All business would have to change their year-end to fit in with the HMRC's tax year. All tax forms would have to be available for on-line filing, with all businesses having an adequate internet capacity.

As a business, every quarter we would have to complete a stock-take (some 2500 lines, a nightmare as we don't have a bar-coding system), calculate accruals, prepayments and Capital Allowances to generate figures for the 3 tax returns. We would probably have to close the business for several days every quarter to achieve this. I can't imagine our customers would be happy at that!

Overall, the administrative burden would be enormous - we would spend more time on admin than on serving our customers. Like most businesses, we have seasonal "peaks and troughs", so cashflow would be a major issue. The more you think about the idea, the more problems it creates.

This proposal certainly wouldn't generate any extra tax revenue and could signal the end of the small / micro-business in the UK.

This is going to put an insufferable extra burden and cost on the business plus diverting more of my time away from real work that earns money. So overheads up and earning down.

Unfortunately civil servants and politicians do not understand the difference between this and productive work. This is exactly what you get from those who only have to park their backsides for a specific number of hours.

This is not a good idea.

As well as the additional administrative burden there would be extra costs involved in finding and switching to new (as yet undeveloped) software to enable this. It is already a struggle for small businesses to adhere to all the admin required (I don't employ anyone because of the added complications) and this would probably discourage new businesses from starting.

It seems the tories are only interested in making things easier and cheaper for their corporate mates, everyone else can go hang.

Yet more administrative burden and cost, we'll have to buy new accounting software which we don't currently need and complying will take up more time if we have to do it every quarter. It's a dreadful idea and makes me look forward even more to retiring and selling up. I also do not employ anyone and never will do because of the complexities in tax and employment law. I really hope this can be halted.

I would say that this is a VERY BIG issue for FSB. Companies House estimate that 80% of UK registered businesses are less than 10 employees. This is where much innovation happens (what the Chinese and others envy about the UK), where, best costs, and at lowest risk is often delivered. To saddle these small, often stretched companies (often high level freelancers with
their own limited company entities) with MORE form filling ( when LESS red tape is the declared target set from the 2010 coalition to this day is simply an extraordinary public sector mistake. And when one understands that tax paid by citizens and companies actually pays for all this, one really does very seriously wonder what planet are these people living on.

I guess this will add cost to my accountancy bill, as a sole trader this is not something I can cover expect by using my accountants. Hopefully my on line accountancy software will limit the cost to this process.

There must be better ways of getting the tax in then loading up small and medium sized business with more form filling. Does make you wonder if it’s all worthwhile!

Idiotic for sole trader

Just one more step towards making running a small business unsustainable - more time on paperwork than on earning so unless you are making large profits already - and who in the SME sector is managing that, it means more accountants bills which will have to come from economy savings? Quickest way of reducing business costs is by increasing unemployment George - Beware!

As an Accountant I suggest HMR&C spend more time on answering the phone & correspondence I suspect that I will spend more time working on my clients reporting duties and will expect to charge more.

Just another action that will discourage continuing running as a small sole trader business

Quarterly online tax reporting will add unacceptable additional burdens in both cost and time to small businesses.

The media also report that the returns will have to be done by Smartphone which will add a security risk as well as another layer of administrative burden, not least because of the frequency that attempting far simpler actions by Smartphone, such as event booking, cannot be completed satisfactorily.

For small business this is madness and will increase costs out of all proportion to any revenue gain

Biggest impact will be negative in added administrative costs. Currently as a small (micro) business I keep my main ledgers up to date but carry out end of year accounts work and this determines the tax bill etc. However, having to do tax returns quarterly will mean I have to do this work 4 times, albeit the work itself will be less intensive. Doing 4 short accounting periods will still take considerably longer than doing one 12 month accounting period.

The other negative aspect is the anticipated negative effect it may well have on my tax affairs and cash flow. The nature of my business is such that I can often go several weeks with little or no income as work is carried out with no payment coming in until later. With a 12 month financial model I can work my tax affairs around that as the cash flow balances out over the year. However, with quarterly returns there will inevitably be some months where the situation looks very positive, thereby generating a large tax bill regardless of current cash flow situation. This worries me hugely.
There are several negative impacts.

1. Obviously significant more administration of little value but high risk if you get it wrong.

2. There will be an impact on cashflow for small business as the motivation behind this is to bring forward tax receipts. The effect of this is to suck working capital out of small businesses which is bad for the economy.

Who has the time to fit this in amongst everything else that's going on? I couldn’t afford to employ someone to do this, and I am too busy operating and running the business? Who ever thought of this idea (presumably has never been a sole trader) must have a vision of a medium sized firm employing book keepers and secretaries, that administer the PAYE, VAT etc. In my business it's just me that does everything. There is no way I could afford or justify taking time out for this.

Agree with all the other comments submitted.

I expect as a one man band to lose an additional three days of working time, as if one wasn’t enough of an inconvenience. Presumably that will result in less profit, and less tax for this red-tape hating chancellor.

This can only introduce extra cost and extra work - time and money that should be spend on the business rather than just more paperwork.

Another burden for small business. I do not want quarterly tax reporting.

Anybody working in the Chemical business is already swamped with unnecessary bureaucracy relating to REACH, ADR transport, labelling etc. Such nonsense has already made a mockery of simple MSDS advice sheets e.g. white spirit now has an MSDS in excess of 100 pages with details to PhD level, it is no longer useful to the end user. Anybody making paint with 10-15 components has to process over 1000 pages of PhD level chemistry for each product. Only corporations have the resource levels for this lunacy.

The proposed quarterly tax reporting will prove to be the straw that breaks the camel's back. I already spend a week collating all of the data for end-year reportage I will need to schedule 4 weeks per year if this proposal is implemented, unless of course it is amalgamated with the VAT return utilising a simple interface.

There is also the cost of accountancy; will the reportage need to be signed off annually or quarterly by an accountant? If an accountant is required quarterly then I will simply close the business. I can see no end to the amount of time I am expected to expend on unnecessary bureaucracy designed to make our Civil Service masters' jobs easier than they already are.

I'm at the tipping point, easier to walk away than carry on.

This will not work for a small business as the extra time and costs involved in filling out forms will be more of a financial burden detracting from the overall profit. Soon won’t be worth running a small business!!!

We will gain as accountants to several overseas companies with UK subsidiaries but at the same time, we will have new fights on our hands with them to
Federation of Small Businesses – Written evidence (FBB0007)

1. Get the information from them on time
2. Persuade them that when they are late and receive fines, it was not our fault
3. Persuade them that we are not overcharging for unnecessary work as European companies do not have this burden
4. Persuade them to pay more fees as we will need more staff to handle the work

Small businesses will suffer yet again with further administrative burdens when the government’s election campaign was based on reducing the bureaucracy not increasing it. No change there then! "Don’t believe a word you hear or half of what you see" is the adage I believe with politicians.

This is frankly stupid, greedy, and will only serve to increase an already oversized government structure, cost more in taxes to pay for the additional "civil" service staff and continue the road to ruin that consecutive governments seem duty bound to follow. Can you not tell that these career politicians have never worked a day in their life in the real world.

Any chances of organising a nationwide general anti-tax strike? Let us treat this proposal in the same way as Poll Tax in the eighties. Do not do it. If everyone stops filling in HMRC forms they will find the court system will collapse like it did for Thatcher.

Our small partnership puts on an annual conference and is therefore seasonal. Our money starts coming in in January and builds up with the ticket sales, and we have some small outgoings. Around the conference at the end of July, the money all goes out - to the speakers, hall hire, AV hire, technicians etc. If we had to pay tax on the income quarterly, we’d have no money to pay for the conference itself. Quite simply, we'd either have to borrow from the bank (!) or go bust. We'd probably choose to go bust.

This would have a knock-on effect in the town, as we are one of the major tourist attractions, thus generating lots of money for B & Bs and restaurants. A lot of businesses would suffer.

Looking at this I can’t see the point in it. I already struggle to find the time to file my return as I am out trying to get the work in in the first place.

The business I am in is fairly seasonal orientated with an influx of work over the summer and a wee bit quieter over the winter. I like doing my returns once a year as I can be assured to be able to donate one day of unfavourable weather to navigate the tax return. To increase this to 4 times a year I would be seriously pushed to complete. I do two returns so to say as I write it down on paper first to check my calculations then fill in the online system. I would have to seriously consider my position, as the government are not being very proactive with encouraging small businesses. I am looking at expansion but with all the changes it is ringing alarm bells and with all these changes it is going to mean that I may well go out of business as I can’t afford to give over days when I need to be bringing in the money to enable me to jump through more hoops.

Is there any help and advice? Yes it would be helpful for one of these bureaucratic red tape makers to actually put down in simple terms what the purpose behind this and their other ideas, why they think it is something that will not make an impact on small business, why are
they victimizing small businesses (most of which don’t make massive profits). At the moment how much actually do they recover in the pound after costs? Do they really think that by making returns 4 times a year that they will improve the return? I doubt it.

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I also work for another small business which has a much bigger turnover, being a residential centre for groups to hire. Being a large site (an old farm) we save up money and then do building projects to improve the amenities. We have rarely borrowed from the bank to pay for improvements. If we had to pay tax quarterly, we’d have to borrow to fund projects, thus a) making it more expensive and b) putting us in hock to the banks. But maybe that’s one their purposes for doing this?

We would also have to change our book-keeping system to Sage or something, as we currently manage very nicely with Excel which is free.

Can I suggest FSB gets on the case as well with Her Majesty’s Opposition? This is a great one for them to get their teeth into. Because it certainly isn’t going to help businesses at all. And may also put people off setting up businesses in the first place. Foolish.

We might actually keep our books up to date! It will mean a new business pattern as we are a seasonal business and have lulls at certain periods which we use to catch up on non-essentials. Probably a good thing to be more on the ball. We used to be when we were VAT registered.

It's bad enough having to do all our VAT quarterly and all the tax filing to HMRC and DWP takes up so much time, even though it is all now online (but not joined up still). This would be even worse - why us!? Also will it make life easier for HMRC - or is this just to even out cash flow!?

Perhaps they should trial it first with some guinea pigs from the SME sector and then decide.
As a sole trader with modest turnover this will have a disproportionately negative impact on my accounting costs. I think it should not apply to sole traders or small businesses with turnover below a certain amount.

Major impact. I expect I will be required to do 4 stock takes each year and 4 times the cost for the accountant. I may as well pack it all in.

More time spent doing HMRC work for them. As a sole trader he amount of tax / NI paid does not justify doing it 4 times a year. This government promised to reduce red tape not increase it.

Again the civil servant rule the government of the day. They just cannot leave people to live and run their business without meddling in our lives. Can they come up with a rational to justify this.

I see nothing positive for my business. This will just add additional work with no perceived benefit.

Awful. No benefit whatsoever. More paperwork. The only winner here are the accountants who will be charging more for the additional work and the HMRC who presumably think this will result in more cash for them.

Additional time and costs, I thought HMRC were making the red tape easier not harder, must live on another planet.

How would this work with annual allowances? If it is done properly and similar to VAT then perhaps more SMEs could do without accountants? Having said that .. what are the chances of it being done properly?

Our accountant will do it so no big extra time element for us. We already do quarterly stock takes so that won't be an issue. The main effect will no doubt be extra costs via our accountant and although they do an excellent job for us with quarterly management accounts etc, this will still mean larger accountancy bills I imagine.

It will just be 4 times a year we have to pay rather than two. Our accountant checks the amounts and we pay by BACS from a dedicated bank account that keeps our tax money owed.

This is a dreadful prospect. In my case it it mean a quadrupling of my accountancy bills (rather than an extra admin burden on me personally), and this is money that would otherwise be gainfully employed within the business (or, in the worst case, money that I just can't afford). If HMRC are aiming to improve their own cashflow, then some really simple payments-on-account system would be the least painful solution. If they are aiming to reduce fraud and/or tax evasion, then quarterly accounting will not achieve anything that annual reporting doesn't.

And don't even get me started on the relative merits of going after small businesses rather than the usual corporate giant suspects...

Time, (filling out a form 4 times is lengthier than filling out one form) Cost (you don't think an accountant will charge 1/4 the price of a current form do you?), Bureaucracy (Well there has
to be 4 times as many civil servants opening forms because there are 4 times as many forms!),
Are all words that spring to mind!

As a new sole trader this seems to me to be drawing me away from my core businesses and
focusing me on what is good for some accounting system. No doubt dreamed up by someone
with too much time on their hands and too little understanding of the people this will impact
on. I don’t for the life of me understand why a return more than once a year would be
required or desirable. Please just let me get on with running my business.

I thoroughly object to this. My business is a reasonable size and I keep up to date with my
accounts but having to do this on a quarterly basis (and no doubt risking fines if I don't) is not
acceptable. HMRC say their new apps will ensure everything is simple but what about
prepayments and accruals, for example? Small businesses already have enough burdens and
don't forget we're the country's unpaid tax collectors, collecting, calculating and handing over
VAT, employment taxes and our own profit's taxes. This really has to be an issue when the
government does a U-turn. I thought the Conservatives were on the side of small business -
clearly not if they implement this.

This will require much more time and a much bigger bill from our accountants. What
happened to the conservative promise of less red tape for businesses? This will just add
another layer of stress for those running small businesses and many may decide it is no longer
worthwhile being in business. Our business will become less profitable. Some businesses will
close and more people will become unemployed.

My first reaction, like many of the posts above, is that this is another example of how the
current Government just doesn't get small businesses as it would add to the administrative
burden that many SMEs are creaking under.

To make a full assessment though more information on the proposals is needed; how do you
account for projects where you do the work in one quarter and bill in another? would
corporation tax payments become quarterly? what level of accountancy support be required?

I really cannot see any benefit for a small business and the impact for financial burden would
be huge - perhaps only the accountants would be happy invoicing 4 times a year?

As an accountant I am appalled at the idea.

I believe the reason behind this is for universal credit (are they still bringing it in?), being the
next stage after RTI.

In theory with RTI they know how much someone in employment is earning on a weekly basis
and so can ensure that they do not overpay tax credits/universal credit to them. It should also
mean that they can get the tax code correct - that is of course not happening in practice.

With quarterly reporting they will know the income of self-employed people quarterly and so
they can correct the errors in the tax credits/universal tax credits.

Of course there is the assumption that all self-employed are receiving huge over-payments of
tax credits. AND there is the advantage that they can get the tax correct as well four times a
year (I would love to see that).
Federation of Small Businesses – Written evidence (FBB0007)

All those who say "I use cloud bookkeeping so I do not need to do anything else" should probably go and see an accountant as bookkeeping figures and taxable profits are two very different things.

I personally do not want to have to waste time doing tax accounts four times a year for anyone as they are no use to anyone except HMRC. I would much rather do proper management accounts which are no use for HMRC.

HMRC will not employ more people as it will be our job to enter the information, via the internet (anyone still on dial-up?), straight onto the tax payers "tax account". Where as currently if it is a refund or "odd" it will be flagged and a random sample will also be chosen for examination.

It is an expensive, unnecessary burden on small businesses that may well break the tax system (which with all the draconian fines etc. is already close to being broken) as we give the government permission to tax us and we can withdraw that permission.

It will make things difficult - neither me nor my accountant have time to do the accounts 4 times a year - once is bad enough; I can't afford to pay for my accountant to do them 4 times a year anyway, and I already operate RTI which has proven to be a farce - am scared of this, as a 2 person company, we are not accountants, we don't understand it all and it is scary - if we need the accountant to do this 4 times year it may very well wipe us out financially - we don't have a huge turnover, it’s a lifestyle business, so this could be the end for us frankly.

It's yet another badly thought-out policy from Government! Who is going to pay for someone to do the extra work? I can't afford it - my wife already does our bookkeeping to save on accountancy fees (which are still nearly £1,000 a year). For a two person partnership our small business simply couldn't afford the time or money for this ridiculous idea!

This will also give HMRC more work to do. Last time I phoned them I gave up after just over an hour on hold. Do HMRC staff use watches or calendars?

Ours is a seasonal business, which means we are profitable at only during season and not so when we are out of the season. When we are filing the return for the whole year, this balances out. If we would have to file quarterly returns, we would be paying corporation tax in one quarter only for it to be reclaimed back next quarter. Overpaying tax (I presume there would be deadlines) and reclaiming the overpaid tax from HMRC (refunded at their own convenience), would have extremely negative impact on the cash flow of our business, though I could see that this would reduce treasury's need for borrowing. Only somebody who has never been in business could think of such foolhardy policies.
Case Studies - Changes to tax treatment of dividends

August 2015

The FSB asked members what impact they thought changes to dividends tax would have on their business. The following are some of the unedited responses we have received from our online research community, Big Voice. If you would like further information on specific case studies do let us know and we will contact the relevant member.

- **Disgusted! SMEs are the backbone of the resurgence in our economy. It is no good taxing the shareholders to the hilt with the promise 5 years down the road to reduce Corp Tax by a couple of percent. This sort of thing makes me want to sell up!**

- **This will mean that I will probably have to let my part time employee go and my financial advisor will earn a few bob advising me on how to legally minimise the impact of these changes.**

- **Tax increases always impact on businesses. To increase a director’s fee instead of a dividend, means an increase in personal tax.**

- **This will affect my plans for next year. I have not taken any dividends for the last two years, and was planning to take them in April 2016.**

- **As a husband and wife company who have been taking a minimum salary and then taking dividends (on the advice of our accountant), this is going to cost us in excess of £2200 we think. Even worse, I assume that this will be taken as a bill at the end of the year when we have calculated our tax bill, which will be an additional concern. Yes, we should put money aside as we go along but, given the cyclical nature of our business and the fact that some months we have had no revenues, this is a lot easier said than done!**

  With 2 young children (thank goodness the younger one starts school this year so we no longer have nursery fees to worry about), I am despairing.

- **We are also a micro business taking a small salary and topping it up with dividends. This is going to have a big impact on how we run our finances, employing anyone else (we have also got to factor in the increase in the living wage, pension contributions etc), and generally keeping our heads above water in a very competitive market. For small businesses this double taxation as I see it, may be the final straw for many and stall the recovery. We have not had a pay rise for many years, paying it in dividends if we have enough money at the end of a tax year, in order to keep employing our small workforce. During the recession we did not pay our dividends to ourselves (that was a frightening time!) in order to keep paying the three other employees-having the dividend system as it is for small businesses-was crucial to our survival as a company.**

  I can understand that everyone needs to be a bit more transparent with tax, and this is a tax loophole-except that it does get taxed through corporation tax, so there are less profits to share- and that as a country we face huge economic problems, but £5000 is too low-especially when you consider the big players and their schemes of avoidance. Raising the limit to say £30000 would be much better for the health of small businesses, many of whose directors
sacrifice much in initial finance, long unpaid work hours and family sacrifice in order to give the country such a wealth of healthy small businesses.

- I’m horrified. Like "all" other company owners I take a minimal salary and the rest as dividends.

I can see the reasoning for the change as we have been avoiding NI, and it is true that many people incorporate just for this advantage. However it has been like that for donkeys so, avoidance or not this is a tax increase of 7.5% on everyone who owns a business.

Morally it's also wrong as it will be a benefit to overseas owners/shareholders - as corporation tax reduces there will be more to pay out in dividends but if that's to overseas residents they won't pay UK tax....

It's a real bodge to the tax system - what happened to "simplification".

The tax is 7.5% on top of already taxed money, so from 20 to 27.5% tax rate. However as Income tax plus NI is 32% (plus employers NI), there seems to be no benefit to going back to unincorporated or proper salary etc.

The answer! Have multiple companies and take a basic salary of around £800 from each. Income tax will be at your normal rate but as NI is per job, there will be none to pay.

- I am really shocked. The fact that I withdraw very little dividends anyway and would personally would earn more pay if I worked these hours at Tesco's and not employ people, being taxed that much on my small amount of dividends over the £5000 mark would lead to me even more seriously thinking of giving up and taking the easier option, closing down my business after 10 years. The 0% mark should at a minimum be raised to £10000. It should follow what salaried with no dividend tax payers pay. I think that overall the number of small businesses will decrease due to this!

- Feeling totally betrayed and let down by a Government that’s courted Small Business. This comes on top of having to pay the Living Wage of £7.20 from April 16, then I have to factor in Pension Provision for my employees and then I might actually be able to calculate if I've even made a profit never mind, considering the size of any dividend I could take!!! My business is 6 years old this year, I doubt it will reach 7 years and 4 employees will be out of a job and I’ll be looking for one!!

- This will have a large financial impact on mine and my clients' Ltd Co's. We are accountants for 33 companies and with an average dividend taken of roughly £20,000 the tax on that will be £1,125. We are evaluating this with a view to moving these Directors to a self-employed basis.

- I am an accountant acting for a number of small businesses, many of whom are limited companies (including my business) and the financials are arranged so that the director/shareholders receive a minimum salary and the balance of their income in dividends. It is tax avoidance, but as neither my clients or myself are additional rate tax payers (most not even higher rate tax payers) this is a sledgehammer to crack a walnut.
From my point of view I can pay myself additional dividends this year (and still not hit HR tax) and then draw the cash out of my business slowly so that over the next two or three years the effect of the additional tax is minimised, but thereafter I will be back to square one.

However, this is double taxation on the part of the government, as all dividends are paid out of post tax profits and then treated as untaxed in the hands of the recipients - is this morally acceptable - Mr Osborne has shoved morally unacceptable practices down our throats recently and yet it seems one rule for us and another for him. All other income taxed has been relieved of tax for the payer.

As a person teetering on the Higher Rate threshold but staying below it I have found that it is this category of has been squeezed. The HR threshold has not moved for several years and now. HR tax payers have always paid 32½% tax on their dividends, but they got credit for the 10%. So they only lose the 10%. BR tax payers are not only going to lose the 10% but have to pay 7½% as well! I am sure the FSB will act in the interests of me and all of my clients.

I haven’t done the maths but I don’t think I would disincorporate - the tax is 7½% for a BR tax payer and there is £5,000 tax free dividends. As a sole trader the tax would incur 9% class 4 NIC instead and I would have to start paying Class 2 NIC again. Incorporation also provides other commercial benefits not given to a sole trader. And the bigger the business activity the more beneficial the protection of the a limited company.

I will need to consider how I advise my clients and at least advise them of the changes and the potential impact. I have no doubt my cpd advisors will look at the best way forward. For me (based on 2013/14) the additional cost would be £1,020 - I don’t know the answer for 2014/15 yet.

- I am an accountant in practice. My firm still operates as a partnership so we are not directly affected. However many of my clients will be. Dividends still appear to be beneficial. So will incorporation so those whom have substantial business risks. I am old enough to remember investment income surcharge of 15% on dividends.

This is a further cost being imposed on owner managed businesses. The so called Living wage is another one. I can understand why it has been done, but feel it should have been restricted to large companies. Owner managed businesses are still coming to terms with auto-enrolment with the additional payroll and admin costs. The extra tax on dividends appears to be another betrayal of small business.

29 January 2016
Submission to be found Institute for Fiscal Studies, and Professor Judith Freedman, University of Oxford – Oral evidence (QQ 15-24) (FBBOE0001).
The FCSA welcomes this opportunity to respond to the Sub-Committee’s inquiry into “the extent to which the measures proposed in the draft Bill contribute to the simplification of the personal tax system and their impact on the compliance burdens of individual taxpayers”. We would be very happy for the opportunity to give oral evidence to the committee.

Tax implications on the UK’s flexible workforce

The FCSA supports the Government’s crackdown on tax avoidance, but we believe the Finance Bill 2016 disproportionately penalises the UK’s flexible workforce as part of this drive. The Government will introduce new measures in the Bill which will restrict the tax relief on Travel and Subsistence (T&S) expenses that freelancers and contractors claim when traveling to temporary work sites – impacting upon thousands of individual taxpayers. FCSA research shows that our members who claim T&S commute 75 miles a day - over double the national average of approximately 16.7 miles per day. The restriction of T&S is a personal tax alteration which will mean that approximately 750,000 workers may no longer be prepared to undertake longer distance/remote working, including health workers, supply teachers and accountants.

At a time when the UK suffers from skills shortages and remote locations are reliant on the flexible workforce for essential skilled jobs, the T&S reforms will be extremely damaging to the national economy and productivity. We fear the forthcoming reforms, if left unchanged, will see a postcode lottery across the country where schools, companies and other employers in more remote towns and cities will have limited access to high quality temporary contractors and freelancers.

Compliance burden

The supervision, direction or control (SDC) tests that will be introduced in the Bill for determining whether an employee is eligible for claiming T&S relief will add considerable burden to employers, employment intermediaries and HMRC. The tests for determining whether a worker is under SDC are vague and unworkable and HMRC have not yet published guidance on how to determine if SDC applies.

Moreover, recent surveys have suggested a very low awareness of these changes amongst the many businesses that rely on the flexible workforce as an important element of their strategy. Given the new rules will be introduced in the coming months, this added compliance will therefore catch many by surprise and result in severe consequences for the flexibility of the workforce. Furthermore, HMRC’s requirement to publish guidance and provide constant updates for employment sectors means added administrative burdens to an agency which is currently undergoing reductions to their resources.

Recommendations

We recommend that an exception should be created if an employee attends a workplace to perform a task of limited duration, and subsequently the SDC rule would not apply. The FCSA believes that the result would be as follows:
- More straightforward for all employers to apply in practice
- A reduced burden on HMRC compliance procedures
- It would be more efficient for HMRC to review T&S relief claims
- The individual taxpayer would find the T&S reforms easier to understand
- It would reduce the need for detailed examples in HMRC Manuals and lower the chance of the individual tax payer becoming confused
- Maintain the competiveness of UK PLC to attract project based work

**Impact on individual taxpayers**

The FCSA believes the Finance Bill 2016 measures for restricting T&S are counterproductive to the Government’s objective to “level the playing field” with other workers; instead they will likely disadvantage temporary workers who will not have the same T&S benefits afforded to permanent workers, and still have greater distances to travel to the workplace than typical agency workers.

The Government argues that the current T&S relief rules for temporary workers are unfair, yet fails to understand the sacrifice the flexible workforce makes to provide crucial jobs, often in remote locations across the UK. A recent survey of 200 supply teachers at one agency revealed that 64% of teachers do not currently claim T&S relief and the 36% who do claim, travel an average of 42 miles per day to work – clearly demonstrating that those who claim the relief do so when they are traveling distances far above the national average.

**About the FCSA**

The Freelancer & Contractor Services Association (FCSA) is the independent leading trade association for professional employment services, with members providing umbrella, accountancy and business support services. Set up in 2008 as a not-for-profit organisation, our 49 strong membership represents over 100,000 workers. In an industry which has seen various levels of compliance and ethics, the FCSA was established to set an industry-leading standard for the sector. We operate a rigorous Best Practice Code of Compliance which we expect all of our Full Members to adhere to by providing compliant advice and/or employment supported by the highest level of professional and ethical standards. We are the voice of fully compliant and responsible employer intermediaries with a collective aim to support and sustain a long-term flexible workforce in the UK.

30 January 2016
Examination of Witnesses

Brian Redford, Director of Specialist Personal Tax, HMRC, Emma Churchill, Director of Specialist Personal Tax, HMRC, and Cerys MacDonald, Deputy Director, Personal Tax, HM Treasury

Q77 The Chairman: I welcome our witnesses this afternoon. Our ranks are a little depleted because of the incidence of inclement weather. People have been blown off course by it. Hopefully some of them will be able to join us during the hearing.

The Office of Tax Simplification was established five years ago, and last year it published a detailed report on how it was doing. It is obviously a numerical calculation, but it would appear that, of the 402 recommendations that they made, some 47% have been implemented or partly implemented, and the rest are under review, there was no response or they were rejected. That is one numerical way of looking at its performance.
We have heard from a number of witnesses that they consider that HMT and HMRC have not sufficiently embedded simplification thinking into their approach to policy-making. Two questions flow from that. First, do you agree with that assessment, or how do you react to that evidence? Secondly, is 47% a good, bad or indifferent score, or is the game still in play? How would you characterise it? In other words, how do you see the performance of the Office of Tax Simplification?

**Cerys MacDonald**: I assure the Committee that the Treasury and HMRC take tax simplification absolutely seriously, and the creation of the OTS back in 2010 and the decision to put it on to a statutory footing means that in the UK we now have a permanent body leading the public debate on tax simplification, and rightly so; it provides a challenge to the Treasury and HMRC to tackle the complexities that they themselves identify. The Committee has had our memorandum, which confirms the statistics that you referred to. I would like to reassure the Committee in that I do not think you can look at the number of recommendations as a sign of success or lack of success; it is important to look at what has actually happened and what the taxpayers are realising and reaping the benefits of. In my own area, we have made significant improvements to the tax system for the self-employed. The OTS pushed hard for the introduction of the cash basis of accounting in one of its early reports in 2010, and the take-up of that has been a success: over 1 million self-employed individuals have taken up that new system. So it is important to look at what is happening on the ground and what benefits individual taxpayers are on the receiving end of. Of course, the Government, when reflecting on the OTS’s recommendations, have to look at tax simplification alongside other objectives which they also seek to achieve through the tax system, whether that is fairness, growth, or the wider fiscal context at each fiscal event, so it is not right to look just numerically at the precise number of recommendations that have been accepted.

I would also emphasise to the Committee that a number of the OTS’s recommendations have looked at far bigger strategic areas of the tax code and do not lend themselves to an easy yes or no answer from the Government, but they do inform and shape the work that is done in preparing for future fiscal events.

**Brian Redford**: My engagement with the OTS over the last five years has actually been very challenging. HMRC has learned a considerable amount from the work that the OTS has done. Cerys mentioned some of the early work on simplification for small businesses, and I recall the discussions at the time. It opened up a line of inquiry and interest that previously perhaps we had not been alive to. My own view of the work that the OTS has done is that it has been very positive. I agree that it is difficult to chunk up the number of recommendations and say that they are all the same weight and therefore a good measure of the contribution that they have made. But certainly in some of the bigger strategic areas, where we are being pressed on savings, assistance to more elderly folk, and work with the small business community, the OTS has been very challenging and has been resourced well to undertake its role.

**The Chairman**: When the OTS appeared before us, they wanted to feel that tax simplification had been embraced more enthusiastically and more widely—these are my words, not theirs—by your two institutions, but I detected among other witnesses a feeling that a great deal remained to be done and that this tax simplification had not really been clapsed firmly to the bosom and acted upon. Do you recognise that criticism, or that frustration?
**Brian Redford:** There are going to be different views, as Cerys mentioned. The art of each Budget is to maximise interest across the political sphere, whether it is growth or supporting certain areas of the business or personal tax community. Probably everybody would aspire to greater simplification. Sometimes that is a very difficult match to make. Our work going forward will be to look at simplification not just of the tax code but in how we can support customers across the tax-paying base through other means: in other words, simplification of the administrative burden that they have to bear and in the way they do business with us, the way they communicate and the way we then assess the tax and make sure that the right amount is paid over. I know that we will come on to some of that in the Committee’s questions and in looking at plans for making tax more digital and simplifying the way businesses and other customers interact with us.

**Emma Churchill:** I would second that. I am relatively new to HMRC, and a lot of the discussions that we have had as we have been thinking about making tax digital, the five-year transformation programme that we want HMRC to put in place and a lot of the drivers have been about simplification for our customers in the administration of the tax system. That has been a very significant driver in the work that we have been doing. I certainly feel that we have been embracing the spirit of simplification in the plans that we have been making.

**The Chairman:** The Finance Bill places a statutory duty on the OTS to report on its own progress. Would it be more helpful if it were to report annually on the progress towards tax simplification generally?

**Cerys MacDonald:** The OTS’s role is very much to hold the Government to account on in term of progress of tax simplification. Both undertaking quite wide-ranging reviews in some areas of the tax code where it is felt that there might be a case for more progress, often at the request of Chancellor, but it also has the ability to undertake its own reviews. It undertook a couple in the last Parliament on its interpretation of what complexity in tax legislation meant and a piece of work on competitiveness. It can do specific pieces of work where it is making formal recommendations through a policy lens or an administrative lens, and more landscape reviews that paint a picture of how the tax code is developing in terms of simplification.

The content of the annual report which the OTS is now expected to publish remains very much a matter for the chair and the tax director, and it will be interesting to see how it develops the content of that report.

**Q78 Lord Kerr of Kinlochard:** Would the Office of Tax Simplification do more good if it had a forward-looking role—if it could address the implications for simplicity or complexity of proposed changes rather than looking at the existing tax code and trying to think of ways of cleaning it up and simplifying it?

**Cerys MacDonald:** I would make a distinction between policies that have been developed before they are announced and the role of the OTS in helping us to develop and design the detail of policies once they have been announced. Of course, currently the OTS does not have an active role in advising on policies that are in development. That is not part of its remit and Ministers are democratically held accountable for the decisions that they take, not the OTS. However, I would not underestimate the influence the OTS has on how we shape our advice to Ministers on tax policies. We always ask ourselves, “What will the OTS think or say?” Under the new framework, the OTS will for the first time have a formal role in responding to consultations that we undertake on areas of the tax code where the OTS has itself made recommendations. So it will be part of the policy development process as we engage with
Her Majesty’s Revenue & Customs and Her Majesty’s Treasury – Oral evidence (QQ 77-90) (FBBOE0005)

stakeholders, including the OTS, in turning one line in the Budget document into a fully formed tax policy and tax legislation to be implemented. It has a role to play on the flow of tax policy, particularly once it has been announced and is in the development stage.

**Lord Kerr of Kinlochard:** It seems that the OTS is in a way neither fish nor fowl. It is not genuinely independent like the OBR. It is embedded inside the Treasury and yet it does not have a role in looking at Treasury or Revenue draft proposals. It does not see what you are thinking of putting into the Finance Bill and have a chance to say “Are you sure? That would be rather complex”, or “Would it not be easier to achieve what you want to do in a different way?” Can I ask the Revenue whether it sees any advantage in such a different kind of forward-looking role?

**Brian Redford:** That is a very good question. The influence of the OTS extends beyond the piece of legislation or the area that it has looked at in one year. Quite often the recommendations and the thinking that come from the OTS colour our thinking on policy development in the next Budget cycle. But in terms of formulating that policy, it is very much for the Chancellor and his Ministers to determine the shape of the entire financial package that they have put together. I suspect that they would be very cognisant of what the OTS views were in the past and are currently in making those judgments. As officials, we would definitely advise with a view to how simple we can make it. What is achievable with the systems that people will have to cope with, and do we place an unnecessary burden on those who have to operate the systems? I think it is fair to say that its influence lingers much longer than in the particular area that it is looking at. It does feel as though the OTS has had a positive impact in that respect. In the same way as we have had in the aim to reduce administrative burdens and a target to do so. It has become uppermost in officials’ thinking about we can square all the requirements.

**Lord Kerr of Kinlochard:** We are about to come on to taxation on savings, where there is quite a complex array of elements, some new and some existing. I suppose under the present rules the Office of Tax Simplification could not be consulted on whether this plethora of rates, terms and cliff-edges is as simple as possible.

**Brian Redford:** No. I shall ask Cerys to comment on this as well. Under the current system I think the Chancellor would see the determination of the rates and the way in which they should be introduced for different sections of society very much as a Treasury role in setting the Budget for that year. But again, having worked in the area and having seen the advice that was put together at the time, it was very reflective of trying to strike a balance between the aims of the Chancellor in policy-making, any burden that would be placed on business in having to deal with it and customers’ ease of use

**Cerys MacDonald:** I echo what Brian has said. The only other point I would make is that on occasion the Chancellor has asked the OTS to do quite a wide-ranging review, and actually the two reviews that it is currently undertaking on the taxation of small companies and the integration of income tax and national insurance will inevitably lead to informing future decisions taken by the Chancellor in future fiscal events. So I do not think that it is as binary as commenting on stop versus flow. It is a far more iterative process than that. Given that the OTS is a statutory, independent body, it really is having an impact and is influencing policy-making and Ministers’ decisions.

**Lord Kerr of Kinlochard:** If there had been a public consultation on the tax and savings proposals, which there was not, would the OTS have been ultra vires if it had treated itself a
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bit like a member of the public and commented during the consultation exercise, or on the results of the consultation?

**Cerys MacDonald:** I do not think it would have been ultra vires. I do not think the OTS is required to make a formal response to consultations on areas of the tax code that it has not made recommendations on, but I am pretty sure I can remember a number of occasions when the OTS has made its view of a particular government proposal part of the public domain. It would not be ultra vires in that regard, but if I need to stand corrected I will obviously let the Committee know.

**Lord Kerr of Kinlochard:** It is a bit like a poodle, to be honest. It is not a sheepdog it is not out there, and it is not allowed to bark very loud. Would it not be better if it had a louder bark and maybe even some teeth?

**Cerys MacDonald:** Being on the receiving end of a number of meetings with John Whiting, I can give the Committee a guarantee that the OTS is not a poodle. The amount of work it has got through and the number of recommendations it made in the last Parliament is a real testament to the commitment that it has shown. While it is easy to point to statistics that suggest that fewer than 50% of the recommendations have been accepted, a huge amount of progress has been made that perhaps, absent the OTS, would not have been achieved.

**Baroness Noakes:** Does it not seem illogical to have the OTS operating within the Treasury and to say, “We will create legislation in our own way”—the Treasury and HMRC with the Chancellor—however complex that might be, and then, “As soon as we have legislated, the OTS can have a look at it”? You have this resource, which is dedicated to and understands the nature of complexity in the many ways it manifests itself in the tax system, but you are seeking to confine it to an ex-post analysis. It seems to me that if you have that resource, it would be an efficient use of the resources available to public policy-making to embed it into that public policy-making.

**Cerys MacDonald:** There is a judgment to be made about where, in a world of finite resources, one best puts the OTS’s efforts and direction. In the run-up to any fiscal event, the Chancellor will consider a large number of possible tax changes before his Budget, so if the OTS was to be involved in every single one of them, that would take up an inordinate amount of time, probably to the detriment of the other work it wants to do. The decision to have it sitting outside the policy development process as a sort of external body leading the debate and doing specific areas of work commissioned by the Chancellor that can then inform a public debate, rather than making policy behind closed doors, is hugely valuable and a good use of the OTS’s resources.

**Lord Turnbull:** The concept that we are missing here is that of the statutory consultee. In many other areas of public life there are certain people who have to be consulted before you can reach a decision. You do not necessarily have to take their view, but making the Office of Tax Simplification a statutory consultee would give it a status so that when things go out for consultation generally—we shall come on later to the areas where that has not been done—the OTS is one of the bodies that you would expect to commission some response from. What is wrong with that?

**Cerys MacDonald:** I would not argue that there is anything wrong with that. Again, it comes back to what is proportionate, given the resources available to an organisation such as the OTS, and where its efforts are best deployed. As I alluded to in my earlier answer, the OTS has done a huge amount of work over the last Parliament, and I expect it to continue with the
same vigour in the next Parliament. It is right that it is tasked with doing thorough reviews of areas of the tax code that have sometimes been a bit intractable in the past in order to try to move the public debate on. The two reviews I alluded to that it has started in this Parliament will do that work justice.

**Lord Turnbull:** The Government have already taken in some of the intractable areas. That is what the taxation on interest is all about. I cannot see the case for not using this source of expertise. It seems an obvious thing to do. You particularly want to identify where there are big changes affecting large numbers of people. Anyway, you clearly do not agree with that.

**Cerys MacDonald:** As Brian alluded to, I would not underestimate the influence that the existence of the OTS and our informal relationships and engagement have on the way we approach and think about policy and, importantly, tax administration, where the OTS really has shifted mind-sets and put a focus on these areas that they might not have had before.

**Q79 Baroness Wheatcroft:** Miss MacDonald referred to policy-making behind closed doors. There is lots of talk about doing the opposite and having a road map that would make it clear to the country and those affected quite where policy-making was directed. We had a road map for corporate tax, which seems to have gone down quite well. There has not been a road map for savings and dividends and it has led to a fair amount of confusion, both among savers and the industry. I wonder why there has not been a road map. Can you explain when there might be one? Can road maps be drawn retrospectively, which seems rather odd? It takes you to the “You wouldn’t start from here” place. Could you explain to us why it has not happened in this case?

**Cerys MacDonald:** Of course. Obviously the decision to publish a road map would be a matter for the Chancellor rather than for public servants. However, the Chancellor has a balance to strike between providing certainty and stability to taxpayers—that was very much at the heart of the decision to publish the corporate tax road map in 2010—and ensuring that he retains some flexibility to be able to respond at each fiscal event to the events, priorities and public mood at the time. While a stand-alone road map has not been published on personal tax, the Government have significantly improved the tax policy-making process and we now have a longer period over which policies are announced, discussed, debated, legislated and implemented.

While there will always be examples in a Chancellor’s speech that people will point to and say, “That wasn’t expected”, I can think of many more examples where the Government have signalled that an area is under review and have started a dialogue on the direction of travel that has then informed future decisions and formal consultation—the taxation of pensions being a good example at the moment. I know that does not specifically answer the question on why there is no personal tax road map, but it does illustrate that it is a more difficult path to navigate for Ministers than the corporate tax road map may have been in 2010. However, there are other things that we are doing to provide more certainty to individuals.

**Baroness Wheatcroft:** Regarding getting the balance right between giving the Chancellor a degree of flexibility and giving customers some degree of certainty about the direction of travel, do your two colleagues think that the balance is right in this case?

**Brian Redford:** Personal taxation is very difficult. We would probably say that corporate taxes are equally difficult in another sphere. There has certainly been a move over a number of Administrations to try to release the burden from individuals at lower ends of the taxation spectrum, so to that extent I guess that is what we would describe as a road map. However,
as Cerys mentioned, clearly the Chancellor has freedom to determine at any particular point whether the desire of the electorate, which the Administration in power at the time is serving, is best met by particular advantages in different bits of the code. I know we will move on to dividends and the personal savings allowance, but that was a very clear move to, as far as possible, to move a very large tranche of people away from the responsibilities of having to worry about what to do with taxation on the type of savings products that they would hold.

We are caught in a difficulty here. Yes of course it would be lovely to consult on everything, and you would hopefully end up, with something that was acceptable to as many people as possible. However, the reality of policy-making is that there are many areas where the Chancellor will reserve the right to make decisions based on how he sees things at a particular time. I am very happy to explore that further when we talk about dividends and the PSA.

*Emma Churchill*: On the administrative side, we have sought to give a clear sense of direction, which is why we published the Making Tax Digital road map before Christmas. We are seeking to give both businesses and individuals a clear sense of direction in the way we move forward with the administration of the tax system. As we may come back to later, you can sometimes be criticised for setting things out too early, before you have dotted every “i” and crossed every “t”. It is a balance between wanting to show people a clear sense of direction in an area, although that means that you are leaving a lot open for consultation on the way, and giving room for consultation on the administration on both the business and the individual side.

**Q80 Baroness Wheatcroft**: There has been some criticism that this is all rather piecemeal. In particular, the proposed treatment of dividends is influenced not so much by the direction of travel on savings and investment but on influencing the way people choose to be taxed in their employment. Would you agree with that?

*Cerys MacDonald*: I think it is fair to say, and most people recognise this, that the reform to the taxation of dividends was well overdue. The system was designed in the 1970s when the corporate and personal tax systems looked very different and the dividend tax credit was very opaque—it did not exactly make the effective tax rates transparent. However, when the Government are considering any changes to corporate taxes, one has to look at the way that system sits alongside the personal tax system.

The Chancellor was clear in the summer Budget that to continue his ambition to reduce the headline rates of corporation tax and to go further than 20% he would need to increase the overall level of taxation on dividends, not just because of the people who were alluded to who disguise their employment through the use of companies but because of the imbalance of taxation between those who are incorporated and those who are not—self-employed sole traders. In the decision to go further on corporation tax and the decisions he therefore took on dividend taxation, an opportunity was sought to simplify alongside that. The introduction of the dividend allowance has enabled us, as Brian said, to take many people out of worrying about dividend taxation and not be affected by the increase in rates, therefore both targeting the tax increase and providing a welcome simplification at the same time.

**Lord Turnbull**: You said that personal tax is very difficult. I would contend that it is very difficult but that it is also not getting any easier. There was a world once when you added up all your income, you had some allowances and there was a bill to be paid, either through a PAYE system or self-assessment. Now we have a dividend regime with what is sometimes called an allowance but that may in fact be the nil-rate band—that terminology has been used carelessly, in my view. We have done that for dividends and for interest, each with their own
set of income tax rates. We have different allowances for capital gains tax, ISAs and pensions, and you have clawback arrangements for child benefit and for the married couple’s allowance. So, although things may get simpler at the bottom of the income scale, there is a bit around the middle where things have got very complicated indeed and you have all sorts of tapers and so on. Yet this was all done without clear consultation. Why did you think you could introduce these schemes without a major public consultation exercise? It seems that the only thing that was consulted on—and that was only among the cognoscenti—was what interest should be in the TDSI scheme.

**Brian Redford:** That brings a whole load of things together. Having been in taxes for quite some time, I like to think that we will still end up with a bill that someone can understand and therefore pays. It should be a fair reflection of the income that they have received from all sources. Each of these measures is targeted to reflect the changes that are happening in the wider society and the economy. Playing back to the start of Pay As You Earn, those who had significant amounts of investments bearing interest or who would have bought shares in companies and had dividends simply would not have been in a landscape that would be recognised in Pay As You Earn. Each of the policies is therefore attempting to target specific areas where we know that individuals have problems and to come up with a way of reflecting what current life is like and our society looklike. So both for dividends or the allowances that are now available on interest, effectively 95% of individuals who receive either will no longer have to worry about them. They will not have to make a return or account for tax. The money they receive will be theirs to do with as they will. That leaves us with the more difficult cases as we move on to those on higher rate taxes or with a complicated mixture of different investment vehicles. Essentially we are trying to improve the administration and take away the worry for very large numbers of the tax-paying public.

With regard to interest, we were trying to resolve two very difficult things for that 95%; that is, very large numbers of individuals were being overtaxed and, despite a number of tax-back campaigns and encouragement by banks and building societies, did not register to receive their interest gross or did not claim back the difference between the nil band or the 10% band as it was. Equally, we have a tax gap, which is certainly greater than £100 million, that runs from individuals who move into higher rate taxation and assume that the banks and building societies have resolved the extra liability for them by deducting tax at source. That is not true. By introducing a 0% rate to £5,000 and then the new savings allowance, we are essentially saying that for many people will now potentially have the first £6,000 of their interest tax free, which we know will be more than 95% of the population. Yes, it will leave us with some rough edges. Of that 5%, the vast majority are already within the self-assessment regime, so they put their information into the self-assessment calculator at the year end. It will calculate their tax and give them the correct answer. We will be left with a small group of people, probably around 7,000 to 7,500 with dividends and around 8,000 people with interest, who will now find that they receive interest or dividends greater than the £5,000 threshold and will not be in self-assessment. As regards interest, they might not have sufficient Pay As You Earn income to collect the tax. We will have to make special arrangements for that group. But when looked at in the context of the very large number who will now have no administration requirements with the department, we can focus our energies on that group.

**Lord Turnbull:** You making an ex-post judgment there by saying that these people will not pay tax. But they will not know that until some rather complicated calculations have been made. I assume that you are not changing the basis of responsibility in that the taxpayer has to take responsibility for the accuracy of the figures.
Brian Redford: Yes.

Lord Turnbull: We are getting into a situation where some of this money will not be deducted at source but will be covered by a coding. When it arrives, instead of your number being, say, 97466 it is 8394, and you have to work out why that is and whether it is accurate. I do not think you are doing enough to equip people to make that kind of calculation, yet ultimately they have to take responsibility and can be in a lot of trouble if it turns out that you gave them a coding that is wrong, perhaps because something was missing. The idea that people will not pay tax is not the same as the number of people who now have to spend time looking at their figures that either they have collected or HMRC has put to them to see whether they are accurate.

Brian Redford: I agree that an awful lot of this is in the messaging and the support that we give to customers so that they know where they stand. Last week, further information was posted on to the Government’s website, and we agreed with the banks and building societies a note of questions, answers and information that they can then use. I know that some of the banks have already started sending material out to those who have deposits with them, and we know that they will use it in their contact centres so that they can give their customers advice. Certainly, anyone who needs to contact us for clarification can do so, but the overriding message that we want to send through the allocation of both the dividend allowance and the personal savings allowance is that the vast majority of people will now no longer have to worry about tax on that income because we will know that their level of income is below both the allowances. We will make a copy of the documents available to the Committee, if that is acceptable.

Lord Turnbull: The weakness in the system is putting it on to a website. We have a note in our papers—it is the first time I have seen it—on abolishing tax on savings, which is quite clear. How was I to know that it exists? I do not go to the GOV.UK website daily or even weekly. All my contact up to now has been that when HMRC has something to say to me, it sends me something. It can then say, “You may need to start looking at this website”. But I would need some sort of prompt and I have not seen the prompts in the system. We are eight weeks away from the start, which means that people could be taking decisions now. They may ask, “Do I invest in this kind of bond for that kind of duration?”, and so on, which will be affected by this, but millions of people will have no idea that this is about to happen.

Brian Redford: I do hope that the banks and building societies are now engaging with their customers.

Lord Turnbull: What about the HMRC engaging with its customers?

Brian Redford: That would be one direct route, because we know that customers will be going to their banks and building societies to do exactly as you say. They will be asking, “What am I going to do in the next fiscal year, given the value of my investments?” We will change our coding notices for people who currently have to have the bank interest coded out. I am sure that Emma will talk about the personalisation that now goes into those notices of coding to make it very clear why an individual’s tax code has changed and what it reflects. It will also provide prompts towards the website. Our balance has been one of: when do we provide as much information as we think is appropriate so that it is not too early so that people forget about? It should come just at the point when they are making their decisions for the coming tax year. That is why the information has gone out in the past week. We will be engaging further with the banks and building societies.
Lord Turnbull: You say that it has gone out to the banks and building societies as well.

Brian Redford: Yes, and they are now using it as a question and answer guide.

Lord Turnbull: There is quite a lot of interest that is not in this scheme, so people are going to have to know how to deal with that.

Brian Redford: Interest that was not previously subject to deduction at source because it was not part of the bank and building society TDSI will continue to be taxed depending on where someone is with their personal savings allowance, so the individual’s obligation to get information about that interest and return it to HMRC will not change. Our challenge here is to convey convincingly to the vast majority of people that this is very good news not only because they get an extra allowance but because we are taking away any requirement to have to register for gross interest, to claim back tax, or to worry about whether there is further tax to pay.

Emma Churchill: That is really important. For the vast majority of people, this is not just a better tax position but a reduced administrative burden. For all the people whom Brian was talking about earlier, who under the current system might have had to try to reclaim tax back or by coming to give us the form, saying, “I don’t need to pay that tax”, that administrative burden is reduced. Many of those people are our most vulnerable customers and we know that some of them were not doing that and so would have been overpaying tax.

Where I agree very much—and I know that some witnesses have raised this with you—is on the importance of the clarity of the communications. I know that our coding notices have been criticised in the past for being couched in HMRC language rather than the sort of language that a normal human being would understand. We have made significant improvements in that. The P2 notice of coding has recently been completely redesigned in co-design with customers and representative bodies. Stakeholders have told us that they think its clarity has significantly improved.

The other important point that you make about the coding notice is that we must be absolutely clear with people which interest we have coded into their PAYE so that they do not have to guess whether that information was correct. I know that the Committee has talked about the importance of disaggregating different types of interest so that somebody can see at a glance when they get the notice from us whether the information that we received was accurate and whether, therefore, they can sensibly be expected to know whether the information that has gone into the system was right. As we go forward, that will be an incredibly important part of everything that we do, whether it is the notices that we will send to people in a traditional way by post or the information that we put into people’s personal tax accounts.

Lord Kerr of Kinlochard: I think I understand what is being said, but it seems to me that there is another group of people—perhaps a larger group of people—who are uneasy because they are puzzled by, or will become uneasy when they are aware of, what is in the Finance Bill. The absence of anything on ISAs is probably the thing that will puzzle people most. For a huge number of small savers, the ISA has become the way of doing it. Here we do not see an upward on the tax-free permissible annual investment. Here we see the introduction of the personal savings allowance. It is not clear that an ISA is a sensible investment any longer for the small saver—the basic-rate taxpayer. He might do better by investing direct. He or she is not really aware of that yet, but when they are aware of it I think they will start worrying about it—there will be an uneasiness. For the higher-rate taxpayers, there is probably still an attraction...
in an ISA, but you have to think about these cliff-edges at the different rates. Coming back to Baroness Wheatcroft's point, are you sure it would not have made sense to provide some sort of road map? Are you sure it would not make sense even now to say something about the future of ISAs?

**Cerys MacDonald**: The Government have made it clear and the Chancellor has said in a number of statements that they stand behind ISAs and remain committed to the ISA vehicle. Indeed, alongside these changes, reforms are being made to the ISA policy landscape to make them more flexible, so that people can take money in and out throughout the year to serve their purposes. We expect ISAs to remain a very popular savings product, as they are today. Over £400 billion of investment is sitting in ISA products in the UK and we do not expect this to change that significantly.

**Lord Kerr of Kinlochard**: If that is your view, could that not be spelt out in some sort of road map, which would explain how these various new elements fit into the existing picture and provide some sort of reassurance to the small investor?

**Cerys MacDonald**: That is a good challenge. We should make sure that we challenge ourselves to look at the material that is available in the public domain so that it covers the entire landscape and is written through the eyes of a particular individual rather than through the eyes of a particular fiscal event. As Emma has alluded to, HMRC is doing a huge amount of work to improve its communications with customers and to make them more customer-friendly. I think that is a very good challenge and one that we should take away.

**Lord Turnbull**: The Government are saying, "ISAs are a good thing and we will substantially increase the limits and the flexibilities", which means that they are telling people that this is a recommended form of savings. But for a lot of people it will not be the best form of savings, because they would unnecessarily incur the management costs of whomever they are investing with and who is managing their money for them, when they could do the thing direct, either by owning shares direct or by having savings accounts. With the cash ISAs in particular, why do you need to involve anyone else? Why do you not simply go direct to a bank? The Government should be saying to people, "For a lot of you, the ISA is no longer necessary. You can have all the advantages of it without actually having to have an ISA and all the complications about limits and times and involvement with a provider".

**Cerys MacDonald**: It is important that we provide the right information to allow people to make those informed choices, but it is not for the Government to direct individuals towards a particular savings strategy.

**Lord Turnbull**: I am saying that they are doing the opposite. They are not directing people. They are giving them nudges and winks, saying that basically ISAs are a good thing. They are giving information when they should not be. It is called mis-selling.

**Brian Redford**: I guess that in tax terms we would want to leave the decision to the individual investor, but the one benefit of the ISA over and above the personal savings allowance is the ability to bank investment that will then remain tax-free for as long as you wish to keep it by rolling it and rolling it. For those who are beyond having some thousands of pounds in an account that bears interest that is now going to be tax free under the personal savings allowance, the ISA still fits a very important part of their investment strategy if they want to save for the longer term and still want to benefit separately from their personal savings allowance. As Cerys said, the Government have an ambition to make those products more flexible by introducing different investments that you can put in or, most recently, the help to
save ISA, which forms part of the Government’s strategy to add in a bonus for personal property ownership. They stand alongside each other. I absolutely understand the question whether this might overly complicate the investment landscape, but not to provide them would overly restrict customer choice.

**Q81 The Chairman:** There seems to be a considerable amount of change. As Members have said, change brings about anxiety. What steps will HMRC take to communicate? I think this is available if you go on to the website. It is pull rather than push. Are you going to mail a communication pack to taxpayers?

**Brian Redford:** We do not have a plan at present to mail the whole customer population that might have tax on interest. Our preferred method is to do this through the point at which they generally interact with the system, which is through their bank or building society. There is now further information on the GOV.UK website, including guidance from HRMC that was produced on Budget Day to explain the changes that were being made. Further guidance went there this week. As I say, our big push is how we work with those who directly engage with the customers—the banks and the building societies—to explain in some detail, through what is about a three-page information sheet, what it will mean not to have tax deducted in the future and what allowances individuals will now benefit from and therefore what declarations they have to make to HMRC. We would want to follow that up not too long after April, to understand what customer understanding is in this area.

You will be aware from other commentators to this Committee that research undertaken a couple of years ago pointed to a very low level of understanding among those with interest-bearing accounts as to the taxation position. We are trying to simplify that. Part of the challenge is to get that simplification measure over. If we have to do more with the banks and the building societies later in the year, we will step up to that mark. If we find that we are getting quite a lot of confusion and that manifests itself through contacts to HMRC’s telephone lines or through correspondence, we will look to respond. I do not think that we have finished and that is the end of it. We now need to understand whether the messages that we have put out are understood and whether there is more that we have to do.

**Q82 Baroness Drake:** Staying with that point, the efficiency of your communication plan to taxpayers will depend heavily for large numbers of them on the efficiency of the banks and the building societies in communicating the information. When we talked to some representatives of those financial institutions, they talked about being in ongoing discussions but could not give us any certainty as to whether those discussions would be robustly finished in time for the implementation. So how can we be confident that your discussions with them and their readiness for this will deliver their contribution to the efficiency of your comms plan?

**Brian Redford:** We have finished the discussions in so far as this is an agreed text that has been proofed by a number of our stakeholders, including John Whiting from the OTS, those from the Low Incomes Tax Reform Group and other commentators, who say that it conveys the message that we want to convey in language that we think most customers will understand. Only as of last week did we mail that final proof to all the banks and building societies. I fully expect it to start appearing now in branches in static stands or to be given away when people come in and ask about products for next year and what they should do this year. I believe that some banks and building societies are thinking about mailing it out to their customers as part of their end-of-year financial summary. We do not have a locus where we can insist that they do any of those things, but the commentary that we are getting from the banks and building societies is very positive that they are taking that up and briefing all their...
contact centre staff so that they will be able to provide advice and support to their customers. But I would be very interested, as we move beyond April, to understand how well that message is landing and whether we need to do more. As I say, if we start to receive many calls and contacts from people who are confused, it is absolutely right for the department to put more effort and energy into conveying that message more strongly.

Baroness Noakes: You talk about banks and building societies and the savings allowance. Are you having equivalent discussions with dividend-paying organisations? Banks and building societies have a genuine desire to help their customers. I do not think that companies are in the same relationship with their shareholder base, which is very diverse; we do not have the same relationship with them. What are you planning to do for that group, because there will be a large number of people with small holdings as well as the ones further up the scale?

Brian Redford: The legislation that was most recently enacted removed the requirement for companies that pay dividends to create a voucher that shows the tax credit: that has gone. They are still under a requirement to produce a dividend voucher when they pay a dividend to an individual and mail that out so that the individual is aware of the dividend that they have received and the price per share that they are getting.

Baroness Noakes: But is anybody telling the recipient what the new rules mean—including the higher rates?

Brian Redford: As you say, it is incredibly diverse, from the very large blue-chip companies that will mail millions of these vouchers right through to individual company-owner concerns, so we do not have the same ability to say, “Would you do this with all your customers?” To that extent, we have not engaged with them to ask them to communicate; our messaging has been via the government website and will be reflected in our self-assessment products, which will show the different allowances.

Baroness Noakes: And does HMRC think that putting messages on the government website is a good way of communicating with the large number of taxpayers who will be affected?

Brian Redford: Generally, yes. We get very high traffic through GOV.UK and the tax-related pages on that. We know that social media is becoming more and more used, so as a method of communication that ensures that up-to-date information is provided for the widest possible audience, it is a very good way of communicating.

Q83 Baroness Drake: I would like to see the demographic breakdown of that comment—but anyway. One of the purposes of the changes to dividend taxation was to address the situation where private companies pay less tax and national insurance contributions by structuring payments as dividends rather than salary. Could you comment on why the proposed changes to the taxation of dividends were considered a more effective way of addressing this issue than the approaches that the OTS had recommended?

Cerys MacDonald: Yes, of course. As I said when I responded to Baroness Wheatcroft earlier, the UK tax system treats the employee, the self-employed and the incorporated differently. That is a long-standing feature of the tax system. But in wanting to go further and reduce corporate tax rates, the Chancellor was very clear that he could go further on headline rates only if the rates of taxation on dividends were addressed, both to reduce the incentive for tax-motivated incorporation and to limit the fiscal cost of reducing the headline rates, particularly for smaller, privately-owned companies. I am not aware of whether the OTS has made any specific recommendations on the reform of the taxation of private companies,
but the Chancellor did indeed at the start of this Parliament ask the OTS to undertake a wide-ranging review of the taxation of small companies. We are expecting that report ahead of the Budget and I expect the OTS to make some far-reaching recommendations in that area which we will need to consider.

Baroness Drake: I might be wrong, but I thought that the OTS had recommended that one of the ways to address this problem was closer integration of tax and national insurance contribution regimes.

Cerys MacDonald: The OTS is also undertaking a second wide-ranging review, which is into the closer integration of income tax and national insurance, although of course that undertaking in itself would go far wider than just looking at the tax treatment of personal service companies. I do not think it is possible to look at any one aspect of the regime in isolation. What is particularly welcome, going back to our earlier conversation about the role of the OTS, is the fact that it is carrying out these reports in a public way so that some of the trade-offs between things that could be achieved for simplification purposes and things that may be achieved for reducing distortions in the tax system can be debated publicly.

Baroness Drake: And was any assessment made of the impact on the compliance costs for small businesses of these changes?

Cerys MacDonald: Of the increases in dividend tax? Yes, alongside the draft legislation, the Government published a Tax Information Impact Note that would have set out what we consider to be the administrative costs of the changes. I am afraid that I do not have a copy in front of me, but I can make one available to the Committee. It is routinely done as part of the policy-making process.

Baroness Drake: I have a follow-on question. Others have speculated that there could be wider consequences from the dividend changes, and in particular that some private landlords may use incorporated structures in future to get round some of the buy-to-let charges. Has the Treasury thought of that possible consequence, and how would it respond?

Cerys MacDonald: We think about the knock-on consequences of pulling a lever and what behavioural shift that may cause elsewhere. I am not an expert on incorporation, but as I understand it a number of different tax charges may well be triggered were a landlord to incorporate. For example, stamp duty and capital gains tax would need to be taken into account, so I do not think incorporation is that straightforward a loophole in order to sidestep the tightening up of mortgage interest relief. There are a number of factors that an individual landlord would need to take into account. In some cases it may well be in their interests to incorporate, but in many it may not be.

Q84 The Chairman: We have heard from a number of witnesses, particularly those representing small businesses, that this will create a significant additional burden and that the quarterly accounts will also impose additional work on small companies whose incomes fluctuate and do not do tax accounting on a quarterly basis; they do it annually. How are those companies going to cope with the increased requirements?

Emma Churchill: Do you want me to say something about the quarterly updates, because I think there has been a bit of a misunderstanding about the announcement that was made in the Autumn Statement and then again in the Making Tax Digital road map that we published in December. HMRC has put out some hopefully helpful myth-busting paperwork which we will make available to the Committee if you have not already seen it. It is certainly not our
intention to introduce four tax returns a year. We are going to consult on the information that businesses will be required to keep digitally, and the information that they will be required to send us via a quarterly update, but that does not equate to four tax returns a year. The announcement was focused on the way in which businesses will be required to keep their records in the future. Obviously requirements are already in place for businesses to keep the information required to complete the tax return at the end of the year. What we have announced that we will require businesses to keep that information digitally within software or applications that are then linked directly into our systems. We have an API strategy which the Committee may be aware of where we will make APIs available to software companies so that they may make software and apps that integrate directly into the back-end systems of HMRC. The point about digital record-keeping is that it will reduce very significantly the amount of errors that are made. We lose approximately £6.5 billion in revenue from simple mistakes and errors that are made in the system. The Committee will know that £920 million of revenue was put on to the scorecard at the Autumn Statement as a result of this measure. That is not as a result of requiring quarterly tax returns; it is simply the result of the much better record-keeping that businesses will be doing in the future. This will be done in a timely way because we will ask them to update our systems on a quarterly basis with the information that they will be recording digitally in their software or their applications.

Baroness Wheatcroft: How can we be confident that the errors that occur at the moment are so heavily balanced against the Government, and that you are confident that when the digital transactions begin and thus businesses are monitored quarterly, the accuracies will make such a big positive difference for the Government rather than the other way around?

Emma Churchill: There is quite a lot of evidence about the type of mistakes that we commonly see made in those returns. The evidence that we submitted to the OBR, which had to scrutinise it very closely as you can imagine, showed quite strongly that the mistakes were significantly in that direction, if I can say that, with the tax gap. We were heavily scrutinised by the OBR, but I do not know if the Committee has seen a copy of the costing note that the OBR published at the time of the Autumn Statement. Again, I am happy to make it available to the Committee. The benefits to HMRC are very substantially in that revenue, but there are also benefits for businesses themselves. The implication in the question earlier was quite right for many businesses, particularly large ones. They will not be able to see, having submitted information on a quarterly basis, what the final tax bill for the year will be, but around 3 million small businesses have incomes below the VAT registration threshold and are therefore working on a cash accounting basis. Of course, when they send us the quarterly information update and it appears in their personal tax account or business tax account, they will be able to see the amount of tax that will become due. We think that will enable them to plan their business much better because they have greater certainty about what tax we will ask them for. We think there are benefits both for us as the Exchequer but also for small businesses themselves.

The other point I would make in respect of administrative burdens is that we know that many small businesses will need support during the transition phase. We have said that free software will be available and we will work closely with the software companies to make sure that it is, although many businesses may choose to use commercially available software that has additional functionality if it supports them in running their business. Once businesses have made the transition to the new system and have become accustomed to it, there is absolutely no doubt that the button they will need to press in order to push the information into our systems will be significantly less burdensome than the current arrangements for tax returns.
Indeed, we think this is going to take HMRC a long way towards the new target we have been given to reduce the burdens of administration for small businesses by £400 million.

The Chairman: Will this quarterly update, as you call it, lead to a quarterly tax demand?

Emma Churchill: We published alongside the road map a discussion document on payments, which I am sure the Committee will be aware of. We wanted to start a discussion with stakeholders about whether some alignment of payments dates would benefit them.

The Chairman: When you say stakeholders, do you mean taxpayers?

Emma Churchill: And their representative bodies.

The Chairman: Many of whom aren’t represented.

Emma Churchill: Of course, we are talking to representative bodies in the consultations we are running at the moment, but we are also talking directly to businesses themselves, particularly small businesses, because it is generally small businesses that tell us that they would rather have a system whereby they can make more regular payments, because again that enables them plan better and manage their cash flow. No decisions have been taken about where the future might lie on payments, but there is the discussion document that we published and the consultation is going on at the moment.

Q85 Baroness Drake: Perhaps I may continue on that point. Obviously these changes will facilitate quarterly tax payments if that is the direction of travel decided upon, but I want to look further into the balance of benefits for the assessor and those for small businesses. The Treasury submission to the Lords Economic Affairs Committee states in paragraph 8 of the introduction that, “HMRC will collect and process information affecting tax in as close to real time as possible, stopping tax due or repayments owed from building up. For businesses, that means submitting details of income and expenditure quarterly using software or applications.” I would assume that small businesses reading that as the drive behind HMRC’s change will be quite anxious before they press the Send button. There will be a consequence from that data being captured and there might be a move towards quarterly tax payments. I know that the Economic Secretary is saying that this is all meant to be helpful, but individuals may well be anxious if they need to commit a lot more time on a quarterly basis and need additional accountancy help in order to deal with it. How is the balance of that behavioural reaction being struck? The Treasury or HMRC might be saying that this is highly rational and from a detached point of view it is beneficial to both parties, but a very small business might become quite anxious and see the compliance response as much greater than your more detached and rational analysis of this change.

Emma Churchill: I completely accept that this is a rational explanation of the change. In the first instance, when small businesses push the button that sends the information to us, they will see that immediately in their business tax account and therefore see the information that they have given us and what will mean, or indeed not mean, for their tax bill. They will have greater certainty about what that might be going forward. This is particularly the case for small businesses, as I said, that are operating on a cash accounting basis. This is why we want to consult small businesses directly as well as their representative bodies on a number of points about how we will implement this. We will include in the consultation exactly what kind of information we will require businesses to keep digitally. We will also consult on which information is pushed through the system into ours in order to play it back to them through the digital account. We will consult on both those things. So I hope that through the
consultation period we will have a chance to reassure small businesses in particular about compliance activity, which you raised. The Minister in the Westminster debate the other day gave very clear reassurance that we do not intend the quarterly updates to increase the level of interventions by HMRC. That is not our intention.

The road map makes clear that we will publish a number of consultations throughout 2016, which will of course culminate in clauses for the Finance Bill 2017, on which there will then be further consultation. One of the reasons why we are looking to make 2016 such an intensive year of consultation is that we want to make sure that businesses have a chance to express concerns and ask questions and that we are absolutely clear not just about the information that we are asking for but about what we will do with it when we have it.

Brian Redford: I have a couple of things to add. We have many businesses that are used to more regular engagement with HMRC through the VAT returns system, so they are used to providing electronic information on a more real-time basis and settling bills or claiming a repayment. One of the overriding things that businesses say to us in trying to frame a fair and efficient tax system is that they want certainty, and when they are met with a tax bill that they had not expected some months after the end of the year and they have to go to the banks to borrow to cover it or to change an investment that they might have made in the business, it is really important to them to have that certainty as early as they can. Irrespective of a move to equate earlier knowledge of a bill with whether it is paid or not, which we will consult on over the summer, the businesses have been very clear that they want to know where they stand as they go, because it helps them to run a better business.

Baroness Noakes: You have talked a lot about the consultation. We heard last week from witnesses representing small businesses. A point was made that they understood that there was no intention to produce an impact assessment for your proposals for the extra information that will be required quarterly from companies. There was quite a strong feeling that this would place a significant burden on small businesses through the additional professional fees that they would incur in compliance. You quoted a figure for your contribution to remove administrative burdens, but I would guess, given the sheer number of small businesses and the change in record-keeping that you contemplate for them, which they would have to discharge with professional help, that the burden would be significantly more than the figure you quoted earlier for the administrative savings that you calculate. Is the intention to produce something that shows both the benefits to the Exchequer and the burdens on business, because I do not think they are insignificant; certainly that was the evidence that we received.

Emma Churchill: That is certainly our intention. Initial information on the impact will be published alongside the consultation, when that comes out in the spring. Then, of course, there will be a full set of information on impacts when legislation is published in December. It is absolutely our intention to do that.

Baroness Noakes: Before I move on to my question, I have a question about personal service companies. I should say that I chaired the House of Lords Select Committee on Personal Service Companies a couple of years ago. One of the things we heard at that stage about keeping IR35 was the risk to the Exchequer, which I recall was £400 million to £500 million. The dividend changes would reduce that impact. Have the Treasury or HMRC calculated what risk to the Exchequer they consider would remain post the dividend changes?

Cerys MacDonald: Yes. Alongside the summer Budget when we announced the corporate tax rates and associated dividend tax changes, we were clear that the Revenue gain from the
dividend tax increases was in the region of £2.5 billion, £500 million of which came from the savings from reducing the incentive to incorporate. However, we also set out in the Red Book at the time that the associated costs of IR35 continue to be in the region of £500 million. That is £500 million that we are losing, and it is no coincidence that the number has stayed static and we have done something else. The methodology in the OBR’s forecasts has changed, but we are still at risk, and the Chancellor has indicated that HMRC is reviewing IR35 at present.

Q86 Baroness Noakes: Thank you. We have talked quite a bit about the work that has been done by the banks and building societies to make people aware of the personal savings allowances. We had evidence earlier in our sessions from those who said that because of the lack of awareness of individuals about this, there would be an Exchequer risk from changes not being properly understood: from people not understanding what their obligations would be to return income because of a combination of the complexity of them, especially when you go over the thresholds, and the lack of information that was being put out. To what extent do you consider there to be an Exchequer risk from a lack of taxpayer understanding of the changes that are being brought in?

Brian Redford: Perhaps I can talk about our plans to support customers, and I will ask Emma to cover the impact on the personal tax account. As I say, the original policy intent was essentially to remove both the worry and the taxation for the largest number of people. Beyond that there will be individuals who have income from interest that is beyond the allowance and who therefore need to pay the tax that is due both at the basic rate and as they move up into the higher rates. As far as we are able, we will do that for them through their Pay As You Earn coding, so we will receive details of the interest that is being paid on deposit by banks and building societies. We will then undertake to amend the Pay As You Earn coding, at the level of granularity that Emma laid out, to ensure that the customer knows what the liability is. Do you want to fill in the detail, Emma?

Emma Churchill: Only in the sense that it is important to say that there was already a potential tax gap risk in this area, because although the tax on interest is deducted at the basic rate, there is currently a significant number of higher-rate taxpayers who of course ought to be informing HMRC of that and paying tax on their savings interest but who, as we know from research that we have undertaken, are not aware of that. Actually, through our proposals for coding out for the vast majority of taxpayers who will still owe tax under the new system—and as Brian points out that will take a lot of people out of the tax altogether—for those who still owe us tax we will be able to collect it through the coding out of PAYE and to do it at the correct rate, whether that is the basic rate or the higher rate. So by doing that we will have closed an element of the tax gap.

There will be a very small number—our current estimate is that it will be in the low thousands—for whom we will not be able to code out the tax that they owe, and we will need to inform them of that. For the year 2016-17 we will do that in the summer or autumn of 2017, because we will know that those individuals owe tax on their savings interest, which we have not been able to code out. We will either write to them or, if they are in a personal tax account, indicate to them through their personal tax account that an amount of tax is owing. Of course, they all have a wide variety of options for payment of that tax.

Baroness Noakes: How effective is coding out for dealing with taxpayers who hit one of the cliff-edges and go into the higher rate and additional rate bands?

Emma Churchill: We will code out on the basis of an estimate of whether that person is a basic-rate taxpayer or a higher-rate taxpayer based on what has happened in the previous
year. You are right to say that there will be some cases where we will need to reconcile at the end of the year if the assumption has turned out to be wrong. If someone had been a basic-rate taxpayer the year before but has now moved into being a higher-rate taxpayer, we will have coded out on the basis of them being a basic-rate taxpayer the year before, so at the end of the year there will be some additional tax to be paid.

**Baroness Noakes:** Or vice versa.

**Emma Churchill:** Yes indeed.

**Baroness Noakes:** So if it is the other way around, does HMRC have an obligation proactively to search out those areas where they have over coded?

**Emma Churchill:** Yes, absolutely. It would be equally clear to us in our systems if we had assumed the higher rate figure and in fact someone turned out to be basic rate for that year. We could put that into the end of year reconciliation and code it out. We are able to deal with that.

**Brian Redford:** Can I just add to that as regards mistakes? A very significant proportion of those individuals will also be within the self-assessment system in any event, so their annual reconciliation, even though they will have had a figure deducted through coding in Pay As You Earn, will be reflected in the self-assessment process. If a repayment is due, it would be generated as a result of that.

**Baroness Noakes:** Does that mean that the population of self-assessment payers will not change?

**Brian Redford:** We are making a number of changes to remove as many people as we can when we decide that they are low risk and no longer need an SA return, but for this particular measure I do not believe that it will result in a significant reduction in the number of those within self-assessment.

**The Chairman:** First, the new regime will require a much greater amount of third party-generated information. We have been told that many third parties simply do not have the taxpayer identification. How will you resolve that issue? Secondly, will the taxpayer receive a simplified form which explains where the money has come from and how it has been calculated so that they can actually compare that with their own experience in their bank details?

**Emma Churchill:** Of course you are right that matching the data is going to be incredibly important, as will be doing that as accurately as possible. Indeed, it is something that will be very important during the coming year when it comes to matching the BBSI income so that we can correctly code out. In terms of the level of confidence we have about the information that is already coming to us from the banks and building societies, as you would expect, we have been doing a series of test matches in our data systems. At the moment the level of accuracy is high, in the mid 90 percentage points. Of course that is not 100%, and we will be talking to the banks and building societies about whether there is anything we can do to increase it right up to 100% matching.

The question you asked is about the future road map. You are right that we have said that in order to end the tax return, what we need to look for is a greater range of data from third parties. Before we get to that point, I should say that there is a very significant amount of
information that HMRC already collects but which we do not utilise in a way that is helpful to our customers. If we go on to talk about simple assessments, we will come to some examples of that. What we have said is that where we think that better and more data feeds from third parties will reduce the reporting burden on individuals, that is a conversation and discussion we want to open up with those third parties. We have said that we will publish a consultation document later in the year which will look at those potential sources of data and how that might work. In the run-up to developing the proposals, we will of course be talking to a range of stakeholders and those from whom we might potentially be getting this information. What we need to be able to do within our own systems is take the information that we are given and match it accurately to the customer to whom that data pertains. We are doing a very significant amount of work in HMRC at the moment looking at our current systems and trying to move towards a position where we will have what we call a golden customer record. Of course we have a large number of legacy systems. At the moment it is not the case, whether you are an individual or an organisation, that we have a single golden customer record where we have with a high level of confidence associated all the different records about you. As I say, a significant amount of work is going on in HMRC to create that golden customer record. The issue about matching is not just about the quality of data we get from other organisations, it is also our own ability within HMRC to be clear that this is the customer who we need to match the data to. We are not at all complacent about the amount of work that needs to be done in order to achieve that. We are getting on with the work, as you would expect, as we discuss with those potential third party data suppliers what the consultation proposals might look like. They will include the kind of data attributes, if you like, that we would need in order to match with a high level of accuracy within our own systems before we present the information to the customer.

**The Chairman:** Will the taxpayer receive a summary statement of all of the inputs that you have to collect?

**Emma Churchill:** There may well be a summary at the end, but it is important that it is not only a summary that they receive. This goes back to the conversation we had earlier about the importance of disaggregating for customers all the data sources. It is no good showing someone something and saying that the answer is 152. How would I as a customer know whether that was the right number or not? It is very important, whether our communication with the customer is through the post, the traditional way, or whether it is as it increasingly will be through the personal tax account, that we set out clearly exactly what information we have, from what source, and how those pieces of information have been used to prepopulate and come up with the tax calculation.

**Baroness Wheatcroft:** Getting these systems up and running is clearly a massive undertaking. Do you have the resources within HMRC to do that or are you having to bring in resource from outside to get all this ready in what is really quite a short space of time?

**Emma Churchill:** Of course, this is a five-year programme. We have not even got to the point yet where we are ready to consult people what that new third-party data might be. So we are not quite there yet, but the Chancellor's announcement in the spending review of £1.3 billion of investment in HMRC over the period specifically for the work that we need to do to make a reality of the vision that we have set out in the Making Tax Digital road map. We therefore have £1.3 of investment to make the changes to the underlying systems that we need.
Baroness Wheatcroft: And is that going on bringing in HMRC staff, or outside consultants and so on?

Emma Churchill: The programmes will need to do a range of things to deliver. Once we have consulted and had the new legislation, we will have programmes that are designed within HMRC to deliver, and the investment will go on a wide range of things, including the systems changes that we need to make to the underpinning systems—the plumbing, if you like—in HMRC, and the development of our digital accounts, which our customers will see increasingly in the future. It will also go on the integration layers within our IT that we will need in order to make the back-end systems translate for our customers what they need to see. That investment will be made to develop all those systems.

It is also important to say that we also have in our spending plans for HMRC the support that customers will need to make the transition to digital. We have not forgotten that there will be customers right through this period who will need a range of support, including by phone. The Committee will know that customer service on our phones has not been good enough in the past. We have seen investment in that, which has led to significant improvements. Over the self-assessment peak, 90% of calls were answered in five minutes. We know that not all customers will find the transition to digital easy, and that we will need to continue to invest in multichannel support, whether by phone or through our Needs Extra Support service. So there will also be spending and investment in supporting to make the transition to digital.

Q87 Lord Kerr of Kinlochard: You are going to introduce so-called simple assessments, which will go out in summer 2017. Your evidence to us says that you plan to send them to about 750,000 taxpayers, principally those who do their own tax returns—pensioners, those on a low income. Are you sure that you have available for them the support that they will need as they take on this task of checking your assessments? What sort of support will they get?

Emma Churchill: The full range of support will be available to them. I should say that we are starting with that customer segment because HMRC is not reliant at all on getting new information from them into our systems in order to give them tax bills. These are customers for whom we already have the information in HMRC. Nearly 750,000 of those customers will have underpaid on their PAYE the previous year but for whom we cannot code out. At the moment, that is information that we send to those customers. We say, “In order for us to enforce this tax bill, we need you to fill in a self-assessment return”, and we send them a notice to file. You will not be surprised to hear that our advisers take a good many calls from people saying, “You have sent me all this information”. We say, “Are you happy that it is correct?”, and they say, “Absolutely”. We then say, “We would now like you to key all that information into a self-assessment return”, and they say, “Why? You’re the people who have sent us this information”. For 2016-17, and the letters that we will send out in 2017, we are trying to avoid telling customers simply that we know this information to be true, either because we have had the data from an employer or, in the case of a much smaller number of pensioners who receive a state pension that puts them over the personal allowance, because they agree with us that it is right but we still have to ask them to fill in a self-assessment return, because otherwise we have no means of enforcing that payment. This is designed to be a significant reduction in the burden for those customers, but of course we will need to make sure that the notifications that they receive are crystal clear about the information that we already have in our systems and why we therefore believe that the tax due is what we say it is. It is to avoid the very unsatisfactory situation where, even though we have absolutely all the information that we need in HMRC, we still ask people to fill in a self-assessment.
Should they believe that the information is wrong, there is a full range of channels through which they can get support. They can phone us, as I said. But we appreciate that it has not been adequate in the past.

**Lord Kerr of Kinlochard:** That is where I start to worry. I start to worry anyway when you say that you have the information and that you know. If the replacement for tax deduction at source and for dividend vouchers and so on has gone swimmingly, the information that you have will be correct, but I do not know that you can really assert that you have all this information, because quite a lot of those 750,000 people will have some sort of income in addition to their pension or their wages. You say that they may telephone. I have never got through in less than 50 minutes. You say that it will all be online, but your own documents show that 7 million people are digitally excluded. I am uneasy. I see what could be a train crash coming down the line. I have been struck, as we go through this session, by the way you reply to questions about informing the taxpayer. In answer to the question about the abolition of tax deduction at source on interest, your reply several times was that you are talking to the banks and the building societies. When the question was about the end of the dividend voucher, you said that you are talking to stakeholders and companies. You tell us that all the information that the taxpayer needs will be available on the government website. I think the taxpayer likes to think that he has a relationship with his tax inspector and would expect to hear directly from HMRC about changes, not necessarily a communication specific to him and not necessarily telling him about the changes in the numbers for him, but a communication telling him about the changes in the regime and the changes in the administration of the regime. I have heard nothing yet about that direct communication to the taxpayer. That is really quite important.

**Emma Churchill:** It is worth taking a couple of steps back to the beginning of your remarks. I just want to be clear that the simple assessments that we will send out in 2017 will not include the dividend, so they will not include people who have dividend income because we will not have put a system in place whereby we receive that information from third parties. The simple assessments that we will send out in 2017 are really only, to start with, for customers who have only the underpayment from PAYE the previous year, because we have that information through the RTI system from employers and for the very small group of pensioners I referred to where we have the information from DWP. So it is only those groups of taxpayers who we will send a simple assessment tax bill for the year 2016-17.

**Lord Kerr of Kinlochard:** Thank you. I had not grasped that. That is very clear. I am not sure when to date my train crash now. The train may stay on the tracks till 2018.

**Emma Churchill:** It certainly leaves us with more time for consultation in order to deal with some of the issues you have raised. Perhaps I can come back to your point about direct communication with our customers, because of course we think that that is very important. For customers who have been completely unnecessarily in self-assessment in previous years for the reasons we have articulated, we want to say, “You do not have to do a self-assessment any more. We will be moving you into this much simpler system”. That absolutely will be a direct communication from HMRC because we know exactly who those individuals will be. Whereas they would previously have received a direct communication from us stating, “Here is a notice to file. Please fill in the self-assessment form”, they will receive a direct communication from us which explains that no longer do they have to be in self-assessment and that we are instead sending them a much simpler tax bill. I should say that if the circumstances of those individuals have radically changed, while of course we will have selected them on the basis of what has happened in previous years, so that they now have
other sources of income of which we are not aware, they will need to tell us that. We will be very clear about it because it will not be reflected in the bill we send them. That bill will reflect the information that we already have. Again, we will be very clear about that and it absolutely will be a direct communication from HMRC to our customers.

**Lord Kerr of Kinlochard:** If you under-record, the temptation of Lord Forsyth’s aunt—you are lucky to have been spared Lord Forsyth’s aunt because he is caught up in Scotland—who has difficulty with tax matters so he advises her. If you under report on the simple assessment form, I think that quite a lot of people out there will think, “Well, they must know that it is less than I thought it would be, but okay, they know”. If on the other hand you over-report, people will panic and start trying to ring you up, at which point the 30-day appeal rule comes in. Are you sure that 30 days is not going to be a little short for people who for the first time are going to have to do things which in some cases, particularly pensioners and the people you are starting with, the lower income groups, are going to be quite difficult and worrying? Are you sure that a 30-day appeal period is right?

**Emma Churchill:** The 30-day period is for people to check whether the information is correct. Of course this is something that we have put out for consultation. The legislation is out for consultation and this is an area in which we have received a lot of responses, which of course we will take into consideration.

**Baroness Wheatcroft:** You are talking to stakeholders about how you will get the sort of information that you are going to need. Could you be specific on the issue of dividends? Are companies going to be obliged to tell you about the dividends that they currently pay? At the moment you get the information through tax credits. Are they going to have to make a new and separate filing to HMRC about all their dividend payments?

**Emma Churchill:** No. For 2016-17 no changes are being made to what people are required to do in respect of dividends. As Brian mentioned earlier, the requirements to send out dividend vouchers are unchanged, it is simply that they will be without the tax credits. We are not asking people to do anything different at this stage. When it comes to further consultation, of course this is one of the areas that we might look at, but we are absolutely not asking anybody to do any more for 2016-17.

**Baroness Wheatcroft:** How for the purposes of simple assessment will you have the information?

**Emma Churchill:** I am sorry, I intended to make that clear in my previous response. The information about dividends will not appear for those who are getting simple assessments. The simple assessments for 2015 to 2017 are only for two very narrow sets of customers. The first set is where we know that there is underpaid PAYE from the previous year and the second set is the very small group of pensioners where we know that the state pension they receive takes them over the personal allowance. I think that there has been an unhelpful bringing together of two different areas. As I say, the simple assessments for 2017 are focused on those particular groups. There will not be any information about dividends in the simple assessments because they relate only to information that we are currently holding within HMRC.

**Baroness Wheatcroft:** What proportion of the people that you think will get simple assessments will then have to use them simply as a starting point?
**Emma Churchill:** For the vast majority they will not because their circumstances will be unchanged. If there are people in 2016-17 and 2017-18 who have seen a very significant change in circumstances, they will need to inform us of those changes in the way they normally would.

**Brian Redford:** I think I might be able to pass over some figures which we can check with the Committee Clerk afterwards. Our current estimate is that something like 5.2 million people in the UK receive dividends. The vast majority of them will now no longer have any form of liability because they will be under the £5,000 annually 0% band. We believe that there will be around 8,500 people who will have dividend income of between £5,000 and £10,000. The reason that that is relevant is that those with a dividend level of more than £10,000 will already be returning their income through self-assessment. That is where we will get the information from. So we have a group that is very small in comparison with the 5.2 million group who we will have to work with in order for them to declare the dividends that they now receive. Of course this is one of the areas where the policy means that they will now have a liability where previously as basic-rate taxpayers they would have had a tax credit to offset it. I hope that that is helpful on the numbers, but we will confirm them.

**Baroness Wheatcroft:** 8,500 is not a huge number by any means.

**Brian Redford:** No, it is not, but we still need to look after them.

**Q88 Lord Turnbull:** It states in paragraph 27 of the memorandum you sent us that, “Nine-five percent of all taxpayers—and more than three quarters of all those who receive dividend income—will either pay less tax … or be unaffected”; and then you mentioned the very small number. However, in paragraph 30 it states that, “Around 2 million individuals are expected to have some tax to pay on their dividend income after April 2016, compared to 1.8 million if these reforms had not been put in place”. In other words, these reforms will bring 200,000 people into paying some level of tax on dividends which they did not before. Can you tell us the profile of those people?

**Brian Redford:** Under the old system they would have been people who were basic-rate taxpayers, so the dividend credit would have met their liability for those dividends. But in the future they will have a dividend profile greater than £5,000 with no tax credit attaching any longer. They will therefore have to pay tax on the bit over £5,000. So there are extra liabilities within this policy. It is the Government’s decision where they choose to tax individuals.

**Cerys MacDonald:** I do not have the exact breakdown, but in terms of providing a little colour to the profile, a large proportion of them are likely to be owner-manager businesses who are drawing down dividends from the company, but they do not take those individuals into higher rate tax.

**Lord Turnbull:** You have not mentioned capital gains tax, which produces liabilities that can be highly variable from year to year and for which there is an allowance of something like £11,000 a year. If you have more than £11,000, does that mean that you have to be in the self-assessment system? I cannot see how else this can be dealt with in the simplified arrangements.

**Brian Redford:** I shall touch on this. You are absolutely right, Lord Turnbull, that this can be a highly volatile area. Individuals will make gains in one year but may not do so for another couple of years. Equally there are concerns if there is a consistent level of gains every year that are returnable. In the past we have used the self-assessment vehicle to deal with those
individuals. For people who make a one-off gain, perhaps through inheriting a property which they have let out and then finally sold, it is quite an expensive way of managing an administrative process for one particular gain. One of the things we would like to look at as we move towards simple assessment and the way information is provided is whether there is a way of dealing with one-off and fairly simple capital gains that does not have to have the paraphernalia of self-assessment wrapped around it. We need to look at this. As I say, there are those who are very regular capital gains individuals for whom the self-assessment process is absolutely right, but there is a group for whom we ought to be able to make it simpler. We would like to use the vehicles that we are now constructing to see whether that is possible.

Lord Turnbull: I should like to cover another category of people: those who are digitally excluded. I do not know how many people that would cover, but I would imagine that it is a relatively common occurrence. Let us take a couple, and let us say that the husband has always looked after their financial affairs. He may do that digitally and have a good relationship with it. He dies and the widow is left not only with her own tax affairs, which were probably not complicated, but with the whole paraphernalia of tax, never having done it before. She is possibly in her 80s. How will you deal with that kind of case? There may not be that many of them, but equally they are not going to be that uncommon.

Brian Redford: I agree, and they do exist. It is not an easy position, especially if the spouse has just lost her husband and is left managing financial complexity that she had not previously been aware of. We use our Needs Enhanced Support team to fill the gap. When we are advised of a bereavement and someone needs extra support to put them into a position where they can do the right thing, we will deploy our resources to give them that support. Very often it is linked to bereavement and a declaration for inheritance tax purposes. What we try to do is provide a complete service which makes it as easy as possible.

Lord Turnbull: How will the widow know that this service exists?

Emma Churchill: We have trained our customer service advisers to recognise early on that where they think a customer will need the extra support service, they can be proactive in making sure that the customer gets the support they need. It might be just additional support over the phone or it might require a face-to-face appointment, which our advisers can organise. We have been proactive in training our advisers to make sure that when people come into the system, they can be identified so that the support they need is there for them.

Brian Redford: We get referrals through working with the bodies associated with Low Income Tax Reform and with TaxAid. They will make referrals if they think it is appropriate to do so.

Q89 The Chairman: Can we finish with two specific questions, among many that have been raised by other witnesses, which are really addressed to the Treasury? The first is that the Chartered Institute of Taxation believes that Clause 12A(1) is very confusingly drafted, and in particular does not make it clear that an individual who has savings income below £5,000 is entitled to the nil savings rate. Will that drafting be changed as part of the consultation process?

Brian Redford: Yes.

Q90 The Chairman: The second question is this. Crunch accounting, which looks after 45,000 microbusinesses, has made a range of representations about the impact on small businesses, stating that the burden is greater on small businesses and those that are reasonably
new. It regards that as unfortunate and cites a particular example: the director of a limited company paying themselves primarily through dividends will be paying £1,528 more tax a year on pre-tax profits of £48,000, whereas a director with a pre-tax profit of £78,000 will be paying only £1,343 more. Is that what the Treasury intended?

**Brian Redford:** I will take the first one, because it is easier to respond to. Clause 12A is drafted to give effect to something that we have been discussing: the nil rate band for savings and the personal savings allowance. We are grateful to the Chartered Institute of Taxation and the Association of Accounting Technicians for making those comments. As the Committee knows, the consultation on the draft legislation has just finished. We will fold their comments into that and see if we can make it easier.

**The Chairman:** What about the regressive nature of the tax on the poor company director?

**Cerys MacDonald:** I think it is possible to do calculations that can give all sorts of different results on people's tax liability. It depends on how individuals remunerate themselves and whether they are drawing a minimum salary below the personal allowance, what practices they may have for income shifting between themselves and their partner if, as in many cases, they and their spouse are involved in the business, and the strategies they are employing on earnings that they retain in the business for future use. I do not think it is possible to validate the figures quoted without having the specific assumptions that were made in those calculations. I can assure the Committee that we recognise that the dividend tax changes will mean that a lot of people in owner-managed businesses are now paying a higher level of tax than previously, despite the benefit that they will see in the reduction of the corporate tax rate. But they are still paying less tax than they would be if they were operating as a sole trader and not incorporated.

**The Chairman:** I think the question was whether it was intentional or accidental that this is regressive.

**Cerys MacDonald:** I do not think I can confirm that it is regressive. It would very much reflect the specifics of the case.

**The Chairman:** I recommend the statement of Crunch accountants to you. Thank you very much. You have combated the noise of the wind on the windows rather well.
Draft clauses for Finance Bill 2016:

Submission from HM Treasury and HM Revenue and Customs to Finance Bill Sub Committee of the House of Lords Economic Affairs Committee

February 2016
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Introduction

Finance Bill 2016

1. Draft clauses for Finance Bill 2016 were published for consultation on 9 December 2015 in line with the Government’s new approach to tax policy making (introduced in 2011). The publication includes 88 draft clauses and related schedules, along with draft explanatory notes. Draft legislation is included or measures announced earlier in 2015 and at Autumn Statement 2015. The consultation closes on 3 February.

2. Publication of draft legislation is an important way to improve tax legislation and helps ensure that when the Finance Bill is introduced in Parliament it has already had the benefit of technical consultation. It meets the Government’s commitment to publish the majority of Finance Bill clauses in draft at least three months ahead of the bill being introduced.

3. Alongside the legislation and explanatory notes, HMRC and HMT published Tax Impact and Information Notes (TIINs), which set out a range of summary impacts for each measure in line with the Government’s regulatory impact assessment guidance. Included in the impacts are impacts on individuals and households as well as impacts on business and equality impacts. The TIINs are published as part of the Overview of Legislation in Draft, which also includes information about when different tax measures will be legislated (including measures for future Finance Bills and secondary legislation).

Tax simplification

4. The Government remains committed to a simpler and more transparent tax system.

5. The Government created the Office for Tax Simplification (OTS) in the previous Parliament to identify areas where the tax system could be simplified. At Summer Budget 2015, the Chancellor announced that the OTS would be put on a permanent, statutory footing with an expanded remit and capacity. More detail on the OTS is provided below.

6. At the 2015 Spending Review the government announced it would invest £1.3bn to transform HMRC into one of the most digitally-advanced tax administrations in the world. On 14 December HMRC published the Making Tax Digital Roadmap, providing a high level outline of how taxpayers’ experience of dealing with HMRC will develop.

- The Making Tax Digital vision is about much more than simply adding digital tools to the current system; it is about transforming the UK tax system into something that feels completely different and which will see the end of the Self-Assessment Tax Return as we know it. During this Parliament, HMRC will make fundamental changes
to the way the tax system works — transforming tax administration so it is more effective, more efficient and easier for taxpayers.

- By 2020, for the vast majority, there will be no need to fill in an annual tax return; businesses and individual taxpayers will be able to register, file, pay and update their information at any time of the day or night, and at any point in the year, to suit them. Taxpayers will not have to give HMRC information that it already has, or should be able to get from elsewhere — for instance, from employers, banks, building societies and other government departments instead HMRC will collect and process information affecting tax as close to real time as possible, to stop tax owed or repayments due from building-up. For businesses that means submitting details of income and expenditure quarterly using software or applications.

- These reforms will transform the experience of millions of taxpayers. More detail about how these reforms will be implemented, and some aspects of their design, will be the subject of further consultation. These consultations will give stakeholders and customers the opportunity to contribute to this work and shape tax administration for a generation to come.
Proposed changes to the taxation of savings

Background

7. Income tax is currently chargeable on most savings income, such as interest from bank or building society accounts. While a 0% starting rate for savings is available for certain lower income savers and around 23 million individuals have a tax-advantaged Individual Savings Account (ISA), most savers currently pay tax on some or all their savings income.

8. Deposit-takers (such as banks) and building societies currently deduct tax at 20% from account interest before paying it to individual account holders, under the Tax Deduction Scheme for Interest (TDSI). Individuals who are not liable to pay tax on their savings income (for example because their total income is below their tax-free Personal Allowance) can register accounts with their bank or building society for interest to be paid without tax deducted. Savers who are liable to pay tax on only some of their account interest will have tax deducted under TDSI, but can make a claim for repayment to HMRC. Individuals who are liable to pay tax on their savings income at the higher or additional rate should notify HMRC, so that they can pay the additional tax due after the TDSI deduction of 20%.

9. In May 2015, HMRC published research\(^1\) on customer awareness of how bank and building society interest is taxed. This research found that customer understanding in this area is low, and that some savers are overpaying tax because they are not aware of the account registration or reclaim process. In addition, many higher rate taxpayers are not aware of the requirement to account for additional tax, after the TDSI deduction by their bank or building society.

10. This research complements the findings of the Office of Tax Simplification\(^2\) about awareness of the starting rate for savings among pensioners, and some of the difficulties faced by some customers wishing to register their accounts for interest to be paid without tax deducted. The Low Incomes Tax Reform Group\(^3\) has also highlighted problems with the current system, including eligible savers being unable in some cases to access the information and forms they need to register their accounts, with the result that some are paying more tax on their savings income than is due.

Proposed changes

11. Draft Finance Bill clauses have been published for the introduction of a new Personal Savings Allowance (PSA) from 6 April 2016. This will enable basic rate

\(^1\) ‘Awareness and Understanding of Taxation of Savings Interest (May 2015), prepared for HMRC by IFF Research, HM Revenue and Customs Research Report 370


\(^2\) ‘Review of pensioners’ taxation: Final report’ (January 2013), Office of Tax Simplification


\(^3\) ‘Banks, building societies, HMRC and their non-taxpaying customers – a plea for better service’ (January 2013), Low Incomes Tax Reform Group of The Chartered Institute of Taxation
taxpayers to have up to £1,000 of their non-ISA savings income tax-free each year. Where an individual has any higher-rate income in the year, their PSA will be £500. Additional rate taxpayers will not qualify for the PSA. Interest and other income from Individual Savings Accounts (ISAs) will not count towards this Personal Savings Allowance.

12. Draft clauses have also been published that will remove the duty on deposit-takers and building societies to deduct tax on the account interest that they pay. Alongside these changes, the Government has announced that HMRC will introduce automated coding-out of savings income that remains liable to tax, through the PAYE system.

**Simplification benefits of these proposals, and their impact on the compliance burdens of individual taxpayers**

13. The changes will allow around 18 million savers to benefit from a tax reduction, and mean that approximately 95% of taxpayers will have no tax to pay on any savings income. They also significantly simplify the taxation of savings for most taxpayers. As a result of these changes, most savers will have no tax to pay or reclaim on their savings income.

14. Ending deduction of tax from account interest will remove the need for savers who are not liable to tax on their savings income to register their accounts for interest to be paid without tax deducted, or to reclaim amounts from HMRC. This will remove the possibility that low income savers might pay too much tax on their account interest because of a lack of awareness of the relevant tax rules or processes, or because of difficulties in registering their accounts or reclaiming sums from HMRC.

15. However around 1.4 million individuals are expected to still have some tax to pay on their savings income. These individuals will usually be additional rate taxpayers, or taxpayers with a higher than average amount of savings.

16. For many of these customers, the way in which tax due on account interest is collected will be significantly simplified. Where possible HMRC will automatically code-out tax due through the Pay-As-You-Earn (PAYE) system, using information provided by deposit takers and building societies. This will remove the need for many customers to contact HMRC in order to pay tax due on their account interest.

17. In the small number of cases where it is not possible to collect the tax due on savings income through PAYE, HMRC will make available simple and accessible methods by which savers can settle their tax liabilities. Further details will be published in good time before any tax is due.

18. December 2015 saw the publication of the Making Tax Digital roadmap. This sets out how HMRC will go about transforming the UK tax system into something that feels completely different and which will see the end of the Self-Assessment Tax Return as we know it.
Proposed changes to the taxation of dividends

Background

20. Currently, when a company distributes part of its profits to its shareholders, the distribution (most commonly a dividend) is paid with a tax credit equal to one ninth of the dividend paid. This tax credit can be set against the person’s liability to income tax on their dividend income.

21. For example, if a company pays a dividend of £90 the shareholder receives the dividend of £90 plus a tax credit of £10, giving them dividend income of £100. The shareholder can set the £10 tax credit against their tax liability on their dividend income.

22. The dividend tax credit was introduced in 1973 as part of the system of Advance Corporation Tax (ACT). Payable tax credits were abolished for pension funds and companies from 1997, and (subject to transitional arrangements) were abolished along with ACT for other taxpayers from 1999. Since then, although the non-payable credit has remained, a person cannot ask for the tax credit to be paid to them even where they do not have to pay tax on their dividend income (for example because the income is below their personal allowance).

23. HMRC frequently receive questions from people who often misunderstand the complex rules and the reason for the credit being non-payable.

24. The existence of the tax credit makes it more difficult to understand the tax rate actually payable on dividend income. The headline rates of tax on dividend income are currently 10%, 32.5% and 37.5% for basic, higher and additional rate taxpayers – but the effective tax rates (after the tax credit is accounted for) are 0%, 25% and 30.56% respectively.

Proposed changes

25. In the 2015 Summer Budget the Chancellor announced that from 6 April 2016 the dividend tax credit will be repealed and replaced with a new tax-free dividend allowance. Draft Finance Bill clauses have been published for this announcement. The Chancellor also announced that dividend tax rates would be adjusted from April 2016. These changes follow a reduction in Corporation Tax (CT) from 28% in 2010 to 20% in 2015, and the announcement that CT rates will be further reduced to 18% by 2020.

26. The dividend allowance is a 0% rate on the first £5,000 of dividend income. Where a person has dividend income of £5,000 or less they will pay no tax on it. Dividends received above £5,000 will be taxed at the new dividend rates (7.5% for dividends in the basic rate band, 32.5% for dividends in the higher rate band and 38.1% for dividends in the additional rate band).
Simplification benefits of these proposals, and impact on the compliance burdens on individual taxpayers

27. Ninety-five per cent of all taxpayers - and more than three quarters of all those who receive dividend income - will either pay less tax on their dividends as a result of these changes, or be unaffected. Around 1 million individuals will benefit from a tax reduction on their dividend income due to the dividend allowance.

28. The majority of non-taxpayers and basic rate taxpayers do not currently need to inform HM Revenue and Customs (HMRC) of their dividend income. From April 2016, individuals who receive dividends between £5,001 and £10,000, and who need to pay tax on those dividends at the basic rate, will have to inform HMRC of their dividend income for the first time. This group is estimated to be fewer than 8,500 individuals.

29. Individuals with more than £10,000 of dividend income are already required to be in Self-Assessment, and those who are not in Self-Assessment but pay tax on dividend income at the dividend higher rate already need to inform HMRC. Those with dividend income below £5,000 do not need to notify HMRC, unless they are in Self-Assessment for some other reason.

30. Around 2 million individuals are expected to have some tax to pay on their dividend income after April 2016, compared to 1.8 million if these reforms had not been put in place.

31. In most circumstances tax will be automatically coded out through the PAYE system using the information provided to HMRC by the taxpayer or included in the self-assessment return. Where dividend income between £5,001 and £10,000 is received and it is not possible to collect the tax due through PAYE, HMRC is considering a range of options to make it easier for investors to pay the tax that is due rather than through the self-assessment system. Further details will be published in good time before any tax is due.

32. HMRC has published a Tax Information and Impact Note on the changes, which can be found on the gov.uk website: https://www.gov.uk/government/publications/income-tax-changes-to-dividend-taxation
Simple Assessment

Background

33. In March 2015 HMRC published ‘Making Tax Easier: The end of the tax return’ setting out its vision to modernise the tax system by introducing digital tax accounts for individuals and businesses. This will lead to millions of HMRC customers no longer needing to fill in tax returns.

34. Simple assessment is an early step towards this vision.

35. At the moment hundreds of thousands of people have to fill out a Self-Assessment tax return every year simply because they have a tax liability that cannot be collected through PAYE. Where we cannot collect tax via PAYE the only way for HMRC to collect the tax due in these circumstances is to require the completion of an SA Return. This is expensive and time-consuming for both the customer and the Department.

36. The new simple assessment legislation will allow HMRC to send a tax calculation (along with a request for payment) to customers where HMRC already have enough information to make an accurate assessment of tax due.

37. HMRC already holds a wide range of information, such as employment income and the amount of Child Benefit paid. In addition HMRC receives information:

- from banks and building societies about savings income
- about pay and pensions from employers, pension providers and DWP
- directly from customers.

38. HMRC already uses the information held on its systems to calculate individual’s tax liabilities in the annual PAYE coding run. To enable HMRC to send a tax assessment to customers where tax cannot be collected via PAYE, HMRC needs new legislation, in addition to Self-Assessment which will allow HMRC to assess and collect the tax that is due.

Customer benefits

39. Introducing the simple assessment process for customers will:

- save many customers from having to fill in a Self-Assessment tax return, reducing their costs and making the process simpler
- reduce the number of customers who contact HMRC because they need help completing their returns or are worried about their tax affairs, creating a value for money customer service
reduce the number of customers who pay interest and penalties because they have made simple errors on their tax returns or have sent them back late

reduce the incidence of customer overpayment due to simple errors on their part

Implementation

40. Simple assessment will begin in 2016/17 for people with the simplest affairs.

41. Instead of being issued a Self-Assessment tax return or a notice to file these customers will receive a simple tax calculation and a request for payment.

42. The first customers to benefit from simple assessment will be unrepresented individuals and those in lower income groups. These customers will include:

- 730,000 people who underpay though PAYE, and for whom HMRC cannot collect the difference through the next year’s PAYE – who would otherwise have to fill in a Self-Assessment tax return
- 17,700 pensioners whose state pension exceeds their personal allowance (e.g. people with a full basic and a full additional state pension)

43. Calculations will be sent to customers in a rolling programme between June and October each year, starting in 2017.

44. As digital tax accounts evolve and HMRC develops its IT capability, HMRC will use this new process to create a tax bill for customers whose tax affairs are more complex but where the information required is already known. HMRC will consult on this, as its digital plans develop.

45. The number of individuals who will benefit from simple assessment will vary from one year to another however it is estimated that up to 2 million individuals will, in time, benefit from simple assessment.

Help for customers

46. HMRC intends the process for customers to be on-line and as simple as possible and so has aligned the payment dates and interest provisions with those that already exist for self-assessment.

47. The current processes for hardship will continue and there will be assistance for customers who have difficulty going on-line including a paper process for customers who are unable to access digital accounts.

Customer rights and responsibilities

48. As now customers will be advised to check that the information in their simple assessment tax calculation is correct.
49. If customers think the information or calculation is wrong they will need to tell HMRC and obtain a revised tax calculation.

50. Customers will be able to challenge figures and there will be a right of appeal if disputes cannot be resolved informally.

51. Customers will still be able to fill out a Self-Assessment return if they wish. HMRC will still send a simpler assessment to individuals with straightforward affairs, but they will be able to complete a return if they want to or if they have to declare changes to their circumstances.

52. Customers will still be required to notify HMRC of new income and capital gains and simple assessment will not apply and will not be used to make estimated assessments where it is believed that a customer has deliberately not declared all their income.

53. Simple assessments will only be used to collect the tax that is due based on information about income and circumstances already known.
The Office Of Tax Simplification (OTS)

Background

54. The OTS was established as a temporary, non-statutory office of HM Treasury in July 2010 to advise the Chancellor on delivering a simpler tax system and to provide independent advice on options for addressing existing complexity in the UK tax system.

55. At Summer Budget 2015, the Chancellor announced the Government’s intention to introduce legislation to put the OTS on a permanent, statutory footing with an expanded role and capacity. This delivered on a commitment made in the Conservative Manifesto for the 2015 General Election.

56. The Government published an interim Framework Document before the summer recess in July 2015 detailing the changes it would make to strengthen the structure and operation of the OTS before legislating in Finance Bill 2016. These include a larger OTS Board and a larger secretariat to support its work.

57. The expanded OTS will advise the Government on how to move towards a modern tax system that is efficient, predictable, simple and fair. The draft Clauses 83 – 88 for the Finance Bill 2016 provide for the permanent establishment of the OTS in statute, specify its functions and make certain provisions for the governance and operation of the OTS. For example, the draft legislation provides for the OTS Board to have no more than 8 members with representatives from HM Treasury and HM Revenue and Customs. The OTS Chair will be able to nominate up to four non-Executive members.

58. The Rt. Hon. Michael Jack CBE, having served a full Parliament as Chair of the OTS, stood down last year. Following an open competition, the Chancellor appointed Angela Knight CBE to the post of Chair on 9 December 2015. The OTS also appointed David Halsey, a senior civil servant, to the post of Head of Office from 4 January 2016, to support the Chair and John Whiting OBE, the Tax Director.

Current reviews

59. The OTS are carrying out two reviews, on the taxation of small companies and the closer alignment of Income Tax and National Insurance contributions. These will report ahead of Budget 2016. Further OTS reviews will be announced in due course.

Tax simplification

60. Since it was established in 2010, the OTS has made 402 recommendations to simplify the tax system, 192 of which have already been implemented or partly implemented by the Government. These include simplifying employee benefits and expenses to save employers an estimated £20 million per year in administrative costs and introducing cash basis accounting for tax. 1 million self-employed
individuals took up the cash basis in the first year alone and now no longer need to understand the tax rules designed for larger companies.

61. To guarantee the independence and strengthen the operation of the OTS, the Government has committed to legislating for the permanent establishment of the OTS in statute, and made the changes introduced in the interim Framework Document (the Government proposes to publish a final Framework Document later this year). The OTS will be able to formally respond to HMRC and HMT consultations on the implementation of its recommendations. The Government will also be required for the first time to respond formally to OTS recommendations. The draft legislation requires the OTS to publish an annual report, setting out its activities and plans.

4 February 2016
Her Majesty’s Treasury and Her Majesty’s Revenue & Customs – Oral evidence (QQ 77-90) (FBBOE0005)

Her Majesty’s Treasury and Her Majesty’s Revenue & Customs – Oral evidence (QQ 77-90) (FBBOE0005)

Submission to be found under Her Majesty’s Revenue & Customs and Her Majesty’s Treasury – Oral evidence (QQ 77-90) (FBBOE0005).
Supplementary written evidence (FBB0016)

Her Majesty’s Treasury and Her Majesty’s Revenue & Customs – Supplementary written evidence (FBB0016)

**HM Treasury and HMRC: Supplementary Evidence**

1. Would it be ultra vires for the OTS to respond to consultations about proposed legislation? John Whiting told the Committee in his session that “[the OTS] constitution so far has been very firmly that we can look only at what is on the statute book” Ms McDonald thought that the OTS would not be prevented from responding to consultations.

   The OTS is currently a non-statutory Office of the Treasury, with the aim of providing independent advice to the Chancellor on simplifying the UK tax system. The OTS is currently governed by the interim framework document published in July 2015. This document specifically provides for the OTS being able to comment on government consultations that result from OTS recommendations. A revised framework document will be published once the Finance Bill 2016 clauses come into force and this will set out the position on responding to consultations. The draft clauses do not preclude the OTS from responding to government consultations.

2. Please provide the Q&A document for Banks and Building Societies referred to in evidence

   *Please find attached*

3. Impact notes.
   
   a. The impact note on the changes to dividend taxation. Can HMT and HMRC confirm that the impact note referred to is [this one](https://www.gov.uk/government/publications/income-tax-changes-to-dividend-taxation)

   *This is the correct Tax Information and Impact Note.*

   b. The impact assessment on the quarterly reporting proposals. Has a TIIN been prepared/published for this proposal?

   *A TIIN will be published with the draft legislation for Finance Bill 2017 in the normal way (in December 2016).*

4. Ms Churchill stated that none of the simple assessments for the 2016/17 tax year, to be issued in summer 2017, will include interest or dividend income. If a tax payer has any interest or dividend income (not just interest or dividends covered by the various allowances) is it correct that they will not be issued a simple assessment?

   *For the tax year 2016/17, with assessments being sent out to customers in the summer or autumn of 2017, simple assessment will focus on customers with very straightforward affairs where HMRC already has the information to make an accurate assessment of tax due. This customer group comprises around 750,000 individuals - the majority are customers where they have underpaid PAYE for the previous year but it cannot be coded out through PAYE, but in addition there will be a small number of pensioners whose state pension takes them over the*
Her Majesty’s Treasury and Her Majesty’s Revenue & Customs – Supplementary written evidence (FBB0016)

personal allowance. We will have the information to make an accurate assessment of tax due from these customer groups because of the information we already get from employers and the Department for Work and Pensions.

Many individuals will receive interest or dividends that are covered by their Dividend or Savings Allowances, and on which they therefore owe no tax. These customers will not be excluded from receiving a simple assessment if they have underpaid tax through PAYE that cannot be collected through coding adjustments.
Where individuals receive bank or building society interest in excess of their Personal Savings Allowance for 2016/17, HMRC will routinely seek to collect the tax by adjusting tax codes. This will be possible in the vast majority of cases. Our most up-to-date estimate is that there may be around 7,000 customers for whom this is not possible. Many of these customers will already complete a tax return. For those who have straightforward affairs and would not otherwise have to complete a tax return, we are currently considering a range of notification and payment options. It is possible that the simple assessment process may be suitable for some of this very small group of customers.

The position in relation to dividends is different because HMRC does not receive information about dividends from third parties and we would not therefore be in a position to include information on these in any simple assessments for the tax year 2016/17 unless the customer provided us with that information themselves. If they did so, it may be possible for them to be dealt with through simple assessment.

As set out in the Making Tax Digital roadmap, HMRC will consult in 2016 on how information from more third parties might reduce the reporting burden on taxpayers. This will enable more people to benefit from simple assessment in future years.
**Overview**

From 6 April 2016, taxpayers will have a new Personal Savings Allowance. This means that up to £1,000 of income from savings (e.g. any interest earned) will be tax-free for basic taxpayers, and up to £500 of savings income will be tax-free for higher rate taxpayers.

Currently, banks and building societies are required to take basic rate tax from their customers’ savings interest. From 6 April, they will stop doing this because the vast majority of people will have no tax to pay on this income.

There is no action for most customers to take. Those with savings income below their new Personal Savings Allowance will have no tax to pay. Where possible, those with savings interest above their Personal Savings Allowance will have any tax they have to pay collected automatically by HMRC, through a change to their tax code - based on information provided by banks and building societies. Those who currently complete a Self Assessment tax return should continue to do so.

For further information about these changes, go to GOV.UK and search for Personal Savings Allowance. Full details will be added to the website in April when the new rules come into effect.

**Q&As**

The following questions and answers should help customers who receive account interest from banks and building societies.

**What is savings income?**

Savings income includes:

- interest from banks, building societies and other account providers (such as credit unions and NS&I)
- interest distributions (but not dividend distributions) from authorised unit trusts, open-ended investment companies and investment trusts
- income from government or company bonds
- some types of purchased life annuity payments and gains from certain contracts for life insurance

**Does income from ISAs count towards my Personal Savings Allowance?**

No, income from ISAs does not count towards your Personal Savings Allowance.

**Will the changes affect savings income received before 6 April 2016?**

No, changes only apply to savings income paid after 6 April 2016.
Do taxpayers need to tell account providers about other savings income or their tax rate?
No, taxpayers do not need to give any information about their tax circumstances or other savings income to their account provider.

Their total taxable income is less than £17,000, what will the changes mean for them?
From 6 April 2016, if their total taxable income - for example, from wages, profits, pensions and savings - is less than £17,000, they won’t pay any tax on their savings income.

They are a basic rate taxpayer, what do the changes mean for them?
From 6 April 2016, if they are a basic rate taxpayer, up to £1,000 of their savings income will be tax-free.

For example, if they earn £20,000 a year and receive £250 in account interest, they won’t pay tax on their interest because it’s within their £1,000 Personal Savings Allowance.

If they earn £20,000 a year and receive £1,500 in account interest, they only need to pay tax on £500 of interest because their Personal Savings Allowance covers £1,000.

They are a higher rate taxpayer, what do the changes mean for them?
From 6 April 2016, if they are a higher rate taxpayer, up to £500 of their savings income will be tax-free.

For example, if they earn £60,000 a year and receive £250 in account interest, they won’t pay any tax on their interest because it’s within their £500 Personal Savings Allowance.

If they earn £60,000 a year and receive £1,100 in account interest, they only need to pay tax on £600 of interest because their Personal Savings Allowance covers £500.

They are an additional rate taxpayer, do they get a Personal Savings Allowance?
No, they will not receive a Personal Savings Allowance.

They registered their account to receive interest without tax taken off, what do they need to do now?
They do not need to do anything because from 6 April 2016 all account interest will be paid without tax taken off.

What about interest paid on PPI and other compensation payments?
Banks and building societies will still be required to take tax from any compensation interest paid. Customers may be able to claim the tax back by filling in form R40 (or form R43 if living overseas) and sending it to HMRC. These forms are available online at GOV.UK.
Her Majesty’s Treasury and Her Majesty’s Revenue & Customs – Supplementary written evidence (FBB0016)

**How do they claim back tax paid on other savings income?**
From 6 April 2016, banks and building societies will pay account interest with no tax taken off. However, customers may still receive other types of savings income with tax taken off. They may be able to claim this tax back by filling in form R40 (or form R43 if living overseas) and sending it to HMRC. These forms are available online at GOV.UK.

**They are a basic rate taxpayer and their partner’s a higher rate taxpayer; which Personal Savings Allowance applies to their joint account - £1,000 or £500?**
They will both receive a Personal Savings Allowance (£1,000 for the basic rate taxpayer, £500 for their partner) which they will use against their share of the interest.

**Will the Personal Savings Allowance affect the new £5,000 Dividend Allowance?**
No, they are two separate allowances.

**They are a business / a charity / a club / an association / a trustee / administering an estate – what will this mean for them?**
Only individuals get a Personal Savings Allowance.

If they are a business, charity, club or association, they will already receive interest without tax taken off.

If they are a trustee or are administering an estate, banks and building societies will no longer deduct tax from the interest they pay, so any tax due will have to be paid through the trust/estate tax return, where appropriate.

4 February 2016
FINANCE BILL SUB-COMMITTEE

Inquiry on

DRAFT FINANCE BILL 2016

Evidence Session No. 1 Heard in Public Questions 15 - 24

MONDAY 25 JANUARY 2016

3.30 pm

Members present

Lord Hollick (Chairman)
Lord Bilimoria
Baroness Drake
Lord Forsyth of Drumlean
Lord Kerr of Kinlochard
Lord Teverson
Lord Turnbull

Examination of Witnesses

Paul Johnson, Director, Institute for Fiscal Studies, and Professor Judith Freedman, Professor of Taxation Law, Said Business School, University of Oxford

Q15 The Chairman: Professor Freedman, Mr Johnson, thank you very much indeed for joining us this afternoon. You came in at the tail end of the previous session where I was summarising what we had heard from the representative bodies. That was that the tax changes are baffling, complex and transfer the burden—and, indeed, some additional cost—to the taxpayer. That seems to sit rather oddly with the comment that the IFS made, which is that the changes, referring particularly to the personal savings allowance and tax deduction scheme for interest, were improving the “efficiency of the tax system” and that the PSA would be “a big simplification”. You do not seem to quite agree with the weight of the evidence that we have just heard.
Paul Johnson: It will be different for different people, but for the large majority, who will not now have to pay tax on interest income, that will look more straightforward. There are significant numbers, of course, at the moment who are taxed at source who do not reclaim that which they are entitled to reclaim, and this will at least get around that. There is clearly a minority with significant amounts of interest income who will now need to declare this separately, and certainly if you are a non-taxpayer or a basic rate taxpayer, for whom that was previously dealt with automatically, this will be more complex. Regarding the weight of numbers of people affected, literally only those who are currently paying tax because it is charged at source and not reclaiming it I suspect will outnumber those for whom this will add complexity.

The Chairman: So the tax-free allowance takes a lot of people out, but those just above the tax-free allowance now have to do rather more?

Paul Johnson: Yes. Again, the majority of those affected will be higher rate taxpayers who will have tax returns in any case. It will add a little bit of complexity to their tax return. Some gain and some lose with regard to complexity, but the judgment we were making was that the significant number who will gain, at least numerically, outweigh the minority who will lose in complexity.

The Chairman: Winners and losers.

Paul Johnson: As ever.

The Chairman: Professor Freedman, would you agree with that?

Professor Judith Freedman: That is logical. It depends whose perspective you are looking at it from. The worry is that the simplification is only in the administration. If you step back and try to understand the system—if I were to explain it to my students—it looks more and more complicated: it is not very logical and you have all these little different bits of savings allowances and personal allowances and dividend allowances. To actually sit down and understand the system, and how much you are paying and why, is difficult. I think we have reached the stage where most people just fill in the forms, rely on the software and hope it is about right. It is a judgment whether that is a good way to run a tax system, but I think it would be quite nice for everyone to be able to understand why they are paying the tax they are paying.

Paul Johnson: I agree with that. If you add the various changes to savings taxation that we have seen over the last few years—as you know we have got the interest allowance, a dividend allowance now, a capital gains allowance—you can take £28,000 of income and capital gains now. If you do it precisely right, without paying any tax at all—obviously that will create some kind of behaviour to try to achieve that—and if you add on to that the complexity that has been layered into the pension tax system, and maybe there will be more of that coming in the Budget, the amount of time people will have to spend getting their savings decisions right, given the way the tax system is structured, is only going up.

The Chairman: Do you see these changes as part of a coherent approach with a sense of direction and a road map so that savers and taxpayers can now begin to see what the
overall strategy is, or do you think it is just a series of individual measures, one heaped on top of another?

**Paul Johnson:** It is slightly hard to see what the road map might be. Elements of the system are becoming more generous in the sense of moving bits of it towards the ISA treatment. ISAs have been made significantly more generous and flexible. We now have a sort of ISA treatment of the first £1,000 or £500 of interest income. Effectively, we have something like an ISA treatment of dividend income, the first £10,000 of capital gains tax. For the majority of people with modest returns, we are moving a little towards that kind of treatment, but then you are adding additional tax to higher payments of dividends, so that is away from that kind of treatment of savings income. As I said, really importantly in here, you have to think about the taxation of pensions in this context, and clearly that is becoming both less generous and more complex over time. Exactly what it is aimed at, I do not know. I could construct this argument which says that we are producing something which is more like ISA treatment for more people and their savings, but whether that is what is intended, I honestly do not know.

**The Chairman:** Do you see the changes that are being made leading to savers having to reshape their portfolio to take advantage of some of the new tax allowances? In other words, there is an opportunity, but also a complexity in understanding. Is that how you would see it?

**Paul Johnson:** For sure. It will do exactly that, because, as I said, you can take advantage of a different set of allowances, which relate to different kinds of savings income, and people will do that. When you are looking at the dividends taxation, the incentive to split between partners in a couple is obviously significantly increased in that sense. Again, if you are a higher earner, because of the pension tax changes, the incentive to put less into a pension and more into something that is going to create dividends or capital gains is clearly increased. Yes, this will, for sure, result in people altering their portfolios in order to maximise their tax advantage.

**Professor Judith Freedman:** That has to be right. The newspapers are already full of advice columns, even for people at the lower end of the income scale, on whether they should keep their money in the bank or in shares and rely on the new savings allowance and taxation of dividends rules, or whether they should go into ISAs. That is quite a difficult decision and there are already newspaper columns on that.

**Q16 Lord Forsyth of Drumlean:** I wonder if I could ask Professor Freedman a general question. I have always thought that it is important that people should be able to know what tax they are likely to have to pay, either at the end of the year or during the course of the year. The changes which are being introduced to the treatment of dividends and savings tax, and the changes in the thresholds, mean that people may very well not actually know where they are going to be at the end of the year and they are going to be informed digitally, whether or not they have got a computer, that they are due X, Y, Z. Is that not a fundamental shift away from what we have always had within our tax system?

**Professor Judith Freedman:** I think the intention is for people to be able to find out more by having their personal account and being able to log on. I think there is an assumption behind some of the literature I have seen that everything is very static and that people
behave in a very simple way if they have very low incomes. Actually, people on low incomes do not necessarily behave in a simple way. In fact, they may have fluctuating income and are perhaps even more likely than people on higher incomes to have fluctuating income. I do not think that the idea that you can foresee and understand tax better if you have simple tax affairs, if you have low income, is necessarily correct.

**Lord Forsyth of Drumlean**: I was not so much thinking about low incomes. Paul Johnson said there are more people. I am thinking of people who find themselves moving from one level of marginal rate of tax to another.

**Professor Judith Freedman**: That is for sure, yes.

**Lord Forsyth of Drumlean**: And people getting caught by the combination of all these allowances suddenly finding a marginal rate of tax of more than 60% and not realising that. They are called allowances but they are not really allowances at all. That seems to me to be a very undesirable change.

**Professor Judith Freedman**: I agree. The interaction between these allowances, or whatever one calls them, and the rates of tax, the schedules, and the withdrawal of those allowances as you get up the rate schedule, is very confusing, and you cannot really know how much tax you are going to have to pay until you crunch the numbers.

**Q17 Lord Forsyth of Drumlean**: I was supposed to ask you about the changes in dividends. I understand that the thinking behind the changes that are being proposed is to address the position of people setting up service companies in order to minimise the amount that they have to pay in income tax and national insurance by paying themselves dividends. Do you think that these changes will achieve this result? Do you think that there will be further changes needed to deal with the unexpected consequences of these changes?

**Professor Judith Freedman**: It helps in some ways and hinders in others. As Paul said, it encourages people to split their income between family members to keep below the £5,000 sum. There will simply be different tax planning around it, I suspect. In a fairly crude way it charges people more tax if they have set up a tax-motivated company, so in a fairly crude way it does a kind of catch-up. It discourages people from converting their labour income into income from capital; ie into dividends. It does that across the board, whatever kind of company you have. It is very crude in its effects. I can see why they have done it, it is quite clever in a way, but I do not think it will stop tax-motivated incorporation, as it is described by the Treasury. I would question whether what is called tax motivated incorporation is always tax motivated anyway. I do not think the new dividend rules will remove the IR35 problem. I do not think they will simplify in the sense of making it obvious that one should operate in an unincorporated form, because there are lots of other reasons for setting up companies.

**Lord Forsyth of Drumlean**: Do you think it will change people’s investment strategy? Will they want to buy shares that have lower dividends or things of that kind? Do you think people will try and game the system?
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Professor Judith Freedman: It depends on the person. The vast majority of people will hold most of their shares in ISAs and it will not make any difference to them. Other people will hold their shares through other vehicles where it will not make any difference.

Lord Forsyth of Drumlean: The vast majority of people, of course, do not pay the vast majority of the tax.

Professor Judith Freedman: For wealthy people, who have more than that amount of dividend income, yes, they will tax plan, I am sure.

Baroness Drake: If I could go back to the coherent strategy point, I think the observation was it is difficult to see one, but there are winners and losers depending on your view of who should win and lose. There is now a range of different tax incentives. Do you think people will understand them? Do you think they will be able to make a coherent assessment of what is out there? What do you think will be the overall responses to this additional complexity in the system?

Paul Johnson: I can only speculate. There will be different groups, as we have just discussed. There will be a small group of very high-wealth individuals, who, in principle, will be paying significantly more as a result of the dividend changes. I am fairly sure those will be well advised because you need quite a lot of money to be in that situation and, as we have just discussed, being advised, they will make changes to minimise tax. For the majority of us, who are not in that happy position, I suspect there will be a lot of uncertainty about how this impacts. My guess is that most people will remain in ISAs, even though for most people now an ISA is not going to be terribly valuable because you do not pay capital gains and you do not pay dividend tax on quite a large amount of returns out of an ISA. If it is more expensive in charges to have money in an ISA than out, they will be losing relative to what might have been possible.

Again, it is really important to see this alongside other changes to pensions, and indeed to buy-to-let properties, where, because this will treat small amounts of interest income, but significant amounts of dividend income, alongside capital gains more generously than it has in the past, one would expect a greater part of the portfolio to be held in that form. The overall direction of change, which is for those with higher levels of dividends, those with large amounts going into pensions and so on, is the amount of money that goes into owner-occupied housing may go up, which is the only bit that has not been touched by any of these changes.

I suppose one worry that I have is that an unintended consequence of putting all these things together is that owner-occupied housing looks increasingly like the best bet from a tax point of view and, therefore, the price of that is pushed further.

Q18 Baroness Drake: The Government are clearly keen to set the pace at moving to digital accounts and clearly that is quite an aggressive agenda. Would you suggest any changes to the personal taxation system that could enhance that transition to digital accounts? In your view, are there particular areas that stand out that, if simplified, would assist that transition?
Paul Johnson: I am no expert on the digital accounts, but, as with most areas of the personal tax system, one’s eye is immediately drawn to the national insurance system and the fact that it is still administered entirely separately for different jobs and between self-employment, employment and incorporation, and creates complexity in every imaginable dimension of thinking about this. So long as you have a different treatment between income tax and national insurance, and different treatment of national insurance between different forms of income, and, if you have more than one job, different treatments again, I would assume with digital returns, as with everything else, that is going to be one of the big problems. Judith may have more sense of that.

Professor Judith Freedman: I wonder about that question because we should be thinking what is our ideal system and then backing that up with the new technology, rather than saying, “Here is the new technology; let’s devise a system that works with the technology”. I think that is one of the worries about the way we are bowling ahead with digital and thinking, “We’ve got to do this because we need the digital account” and “We’ve got to do the other because we need the digital account”, instead of first thinking, “What do we actually want to achieve with our tax system?”

Q19 Lord Teverson: I did not declare my interests. I am a fellow of the Chartered Institute for Securities and Investment. I absolutely agree with your point that some of the less well-off people are the ones with the most complex jobs. Certainly down in the far south-west of the country, which is one of the poorest, the feeling is that everybody has to have at least three jobs, so it tends to work that way. Can I come back to the strategic area of government policy on taxation? A number of people would say there is a tendency to introduce significant tax changes on a very piecemeal basis rather than what one might call a coherent long-term plan, even over the period of a Parliament. Obviously beyond that it can be more difficult. Do you agree with that, or can you see that there are specific strategies going on at the moment that are at least coherent in a broader sense?

Professor Judith Freedman: I suppose some people might have coherent strategies in mind, but it can be hard to discern them.

Lord Teverson: Would you say they have been clearer in the past? I can remember times in the 1980s when you had an impression that it was going in one direction. Is that looking back rosily in history?

Lord Forsyth of Drumlean: No, you are right.

Professor Judith Freedman: I think we have had periods where there has been a clear aim to do certain things. There is now a clear aim to reduce corporation tax rates, for example.

Lord Teverson: Yes, that is true.

Professor Judith Freedman: There are some clear aims, but it is not always clear why we are reducing the corporation tax rate, for example. We have had road maps which have been successful. The corporation tax road map was considered to be quite successful. We are going to have a business tax road map apparently, but the question will be whether that road map comes from a wish to have a coherent way forward or whether everyone is casting about for things to put into the road map. I do not know yet which it is. Even when
you have a road map, rabbits are pulled out of the hat which throw the road map, and that has always been the case. I do not think it has necessarily got that much worse. Ever since I have been working on tax, people have been saying the same thing. Maybe there are some rose-coloured spectacles around.

Paul Johnson: If I want to really depress myself I will go back and look at the article that was written when the IFS was founded in 1969 by our founders, which bemoans the way in which tax policy was made back then, and many of the things they complained about are still true. I think it is a desperate failing of the way that we make tax policy, relative to most other policy, where there are strategies coming out of departments’ ears and lots of consultation on good and bad policies. Regarding the high-level direction of tax policy, we get none of that essentially. We have no sense of where we are going on taxation of housing, pensions, or indeed savings, until it is sprung on us. I think some of this is terribly damaging.

The change year after year after year in taxation of long-term vehicles such as savings and housing is clearly damaging; the new continued increases in stamp duty on the one hand, or reductions in pension tax relief on the other, or changes in buy-to-let. Some of that may be entirely sensible, but it needs to be thought through as a whole, particularly if in one year, for example, you are going to change the rules around annuitisation and tax relief for pensions, and the next year think about the whole structure of pension taxation. My sense is that the one was decided and then the other was thought about, rather than thinking about all those in the round. I do think a lack of long-term strategy is a significant problem and significant cost.

It is a political cost as well, because we have seen both the last Labour Government and coalition Government bring in policies which make no sense and then have to go through the political pain of repealing. One can think of 0% corporation tax rates and very low rates of capital gains tax under the last Labour Government. One can think of pasty taxes and other types under the coalition Government. Not having that strategy is not only economically damaging, obviously it is not politically helpful either.

Lord Teverson: How could those sorts of instances you are thinking of, Mr Johnson, have been improved? Were they areas that were not properly consulted on, or were they consulted but there was a political motive that effectively meant that these things had to happen anyway? How does that improve?

Paul Johnson: Those sorts of things were just sprung. They were not consulted on at all. The worst type tends to be that which comes out of nowhere in a Budget announcement. I think you have to have a sense of the direction you want to take the capital gains system, or the business tax system, or the housing tax system, and give people a sense of that direction, putting your policies into that framework. Clearly, you are never going to get fully away from things being announced on Budget Day, because it is an exciting thing to do, but being clear that what you are announcing is consistent with a long-term direction is less likely to make mistakes, and will make it easier for people to plan in some sense of where that is going to go.

Lord Teverson: Is that possible in a political environment? We can get better at it, can we?
Paul Johnson: I think it is possible to do more than we do at the moment. Not all countries do it in quite the same way that we do. For example, there have been periods when we have gradually got rid of mortgage interest relief or the married couple’s allowance, or what have you, where it has not been announced exactly where we are going, but it has been pretty clear what the direction of travel has been. In the 1980s, I think one did see some clear sense of direction. I do not see evidence that recent Chancellors have had that in mind.

Lord Bilimoria: You made the point about the lack of a road map and said that even with the corporation tax it is not clear why they are doing that. Is it not quite clear why the corporation tax is being reduced?

The Chairman: We should be back in about six minutes.

The Committee suspended for a Division in the House.

The Chairman: I am sorry for the length of that but it was quite a crush. Lord Bilimoria, would you like to repeat your question?

Lord Bilimoria: Thank you. I resume my question. My understanding is it was being explained why there is an advantage to have a low corporation tax for the benefit of the economy, industry and foreign direct investment. In the same way, do you believe that why income tax rates are the way they are, or entrepreneurs’ relief or capital gains tax, should be articulated very clearly? Surely the objective is not to raise as much tax as possible, but to make the economy more competitive?

Professor Judith Freedman: Obviously the Government’s aim is up to them. If their aim is to be more competitive, you then have to analyse what makes you more competitive, not just assume that reducing the corporation tax rate will be the thing that makes you most competitive. It may be that there are other priorities that business might have for competitiveness. That is what I meant. You need to look at the tax rate in the context of a wider debate about capital allowances, for example, and other issues, because it may be that you can have a very low tax rate and still not be competitive because of some other tax factor.

Paul Johnson: I think it is very important in that debate to recognise there has been not only a cut in the main rate of corporation tax but a very big shift in the structure of tax as it affects business. Proportionately, business rates have become much more important over the last eight or nine years. Business rates are not a terribly good tax. They create problems for particular parts of the economy. As Judith said, whilst we have reduced the headline rate of corporation tax, we have reduced capital allowances and so on. Both business rates and lower capital allowances reduce the incentive to invest while the lower rate of corporation tax achieves exactly what it was supposed to, which is international competitiveness for attracting high profit, internationally mobile profits and business, as does the patent box. There is a trade-off. To be fair, the Government have fairly explicitly taken one route down that trade-off, but I do not think we spend enough time discussing the fact that there is a trade-off. The amount and sort of business taxes that businesses pay is changing really substantially, and I think more than has been properly debated.
Lord Bilimoria: So this should be highlighted much more and explained much more clearly.

Paul Johnson: I think it should, yes.

The Chairman: Baroness Drake, did you want to come in on this as well?

Baroness Drake: You started to anticipate it, because I was going to ask about the structural changes in the tax take. It came up previously why the Government may be reluctant to have a road map, particularly in the area of personal tax and national insurance. As the source of tax revenue shifts, that may produce a political resistance to having road maps in certain areas because of the importance in the tax take and the political nature of the tax take it comes from. What you are suggesting is there is benefit in looking at the structural changes in the tax take and having a more open debate about which lever is most effective.

Paul Johnson: Very much so. That structural change in the tax take is most evident in the business side. If you look at the personal side, VAT has become slightly more important over the last few years, particularly as a result of the increase in the main VAT rate. Income tax and NI remain the two biggest—NI is more important than it was relative to income tax 20 or 30 years ago—but the changes are pretty gradual at the moment.

Baroness Drake: I thought personal tax and NI had risen quite significantly as a proportion of the tax take over the last 10 years. Is that not the case?

Paul Johnson: As corporation tax has gone down, the personal tax and NI proportionately have risen. I meant I do not think the relationship between income tax and NI has changed dramatically recently.

Q20 Lord Bilimoria: Can we move on to the OTS? The draft clauses in the Finance Bill on the OTS broadly give statutory effect to the current operating model. Professor Freedman, you have written of the need for a radically different model, an office of tax policy, which might have an independence and influence similar to the Office of Budget Responsibility. Can you explain why this is better and what you have in mind?

Professor Judith Freedman: The first problem with the Office of Tax Simplification is the name. Just looking at simplification without looking at policy more broadly is always going to end up with people having to work on the margins. If you cannot look at underlying policy then there are limits to how much you can simplify. In fact, the Office of Tax Simplification has found that. In many of its reports it has gone further than just fiddling at the edges and has talked about policy. I think the emphasis on simplification is oversimplistic, if you like. You cannot only look at simplification.

The other problem is that it is not independent. It is funded by the Treasury and, even now that it has been established by statute, the funding is purely at the whim of the Treasury. The appointments of all the people involved are by the Chancellor. There is a sense in which it is neither one thing nor the other, because it is not part of the Treasury, so it may not have access to some of the information that the Treasury or HMRC has, but it is not outside the Treasury either and completely independent. In the statute, they have established that they can look at issues that the director of the OTS wishes to raise, not only things the Chancellor asks them to look at, but they are entirely dependent on the Chancellor for the
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funding. They do not have a devolved budget like the Office for Budget Responsibility. They could raise something, want to look at it, and then be starved of the resources to do that.

Lord Bilimoria: Would you agree that many people say the Office of Tax Simplification is an oxymoron? There have been thousands more pages of tax law added over the last Parliament, and tax reliefs that were reduced by the OTS, for example, but then if you take the new reliefs introduced there has been a net increase. It seems to me that it is having the opposite effect of what was intended.

Professor Judith Freedman: Well, that is not their fault. I think that they are being given a really difficult task, because you cannot simplify tax simply by looking at a few little bits and pieces; you have to look at the whole system and look at it long term. All too often, the Office of Tax Simplification is given tasks and required to report within a year, and you cannot simplify like that. They also do not have enough staff, or the right sort of staff, to do any kind of radical work, which is what I am arguing they need to do.

Lord Bilimoria: Mr Johnson, what is your view on that?

Paul Johnson: I agree with that. On the plus side, it does mean that there is a focus on some of the administrative issues in tax, which if not quite within the Treasury is almost within the Treasury. The amount of external input that the OTS has ensured that it has got has been significantly more than existed without that. The issues are rather as Judith says. You cannot overstate the point that thinking about simplification without thinking about the structure of policy is extraordinarily hard, if not impossible. What are the things that create complexity? They are the fact that we treat self-employment income differently from employment income, differently from corporate income. In that world, complexity is inevitable. If you have an Office of Tax Simplification looking at simplification without being able to address those things, it is only ever going to be able to get so far. For one, that is clearly important.

Secondly, how do you make something like this have a real impact on the policy-making process? Again, as Judith says, I think you need to be clear. Is it a powerful voice within the Treasury having that effect, or is it something external such as the OBR? It is a little bit stuck in between. I do not know how effective and powerful a voice it is within the Treasury, but unless it is a very effective and powerful voice within the Treasury—and I suspect it is not as effective and powerful as the baronies that are running each directorate within the Treasury—it is going to have a more limited impact. We need to decide which of those things it is doing.

Thirdly, of course, it is by construction allowed only to look at historical policy, as it were, and is not involved in all this new additional complexity that you are describing, which is inevitably going to lead to exactly the question that you asked, which is they may be tidying up some mess that was made a few years ago but some more mess is being made without their input.

Q21 Lord Forsyth of Drumlean: Perhaps I should declare an interest: I chaired the Tax Reform Commission in 2006 for the Chancellor and the Prime Minister, while we were in opposition, and it recommended setting up an Office of Tax Simplification. The idea was that the shadow Chancellor was committed to having a lower, flatter, simpler tax system.
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That was the declared policy. The idea was to set up a body which would make recommendations that would enable him to achieve that through areas such as, for example, removing allowances and reducing rates, looking at merging national insurance and income tax, and so on. These were all approved while we were in opposition. Clearly the resource point is an important point and, if it is going to be put on a statutory basis, should one not expect there to be resources to enable the organisation to help the Chancellor—if those are still his objectives—to achieve them? More importantly, do you think that part of the difficulty with what you are suggesting, Professor Freedman, is if you had an independent body it would take away from the freedom of the Chancellor? The Treasury is never going to agree to that. Perhaps there is an oxymoron, but is there not an opportunity, properly resourced and brought in at an early stage in thinking about ideas that occur to the Chancellor in his bath, to look at these from the point of view of tax simplification? Is that not something which could help, given the resources, if the Government were committed? That is the first question. The second question is, why do you think so many of the recommendations have not been taken up?

Professor Judith Freedman: To start with, some of the recommendations have been taken up. They may not be very exciting ones.

Lord Forsyth of Drumlean: Most have not.

Professor Judith Freedman: Some have, and there have been some administrative advances, so I do not think we should be wholly negative about what they have done. The big recommendation, and the one that I think is the most important, which is to merge tax and national insurance, is so difficult and so intensely political that, having made that proposal, it has now been taken back off into the Treasury. That was almost inevitable.

Lord Forsyth of Drumlean: That is one of about 400.

Professor Judith Freedman: Many of the other recommendations are small. I think more than you are saying have been taken up, or maybe it just takes time. It takes time for them to filter into the thinking of the Treasury. Quite a lot of things have been taken up, but not always in the way that they were intended. Cash accounting, for example, was picked up, taken up, but then implemented in a way that was never intended by the Office of Tax Simplification. One of the problems is follow through. Once they have made the recommendation, it can just disappear and they may not know what is happening with it. It may be taken up, but not taken up very well.

Lord Forsyth of Drumlean: As at March 2015, 60 big picture recommendations had been made and 342 other formal recommendations; 16 had been accepted of the big picture recommendations and 150 of the formal recommendations. Why have a dog and bark yourself?

Professor Judith Freedman: Some of them may still be wafting around in the Treasury, and some of them are interconnected. There have been a lot of partnership recommendations, for example, which take time to analyse. I think the problem is the other way round—everything is supposed to be happening very quickly, and if you really want a body to think carefully about tax you should not be expecting it to happen overnight; you should be giving them time. We should not be looking for quick fixes. One of the problems is that when one
is involved with the Office of Tax Simplification, one is asked to find quick fixes. I am on one consultative committee only, so I only know about that. I am on the Consultative Committee on Small Company Taxation. Rather than being able to go away and do two years of research, which is what I think we should do, we are being asked to come up with things quickly for next March. That is not the way to do big reforms.

Q22 Lord Kerr of Kinlochard: I should declare a vanity-of-human-wishes interest too, like Lord Forsyth. I was amanuensis to two Chancellors, and they both thought long and hard, Mr Johnson, about your idea that the most obvious simplification, getting rid of complexity and regressivity in the personal taxes, would be to combine national insurance contribution and income tax. It is obvious. They both thought about it and both rejected it, though they were very powerful Chancellors; they felt it should happen, but could only happen at a time of high growth when there was a giveaway Budget because although the nation would undoubtedly be a gainer, there would be lots of losers on the way. The suggestion you have made is not going to happen, because we are not at such a time now—growth is not very high, there is a deficit to reduce, and so on. Have you any other ideas that might actually be implemented on the simplification dossier?

I have an organisational question too. Of your two models—the genuinely independent outside the Treasury, high-profile operation, and the powerful body inside the Treasury, headed by some senior mandarin, like Lord Turnbull used to be—it seems to me it has to be the second. The Office of Tax Simplification will not work until it has an ex-ante role, until it is allowed to look at the future direction of travel and the Budget measures that are intended, and is allowed to say which of them it likes and which of them it does not like, and is allowed to suggest some. If it is simply dealing with the existing statute book and saying how it could be changed, it is obviously going to have a fairly marginal role, it has to be ex ante. No Chancellor is going to have an independent, high-profile figure limiting, as he would see it, his Budget options. A powerful colleague is not going to be allowed to play that role, so it has to be a Lord Turnbull figure, a sinister, grey man sitting alongside him who is going to play this role. Question two is do you agree with me on that?

Question three is, if you do, is it fair on Angela Knight to ask her to take on that role? Clearly she is adept and skilful at the presentation of policy, but is she a natural Andrew Turnbull?

The Chairman: There is no need to give a specific answer to that.

Paul Johnson: I am not sure that I can comment on how similar Angela and Andrew are.

Regarding the premise of your second question, you have to be right, but I think I am going to be greedy and say you could have both in some sense. I think it is important that there is a powerful person within the Treasury whose role it is to look very specifically at the structure of the tax system and its long-term simplification, and to some extent that clearly ought to be taken by the managing director responsible for that at the moment. It is interesting that, nevertheless, the OTS has added to that process. It has added to it by bringing in people with some very specific kinds of expertise, by particularly being outward-looking and having a bit of a focus on simplification specifically. I think you can big that up by having an éminence grise, or however you want to describe it, within the Treasury playing that role, possibly with a more formal and powerful set-up than is the case at the moment.
I think this would have to be a step even further from Government than the OBR, whether it is within Parliament or externally, having some serious long-term work that is not under the control of the Chancellor looking at some of the changes that might be available in a slightly less constrained political sense. This is a role we and some of the professional bodies take to some extent. Judith reminded me this morning that the last time there was any external official commission on taxation was 1955, and that is quite a long time ago for this to have been looked at officially, but outside of government. Maybe after 60-odd years it is about time to think again.

Professor Judith Freedman: There have been calls for another royal commission, but then we would have the same problems as they have had in Australia, where they have had many commissions and it may be nothing happens. Many of the things that the 1955 Royal Commission recommended have not happened yet.

Paul Johnson: Perhaps we could leave it a little longer.

Professor Judith Freedman: I am not sure about that. I think it would be asking a lot of the Office of Tax Simplification, as it is currently constituted, to look at everything that is coming up, because it simply would not have the time and the resource. It is more than that—it is not just resources. There is a time constraint, because once it has been announced and gone into the Budget there is not much you can do about it. That is why I think you have to have much longer term thinking, and that can be outside because it is not committing anybody to anything, but it would feed into the thinking of the Treasury. Obviously, ultimately, the decisions are going to be political, guided by the wise people in the Treasury, but they would have more to call upon if they had that longer term work going on. I am not suggesting that my proposed Office of Tax Policy could dictate policy—clearly it could not, that would be unrealistic—but I still think it is useful to have that work going on and to be there for people to call upon and be able to say to Chancellors, “This work has been done. These people have looked at this idea and it will not work for these reasons”.

Lord Kerr of Kinlochard: Of course I agree with you. I think the most effective simplification that I have seen was Lawson in 1984 on corporation tax, where the aim was to encourage investment while making a bonfire of allowances, and, therefore, a five-year guaranteed programme of reduction in rates was written into the Budget. I have to admit, all the Andrew Turnbulls of the Treasury thought that was completely crazy and it was a disaster to tie your hands five years out. Chancellor Lawson went ahead and did it, and it worked extremely well. Perhaps it can only be done by a Chancellor.

The Chairman: I think it is time we heard from Lord Turnbull.

Q23 Lord Turnbull: Returning to 1984, I think the grizzled figure you are looking for is Arthur Cockfield, who was given this kind of role, although Lord Stern, when he came back from the World Bank, thought he would have a go at creating a kind of global look at the tax system and it quickly became apparent that Gordon Brown had no interest in it whatever.

Can I come back to this rather cheery assessment of the measures at the start? I think you were saying there are more people benefiting than not, and a lot of the people who are benefiting are people basically getting another £200, some bank interest—it could be children, the elderly or whoever—who are not getting taxed on that and probably not
reclaiming it and so they benefit. If you take a different metric, it is not the number of people who benefit, because they never dealt with the tax people in the first place and are not dealing with them now. Looking at the number of people who have to be involved with their tax returns in a way that they did not before, I wonder whether the assessment is quite as cheerful, because under this new system you will be told that a lot of the money that previously would have been deducted has now got to be settled, so at this second stage more money will be at stake. It is not simply a kind of settling-up system any more, it is actually taking the tax off, none of which has so far been paid on account. That raises the stakes for people. Previously, you got the money from the banks, paid net, and you knew you had nothing more to do with it. Now you will get a list of all the people that have paid you interest and you have to work out, “Who are they? I don’t remember that one”. Even if they end up not paying and challenging it, they have to start looking at their return. Then you have all these allowances: an interest allowance, a dividend allowance, an ISA allowance, a CGT allowance, a pension allowance. They all have different amounts and different rules. Some of them get tapered; some of them get taxed at higher rates. It seems to me that the whole thing is incredibly messy and not getting any clearer.

Paul Johnson: I do not disagree at all. I would say several things. The first is I am sure that there are a significant number of people who were claiming back interest who now no longer need to, and a significant number who were not and who are now going to be paying the right amount of tax. That is a clear move in a simpler and better direction. It is also worth saying, of course, that higher rate taxpayers were not getting everything deducted at source, so they have to declare that anyway. Higher taxpayers are not massively additional.

As I said at the beginning, for sure, the number of these different allowances which add together in different ways is going to make planning much more complicated. As someone said earlier, which I think is quite important, the point at which you now shift over from basic rate to higher rate in a whole number of ways is becoming a very expensive moment. The biggest thing is you lose the married couple’s allowance immediately, so you are facing several hundred per cent tax at the point at which you move from the basic to higher rate. You are also having your £1,000 interest fall to £500, so you have an additional hit there, and once you get to £50,000, of course, you are having your child benefit taken away. So you are having all sorts of additional marginal rates layered on top of each other, and once the higher rate threshold hits £50,000 that will all come in at the same point. So becoming a higher rate taxpayer is going to become a very expensive part of your life, particularly if, as the press have speculated, you can no longer get relief on your pension contributions at your marginal rate, if that comes in. The cost of becoming a higher rate taxpayer is going to become very high indeed. For that group, this is definitely hard work.

Lord Turnbull: The point we have reached in the policy, both in the amount of taxation and the ease of handling it by houses, and the fact that inheritance tax is being eased further there, means that everything is channelling into that conclusion, and tomorrow this Committee gets into that world. If you are looking at an ideal, various great men of economics, Meade and Mirrlees, and so on, have tried to design the principles. Are we getting any nearer what they would regard as a rational basis for taxation?

Paul Johnson: Not really. Regarding treatment of interest income, taking most of that out of tax is moving to a more rational treatment, because you are avoiding the double taxation of
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interest income for most people, but clearly not for those who have large amounts of interest income.

Lord Turnbull: Not double taxation; that is interest, and possibly not all interest.

Paul Johnson: Yes.

Lord Turnbull: But you are still paying tax on dividends.

Paul Johnson: Sure, that is why I said specifically interest.

Lord Turnbull: And then tax on the return on that.

Paul Johnson: If you look at the recommendations from the Mirrlees review, one of its recommendations was specifically to take bank and building society interest income out of tax, because you do not get excess returns on that, so you do not have to worry about people making excess returns which remain untaxed. Then for other forms of savings income, you either go for the expenditure tax system, such that you put the money into the savings before you pay tax and then pay tax at the other end, or you put in place what Mirrlees referred to as a rate of return allowance, such that you save out of taxed income and then only pay a tax on anything above the normal return that you might get, and that is what allows you, at least in principle, to match the marginal rates on returns.

Lord Turnbull: Do you still entertain hopes that by the end of this Parliament we might be a little nearer that point?

Paul Johnson: Not very strong hopes. You could make the argument again—and I do not think the Chancellor has put it this way and I would not put this argument very strongly—that the new system for taxing dividend income, because it increases the tax on high levels of dividend income, is moving you slightly closer to the point at which the marginal rate of tax on that dividend income over £5,000 a year is a bit closer to the marginal rate of tax on labour income. Obviously, on the first £5,000 it is a lot less, so it is a very kind of messy move in that direction, but I could just about make an argument that that was a move in that direction. I think Judith is less positive about it than I am.

Lord Turnbull: I have one more question for you, Professor Freedman, but do you want to comment on that?

Professor Judith Freedman: On the dividend point, it is clear that it is achieving kind of simplification in such a very messy way that you cannot really see that is what is being achieved, but I can see why they have done it, because it is a crude way of achieving higher taxes on certain types of dividend, which was what Mirrlees proposed. The chapter that I helped to write proposed that we should increase the tax on some dividend income.

Lord Turnbull: We are clearly moving towards many jobs, more people are becoming self-employed, their income is complicated. Is the way in which small businesses, sole traders, and so on, are being taxed going to get any simpler?

Professor Judith Freedman: I do not think so, although that is what the Office of Tax Simplification is currently tasked with looking at. It is tasked with looking at the taxation of
small companies. At the same time, there is another committee looking at IR35 (that is, personal service companies). There is another committee looking at tax and national insurance. There are three different committees looking at those things. The other thing is that BIS is also looking at how we define employment. There is not only a problem of whether we have joined-up tax policy, but whether our tax policy is joining up with what is going on in other government departments. That is a further complication. There is a great awareness that we need to do something about that, but I am not sure that there are any easy answers out there; the only really easy answer is the one we have already said is very difficult, which is merging tax and national insurance.

Q24 The Chairman: One area where the Chancellor has set his road map out very clearly is corporation tax. He has also made it clear, repeating it over the weekend, that we have a much lower tax here than many countries, but he does expect companies that are here and operating here to pay that tax. If you apply the 19%/20% tax on profit achieved by Google in this country, according to their filings in the United States, then the £130 million that was paid for the 10 years would be roughly what they would probably pay in one year, let us say somewhere between £100 million and £150 million. What advice would you give the Chancellor to achieve his objective of making sure these companies actually pay the lower rate of corporation tax that he wants?

Professor Judith Freedman: I do not have any inside information about that particular case. I think that great steps are being taken by HMRC to tax companies in the way that they should be taxed under the law. A lot of the settlements that we look at are based on past law. The law is changing going forward. With some of the comment from Google, we saw that it is expecting to pay more tax in the future because of the way the law is changing. The UK has taken quite a strong role in trying to get the BEPS project—Base Erosion and Profit Shifting—under way. We have to change the law before we can change the amount of tax we can collect. You cannot look at the gross figures and work out from them how much tax should be collected, because that depends upon what the tax law says.

The Chairman: Mr Johnson?

Paul Johnson: As with all these things, there is a trade-off. There is a whole series of things going on when you have got what appears to be a low rate of tax overall. A lot of it is entirely deliberate, such as capital allowances and R&D tax allowances, and so on, and those are designed into the system. You could decide to undersign them, but very often that has negative consequences. One of the biggest choices facing the Chancellor—and I certainly would not advise him necessarily to take the most radical view here—is how far he goes down the line of reducing the amount of interest deductibility that is available. That is one of the things he is consulting on at the moment and one of the recommendations, but not mandatory recommendations, out of the BEPS process. That could make quite a big difference to the whole structure of the UK corporation tax system, if you limited that significantly, but at the cost probably of overtaxing a number of companies and reducing the incentive to invest. That is a big trade-off, because it would also reduce the amount of potential avoidance cross-border that you get there. He is going to have quite a difficult choice to make on where he comes down on that.
Professor Judith Freedman: That is one of the changes that is arising from the BEPS programme. The other change is the way we look at transfer pricing, and so on. We are going to see a number of changes going forward.

The Chairman: Do you think he has the tools to achieve his objective?

Professor Judith Freedman: Not yet. It may be that BEPS will not completely solve the problem. I very much doubt that BEPS will completely solve the problem, but it may improve things. A complete solution would need probably much more radical change, maybe getting rid of corporation tax altogether, but calling it something else and basing it not on profits at all but on sales; that is what everybody seems to want to tax companies on—their sales or transactions rather than their profits. That would be a very different tax. If you have a corporation tax, and it is a corporation tax on profits, then it is profits you have to look at and not revenues.

Paul Johnson: Another thing that he needs to look at to some extent is the patent box as a result of some of the BEPS changes. Not as much as some other countries do. The patent box is a very interesting illustration of where he is putting the balance. It is nothing other than a tax competition measure aimed at attracting the declaration of certain kinds of internationally mobile profits in this country by offering a very low rate of tax. Again, there are choices and trade-offs over that and I think we get some fairly clear indication of where the Chancellor sits on that.

The Chairman: Do you think that has been effective?

Paul Johnson: Frankly, I do not think there was ever any chance that it was going to be effective in the sense of increasing the amount of R&D that goes on in the UK, because it is not particularly associated with where R&D happens, and, even if it were, the tax comes at the point at which you are already making substantial profits rather than earlier on, which is when you would need the subsidy or the tax break. It may prove to be effective at bringing that income into the UK regarding tax competition, which is what it was aimed at.

Lord Forsyth of Drumlean: Picking up Professor Freedman’s point, with the growth of the internet and its importance in retail, do you think it makes sense to have a system that relies on profits as opposed to volume of sales for tax purposes? That is the fundamental problem with the Googles and the Amazons, and all the rest.

Professor Judith Freedman: You may need to look specifically at e-commerce and have some special tax for that. That has been rejected by the OECD at the moment. It thinks it needs to be dealt with as a whole. It may be that we have to change the tax base. Maybe we have to look to some more VAT, which is, after all, a transactions tax. We may have to consider whether a profits tax is the right tax. There will be certain types of activity which you can only catch with a profits tax, so we should not be so focused on those activities where sales seem important that we forget about the other activities where we want to catch things where there are no sales.

Lord Forsyth of Drumlean: So you think we need both?

Professor Judith Freedman: We probably need to balance those if we want to catch all those different types of activities.
Lord Forsyth of Drumlean: Following up on the Chairman’s question about Google, do you think where there is a wide public interest and we are dealing with companies, there ought to be more transparency about how these numbers are reached?

Professor Judith Freedman: We had this debate before when we allegedly had deals going on in the past, and we had a process set up within HMRC, the Assurance Commissioner, to deal with that. I think I am on record as being a bit dubious about whether that process was going to be robust enough. The current debate suggests to me that maybe we need to think more about that institution. We probably do need some kind of institutional check on what is going on and maybe it needs to be somewhat different from the way in which the current system has been constituted. We cannot all second-guess every single settlement that is reached, because we simply do not have the know-how or the information.

Lord Forsyth of Drumlean: Perhaps to the nearest billion.

Professor Judith Freedman: I would like to feel that we could trust the systems that we have set up because we do have to have a system where it is possible for settlements to be reached; you cannot litigate everything. The idea that there is a precise, right amount of tax is also very misleading, especially when you are talking about valuations and pricing. There has to be some judgment in the process to make it work. We have to rely on the people that we employ to exercise that judgment, but we do need systems of checks and balances. We have an Assurance Commissioner, who will undoubtedly have had to approve this agreement.

The Chairman: Thank you very much indeed for your evidence this afternoon. Thank you also for the discussion we have just had on a very topical issue.
The Chairman: Gentlemen, welcome to this first meeting of the Finance Bill Sub-Committee. Some of us on this side of the table are familiar faces and most of you on that side of the room are also familiar faces. Thank you very much for joining us today. We are looking into two or three of the changes that have been proposed in the Finance Bill. Perhaps I can start off with the personal savings allowance. Very significant changes were announced in the 2014 and 2015 Budgets. The draft Finance Bill introduces a new personal savings allowance and abolishes the tax deduction scheme for interest. It is quite far-reaching and, for some of us, rather baffling. Do you see these changes as simplifications of
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the personal tax system? Do you have any concerns about their practical implementation or, should I say, do your members have any concerns about their practical implementation? Mr Roy-Chowdhury, would you like to start?

Chas Roy-Chowdhury: Thank you. It is very nice to see you all. Thank you for the opportunity to speak on the Finance Bill draft clauses. We do not think it is simplification. We think if the £1,000 allowance or exemption was across the board rather than across different tax rates, that would be simplification. As it stands currently, the basic rate taxpayer has a £1,000 exemption, the 40% taxpayer has £500 and the 45% taxpayer has nothing. We think the cliff-edge effect is unnecessary and is going to cause complexity. Certainly where you are completely out of paying tax altogether, that is fine, but where you are going across from one rate to another, it is going to create complexity unnecessarily.

The Chairman: How would you propose to remedy that?

Chas Roy-Chowdhury: It should be £1,000 all the way across, so that everybody has the same and there is no cliff edge; it does not matter which rate of tax you pay, you have the same allowance.

Frank Haskew: Effectively, what we are saying is that it would be much easier if the amount was a straightforward exemption, so that that amount was taken off your taxable income and then you computed your tax liability based on that net figure.

John Cullinane: Yes. I think the term “allowance” is a bit of a misnomer for the reasons my colleagues have given. It is not strictly taking it out of taxable income. It is leaving it there, so it will impact on your total taxable income. That will impact what rates of tax you pay, which will impact other things, such as whether you have personal allowances withdrawn at a certain income level. Then, depending on where you are, it will feed back to how much is simply not taxed. It is almost like two or three, depending on how you look at it, different 0% bands, so it is quite convoluted in concept.

For the vast majority of people, who are clearly basic rate taxpayers, effectively they will no longer pay tax on their interest income. I am sure they will be pleased about that. At the moment they probably do not have much of a compliance burden in respect of that, because it is taken off them by the bank, and in the future it will not be and they still will not have a compliance burden. However, the people at the margins between these rates are affected by the complexity. It will certainly be over 1 million people who will still pay some tax on the interest income, so the compliance burden will probably increase rather than reduce.

The Chairman: Increase rather than reduce?

John Cullinane: Yes.

Chas Roy-Chowdhury: May I add to what John is saying? I think there is a real problem with the fact that people are going to have to self-assess. Basic rate taxpayers who are not in self-assessment at the moment are probably going to have to self-assess. We have the simple assessments coming up later on. We also have the quarterly filing coming in from next year. Interest is paid annually, so how is that going to work regarding what people need to work out for their tax return purposes or this filing purpose? It seems as though
there is a whole can of worms being opened up unnecessarily in the guise of simplification, which it is not really achieving.

**Frank Haskew:** For practical purposes, for most basic rate taxpayers receiving interest income or dividend income, that is really the end of the matter, due to the fact that you get a deduction of tax or a tax credit, which satisfies your liability. At the moment, in practical terms, basic rate taxpayers have nothing to worry about, whereas under this system, potentially, they will have much more to worry about and might have to pay some tax as a result.

**Q2 Lord Forsyth of Drumlean:** When I was preparing for this session and looked at all the changes, I found myself trying to work out how I would have to organise my savings and dividends and other income in order to minimise my tax bill. I do not know if that is frowned upon by the Chancellor, but I suspect that is what most people will do. What is not clear is whether, with the combination of this measure and the point you made about not having an allowance that applies across the three tax rates, some people are going to end up, unless they organise themselves, with very high marginal rates of tax in excess of 60%. Would it be possible to provide the Committee with some examples of how all these changes might have an effect? For example, there is the business that you mentioned a few moments ago of it being looked at on a quarterly basis; you could find yourself then going over the threshold. I think people are going to play games with it in order to minimise their tax, are they not?

**Chas Roy-Chowdhury:** Yes.

**Lord Forsyth of Drumlean:** The sums involved are quite substantial. I am really asking you whether it is sensible in the context of simplification to have different thresholds for different allowances applying. I produced the tax simplification report for the Chancellor in 2006, and one of the things we recommended was setting up an Office of Tax Simplification, which has been done, and getting rid of allowances and having lower rates, which at that time the Chancellor was in favour of. This seems to me to be taking us back into a morass. Is that right?

**Chas Roy-Chowdhury:** Yes, I think that is right. What I would say is that at the moment the Government have a sure thing in getting the financial institutions to deduct tax. Now they are going to be relying on individuals to declare how much tax they need to pay. We talk about the tax gap all the time. Is that really the road we want to go down by creating another problem regarding the tax gap where people are not aware of how much tax they should be paying, if anything, and they get it wrong? Yes, I think it is creating complexity, both for the Government in knowing where they stand regarding tax take and for individuals not knowing where they stand and mis-declaring taxpayers. They may have vehicles where they get dividends and interest and they do not know until the end of the year what that is going to be and, therefore, again, what do they file, with quarterly filings coming in from next year? There is a whole array of different areas that do not seem to have been properly thought about, and there has been no consultation before the announcement. It seemed like a great idea before the election, because this was when this was first announced, and then thinking through the details has kind of come afterwards.
Q3 Lord Turnbull: Are we getting towards a more generalised scheme of giving people an allowance and then for higher rate taxpayers taking it away, and certain tax allowances being dealt with in the same way, but when we come to dividends, we have a £5,000 allowance and then a series of rates which you are then taxed at and higher rate taxpayers and additional rate taxpayers pay the highest rates? Am I right in saying that those two regimes are operating using different methodologies?

Chas Roy-Chowdhury: Yes.

Frank Haskew: Yes.

John Cullinane: Comparing the two, the dividend one is simpler and, to the extent that that is the case, one does not understand why that same principle could not be applied to the interest.

Lord Turnbull: It seems to me that in order to know what to take off you need to know the answers to all the sums, but you cannot know the answer to all the sums until later.

John Cullinane: There is a bit of iteration about it, yes. That is correct.

Frank Haskew: You should be able to work out your tax liability with a sheet of paper, the rate of allowances and a calculator. I think citizens are entitled to expect that. The fact is once all these changes go through it is almost algebra and you are going to need software, and most people will not understand it.

Going back to your point, Lord Forsyth, we have had some examples of how the dividend rules, which were prepared by our former chairman, are working. Obviously we can send these to you. When you look at them, you will see that they are incredibly difficult for people to understand. We struggle as tax practitioners with this. We have had quite a lot of arguments about how the rules work. If we are having trouble with it, I think it is going to be very difficult for the ordinary citizen to understand how their tax is being calculated.

Lord Turnbull: Are there kinds of interest that are not in this scheme? Is interest on bonds and gilts in the scheme or not?

Frank Haskew: The rules on savings income refer back to savings interest within the Income Tax Act 2007. We had a question this morning about peer-to-peer loans, which is becoming a major issue. The question was whether they are subject to the savings income exemption and the answer was, “We do not know”.

Q4 The Chairman: I think this raises another point. With peer-to-peer lending, do you get a return from the intermediary? If you buy a foreign sterling-denominated bond or a bond issued by a UK company that happens to be issued by an overseas subsidiary of it, do you get an annual return? I suppose the follow-up from that is, given that complexity, which can sometimes lead to an opportunity for people to play games, or maybe to pay less tax than they should be paying—not always for reasons of trying to evade tax—is the net result of this arrangement possibly to reduce the tax take to HMRC?

John Cullinane: I do not have to hand what the figure was, but it was certainly estimated to reduce the tax take, because, obviously, the broad swathe of basic rate taxpayers were
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suffering from tax being withheld by the bank. It was not a compliance burden to them, but they were getting net interest, not gross interest. Now, to the extent they are below that threshold, they will get it gross, so there was budgeted to be a reduction in the tax take.

The point that was made earlier that this came out without any consultation is the key point, because when these ideas, which might sound quite good and appealing, are discussed by a limited number of people, albeit expert, within the context of a massively complicated code already, there are all sorts of interactions with other features and ramifications they do not work out at the time. What happens if people have trusts and what happens in the example you have just given? I do not think it will open the floodgates to avoidance, because at the end of the day it is only £1,000, and that only applies at the basic rate, so it is £200, and people are pretty much being given that anyway, but it will add a lot to the complexity of the system.

The Chairman: Lord Turnbull, would you take us on to dividends?

Q5 Lord Turnbull: I have one more general question. One of the criticisms that has been made is that changes are being made piecemeal. Normally you would have expected that a destination and some principles about that destination would have been described, and then, “Here are the steps that lead you to that destination”. Do you think there is a destination? How far are these changes consistent with that and how far are either bits of it inconsistent or even taking us further away from that destination?

John Cullinane: We do not really know what the destination is, because there is not a road map. If you compare it with what the Government did in the area of corporation tax rates, they said, “We are going to try and bring the rate down over the years. Having said that, we are going to do this, that or the other on avoidance so that people pay what they are supposed to”, so there was a clear strategy set out, whereas that is not the case here. You do not know whether they have done this and that is the end of it, or whether the £1,000 will go up over time, or quite what the intention is.

Chas Roy-Chowdhury: I think John is absolutely right. There is no road map as there was for corporation tax and as there will be next year for business tax. We are seeing ad hoc tax changes right across the piece. We are hearing announcements being floated in the media about things such as pensions and tax changes. There are all sorts of changes which are being sounded out in the media rather than a proper holistic road map being put out there so that we can discuss, debate and actually feed into the process. There was no consultation on the policy issue of quarterly filing, only around how to implement the policy. I think it would do a lot of good in all these different areas of tax policy if we could properly debate and discuss them before they are announced and before they are put out to the general public when they cannot be drawn back.

Frank Haskew: Could I follow that up? Shortly before the last election we had an event attended by a government Minister and a shadow Minister, and we said, “Why don’t we have a personal tax road map as we have for corporation tax?” Interestingly, the Government Minister concerned and the shadow Minister both said that they would not consider a personal tax road map. The thinking seemed to be that the figures—if you like, the amounts of money coming in from personal tax, and presumably national insurance—
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were so large that there was no appetite at all to lose any control about how personal tax policy might be developed.

**Lord Turnbull**: You can keep control of the money by the size of the allowances and the rates. The structure does not necessarily commit you to reducing tax over time or at any particular speed.

**Frank Haskew**: I would entirely agree with that, Lord Turnbull, but that area seems to be kept very close to the policymakers and not shared.

**Q6 Lord Turnbull**: If I come to dividends, it is the same kind of question. It is described as the last knockings of the imputation system from 1970 or 1971, or something like that, so it has been a long time dying. Should we regret that? Although in some ways it looks illogical to tax a company and then out of the post-tax income of the company tax the recipient, it is actually a much simpler scheme. On paper this looks a much simpler scheme, but do you see problems with it?

**Chas Roy-Chowdhury**: I think again there are huge complexities. It is a nil-rate band and should be referred to as such. It is not an allowance or anything else; it is a nil-rate band. Again, it is all about raising revenue. It is all about anti-avoidance around people taking remuneration in the form of dividends to escape national insurance. It has created a lot more complexity. Basic rate taxpayers, once they get over the £5,000 nil-rate band, will be subject to tax and self-assessment, where they have not been in the past. Again, it is possibly going to draw a whole raft of new people into self-assessment. There is going to be a situation again where you have quarterly reporting, or quarterly filing, or whatever it is going to be, where people are going to get it wrong and are going to have to rely on business to supply the information on a timely basis and on a quarterly basis, even where they have overseas holdings. There is a whole range of knock-on effects and impacts that have not been properly thought through.

**Lord Turnbull**: Is getting rid of tax credits not a benefit?

**John Cullinane**: You can view the dividend so-called allowance as two things. First of all, portfolio shareholders—people who happen to have a few shares and get a few dividends in large companies they otherwise have no real relationship with—are being taken out of tax altogether, so there will not be this complicated situation of being theoretically taxed but having a credit. You can see that. Then on the other side, for people who either control or together with a number of other people control a company, the Government clearly wanted a rough-and-ready way to get closer to a position where, whether people were sole traders or had companies and took the dividends out, they were paying something more comparable overall. You can see what they are trying to do there. You can see that is rough justice, as it were, rather than all these calculations of tax credits. I can see a simplification argument for the broad concept.

However, they have not introduced those two regimes by trying to distinguish between the portfolio shares and the ownership shares. They have done it by saying it is £5,000. If you had done it the other way round and said that when a company pays a dividend to those individuals controlling it, then they have to withold some tax, you could have done it by withholding tax, but because you are saying it is only a question of the overall amount, the
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onus is on the taxpayer to keep tabs on what is coming in from all over place. I think the compliance burden for those affected is probably going up.

**Lord Turnbull:** In my case I only have a few shares, and the company gives you an end-of-year statement showing how much tax, the dividend and the tax credit. Is that going to go? Will you be sent a note saying, “The dividend you have is such-and-such”, and then you have to make your peace with the tax authority, whether it is at the 7% rate or the 38% rate?

**John Cullinane:** I think this is similar to the last change. It is rather working against the grain of where they are trying to get to with digitalisation, which is to have more done automatically, or by third parties, and less onus on you to have to work out complicated calculations for yourself. It is throwing more into the area of your own calculations and it is making those calculations more complicated.

**Q7 Lord Forsyth of Drumlean:** Before we leave the dividend issue, can I be sure that I understand this? Higher rate taxpayers are going to be paying at 32.5% and additional rate taxpayers at 38.1%. Going back to what I asked right at the beginning about people trying to organise themselves, the income will be treated as taking you towards the threshold. Is there not a danger that people are going to manipulate their equity ownership so that they avoid dividends that are going to take them over the threshold? Is that kind of thing not going to happen?

**John Cullinane:** Yes, people are very alive to the differences between the rate that a sole trader would pay and the rate that would be paid on that business if it were incorporated. When we had the small company rate of zero everybody incorporated and people did those calculations quite finely. I suppose the Chancellor’s defence on this one is that the situation was very complicated and depended on the circumstances, but, generally speaking, the overall tax take was lower if you were incorporated, and this is largely redressing that balance—leave employment out of it, but as between self-employment and incorporation.

**Lord Forsyth of Drumlean:** I was thinking you would not want to have a share that gave a high yield. You would not want to have Glaxo. Will it not distort people’s holdings?

**Frank Haskew:** Yes.

**Chas Roy-Chowdhury:** Investment, that is right. Why would you want the dividend where you are going to pay a higher right of tax as opposed to a capital gain?

**Lord Forsyth of Drumlean:** Not only the dividend; it may take you into a huge tax liability.

**Chas Roy-Chowdhury:** Absolutely.

**Frank Haskew:** We are likely to see changes in investment tactics and that will have knock-on consequences.

**Q8 Lord Kerr of Kinlochard:** Following up on Lord Forsyth’s first question, I did not hear, or perhaps I missed it, whether you can give us some worked examples of the increased complexity. A rather brilliant note I read in preparing for this session suggested that the combination of different elements in an individual’s tax return, if he was a recipient of interest, could mean, if he was a middle-income, higher rate taxpayer, that he was facing a
marginal rate as high as 60%, with a combination of all these things. If that is the case, could we see one or two worked examples of how that goes?

_Frank Haskew:_ We could certainly forward those to the Committee, yes.

_The Chairman:_ That would be helpful.

_Lord Kerr of Kinlochard:_ Following up on Lord Turnbull’s question, if one no longer receives the dividend voucher, if one no longer has the interest on a bank account deducted at source, what will be the effect on the Exchequer’s take? It seems to me that if one’s tax return is pre-populated with numbers and they underreport, the temptation will be not to correct it.

_Chas Roy-Chowdhury:_ Yes.

_Lord Kerr of Kinlochard:_ In the case of bank interest, if it is not there on the tax return, one has, rightly up to now, assumed that the bank is deducting it. Will the temptation not be—or perhaps not the temptation, but will the fact that you have not had to fill it in before, because it was already done for you by the bank, not take you in the direction of underreporting as well? Is there not a danger that the Exchequer is going to lose?

_Chas Roy-Chowdhury:_ That is the point I made earlier. I think the tax gap is going to be affected by these changes, because the ordinary taxpayer has, as you quite rightly say, been used to the tax being deducted at source and now they are going to have to declare it. If they are relying on pre-populated tax returns or quarterly filing returns, why would they doubt what is put in there by HMRC? They probably were not even aware that their tax was deducted at source from interest. Now they are getting it gross, they probably will not be aware there has been a change. Unless there is a huge educational piece that goes on with this, for the ordinary person in the street there is going to be a cash-flow impact, which makes me think that quarterly reporting is all about bringing in quarterly tax as well, to compensate for this.

_Lord Kerr of Kinlochard:_ In practice, this is happening this year because the first tax year this comes in is the one we are in right now.

_Chas Roy-Chowdhury:_ It is 2016-17. From 6 April.

_Lord Kerr of Kinlochard:_ Do you think the Government are doing enough to explain these changes to people? I confess that until I started preparing for this inquiry I had no idea.

_Frank Haskew:_ I think our view is they probably are not doing enough. It is a major change. Effectively, it is shifting the burden from the banks, and potentially companies, on to the individual taxpayer. That is a major shift. We have had a tried-and-tested system of tax deduction in this country for a long time, which I think works for most people and, effectively, enables them to be fairly confident about their tax position. We are now going to move away from that. I do not think that most ordinary taxpayers really understand where this will lead to. I think there is a real need for education here for taxpayers to understand what it will mean for them. We are already receiving reports that the banks are struggling to explain how this is going to work. We are only a few months away from this actually coming in.
John Cullinane: The starting point of calling these things allowances when they are not does not help with the education. You have ISAs and other elements and other terminology in the piece as well.

Lord Kerr of Kinlochard: I think the only thing that the public understand and are puzzled about is the fact that the ISA allowance is not going up. The ISA seems to me to be an extremely popular savings vehicle, almost as popular as the defunct savings certificates used to be. I think the average higher-income taxpayer deeply regrets the fact that children’s savings certificates do not exist as a way of passing on money and is puzzled that the Government have frozen the limit on the ISA. I do not think that he has grasped at all the complications of the personal savings allowance and the tax deduction scheme for interest, and so on. I do not think any of that has got through. It seems to me there is an education task which is quite important and quite urgent.

Chas Roy-Chowdhury: That is right. We find that in every Budget, or several Budgets a year—and it is happening now with Autumn Statements—there are a number of changes which seem to happen and which are left-field. You do not expect them, or you do not expect them to land in the way you do when you see the draft legislation. It really goes back to having a road map and, if not a road map, a discussion—let us try and do things properly in tax rather than making the complex tax system ever more complex.

Q9 Lord Bilimoria: Clause 71 introduces a new power for HMRC to assess individual tax liabilities using information supplied by third parties, such as banks. How does this change the individual’s current responsibilities under self-assessment? To what extent will ordinary taxpayers have the ability and information to check and, if necessary, dispute HMRC’s tax bills?

Chas Roy-Chowdhury: Again, it is all around greater complexity. These are going to be people who presumably are not filling in self-assessment returns. Regarding the obligation on the taxpayer, my understanding from reading the draft legislation is that they will no longer need to put their hand up with a self-assessment return and notify HMRC. That is one obligation that will then disappear if they get a simple assessment. The point is they can receive more than one simple assessment, because it could be that HMRC at the start of the 2016-17 tax year gets certain information—one bit of information about dividends or interest—and sends out a simple assessment, and then later on it gets more information, so there could be multiple simple assessments that the same taxpayer could receive in a tax year, which is highly onerous and highly complicated. I imagine most taxpayers will merely say, “Yes, it must be right”, and they will not have the ability to check. Again, where are we actually going with all this? It is layers and layers of complexity that again are bringing more people into self-assessment.

Lord Bilimoria: Before you go on, as it is the first question I am asking formally, I should have declared my interests. My interests are as in the register of Members’ interests, and also I am a Fellow of the Institute of Chartered Accountants in England and Wales. I am a member of the alumni council of Ernst & Young and I have this month taken over, which may not be in the Register of Interests, as the chair of Cambridge University Judge Business School. Please do carry on.
Frank Haskew: What HMRC is introducing with Clause 71 is a not unreasonable power to make it easier for a taxpayer, who is probably not within self-assessment, for their affairs to be dealt with. I think it is a reasonable principle, particularly with the move to digital, and I think that is understood. We are at the very early stages of all this. We do not know where the digital agenda will end up. There is still a lot of confusion as to how those provisions are going to work in practice. If your affairs are anything out of the ordinary, or slightly complicated, you are probably not going to be a person for whom simple assessment will work. There are going to have to be further discussions on the whole process and who is going to be within it and how it is going to work. Obviously, we will be taking part in those discussions, but it is very early days for these provisions and, as Chas said, the provisions they are looking to introduce already seem quite complicated, which seems to be a feature of the UK tax system in any new measures introduced.

Chas Roy-Chowdhury: The only thing I would say before John comes in is that what we usually find with anything new in tax is they come in very light touch, but they will not stay light touch. Even if we are talking about this simple assessment coming in—a few lines, very easy for people to check, no penalty regime, no interest charges—it is not going to stay that way. Five years down the track, which is what we need to think about, how is this going to evolve? We need to be careful about the seeds we are now sowing.

John Cullinane: At the very basic level, as Frank says, it is a good idea, because if you take an old-age pensioner, the state pension is taxable, but the department does not take on itself the job of withholding the tax that is imposed on everybody else. Many pensioners have to report the state pension on their tax return when the state clearly knows how much pension they have had. In that type of situation, or a situation of a third-party provider, the basic idea to get the information off that third party at source and then to make an assessment based on that makes sense. Given that the system is very complicated and the third-party provider only knows their piece, I think the issue will be how it will be got right as you move on that model towards the digitalisation world. It is a bit like comparing the people who have to do tax returns, where, when they sign their tax return, they may find it difficult and complicated but they know they are on the hook for trying to get it right, and when you get a PAYE code, where I suppose you feel you ought to get it right but the sense in which it is your responsibility is diminished because you naturally think, “The employer and the HMRC know a lot about me between them, surely, they have it right”. Whether people will then under-declare or over-declare, on balance, who knows? In many cases, they will be impelled to accept more errors against themselves, or not even notice, than the other way, because one way round they are subject to penalties if they get it wrong.

In this particular area it is not at all clear whether the individual would be exposed to a penalty if they felt that the assessment was inadequate and they had kept quiet. Many people simply will not know. They might have a suspicion, but they will not know because it is too complicated. I am not calling for harsh penalties. That is an oddity in our system. As I say, it is not 100% clear, but I cannot believe, once digitalisation is up and running, that people who end up in under-declaration situations will be let off penalties merely because things have come from third-party providers, but as of now that is a little unclear.

Lord Bilimoria: Later we are coming on to the Office of Tax Simplification and the whole idea of simple assessments. To be clear, was this really necessary? Could the HMRC not deal with this under existing powers?
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Chas Roy-Chowdhury: Yes, that is our view. It may well seem like a good idea at the moment, but I do not think it is going to stay that way. If they are getting a whole lot of information and their IT systems are getting better and more clever and more holistic and able to capture everything there is out there about the taxpayer, why do they need to go down this road for the very lowest-level taxpayer? It does not seem an appropriate or necessary measure.

Frank Haskew: The self-assessment regime is quite a complicated regime once you are into it. This is an attempt to have almost “self-assessment lite” for people who have slightly easier tax affairs. The principle of that is not unreasonable, but whether we are going about it right, having self-assessment lite for people with very simple affairs who probably do not warrant self-assessment, is a moot point.

John Cullinane: I do not know if it would be a good idea. I am sure HMRC could deal with it simply by not raising an assessment at all and, if people have suffered tax at source, they keep quiet. I am not sure I would criticise them for, as it were, seeking to codify it in legislation rather than leaving that under the carpet. You would not get the opportunity to inquire into what they are doing. I do not criticise that basic idea of having this sort of provision in the formal system.

Lord Bilimoria: May I have one more question on this? Does HMRC have the resource to provide the sort of customer support this will require?

John Cullinane: No.

Frank Haskew: We could certainly provide the Committee with a recent survey that we did of HMRC and its service standards. The anecdotal evidence is that in the last few months it has improved, but the fact is that over the last few years the service levels have fallen off a cliff. HMRC is in a very difficult position when the Government are constantly changing the rules. We need some stability and certainty in the tax system for HMRC to be able to operate it correctly. By its very nature, if you are changing things all the time you are going to get more phone calls and more inquiries, which puts huge pressures on HMRC.

John Cullinane: And then there are the annual cuts.

The Chairman: If you could provide us with that sort of feedback that would be really helpful.

Frank Haskew: Yes.

John Cullinane: The trouble with service levels is that the vast majority of taxpayers and commentators think about them against the background of the way things have happened traditionally. People fill in their tax return. They are maybe a little worried that they have not filled this bit in correctly or that bit in correctly, so they might phone up and ask, and then they might wait a long, long time to get an answer, and they probably will not get an answer from somebody who knows about the issue that has concerned them. The HMRC strategy, approved and required, in a sense, by the Government, is not to gear themselves up to be able to provide those answers on the phone; it is to provide a framework of guidance, and so on, and for the taxpayers to fend for themselves. That is where they are trying to get to with the level of resourcing that has been provided. It is a little unfair to
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criticise HMRC. There is an odd policy mix where you have that trend towards digitalisation, which is a little bit of the modern world and how your utility company tries to deal with you, and many other big organisations that you are the customer of, versus a set of rules that is vastly more complicated than any electricity tariff and a little bit bewildering to people, however well it is described in guidance.

Q10 Lord Forsyth of Drumlean: I am confused about how it will be decided who is covered by this regime. How will you work it out? It is the point that Mr Cullinane made about elderly people. Reading this, I am thinking of elderly relatives who get in a complete panic about their tax return. If they get a letter from HMRC saying, “You have to pay £1,200”, and they have dividend and other income, how are they going to work out whether that is right or not? It is probably quite good news for accountants, but who is actually going to be involved in this regime? How can we be sure about the quality of the data? Am I right in suspecting that quite a lot of the people who will be involved in this are elderly people, particularly if they are going to get more than one letter in the year? My mother-in-law starts panicking about her tax return now and it is not actually due until the end of the year. Is this an issue or am I imagining it?

Chas Roy-Chowdhury: You are absolutely 100% right. It is the same thing with quarterly filing. There are those people who are digitally excluded. I would mention my 82 year-old mother. She is not on the internet. She has no idea about different rates of tax and things such as that. The underlying concept is all right for people such as us who are working, who have internet access and who are participating in the workplace. There needs to be a reality check around trying to bring more and more people into the tax return system, if you like, for want of a global term. We need to look at where we are going with this, because it is going to affect a lot of elderly people who are not going to be able to fend for themselves. They will not want their neighbour looking over their shoulder to help them with their financial situation or their sons or daughters helping them. There needs to be a better way of doing it.

It is a different world for the elderly. There is a whole raft of people out there who are trying to take advantage of them, and we do not know who may then try and “help” them, as it were. We need to be very clear where we are going with this agenda of trying to make everything digital. I know the numbers with digital access will increase over time, but at the moment there are a lot of people who will not be able to take advantage of this and will not be able to give the Government that kind of digital landscape they are trying to work towards.

Lord Forsyth of Drumlean: Does the information come on computer then, or is it in the post?

Chas Roy-Chowdhury: My understanding is that it is part of the digital agenda, but I am not sure of the underlying detail.

Lord Forsyth of Drumlean: What does that mean?

Chas Roy-Chowdhury: Yes, by computer.
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**John Cullinane:** You can use the example of the state pension. Certainly when I helped my mother with her tax return, the pension figure on the assessment would always be a pound or two different from what you calculated. The information must have come from somewhere. I do not believe somebody sat in an office increasing it or reducing it by a pound. Under the current system there have been a lot of feeds that the Revenue is getting independently. I can completely understand the basic thought of why make people assess themselves when they have the information anyway, and I can also understand them wanting to put a statutory framework around this, but it is doing that in the context of a system that is being made ever more complicated and of the digitalisation agenda. I entirely see they have to move with the times and improve the efficiency with which they deal with this.

**Lord Forsyth of Drumlean:** If this information comes by computer, do you have to be computer literate?

**Chas Roy-Chowdhury:** Yes.

**Lord Forsyth of Drumlean:** What about elderly people living in rural areas where their internet is slow and all of those kinds of issues?

**Chas Roy-Chowdhury:** We made all these comments around quarterly filing to the Minister. We have said all this. We have also talked about people who are illiterate and all these sorts of things. However, the policy has been decided and it is the implementation of the policy that is up for grabs.

**Q11 Lord Turnbull:** I want to make a very quick point. The big picture is that for 60 years the Inland Revenue worked on the basis that it wanted to get the money before you got it and this self-assessment was a settling up at the margins, and if you had a bit of gift aid, you could get money back, and sometimes you had to pay a bit more. This is not only going to increase the number of people, but the amounts at stake are going to be much larger than they used to be because far less is being taken off at the start. In a world in which you are trying to improve relations between the tax authorities and the public, this seems to be a recipe for increasing the acrimony, because it is not a few tens here and there or a few hundred here and there, it could be a few thousand here and there. This seems a very poor way of improving relations with the taxpaying public.

**John Cullinane:** I do not think that is strictly true though of the simple self-assessment proposal in isolation. That is merely to codify the Revenue’s ability to deal with something on the basis of what a third party has at least provided information on. I think that particular change has merit about it.

**Lord Turnbull:** You are then told that you receive this amount of interest or this amount of dividend or whatever, as opposed to your pay packet and what you previously had. You always knew that you had paid something on account, and therefore the amount that could be in dispute would be that much less because you had always paid the first 20%. That is no longer going to be true and they are going to say, “You received all this”, but the amounts will be of a size that you will feel you have to check it. You will be very poorly placed and they will not tell you exactly who paid it to you and when they paid it to you. It looks to me as if it is taking 60 years of history backwards.
Frank Haskew: I think that is true, but we need to remember that PAYE is still the large area where tax is being deducted, and that is going to continue. There are still going to be huge amounts of income tax and national insurance coming in every month under PAYE. By comparison, the amounts coming in under interest on dividends are considerably less than that.

Baroness Drake: Could I pursue Lord Forsyth’s point on digital transition and digital engagement? The self-employed population has increased exponentially over the last few years. There is a debate in the Commons today, because people are saying that a significant part of this population has neither the means nor the ability to engage digitally and, as I understand it, the Treasury has said that they can engage verbally. I do not know quite how you do that. It would be quite interesting, because it is clearly topical and is out there in the Commons. It would be useful to have your views as to what you think the challenges are around, in particular, the self-employed, particularly those on more modest incomes.

Chas Roy-Chowdhury: We fed into this debate that is going to start at 4.30, I believe, and that was the meeting we had with the Minister a couple of weeks ago. It is around digital capability where people can file four times a year. It is not meant to be a tax return, but I am sure eventually it will be, and then probably a fifth time to make the four returns tie up and, therefore, give a true and fair view of their income. Some of those small businesses are illiterate. We gave an example of the type of paperwork that accountants receive from those types of clients. They will not even know how to file or put the paperwork together. It is all about keeping records on a regular daily basis. Do the Government want businesses to do business or merely be bookkeepers and record keepers, and that is all they do, rather than going out there hiring people, making their businesses work and making a success of the UK economy? That is a very short summary, but it is around those kinds of areas. There does not seem to be an understanding of how to work out a profit for filing or work out an income for filing and how you do that on a quarterly basis. It does not work in that way. From an accounting point of view, you work out the accounting profit that you use ultimately as a basis for filing a tax return. How do you do that in a quarterly return? There are all sorts of questions around that. We have already mentioned interest, which is paid annually. How do you gather the interest details on a quarterly basis? There is a whole range of things that have not been fully thought through and are going to be steamrollered through regardless.

Q12 Lord Teverson: Could I follow up on one small thing? The perfect system for this, as the Government would see it, is that they are able to collect all that information anyway and present it to you electronically and you will say, “My goodness, I didn’t realise you knew all that about me; yes, that is right”, and it goes like that. Clearly, that is not going to be the case. You mentioned particularly the self-employed. What other areas are beyond the Government’s capture for this population of people? Is it foreign earnings or something else? Give us an idea of the proportion of things that will be missing, coming a bit back to Lord Turnbull’s point about things catching up later and there being a big discrepancy at the end of the year?

John Cullinane: There are changes in the economy. The PAYE system works best with people having one full-time job for life, or as close as you can get it, so there is not a lot of chopping and changing and a great deal of predictability, and then it can operate very efficiently. If the economy moves on and people either become, or are forced to become, more flexible,
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it becomes a lot more complicated. If you look at when buy-to-let first became an investment, there was a lot of talk of tax evasion by buy-to-let landlords. I expect many people in that position had never had an obligation to file a tax return before, because it was the first time they had something that was not deducted at source. I think it is probably a question of being alive to developments in the economy and trying to find a framework for the new and developing areas, rather than leaving people to fend for themselves, and scaling back the deduction-at-source arrangements where they already exist.

**Chas Roy-Chowdhury:** I think it will be the overseas areas as well; overseas rental income, overseas dividends or overseas interest. Those will fail to be captured, at least fully.

**Frank Haskew:** In the Government’s plans for quarterly reporting, they have made it clear that one of the policy concerns, particularly in the SME sector, is that businesses are not keeping proper business records and that therefore there is an underpayment of tax. That is the justification for this, to which I think the push-back quite strongly is that it is a different issue entirely. If you have a problem with business records, then that is a problem that needs to be addressed, and is a totally different issue from quarterly reporting and digital information. The fact is that if you have poor records, you could still be uploading quarterly information which is completely wrong. I think the two are very different and at the moment they seem to be conflated: that somehow digital reporting will answer all the business records problems. We do not see how that can be the case.

**Lord Teverson:** Some self-employment is very lumpy income. Particularly if you are consulting and you are a private service company, you might have a big invoice that comes in a couple of times a year, which your expenses and costs do not mirror. What happens with that? Presumably, that is an issue as well.

**Frank Haskew:** Effectively, you are going to have a position of collecting big data. How is that big data going to reconcile to the annual tax return position that you have? It seems almost inevitable that you are going to have to do your quarterly uploading of information and still have to reconcile it at the year-end.

**Chas Roy-Chowdhury:** I would add that the idea behind the quarterly filing is that those businesses that go in first are going to be the least capable. It is going to be a bottom-up approach, so those who are digitally excluded or illiterate or very small or the most vulnerable are going to be in the system first. Rather than those who are most capable going in, they are going to be in there last. The bottom of the pyramid is going in first and the top of the pyramid is considered to be all right and may never go in.

**Lord Teverson:** Most of the questions that I was going to ask have already been covered. One bit that has not is: what does experience internationally tell us about this? Are we in the vanguard? Are we trailblazing here or have other economies and treasuries gone there before?

**Frank Haskew:** Australia is going through a very similar process at the moment. We saw the representation being made by the Australian institute in an almost identical consultation, and it was saying exactly the same things as us. There are these international pressures going on to move this way, but internationally they have not thought through how
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businesses actually operate. There is a lack of understanding about how businesses operate and translating that into digital tax terms.

John Cullinane: We could probably provide some information on what is available from international comparisons. I agree with Frank that you will not find they are a road map from somebody who is just that bit ahead of us on a similar journey. The issues for the self-employed that you outline are genuinely very difficult to work out and, even under the existing rules, if you get a lot of income one year, the Revenue will assess payments on account for next year on the assumption that it will always be the same, and so people have to know to appeal against those. Things that sound perfectly reasonable when they are introduced at a high level cause issues, and to some extent that is a genuine problem they have.

Q13 Baroness Drake: I have one question on taxation. One purpose of the changes to dividend taxation was to address the situation where private companies were paying less tax and national insurance because they were paying through dividends. To what extent do you think these changes will address that problem? What do you think might be some of the behavioural responses to this mechanism in those companies?

Frank Haskew: It will certainly go some way to addressing tax-motivated incorporation. There is no doubt about that because, effectively, it shifts the balance. Regarding policy, you will probably see a shift more towards people not paying dividends out and accumulating income within the company and potentially then looking to liquidate at some stage, for instance, or doing some other transactions. We also have some quite complicated rules coming up about company distributions in the current Finance Bill clauses. At the moment it is difficult to say, but it certainly will go part of the way to addressing that problem.

Q14 Lord Forsyth of Drumlean: Can I ask about the Office of Tax Simplification, which I certainly thought was quite a good idea? As originally envisaged, it would be a body that would look at the tax system and say, “Can we get rid of these allowances? Can we alter these aspects to make it simpler and fairer and flatter?” That is what the Chancellor used to say when we were in opposition. Looking at the number of recommendations, it is a minority that actually get implemented. What do you think has prevented more of these recommendations from being adopted, given the Government’s mantra that they want to simplify taxation? The Finance Bill puts the office on a statutory basis. I am bound to say that I am not sure I see the point of that or if it is going to make it more effective in carrying out its functions. Or am I missing something?

John Cullinane: Tax simplification is not an important enough priority. That is the basic issue. In general, I think the OTS has done a good job. It probably could have improved its average if it had made only minor tinkering recommendations, but it has tried to deal with some chunky issues, and they are difficult to get through.

Lord Forsyth of Drumlean: Can you give an example?

John Cullinane: The whole area of employers’ national insurance. Effectively, you are taxing something pretty close to everyone. There is income tax on earnings, but there are all sorts of differences. They are looking at some quite big issues, underlying which there are huge revenue flows, so it has not set itself the easiest task. Overall, I have been pretty impressed
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with it, but the real issue is, even if it had a 100% record in dealing with the stock of complexity that has built up, more and more is being piled on every year to dwarf it, as we have seen in some of the clauses we have talked about here. For example, under the statutory provisions for the OTS, it is going to have to do an annual report on its own work, not on the state of simplicity versus complexity of the whole system, and not coming forward with their ideas on other ways in which it could be addressed. It is a little bit of a Maginot line.

Lord Forsyth of Drumlean: Putting it on a statutory basis, it ought to have the power to put up its hand and say, “Hang on a second, this is not a smart idea”.

Frank Haskew: When the Office of Tax Simplification was first set up, the late Lord Howe made a comment that he tried to simplify the tax system, but it was a bit like painting Brighton pier when it was being extended to France. His analogy is so true. For instance, in 2011 we had a 400-page Finance Bill. That was shortly after the Office of Tax Simplification had prepared its report on tax reliefs, and 100 pages were removed from the tax code by the Office of Tax Simplification. I did a quick tally this morning and, in the last Parliament, the Government introduced 2,839 pages of tax legislation. That was their total at the end of it.

Lord Forsyth of Drumlean: Net?

Frank Haskew: No, sorry, that is gross. The OTS certainly reduced that by 100 at the beginning. We did not have any figures after that, but I suspect it was relatively small. The fact is we have had almost 3,000 pages added to the UK tax code, and that was on top of, I think, 9,000 when we started. It is very difficult to simplify a tax system meaningfully when you are faced with that level of extra legislation. The Government said right at the beginning of that Parliament that the pace of change would slow and, in fact, that is by far the biggest number of tax pages added in one Parliament we have ever had.

Chas Roy-Chowdhury: The Government do not take simplification seriously enough. Before the OTS was set up, we advocated the idea of a tax policy committee, similar to the Monetary Policy Committee, which has much more of an independent remit. That was not what was set up. The OTS does its work based on what it is allowed to do by the Minister, so we think going to a statutory basis would help. Two years ago, we had a situation where this Committee was looking at draft legislation around partnerships at the same time as the OTS was looking at simplifying partnership tax. There was a whole raft of new partnership legislation coming in when the Government had already given the go-ahead for the OTS to look at simplifying partnership tax. It seems bizarre that the Government say one thing, and this is not joined up, and then do something else which shoots the OTS in the foot. I think the OTS has done as much as it can within the scope and remit it has, but I do not think the Government take simplification seriously enough. They want to have that badge of honour, “We believe in simplification”, but everything we have discussed today shows otherwise.

Lord Kerr of Kinlochard: I think the Office of Tax Simplification is an excellent idea, but surely what you are describing is bound to happen in this area and the good it can do is bound to be very limited if its role is not ex ante, if its role is ex post, if it is simply dealing with the existing tax regime and suggesting ways in which it could be simplified, because there is inertia in any system and the existing regime is as it is because somebody thought
one particular element in it was a good idea and it accreted over time. Surely it has to have an ex ante role in looking at proposals before they are put into Finance Bills and considering whether they should be in there or not. In this case, is it not particularly odd that, apparently, it does not have any role in regard to the administration of tax? We are talking here about whether it is wise to be doing a major change in the personal taxation of dividends and interest savings at the same time as you are having a major change in the administration of tax, moving, as one must, to a digital system, so-called simple assessments, and all the problems that we are talking about. Surely any organisation with a remit for simplification would say you have to separate these two things. One might also say it is not a very good idea to be making such a “complex” simplification of the regime. One might also comment on whether it is a good idea to do it at the same time as one changes the administration. Am I right that it has no ex ante role and it has no role in relation to administration?

John Cullinane: I think you are right on the first point. On the second point, although they have been trying to develop what a proper measure of simplification is, I agree totally with Frank on his figures and I also agree, by and large, that is pretty representative of how much more complicated the system has become. In isolation, the number of pages is probably not the be-all and end-all of it. You could have something that added a lot of pages, but was a simpler experience for the taxpayer. I think the OTS is alive to that and does take that into account. I think that is okay. The source of the problem is this continual piling on of complexity, as Chas and Frank were saying earlier, often without any consultation. Often the most complicated things that come out are the ones without any prior consultation. I would imagine the OTS would not necessarily want an obligation to vet everything, because then it would be totally bogged down, but some kind of ability to comment on it. Certainly that is where the focus needs to be in the process of generating new, complicated stuff all the time.

The Chairman: Thank you very much indeed. Can I finish up with one point? You have painted a picture of complexity, some baffling changes, a greater burden on taxpayers to actually comply with the new regime, and rather sparse resources of HMRC to help with that. That all sounds like a financial burden that is being transferred to the taxpayer. Would you agree?

Chas Roy-Chowdhury: Outsourced, yes.

Frank Haskew: Yes.

The Chairman: Somebody said earlier that may be good news for accountants, but overall that is probably not something we should welcome.

Frank Haskew: It is not good news for the taxpayers of the UK.

Chas Roy-Chowdhury: I think that is not the kind of work most accountants really want to pick up.

The Chairman: Thank you very much indeed for your helpful answers. We look forward to the further information you are going to provide us. Thank you very much indeed.
HOUSE OF LORDS FSBC ENQUIRY ON
DRAFT FINANCE BILL 2016

The Law Society's response
January 2016
The Law Society of England and Wales – Written evidence (FBB0008)

The Law Society is the professional body for solicitors in England and Wales, representing over 160,000 registered legal practitioners ("the Society"). The Society represents the profession to parliament, government and regulatory bodies and has a public interest in the reform of the law. This response has been prepared by the Society’s tax committee who are formed of practitioners with relevant expertise and experience in this field.

The Law Society of England and Wales Tax Law Committee are very pleased to respond to FSBC’s enquiry in to the draft Finance Bill 2016.

We are responding on two of the three issues raised by the FSBC, namely simple assessments and the establishment of the Office for Tax Simplification on a permanent footing, but also refer to the Finance Bill clauses more generally in assessing whether the measures proposed contribute to the simplification of the compliance burdens of individual taxpayers.

Opening Remarks

Simplification can take several forms: for instance

a. the tax system as a whole can be simpler;

b. the tax system as it applies to individuals can be simple even if the tax regime for companies or collective investment vehicles is more complex;

c. the tax system as it applies to individuals with relatively simple affairs can be [relatively] simple but for individuals with more complex arrangements there is more detail (and complexity); or

d. intermediaries can be required to perform significant roles in relation to tax in respect of payments they make or are responsible for processing (e.g. collection of tax at source in respect of interest; deduction of tax under PAYE; granting tax credits to individuals in respect of dividends which satisfy any liability they have to basic rate tax).

The significance of category (d) in paragraph 3 above, and doubtless there could be further categories, is that actually the system could be quite complex but individuals do not appreciate its complexity because it is hidden from them by the work required of intermediaries and there is a cost, hidden from the general body of taxpayers, of the intermediaries performing the calculations before payments after deduction of tax are received by taxpayers.

One difficulty with making deductions at source at a fixed rate is when the recipient has insufficient income so that all or part of the tax deducted needs to be refunded (relevant to deduction of basic rate income tax interest unless an R85 was completed but not to low paying recipients of dividends accompanied by non-refundable tax credits). For payers of tax at the higher rates insufficient tax is deducted.

One view is that it may be more cost effective for intermediaries to carry out the calculations, make deductions and accelerate payments to benefit HMRC’s cash flow as
compared with gross payments being received by a much larger number of taxpayers who would then need to perform individual calculations.

The counter argument is that by removing withholding tax obligations in respect of banks or other calculations currently performed by employers, either:-

a. the complexity of policy becomes apparent (if left unchanged);

b. the underlying tax policy is changed for all taxpayers: or

c. exemptions for small amounts of a particular class or type of income are introduced, so that a significant number of taxpayers who would otherwise have to understand the tax treatment of a particular source of income do not need to because their receipts of that class of income fall within the exemption.

The approach identified in (c) of paragraph 7 above may incidentally require the level of those exemptions to be indexed or otherwise adjusted periodically to maintain their real value.

In relation to the deduction of tax source from bank and building society interest, it is proposed that the obligation to withhold will be removed from payments. Further, those liable to tax at or below the basic rate can receive interest of up to £1,000 tax free and those liable to tax at the higher (but not additional) rates may receive up to £500 tax free, with the excess (in either case) liable to tax in the usual way. However, as with all arbitrary amounts, the effect of a £1 salary increase for a taxpayer with £1,000 of savings interest who as a result moves into the higher rate, is likely to give him or her a very high marginal rate of tax as they would be potentially liable to an additional amount of tax of £100.40 and an even higher marginal rate of tax for an individual in receipt of £1 pay increase who already receives £500 of interest, who in consequence of the pay increase moves into the additional rate band.

**Simpler Assessment**

The principle behind “simple assessment” is that rather than require individuals to complete self-assessment forms, HMRC can notify those individuals of the amounts of tax that HMRC believe to be due (based on the information received from third parties) to which taxpayers are required to respond within 30 days if they disagree with those amounts, or such longer period as HMRC allow (new section 31AA(2)). If they do not respond within that period the tax becomes due to HMRC (new section 59BA(3)(4)).

If taxpayers do disagree HMRC may (note not “must”) suspend part or all of the simple assessment notice presumably while correspondence (it is not clear whether in paper, email, web chat or other format) occurs to try and resolve the dispute (new section 31AA(3)). Failing which, the legislation seems to have the effect that ordinary appeal rights become applicable again to the amount still in dispute (new section 31AA(7)).

The issues here are not so much legislative as practical and the nature of the relationship between HMRC and the taxpayer. For instance:-
a. if there is a debate between HMRC and a taxpayer whether a simple assessment has been received by a taxpayer, we do not believe that HMRC can rely on dispatch from the HMRC server. For an example see the case involving an employer (the Mother’s Union) deemed by HMRC to have received a notice under regulation 196 of the Income Tax (PAYE) Regulations 2003, despite asserting they had not received a notice (reported at [2014] UKFTT 275). There may need to be an obligation on HMRC, even if that increases the volume of electronic communications in terms of packets of data to and from HMRC, to require a “read receipt” from a taxpayer;

b. we wonder if these need to be an obligation on HMRC to send a reminder after 2 weeks (even if HMRC have received a read receipt to their original message);

c. the rules may need to require HMRC to request a confirmation annually from a taxpayer as to their email address;

d. communications from HMRC will make it clear that they believe a certain amount is due, based on information received from third parties (e.g. employers letting agents (rent), banks (interest), registrars (dividends) and so on). There will be a tendency on the part of the recipients to treat the calculation as correct simply because it is “an official communication” whereas the communication might understate or overstate the recipient’s liability and it needs to be stressed that the recipient is under obligation to verify the data;

e. there are bound to be debates whether a taxpayer communicated any dispute to HMRC within the 30 days allowed to him or her. The onus on HMRC should be able to establish that at the relevant time the HMRC system was fully functional, and not for the taxpayer to demonstrate that the HMRC system was not. Further the system needs to be such that a taxpayer does not need to have received an email from HMRC confirming receipt before the taxpayer’s message is being treated as satisfactorily received, see the discussion in Hansen [2015] UKFTT682 where the Electronic Regulations 2003 were considered, and in particular the presumption that information is, or amounts are, not received unless information is recorded in HMRC’s self-assessment system;

f. newspapers regularly report that taxpayers having difficulty re broadband suppliers particularly on a change of supplier. It is not clear what (if any) thought has been given by HMRC to taxpayers who have supplied a valid email address to which data should be supplied but where they can’t access messages because of broadband service difficulties. It must not be possible for HMRC to claim that the liability is final if the taxpayer can demonstrate difficulties with accessing their HMRC account.

   i. However, particularly as many IT broadband providers (and indeed customer preferences) rely on communications being by mobile or landline it may be quite hard for taxpayers to demonstrate continuing
access difficulties based on third party data unless there are contemporaneous emails. Although, possibly in contravention of employment policies, unless employees use workplace PCs/laptops it may be difficult for them to do so in a secure fashion if they can’t access their own accounts;

g. regularly tax cases appear where HMRC has tried to communicate with a taxpayer at a last known (postal) address (or address of its agent), but for whatever reason a change of address or agent has not been notified. It should not be possible for liabilities under simple assessment to be incapable of challenge, certainly where a taxpayer asserts that he or she has, or his or her agent asserts that they have, notified HMRC of the change of email address (more than, say, 5 working days before issue of the assessment); or

h. Simple assessment will involve HMRC communicating to taxpayers what HMRC’s view is their liability and how payments should be made to HMRC within the relevant period. There might be some additional protection for taxpayers against “phishing” attacks if HMRC’s communications in respect of liabilities refer to previous communications to taxpayers (that have provided details of HMRC accounts to which payment should be made) but not contemporaneous cross references or links. In other words if taxpayers receive an email purporting to come from HMRC which provides additional payment details the taxpayer should have an opportunity to verify that (otherwise than by email communication with the purported sender of the message) for, ordinarily, HMRC would not need to send a link to payment arrangements where details had been provided to the taxpayer earlier.

The terms on which a taxpayer deals with HMRC have been litigated recently in Garrod v HMRC ([2015] UKFTT 353) in which the dispute was whether the taxpayer was liable to a penalty. However the underlying issue was the terms on which HMRC could deal with a taxpayer under the relevant legislation (section 135 FA 2002) and in particular whether being required to acknowledge that he or she had read the terms and conditions (which governed dealings between HMRC and taxpayers) was lawful.

We do not underestimate the benefits to HMRC (and indirectly to taxpayers to the extent that costs of HMRC administration fall) from “Making Tax Digital” working successfully. However it is important that the operational issues governing the rights and responsibilities of HMRC and taxpayers are fair and balanced. If significant groups of taxpayers find themselves liable to tax, which they believe is not due from them, because they have not appreciated the significance of communications from HMRC, it could undermine the extremely high percentage levels of taxpayer voluntary compliance.

Establishment of the Office of Tax Simplification

We strongly support the establishment of the ATS on a permanent footing. Its effectiveness will, however be it, dependent on:

a. it being adequately resourced – see our comments below; and
b. a willingness on the part of HMRC and HM Treasury to respond constructively and promptly to its recommendation.

For that reason we believe it is important that the Chancellor of the Exchequer must prepare and publish his or her response to the reports of the OTS, as clause 85(5) provides. Further we believe it is fundamental to the effectiveness of the OTS that it prepares a report on the performance of its functions (as provided by clause 86(1)) as that will enable it to comment on the extent to which its recommendations have been implemented or the reasons given for non-implementation. In this regard it is key that clause 84(1) enables the OTS either in response to requests from the Chancellor or of its own initiative to provide advice to the Chancellor.

As regards the independence of the ATS we could envisage that the Treasury Committee might want to approve the Tax Director’s appointment (previously announced by the Chancellor of the Exchequer). We would expect that any additional members (beyond the 4 comprising the Chair, Tax Director, HMRC and HMT appointees) who are to be nominated by the Chair, would not be nominated by the chair without some prior discussion with the Tax Director.

There is a risk that simplification of the tax system proposed by the OTS could be frustrated by measures proposed in the Autumn Statement and Budget. Obviously any Chancellor of the Exchequer of the day will wish to retain the flexibility currently afforded to him or her, but given the confidentiality that could be expected of the Chair and the Tax Director there should be an opportunity to enable the ATS to feed into the Finance Bill process. [In this regard we deprecate the increasing tendency “badge” legislation as anti-avoidance (hence justifying no prior disclosure to taxpayers because of fears over forestalling) where another perspective on the legislation is that its revenue raising (but not necessarily at risk of forestalling) such that some prior discussion could not have taken place.] We think this could be satisfactorily achieved by making it a duty on HMRC to consult the OTS when considering proposals that are to be the subject of consultation, formal or informal. While HMRC would not be required to disclose what advice or commentary was given by the OTS to it prior to preparation of consultation document, ideally at an early stage a consultation proposal will still be in development or “worked up” and so might enable proposals that could undermine the simplification and efficiency goals of the OTS to be reconsidered.

The schedule to clause 83 provides that the Treasury determines the provision of staff accommodation etc. “necessary or expedient for the proper performance by the OTS of its functions”. Given current constraints on public expenditure generally, we do have concerns that resourcing might be constrained to such an extent that the OTS was handicapped in performing its functions.

29 January 2016
Submission to be found under Lloyds Banking Group and Legal & General Group – Oral evidence (QQ 38-59) (FBBOE0003).
Good afternoon, Miss Martin and Miss Stevens. Thank you very much for joining us, and welcome to this hearing. As you know, we are looking at a number of different aspects of the Finance Bill. We are particularly interested in hearing something from you about the consequences for your businesses of the changes that have been made. The tax deduction scheme for interest is obviously going to change. It would be useful to know how big a change that will be for your organisation. How will you cope with that change? Are you confident that you can cope with it within the timeframe? Do you feel that the introduction of this measure has been signalled sufficiently in advance to enable you to
get across your possible concerns about the implementation and impact that it will have on your clients? Who would like to start?

**Sue Martin:** Lord Chairman, Committee and clerks, thank you for the opportunity to give the evidence you to your inquiry on the Finance Bill. My name is Sue Martin and I am VAT and operational taxes director for the Lloyds Banking Group. The changes to the TDSI rules are the most significant to come in for many years on the taxation of savings and investments. It is going to be a very technical challenge, but the objective is to make it simple for customers. This is part of a much bigger, broader approach to simplifying tax that is being brought in. From a Lloyds Banking Group perspective, we have a group-wide programme—one of the largest in the group—that is going to deliver the changes needed. We are also putting in, as part of that, an educational plan for our colleagues, so that within the organisation itself we will make sure that our colleagues are in the best place to understand the rules that are coming in. We will then work with HMRC to make sure that the changes that are brought in are smooth from a customer perspective. Obviously a longer lead time would have been better, but we appreciate that this is only as part of a broader range of changes. It is part of many regulatory changes that we are looking at as a wider package. So from our perspective it is a case of working with our customers to make sure that they understand the changes and that this is reflected accordingly.

**The Chairman:** Does it require you to completely rejig your computer system and record keeping? What does it entail?

**Sue Martin:** Yes, from our perspective it means there will have to be changes to IT systems. As the TDSI rules go back many years, a lot of IT programming has been in the system for many years. We have to go into those systems and make sure that, from a group perspective, we identify where all the interest deduction is within them and make sure that we put the necessary changes in.

**Grace Stevens:** Lord Chairman, thank you for the opportunity to come and talk. I am Grace Stevens, the chief tax officer for Legal & General. I look after the Group’s tax affairs as a business and make sure that we provide the right information to our customers. We are very supportive of any measures that make life simpler for our customers. However, unlike my colleague, ours is not a deposit-taking institution, so for much of our business there is not actually an impact from the removal of the TDSI rules. Where it does impact us is in our retail platforms and fund businesses. For many of those, they will still have to withhold income tax on bond fund distributions and the things that they receive into those funds. Under the new rules, some of those will be received gross, but some will still be received net of tax. For us, it is about making sure that our communications to our customers can cope with that distinction and that we are able to provide the right information. To make sure that they can do that, we are in the process of updating our processes and systems, our communications to our customers and staff training. As a further simplification in the future, we could support the removal of the requirement to deduct income tax at source on those fund distributions. This would be a further simplification in the fund space for those investors and create a level playing field with the European funds.

**Q39 The Chairman:** Do you think that there is any risk that, by paying interest gross, there is a compliance problem for HMRC, which may collect less that it would otherwise do?
**Grace Stevens**: I do not have any statistics on how much it collects via us versus interest paid gross. However, in conjunction with the simple assessment stuff and the data they get from other people, it should work together as a package of measures to address that.

**The Chairman**: So you would provide your clients—savers, if you like—with an annual return about the interest they have earned and what, if anything, has been deducted. Is that how it would work?

**Grace Stevens**: Yes. How often those would come through would depend on the product, but they will get at least an annual statement that tells them what return they have made during the period, what has been received gross, what has been received net, anything that they do need to reclaim, and what their own information is. It is about making sure that the communication sets out the types of consequences that they will need to consider and that they have that information in a clear format.

**The Chairman**: So if there is a mix of interest paid net and interest paid gross, you will provide your savers with a computation that shows interest, any deductions that have been and the amount they would need to return in their tax return.

**Grace Stevens**: It is unlikely to be a full computation of that sort, but it will clearly set out what has been received gross, what has been received net and what tax has been withheld. They will still receive tax vouchers for any tax that has been withheld.

**The Chairman**: And if you invest in, say, international bonds, you would have to calculate and show, on the statement, tax that had been deducted, maybe by another jurisdiction.

**Grace Stevens**: Yes, and we are still looking at the easiest way to communicate that and in the simplest way. It requires updating and making sure that it is user friendly.

**The Chairman**: Is that not quite a big exercise? If you have a bond fund that has international and UK bonds in it, you have to segregate them and each investor will then have a sliver of the income.

**Grace Stevens**: Yes. That is what we are doing at the moment. Where you now receive interest net but will receive it gross is a simplification. A further simplification would be to remove it from the bond funds rules as well, so you do not have to withhold income tax at source on those.

**The Chairman**: Your IT systems are certainly going to have to be very sophisticated to do all that.

**Grace Stevens**: Luckily I have people for that. I would not be able to do it myself.

**Lord Teverson**: I have a question for Sue Martin. I am trying to understand the cash flow implications of this for banks. I am not sure when you actually pay HMRC the money that does not go to taxpayers at the moment. Does that reshuffle anything? Are all outgoings the same thing? Do you make a windfall gain or loss of cash?
Sue Martin: At the moment we pay the money over to HMRC on a quarterly basis. It is accounted for as part of a CT61 return. Every quarter, the tax deducted from interest payments to our customers is paid over to HMRC.

Lord Teverson: Right. So is that when you pay it now, or when you will pay it, to your clients?

Sue Martin: As we make the interest payments to our customers, the tax is deducted and goes into the tax account.

Lord Teverson: So it is effectively cash flow-neutral to you.

Sue Martin: Absolutely, yes.

Q40 Lord Turnbull: All this is linked in timing with a change in the way taxpayers account to HMRC. They will receive much of their interest gross, some net and some a bit of each. How do you ensure that the information you are sending to your customers is the same as the information you sent to the Revenue and which the Revenue then uses to pre-populate the forms? The danger is that you would get something from the Revenue saying, “This is what we think”, look at your own statements from the various investments, banks et cetera and spend hours and hours trying to marry the two up.

Sue Martin: That is no different from what we do now. We complete annual returns for the Revenue for the interest payments for every customer who has an account. That is driven from the accounts on our systems, so the returns that go to HMRC come from customer account information. The statements that we send our customers with details of the interest paid and the tax deducted are also driven from those same accounts and those same systems, so the information that is sent to HMRC and to our customers is being fed from the same system.

Lord Turnbull: The difference is that now for basic rate taxpayers—the main body of taxpayers—the tax is taken off.

Sue Martin: That is correct.

Lord Turnbull: So you are concerned only with the difference at the margin. Now, customers will need information to enable them to calculate the total tax they should be paying on the interest.

Sue Martin: That is right, and we are working with HMRC at the moment to understand its future vision as regards digital tax accounts and the timing of returns. We understand that from a digital tax return perspective it is piloting returns at the moment. It is taking the returns that we have submitted to it and it is pre-populating those pilot accounts with the information that we have given it. We understand that while it is still working on an annual basis, any changes will be reflected in tax codings, but we anticipate that it will go on to more of a real-time basis.

Lord Turnbull: When is this all due to start? In eight weeks’ time?
Sue Martin: It is going through phases at the moment. The tax deduction will be switched off in April 2016.

Lord Turnbull: Are you ready for that?

Sue Martin: Yes. We have a group-wide project in place to make sure that we meet those requirements.

The Chairman: Do you feel that you have had adequate notice of these changes?

Sue Martin: Because they are big changes, a longer lead-in time is always better, but once we know when the changes have to be implemented, we obviously work with our people who need to be involved—the IT people—to make sure that we meet the deadline and that we do the best for our customers.

Lord Kerr of Kinlochard: I can see why great institutions like yours would rather like this change. In a way, you have been doing the Revenue’s work for it until now. This means simplification for you and, if I understood aright your answer to Lord Turnbull, a small cash-flow advantage. I can understand why the Revenue likes it, but what about the taxpayer? How many are we talking about? How many people have interest-bearing accounts with banks?

Sue Martin: I do not know the full number off the top of my head, but we have a significant number of customers, and a significant number of those accounts are interest-bearing.

Lord Kerr of Kinlochard: How many does Lloyds have?

Sue Martin: I do not have that number.

Lord Kerr of Kinlochard: Presumably most people have an account that might, in happier days, pay them interest. The work will now fall on them. Simplification means less work for you and for the Revenue but not for the individual. Do you think the individual has understood yet that this task is going to fall on him or her?

Sue Martin: At the moment that has not been widely publicised, and it is something on which we are very keen to work with the Revenue. One thing that we are looking at as part of our group-wide project, certainly on our digital banking platform, is when they log in having pop-up screens that will educate the customer and point them to places where they can go for further information, obviously with links to HMRC and government websites. We are very keen to work with the Revenue to make sure that we support the public information that it puts out, to make sure that we all work together and to make sure that the customer fully understands the changes.

Lord Forsyth of Drumlean: Chairman, just before we leave this point, if someone is a basic rate taxpayer but is not in employment and would previously have got the interest on their accounts with you, under the new system they will have to pay the tax on that interest and will be asked to pay a bigger sum than they would otherwise have done. How are they going to pay that if they are not in employment on a PAYE system and if they do not complete a tax return? How will it work?
Sue Martin: They will be given a personal savings allowance. A new personal savings allowance is coming in that will give them a £1,000—

Lord Forsyth of Drumlean: But if they exceed that?

Sue Martin: If they have these digital tax accounts—

Lord Forsyth of Drumlean: But those will not be in place in April, will they?

Sue Martin: No, they will not.

Lord Forsyth of Drumlean: So if in April I am someone in the circumstances I have described, how do I pay? You will send me a piece of paper that tells me what is being deducted and what is not being deducted, but how do I pay? What do I do?

Sue Martin: That is something on which we will be working closely with the Revenue.Obviously we want to be able to help our customers who do not pay tax.

Lord Forsyth of Drumlean: You say that you are working closely with the Revenue, but this is going to happen in April, which is two months away. I guess that most people do not understand this, so you are going to have quite a lot of people who are confused ringing you up.

Sue Martin: Yes, and that is why, as I said, we are working with the Revenue. We are trying to understand from the Revenue whether it will have any mechanism in place to allow payments back to customers without them having to complete a self-assessment return.

Lord Forsyth of Drumlean: When is the tax due? Do people get until the end of the tax year to pay it, or is it payable quarterly, or what?

Sue Martin: It will depend on their circumstances. If people exceed their personal allowance, the Revenue says that any changes will be put into their tax codings, but obviously if they are not in a PAYE system it will not be put into a coding, and they will have to pay that amount. Again, we are trying to understand what the Revenue will have in place to enable people to do that.

Lord Forsyth of Drumlean: In your earlier answer, you said that you thought you had been given adequate notice, but clearly you have not.

Sue Martin: We have been given adequate notice to make the changes that we will need to make from a corporate perspective. We are working with customers and giving them as much information as we can, and we are working with HMRC and are trying to understand what changes HMRC is making so that those can be reflected in that information.

Q41 Lord Kerr of Kinlochard: I want to turn to dividends, where it all gets much more complicated as far as I can see. First, on Lord Forsyth’s question about timing, I am a director of a finance company, but let us suppose that I was the chairman of a company that had its AGM in May and the AGM was required to approve the final dividend for the year 2015. That dividend would normally be payable to shareholders with a voucher indicating what tax had already been deducted. Is that going to happen this year if it is a payment in
the next financial year? Is the voucher going to be sent out or not? If not, should not I, as the chairman, be preparing my annual report and warning people that this change is going to happen?

*Sue Martin*: From a Lloyds Banking perspective, obviously at the moment we have an obligation to issue tax vouchers. On those tax vouchers we have to detail whether a tax credit or a notional tax credit is attributable to that dividend. Lloyds Banking Group is going to continue to issue tax vouchers. When the requirement to deduct the tax ends, we will show a nil tax deduction on those vouchers.

*Lord Kerr of Kinlochard*: So you will not be required by law to do it, but you are choosing to do it.

*Sue Martin*: Yes, we are choosing to do it.

*Lord Kerr of Kinlochard*: Good. Still on Lord Forsyth’s point, do you think that the shareholder in general is aware that this change is happening and happening so soon?

*Sue Martin*: I have no knowledge of the shareholders’ view on that. I have seen no indication of whether they are fully aware or not aware.

*Lord Kerr of Kinlochard*: Taking the whole of the taxation of dividends dossier, you have the new dividend allowance coming in, you have no increase in the ISA, and you have three rates of tax payable on dividend income, which are different from the standard income tax rates. You probably have a requirement, if you are a saver, to rethink your strategy, particularly because of the £5,000 and particularly if you are a higher-rate payer. Do you think that the whole structure has been sufficiently publicised and understood? You probably ought to be thinking right now about the decisions about what you are going to do with your investment strategy.

*Sue Martin*: Yes, and I think that different investors will want different things from their savings. For us it is about helping them understand the constituent parts. A key thing is putting the information out to our customers. As an organisation, we are trying to educate our customers and give them as much information as we can. We also have to bear in mind that we are trying to complement that with what HMRC is issuing, so that we make it simple and easy for our customers to understand.

*Lord Kerr of Kinlochard*: It was all sold as a simplification. The Government said that it would modernise, reform and simplify dividend taxation, but it all looks quite complicated to me, and I think it will look quite complicated to most of the punters out there. They will need a bit of advice and will need to think about it.

*Sue Martin*: Absolutely, yes. As I said, we are doing as much as we can. We cannot give our customers actual tax advice, but we can help them understand what the changes are. We are putting things in our online systems to give them pop-ups about what things mean and help them get the advice they need.

*Lord Kerr of Kinlochard*: If there had been a consultation exercise—there was not—would you have advised the Revenue that, for the amount of income they wished to take from dividend taxation, to do it in this way this way?
**Sue Martin**: From a Lloyds Banking perspective, the key thing for us on dividends is just one of communication; just notifying what the tax is. It would not have been a big enough thing for us to have dictated how we saw it working.

**Lord Turnbull**: Having seen some calculations from our advisers about tax credits, I can see that this is a much simpler scheme, but it does mean that people have to rethink their finances. A very simple example is a husband and wife; one is a higher-rate taxpayer and one is a standard-rate taxpayer. At present, it would make sense for the husband to hold the ISAs and the wife to hold the shares, but now the obvious thing is for the husband to hold as many shares as will exhaust the £5,000 and no more and then leave the rest with the wife. I have not seen anything that advises anyone about this that tells them that is probably the natural response to this.

**Sue Martin**: I think that all savers will have their own individual needs and requirements as to how to structure their affairs. With different allowances coming in, people will want to make the most of them. It is very difficult to try to put out general information, because different individuals will have different requirements according to their own personal circumstances.

**Lord Turnbull**: This is looking very similar to the interest, where the two big players, so to speak, have sorted things out for themselves but the public are underinformed about how it will affect them.

**Sue Martin**: That is one reason why we are trying to work with our customers and give them as much information as we can without giving them specific tax advice, which we cannot do.

**Lord Turnbull**: Can I just touch on one point that Lord Kerr made? There is a piece of advice we want here. If the dividend declared is a final one that, for a normal calendar year company, would be in the spring some time, which has to be approved by shareholders, often at an AGM in, say, May, it is taxed from the date at which it is declared payable, even if the funds are transferred some time after that. It is likely that this will all hinge on when the annual report is actually issued. Is that right? You are the expert on this.

**Baroness Noakes**: The AGM.

**Lord Turnbull**: That is not when it is declared payable, is it?

**Baroness Noakes**: Yes it is. It is when it is agreed at the AGM.

**Lord Turnbull**: The calendar year people will have to go somewhat to get their AGM before the end of March.

**Sue Martin**: Yes.

**Lord Turnbull**: So your last dividend, which you will pay at the AGM in the spring, is going to be on the new basis?

**Sue Martin**: Yes.
Q42 Lord Forsyth of Drumlean: This question follows the line taken by Lord Turnbull. I assume that both of you sell ISAs to your customers. Are you worried about getting done for mis-selling? For example, there may be somebody who has a small inheritance or something of that kind. Unless they are setting up a number of ISAs each tax year on a cumulative basis, they could be better off not having an ISA than having one, because of the allowances and the costs and fees involved in setting up an ISA. Are you concerned about that?

Grace Stevens: We will be looking at our TCF—treating customers fairly—rules to make sure that all our literature and processes deal with that problem. That is part and parcel of updating our processes and systems.

Lord Forsyth of Drumlean: But you can see that there is a problem.

Grace Stevens: It would depend on an individual’s facts and circumstances, the charges involved—a whole range of things. It comes back to communication, staff training and making sure that we have the right systems in process to provide the information to allow people to make an informed decision.

Lord Forsyth of Drumlean: If you are not allowed to give tax advice, it is difficult to see how you could advise them not to have an ISA.

Grace Stevens: It would depend on their own circumstances across the piece and whether they have come via an IFA. A number will be referred by an IFA, who will give that kind of advice. We can give examples and make sure we set out what our charges are and how things will work within a given product.

Q43 Baroness Wheatcroft: Lord Chairman, I declare an interest as a director of a savings and investment company, but my question is not related to that area at all. I would like to ask Miss Martin about the smaller business customers of Lloyds. There is a belief that a fair number of them incorporate so as to remunerate their owners by way of dividends rather than salary. HMRC would like to get its hands on more of that money and believes that this change will accomplish that. Do you think it will be effective?

Sue Martin: Obviously we cannot give tax advice to our actual customers. For us, the dividend change is one of communication only. I do not have a view on what those businesses are doing.

Baroness Wheatcroft: Do you have indication of how many of your small business customers are incorporated?

Sue Martin: I do not have that information with me.

Baroness Wheatcroft: It might be quite useful if we could get hold of that information. Would that be possible?

Sue Martin: It might be something I could look into getting hold of, yes, but—

Baroness Wheatcroft: At the moment, it is anecdotal that a lot of people pay dividends rather than remuneration by salary. If that is one of the motivations for the change, it would
be good to have some evidence as to whether it is justified. If you were able to get any information for us, it would be appreciated.

Sue Martin: Okay. I will look into it and see if we have that information.

Lord Turnbull: Coming back to interest again, can you give me some idea of the quantitative significance of non-TDSI interest? What kind of products are they and how will they be treated? The idea that you get a return on a “mixed product” did not sound very appetising to me. It would be like getting a PID dividend from a property company.

Grace Stevens: I do not have the numbers on the amount of products that we have, but we can certainly provide that information later. It would be things like a unit trust or investing in a bond fund via that. For that, income tax would still be withheld at the basic rate when it pays out. We also produce statements for that: if you would like to see an example of that kind of statement, I could certainly provide one if it would be useful.

Lord Turnbull: What kinds of things are outside the scheme, apart from bonds? Are Zopa and those sorts of companies in it? I am talking about companies that lend money to a family member and pay you interest. Are they in the scheme? What else is excluded from the scheme?

Sue Martin: Compensation payments are excluded from the scheme as well. The TDSI is about deducting tax from deposit-takers—that is, deposits of money. If a compensation payment to a customer involves an interest payment, that interest payment has to be taxed, and that falls outside the TDSI.

Lord Turnbull: There must be other classes of investment, apart from bonds, where effectively interest is paid but that are not inside the scheme.

Grace Stevens: I think that the peer-to-peer stuff is still under consideration, but at the moment that falls outside the scheme because it is not deposit-taking. Other forms of informal loans may fall outside the scheme in the same way. There will be various things. As Miss Martin says, the TDSI is restricted to deposit-taking.

Lord Turnbull: You do not think that there is a problem that these more varied, sometimes more informal and less structured interest payments are not in the scheme?

Grace Stevens: Certainly from the perspective of our fund portfolio, we would support further simplification involving the removal of that difference. We do not provide some of the other things, so it is difficult to comment on that.

Q44 Lord Teverson: Staying on the subject of simplification, one area that is changing is that companies are no longer required to issue a dividend voucher showing tax credits to shareholders and so on. My question is: do you regard the measures as a whole as simplifying the tax system and that they are therefore positive? How will the administrative burden on your companies change? Do you see this whole area of simplification as a positive way forward or as an interim step, or is it going to make the whole thing a heck of a lot more difficult for everybody?
Sue Martin: From a Lloyds Banking perspective, we see working towards simplification as positive. This is a part of broader measures to implement digital tax accounts. Within a digital tax account, our customers will have various forms of income and have allowances to offset against a specific type of income—hence making things a lot simpler for them. So we see this as part of the simplification process and we are working towards that.

As regards the burden of the dividend changes on our organisation, as I said, from our perspective we are going to continue to issue tax vouchers but they will show a nil tax rate. Obviously there will be an increased cost in changing those vouchers, but other than that we do not see any increased burden.

Grace Stevens: I would echo that. We are very positive about any measures that simplify the system for our customers, and we think that this change offers that. Regarding dividends and the burden for us as an organisation, we are still assessing what we are going to do. We may not necessarily provide dividend vouchers as they currently exist, but we will still provide information on our dividends to our shareholders as part of the normal course of business. We are in the process of updating our systems and documents to work out what that will look like going forward.

Lord Teverson: I am also interested in two areas that come out of that. One is the change in systems. One thing I had drilled into me is that my bank account is based on Fortran language, which goes back to the 1960s. We know that in banks, although perhaps not so much Lloyds, small changes can make big differences to those core systems. Is that definitely not an issue with what is happening here?

Sue Martin: We are in a digital world now, so we are constantly looking at changes to our systems. It is a case of making sure that the programmes that we have in place look across the piece so that we include all the systems that need to change, and that we have the infrastructure and projects in place to make sure that the changes are fully tested and supported before they are implemented.

Lord Teverson: Of course, I meant COBOL, not Fortran, but it seems that there is no issue with that. On the simplification side again, we have taken evidence here about the Office of Tax Simplification. I am not absolutely sure how it operates. Do you give evidence to it? Do you ever interact with the Office of Tax Simplification? Do you have any communication with it at all?

Sue Martin: No, I have not.

Lord Teverson: Do you think that would be useful?

Sue Martin: Possibly, yes. If it is looking at changes that are being made as part of a simplification, it might be useful to do that.

Grace Stevens: We have responded to one or two of its calls for evidence and consultations that it has done. I have sat on a couple of tax committees and the OTS will often come and engage in that format, whether it is at the ABI or the CBI, so I have engaged directly there. Anything that keeps tax simplification on the agenda is really valuable. I have always been very impressed by the interactions that we have had and I look forward to those continuing.
Lord Teverson: Do you feel that that OTS paid attention to you? I am not trying to prompt you to be negative at all. Hopefully it listens, and that makes a difference. What is your feeling about that and about responding to its consultations?

Grace Stevens: We responded to the consultations and I think that the OTS does a good job. Trying to simplify the several thousand pages of our tax legislation is not an exercise that I would personally like to do, but the OTS makes steps forward and it makes a good job of it.

Q45 The Chairman: It seems that these changes will require a significant further investment in IT. Although you do not give tax advice, there is an element of hand-holding, if I can put it like that. People ask, “Is this the right bond or the right fund for me?” A question for both of you is: do you see these changes as increasing the costs of providing the investor products that you currently provide?

Sue Martin: We already have to provide a wide range of products for our customers. It is a case of reacting to customers’ needs. As I said, we try to put as much information as possible into the brochures that we publish on our products to help our customers to understand those products and what they mean. We are constantly reviewing our products to make sure that we have the best ones available for our customers. This is just another process to make sure that we have the right guidelines for our customers within those products.

Grace Stevens: In that sense, it is very much business as usual and involves a product review, terms and conditions, and literature. Every time there is a change in legislation, we have to make sure that what we say on our website, in our product literature and on the TaxFacts app, which gives more general tax information, is all up to date. We are doing that as part of the normal processes. This just forms a part of that.

The Chairman: So there will be no increase in the fees for clients.

Grace Stevens: I cannot possibly comment on the actual fees. It is part of our cost of doing business.

Baroness Drake: Just developing your point, do you think that the industry will respond to these changes by coming up with products that take advantage of the £5,000 dividend allowance alongside the ISA—coming forward with a set of propositions that take advantage of that? Do you see that evolving in the offerings being made?

Grace Stevens: I think that anything is possible, but it is not something that we are currently looking at. There are a number of other organisations out there that provide a number of products. Anything like this will potentially result in some sort of behaviour or product change, but I think it is too early to say.

Baroness Drake: What about Lloyds? Does it retail these kinds of products?

Sue Martin: We are obviously a UK retail-centric bank, and we have the largest ISA customer base in the UK. I am not aware that we are looking to review any of those products in line with any tax changes at this time.

Baroness Drake: You are not or you are?
Sue Martin: We are not, no.

Baroness Drake: No, you are not.

Lord Bilimoria: Can I just refer to some research that was undertaken for HMRC in May 2015, which found that awareness among higher-rate taxpayers of the requirement to declare and pay additional tax on savings, following the initial deduction of 20% under TDSI, was very low? What do you think the implications are of this finding for the introduction, from April 2016, of simple assessments of tax liabilities based on third-party information? Can financial institutions do any more to raise awareness of savers’ tax obligations?

Sue Martin: As we have already said, LBG is certainly keen to help its customers understand the changes and how they are affected. We are looking to introduce as much help on their online accounts as possible. As part of this, pop-up screens will focus on the changes. If they go into them, they will point to additional information and to other websites that they can go into and look at as well. As I said, we have a group-wide project that is implementing these changes. One thing it is looking to do is provide a leaflet that will explain the personal savings allowance and the dividend allowance. The key thing for us is to communicate the changes to our customers and to educate them. It is also key to work with the Revenue to make sure that all the information out there is being complemented between us and the public sector.

Lord Bilimoria: Do you think that HMRC should also be raising awareness about this more?

Sue Martin: Yes. We have already had discussions with it about the personal savings allowance and we understand that it is going to put information on the GOV.UK website. That is one of the discussions that we are having: to complement what will be on there with what we are able to tell the customer.

Lord Bilimoria: For example, do savers know that they have to check and maybe amend these forms?

Sue Martin: I understand that at the moment HMRC is not changing its website until this changes. It can be confusing to change half way through, when people are still looking at one regime. It is keen to put the changes on when they come in, to make it clearer for the customer.

Grace Stevens: To make the same point, it is about no surprises for our customers. In the long term, the move to simple assessments will be a positive step. However, the transition needs to be managed carefully. People are used to the systems they have at the moment; whether they are filing an annual tax return or if they are used to getting interest withheld under TDSI, they are used to that system. It is about managing the transition and providing communication. Similarly, we will update the information that we provide. We will potentially look at providing links to the information available on HMRC’s website. HMRC has already produced a fact sheet on the dividend allowance and I would expect to see more guidance on that come through as we get closer.

Baroness Drake: On the point raised earlier by Lord Forsyth about how people in certain circumstances simply find out how they pay the tax or its impact on their personal allowance, will your communications specifically address the key questions that people will
need to know, even if it is a link? Are your comms being subjected to consultation or oversight by HMRC? Is there an iterative process between financial institutions and HMRC about what their comms contain when it comes to April, or is it left to your discretion, based on what you think your regulatory duty is?

*Sue Martin*: From a banking perspective, we work very closely with the British Bankers’ Association—the BBA. We tend to have those discussions with HMRC from an industry perspective, so we can see what information it is going to put out. We also like to keep it consistent within the industry to make sure that customers are seeing something very consistent. We work very closely with the trade bodies and HMRC to make sure that there is a consistent approach that customers can understand.

*Baroness Drake*: So is it the idea that the industry and HMRC are working together and saying, “These are the 20 pieces of information that people will typically ask for or want to know. Let’s make sure that everybody’s comms cover these issues, even if there is a link to where they find out the information”?

*Sue Martin*: Absolutely, yes.

*Baroness Drake*: So that is a perfectly viable thing to do. You could have 50 questions if you needed to, but are you trying to capture the kind of base information and key questions that need to be answered in the comms that go out from most financial institutions?

*Sue Martin*: Yes.

*Baroness Drake*: So in effect that is work that is taking place?

*Grace Stevens*: Yes, it would be the Investment Association for us but it would be the same kind of thing. HMRC will often publish guidance for consultation before, in which case we would feed in on that as well.

**Q46 Baroness Drake:** We have seen a series of changes to dividends, to savings tax and to a generous and more flexible ISA. Taken as a whole, with your experience and knowledge of the consumer, will those things, taken together, make the personal finance experience simpler or more complex for the UK saver?

*Sue Martin*: Different customers have different savings needs, so it will vary from customer to customer, depending on what they have their investments in. As we have already discussed, this is part of a broader set of packages that are coming into to bring the whole thing together to make it simpler. Once the digital tax account is up and running, our customers will be able to go into their digital tax accounts, see where their different streams of income are, and put their allowances to those different streams. As an organisation, we are very keen to educate our customers and tell them what information we are going to provide to HMRC to populate the digital tax accounts. So it should make it very simple for the customer. Our research has shown that our customers feel that by having a digital account they feel more in control of their finances. By extending that to a digital tax account they should feel in control of their tax as well.

*Baroness Drake*: So on balance that is a yes. Do you share that view?
**Grace Stevens**: Yes. We are supportive of anything that simplifies things for our customers and anything that encourages people to save, and we think this does that. How that impacts on individuals will depend on their individual facts and circumstances. However, for the vast majority of savers this will be a simplification and they will be able to take full advantage of the allowances.

**Baroness Drake**: Do your organisations have an understanding or a belief in what you think is the Government’s direction, in terms of savings and investments. Do you think you know where the journey is going, or are you dealing with it incrementally?

**Sue Martin**: I think there are big encouragements and incentives for people to save. It is about working on the legislation that is there and having the products to give our customers a wide range of alternatives to help them to invest so that they can get what they want from their savings.

**Baroness Drake**: Lloyds is a major bank and Legal & General is pretty big in terms of the funds that it has under management. Do your organisations have a sense that you know where the Government are travelling to?

**Grace Stevens**: There has been a clear steer of encouragements for savings, both in this and in the pensions reform. I cannot presume to speak for the Government or the Chancellor, but that pro-savings agenda comes through and that is what we are working towards delivering for our customers.

**Q47 Baroness Noakes**: You have spoken about digital tax accounts. I know that HMRC is going to be consulting on the details of that, but I just wonder whether you have any early comments on the implications for you as a bank or insurance company in handling what you perceive to be the information requirements to allow digital tax accounts to go ahead.

**Sue Martin**: As you said, HMRC is going to be consulting on that, but from a banking perspective we already send HMRC vast amounts of information on our customers—we report annually to HMRC on our customers. As HMRC starts to consult on its journey into digital tax accounts, it is about working with it just to make sure that the information that we then send to it is the information that it wants in the right form at the right time.

**Baroness Noakes**: Do you think it will require you to get any additional information? You do not necessarily capture tax references or even national insurance information at the moment.

**Sue Martin**: No. Obviously from an ISA perspective we collect National Insurance numbers for our customers. Going forward, we have just implemented the FATCA reporting regime for our customers with US indicia. We are also moving on to the common reporting standard, which is the OECD initiative to report on customers with overseas income.

**Baroness Noakes**: But that will not cover the bulk of your customers, will it?

**Sue Martin**: It will not, but there are various reporting regimes. We currently send to HMRC the bank and building society interest returns on our UK customers. We have the European savings directive, which we send to HMRC on our European customers. We will have the FATCA, which will be US customers, and going forward we will have CRS. All those reporting
regimes have slightly different variations of customer requirements and the information that has to be gathered. As we are moving forward with the reporting regimes, we are looking at our onboarding processes for our customers, making sure that we are capturing information upfront and holding the information that is required of us, ready to report the information to HMRC that we need to. As information requirements change, we can react accordingly and capture the information that we are legally required to and then report it to HMRC if we are legally required to.

Grace Stevens: It is similar for us. The things that we are thinking about are what we already provide to HMRC, what might we be asked to provide in the future and how we would do that. As Ms Martin says, the framework that we have in place across the USD and CRS would allow us to collect that information on UK people, if that became a requirement. There is then the issue of how we communicate with our customers about what we collect and provide to HMRC and how that works. Then there is the impact on us as a business, if we are providing our own digital accounts and how we do that. The other thing that we are thinking about is the digital first approach, which will be welcomed by many people as a good thing. However, a number of people are not digitally enabled and do not have access to the internet or are not able to do so because they have certain vulnerabilities. One thing that we are concerned about and are thinking about is how we and HMRC manage engagement with those customers.

Q48 Lord Forsyth of Drumlean: This is a question slightly from left field. If the Scotland Bill currently before Parliament is passed, it will give the Scottish Parliament the ability not only to alter rates but to alter thresholds, although for savings and investment income there is a UK rate. Do you anticipate any confusion or difficulties arising from that ability to change the thresholds, or will there be a threshold that applies for savings income and another threshold that applies for earned income?

Grace Stevens: That is not something that we have considered in any detail as yet. It will be being thought about somewhere. I think it will all come down again to individual facts and circumstances. It comes back to the point about clarity on guidance on how it will work and communication with customers to make sure that they are not disadvantaged by any changes.

The Chairman: Ms Martin and Ms Stevens, thank you very much indeed for your helpful answers this afternoon.

Examination of Witnesses

Keith Richards, Chief Executive, Personal Finance Service, and Dermot Callinan, Head of UK Private Client, KPMG

Q49 The Chairman: Mr Richards and Mr Callinan, thank you very much for joining us this afternoon. As you know, we are looking into a number of aspects of the Finance Bill—important changes in tax deductions relating to interest and the introduction of the new personal savings allowance. It would be helpful if you could explain the administrative and
operational consequences of these changes in terms of your own businesses. Would you like to start, Mr Richards?

**Keith Richards:** From a personal finance or professional adviser’s perspective, there will be few administration changes or efficiencies, given that there will still be a need to deliver an annual statement on capital gains tax to advisers’ clients. So for typical advice clients, there is unlikely to be a significant saving from an administrative point of view, other than of course for firms that issue the tax dividend statements.

**Dermot Callinan:** KPMG is a global accounting firm and we have the largest tax practice in the UK. As of yesterday, we finished filing 15,500 personal tax returns. The consequence of the changes that are being proposed is that we will need to take them all into account when advising clients on filing self-assessment tax returns. The complexity that these measures begin to introduce, which has to be seen in the context of the inherited complexity, requires us to both train people and incorporate the changes, no doubt working with software providers to ensure that in future the computational changes that are introduced are in the system.

**The Chairman:** Do you believe you will have sufficient time to do that before these changes become live?

**Dermot Callinan:** Yes, I do. The organisation that I work within will be ready. Whether everyone will be, I do not know.

**The Chairman:** In terms of advising your clients and helping them to understand the consequences of these changes, are you going to have to take on more staff? How are you going to rise to that challenge?

**Dermot Callinan:** In the main, all the changes involved are capable of being absorbed within the current resources that we have available to us. Our clients are represented taxpayers, which is obviously a fundamentally different position from that of the general population. As represented taxpayers, they have us to advise them. As long as we are equipped and our systems are up to the standard to inform them of the correct thing to do both in responding to HMRC and in paying the right amount of tax, they will be well serviced.

**Keith Richards:** Advisers often work in partnership with qualified accountants, so the dynamics are slightly different but complementary. You might say that most typical IFA clients will already be fully cognisant with their tax position and therefore the changes will be less likely to have a significant material impact, other than perhaps in considering future investment strategies.

**The Chairman:** You believe that this will pass off without causing your industry great administrative difficulty and that it will be relatively easy for your clients to understand what is going on.

**Keith Richards:** Simplification is clearly welcome, but there are always degrees of complexity that come in with any change. Generally, the feedback is that there is a general lack of understanding of what has been announced or what that will be. In many ways the services of our members are increasingly in demand at times like this to ensure that the transition is as smooth as possible or that clients fully understand the implications for them.
I am not entirely sure that simplification works as well for people who are unadvised at present.

Q50 The Chairman: Do you think that there is a risk that the payment of interest gross could lead to a loss of revenue for the Exchequer?

Keith Richards: There certainly feels to be a risk. Tax is currently taken care of at source, particularly for those who do not exceed the higher-rate tax banding, whereas the onus will now be on individuals to carry out self-assessment and to understand when they have to submit the returns. From that point of view, there is a potential risk of lost revenue for HMRC.

Dermot Callinan: We have no evidence that the withdrawal of TDSI or indeed the further consultation in relation to other savings and deduction of tax at source will have an impact on tax-revenue-raising ability. From our perspective, there is clearly a simplification for the industry, which is otherwise held responsible for tax deductions. In the further consultation, we made the point that we see the attractiveness of having a level playing field across the board so that tax deduction at source becomes less of a feature of the tax landscape. However, what happens next depends very much on progress with regard to digitisation and tax collection. If it is successful and taxpayer digital accounts are accurate, and if they are issued to the right taxpayers and appeals are dealt with in the right way, it could become the norm. But the whole principle behind tax deduction at source in the past has no doubt been to avoid the complexity of trying to obtain tax from individuals who have not voluntarily made returns or have not dealt with the assessments that they have subsequently received. I am old enough to remember the old system of assessing individuals’ tax liability and them having 30 days within which to appeal. HMRC at the time—and I am going back some time, before the mid-1990s—came up with an assessment of an individual’s tax liability. I would like to think that with the passage of so many decades, the effectiveness and accuracy of HMRC digital assessments will be completely different compared with the experience that we had at that time, as well as in relation to the difficulty of dealing with appeals. Much depends on implementation rather than the proposal itself.

Lord Forsyth of Drumlean: I will just follow up on that point. There will be some people who are not paying under PAYE might be caught up in the way that you describe. I think that the proposal is that an assessment will be sent out by the Revenue. I suppose they would have to have substantial income because of the allowance, but if they have several accounts with several different providers, do you anticipate that the Revenue will break that down, or will it just get a number? If it just gets a number, how will it be possible to check it?

Dermot Callinan: Your first point is absolutely correct. Some people will have gross income. I think the point was made in earlier evidence concerning the state pension, for example, which could be tucked up with other savings. I do not know exactly how the Revenue will receive information, but I would have thought that, practically speaking, each organisation operating an account would have an obligation to report the content of the account in terms of interest, etcetera, to HMRC directly, and HMRC will assimilate that information to produce a single digital assessment. If the systems are successfully implemented, that may not be where there is an issue. The issue may be broader than that, for example if the same individual has other sources of income that are not being reported directly to HMRC. That is
when there may be some confusion as to whether the individual should be completing a tax return—they may have been notified that they should—or whether they should not.

Coming back to your original point, I also agree that the presumption behind all this is that 95% of taxpayers will not be affected because they will benefit from an increased personal allowance, the starting rate for savings income and the personal savings allowance such that they will be non-taxpayers for this purpose. My concern rests more with those on the margins—those who are perhaps not sufficiently wealthy to enjoy the services of an accountant or a personal adviser but are sufficiently wealthy to exceed the thresholds laid down by the Government.

**Q51 Lord Forsyth of Drumlean:** Turning to the taxation of dividends, we have had it suggested to us that the proposed changes will modernise, reform and simplify dividend taxation, and alternatively that the dividend allowance is an example of the proliferation of tax reliefs already in the system that add to complexity for personal taxpayers. Which view do you think is right?

**Dermot Callinan:** As an Irishman I can say this. As the Irishman once said, “I wouldn’t start from here if I was you”. When it comes to dividend taxation, you have to cast your mind all the way back to 1973, when advanced corporation tax came into being, to understand the history of how we have got to where we are. Originally, it was a very simple idea: as companies paid corporation tax and dividends to individual shareholders, corporation tax should be paid when the dividend was paid, i.e. early. If it was paid early, and the tax needed to be accounted for, it was accounted for as advance corporation tax. The individual received a dividend and the tax credit was available to frank their income. When it was originally introduced, the tax was paid. In other words, it was not notional. It was not until 1993 that the policy changed. There was a divergence, and as a consequence advance corporation tax stayed at 22.5% but the personal tax on dividends came down to 20%. The more fundamental change came much later, in 1997, when advance corporation tax was deemed to be not reclaimable by many of the institutions that invested in British companies—pension funds, for example—with the consequence that pension funds were the poorer. The other consequence was that we ended up with a tax system with a dividend rate of taxation with a notional tax credit that, by 1999, bore no great relationship to what was paid by the company in corporation tax. Even then, we ended up with a complicated regime that people seldom understand. By moving away from the tax credit that is no longer paid by a company, we are now moving to a system that most practitioners have adopted in their own mind for some time. For some time, practitioners would look at what they considered to be the effective rate of tax on dividends, disregarding the tax credit. If you asked most practitioners what the effective rate of taxation is in 2015/16 for a higher-rate taxpayer, they would say 25%. They would say it was nothing for a basic-rate taxpayer and for an additional-rate taxpayer 30.5%, because they do the arithmetic in their mind and subtract and add the tax credit and apply the tax rate to it. Where we are moving to is simpler to understand in a sense. I certainly find it simpler to explain to a client. If you are a basic-rate taxpayer, apart from a nil rate of £5,000 the rest at the basic rate is going to be taxed at 7.5%, 32.5% for a higher-rate taxpayer and 38.1% for an additional-rate taxpayer. I will also need to explain to the client that this is, in fact, a tax increase.

**Lord Forsyth of Drumlean:** Just for my own information, may I ask about the impact of the Scotland Bill, which is currently before this House, under which the Scottish Parliament will
be able to alter thresholds as well as rates but cannot change the rates on savings and dividend income? Does that mean that the thresholds will be treated differently as well, or is this going to create a complication?

Dermot Callinan: I am sorry to answer a question with a question, but do you happen to know if the power to alter thresholds means that they can alter the basic rate band?

Lord Forsyth of Drumlean: Yes.

Dermot Callinan: If it does, then yes. If the legislation is as proposed and not amended.

Lord Forsyth of Drumlean: They cannot alter the starting threshold, but they can alter the subsequent bands.

Dermot Callinan: Take, as another example, the personal savings allowance. That does depend on what rate you are at. If you are an additional-rate taxpayer you are not entitled to it. If you are a higher-rate taxpayer you are entitled to a lower sum of £500. There is a direct correlation there. In relation to dividend taxation, the rate depends upon the rate band, so again it will impact. As with other sources of income, if that came to pass, I suppose you could end up with a taxpayer liable to taxation in Scotland at a different rate to a taxpayer liable to taxation in England.

Lord Forsyth of Drumlean: On dividend.

Dermot Callinan: On dividend.

Lord Forsyth of Drumlean: Even though the scheme is supposed to be that it will not be affected the affect will be because of that.

Dermot Callinan: Yes.

Q52 Baroness Noakes: We are told that one of the reasons for the dividend tax changes is to deal with the issue of private companies, including but not limited to personal service companies, using dividends as pay rather than employment income, thereby avoiding national insurance. So one of the impacts is that it brings the tax rates closer together. What are the implications for any of your clients, or indeed the clients of your members, in dealing with this? What are they doing to respond to the new rules?

Keith Richards: There is a general acceptance and understanding of why the change is being brought in. It is fair to say that a number of firms have operated within the current framework.

Most advisers are now working, in association with accountants, to advise firms or clients on how they are affected by these changes and what their options are. The dynamics here are that it is not just the advice to our members’ clients: many of our members are small firms themselves and actually use this mechanism to effect. I think there is a general acceptance that it is going to result in increased tax, which in some respects will now change the impact on the operating costs of the firm. There is a general acceptance that it may not force people to rush away from utilising that structure.
**Dermot Callinan**: I think the Government’s intention was quite clearly laid out in the summer Budget Red Book. The changes were intended to start to reduce the incentive to incorporate and remunerate through dividends, but they wanted the tax system to continue to encourage entrepreneurship, including through lower rates of corporation tax. This measure seems to be intended to reduce the gap but, it appears, not to completely eradicate it. To one side, with regard to personal service companies, I think the Revenue has sufficient powers to tackle the abuse of these companies through IR35 et cetera. So I do not see that as being a contemporary problem necessarily. However, the broader use of the legitimate choice of having either a company or a sole trade by many people who are independent in business will be affected by this, because the gap is narrowed. I saw some very good work on this by Rebecca Benneyworth of the ICAEW. She reported on its website on 19 August and took the trouble for her members of going through and calculating how it would affect various different scenarios. She also calculated—I follow her calculations—the impact for people who form companies. She takes the example of a singleton company of an individual with a single personal allowance and calculates the effect at different rates of income. I can see from that that individuals are still, in those circumstances and taking these common factors, benefitting from being corporate. However, that is not so if they are at a much lower level of income: not at all at £18,000 and probably, with costs, not if their income is around £40,000 per annum. However, rising above that, there is a benefit, but a much reduced one. It seems to me that the purpose is to narrow the gap and it is effective in doing so. You can already see from the responses to Rebecca’s calculations from members of the ICAEW that there is genuine concern and uncertainty about how their members will do the computation. Going back to the original question about how it affects us, our members and our work, I do not think it affects us—a large firm of accountants—as much as it will all the independent practitioners who are members of the ICAEW who will have to tackle this problem, on a case-by-case basis, with their individual clients who have companies but who could have been self-employed and who have to constantly make the choice. That will be the front line for this measure, and it will cause complexity in that area. At the moment, it appears that it will still make sense to have a company, but, again, as I said earlier, the real difficulty for all these measures is on the margins.

**Baroness Noakes**: In relation to buy to let, before the removal of interest deduction was announced, there were suggestions that there would be a move towards incorporation. Are you aware of the prevailing view on the strategy for buy-to-let investors?

**Dermot Callinan**: Our view would be to proceed with caution because a buy-to-let investor should weigh up much more than simply the interest deduction. With relatively low levels of interest historically, I would be surprised if many buy-to-let investors benefited from incorporation. Incorporating costs money. Companies have to be maintained, and when profits are realised within a company, they are then taxed in the company and they need to be extracted. If they were to incorporate, they might end up not knowing what the ultimate consequences would be. So I would say “Proceed with caution”. Perhaps if a company is running a larger property-letting business with many properties, it may begin to make sense, but, then again, that is what an ordinary English limited company is there for.

**Lord Forsyth of Drumlean**: On that point, why do you think the Chancellor suggested that you can benefit if you have more than 15 properties? What do you consider is the thinking behind that?
Dermot Callinan: Do you mean benefit from incorporating?

Lord Forsyth of Drumlean: No, benefit in that you can deduct the interest.

Dermot Callinan: I really do not know, sorry.

Q53 Baroness Drake: What impact do you think the dividend changes might have on the investment strategies that might be recommended by financial advisers? Do you think that there will be an impact?

Keith Richards: It very much varies from client to client, but in most instances clients who are under advice already have some pretty firm strategies in place. We do not think that these changes will have any significant impact, unless of course there is a dependency on a high level of dividend income. Advisers will go through each of their client’s portfolios to assess whether they are optimising the various allowances and tax wrappers available to them in the light of any tax change.

Baroness Drake: But you do not anticipate a significant behaviour response from advisers.

Keith Richards: We certainly do not sense that at the moment from the feedback from advisers across the country, but of course individual cases will be made where there is a higher impact on one client rather than a general impact. So from a general point of view, there does not appear to be significant concern.

Baroness Drake: In terms of products for investors, will the industry develop new products to take account of the £5,000 dividend allowance alongside ISAs? Can you see that happening?

Keith Richards: In many ways, the simplification and alignment of language in personal allowances seems to follow a sensible thread that will probably provide a benefit once people become more aware of what is available to them. From the savings strategy point of view, there is some support with the personal savings allowance, the dividends allowance and the ISA allowance increases. There has been an argument that while perhaps there is not an advice gap, there is a needs gap, and the Government currently also have an advice market review under way in recognition of the fact that there certainly needs to be increased access to generic information that empowers people to make more informed decisions and gives them more confidence to invest in the market. So I think that some innovation will follow as a result. But the bigger challenge is that consumers who do not have the benefit of being under advice tend to be hugely suspicious of investing in the markets, and more needs to be done to incentivise them to enter a different landscape.

Baroness Drake: The industry can hesitate on developing new products if it is not confident that the rules are going to hold for a reasonable amount of time and there is going to be quite a lot of change. Do you have any sense of whether the adviser community or the wider industry has a feeling of the direction that the Government are going in the taxation of investments and savings?

Keith Richards: I think there is a level of confusion about the real drivers behind the obvious interest in generating revenue for HMRC versus the fact that there is a need to engage the public more broadly into a savings culture, given the need to help people who are living
longer than they have ever lived before to have less dependency on the state later in life. The public pension reforms, for example, are stimulating a lot more interest from the public. In one fell swoop, effectively the tarnished reputation of the word “pension” seems to have been swept away, and perhaps a lot of that is geared around the fact that people can now access money that may not have been easily accessible to them. It seems to have stimulated an interest in the accumulation stage: giving people greater freedom when they get to retirement or at earlier stages seems to be creating a lot more interest, with people approaching advisers for strategies on how to save for the future better and more effectively. The industry is not entirely sure where all the drivers are coming from, but clearly we know that a win-win situation would be the right solution.

**Lord Teverson**: Mr Richards, I should probably know this by now, but could you explain to me what difference, if any, this makes to collective investment schemes other than investment trusts, which I presume would be dealt with in the ordinary dividends way? I am not even quite clear how they are dealt with at the minute. Obviously a lot of income is rolled back into unit-based collective investment schemes. If you take income out of it, how is that affected, and does it create any reason or motivation to change investment strategies?

**Keith Richards**: That is a good question. We were talking about this before we came in. Dermot, you have an example of that.

**Dermot Callinan**: The answer is, first, that we are not completely clear about the extent to which deduction of tax at source on funds, for example, will fall in line with the abolition of the deduction of interest at source on accounts. Part of the Government process at the moment is the consultation document on the deduction of income tax from savings income. That was issued in July and submissions on it are now in. In our own submission, my colleagues Rachel Hanger and Paul Bradbury put forward the proposition that there should be as level a playing field as possible by withdrawing the withholding tax on interest distributions from authorised investment funds. Our view is that the industry and taxpayers will benefit from some clarity on this. We hope that our representation will be received well. In fact, having looked at the HMRC assessment of the representations, we are probably in line with most of what people have said.

**Lord Teverson**: Is there any argument not to do that, given that, as you say, it would be distorting if it did not happen?

**Dermot Callinan**: I am not sure whether this is an argument, but certainly it is a concern. If individual taxpayers receive much more gross income, will they have a much greater reporting requirement? Will more taxpayers fall within the self-assessment regime? I think you may have heard evidence from our institutes. If digital statements and information passing efficiently from organisations to the Revenue cover the position, there should not be a problem, but that is the only concern that I am particularly aware of.

**Q54 Lord Bilimoria**: I want to build on Baroness Drake’s question and declare my interest. I have been a personal client of KPMG, and the company in which I am a senior director is also a client of KPMG. Would you agree that the complexity of tax is increasing significantly with these changes? From an IFA point of view, are the changes creating more of a burden
for you, or are they creating more business for your financial advisers? Also, from an accountant’s point of view, these constant changes must be good for business.

Keith Richards: I guess my answer would be that the demand for advice has been increasing, and it did even prior to the pension reforms. Since the pension freedoms were introduced, demand has increased further. We are now seeing a lot more active engagement from consumers, who are now actually thinking about investment strategies, so any changes to tax regimes clearly increase demand for effective advice. Therefore, the answer to your question is that, although we see some attempt at simplicity being introduced, those at the margins who are self-reliant may get caught in not declaring tax when it is due.

Referring back to the financial advice market review, the cost of advice has increased over time with the increasing costs of regulation and operation. Now, lower-cost or more simplified advice solutions are being sought, and that in itself could help to aid increased access. A very large part of an adviser’s role is to look at optimisation of tax allowances and the most tax-efficient wrappers to use, but the general public who will be self-serving or who will not necessarily be encouraged to see an adviser would not be aware of the most tax-efficient ways in which to invest. So I think that more needs to be done, and that seems to be recognised through the financial advice part of the review. Certainly “need” is there; “demand” is questionable, but we have been seeing a demand for professional advice over the last two years.

Dermot Callinan: There is clearly complexity coming into the tax system at the bottom end, but it seems to be with a good intention, which is to encourage savings and to take more people effectively out of taxation with savings income. An interesting equation would be to see just how many individuals are lifted out of taxation as a consequence of this, despite the adverse consequence—if it exists—of complexity. I know that I have already emphasised this point, but I think that it is around the margins where there is complexity and where the following sorts of questions will be asked. Am I entitled to the personal savings allowance, or not? Where do I fall in relation to the starting rate of income tax? Should I transfer my personal allowance, or not? Should I receive a dividend, because it is going to be covered by the nil-rate band, or not? Will the dividend that I receive exceed the £5,000 and push me into a higher rate? Will I straddle two rates? So it is at these margins that we have complexity.

I am very confident that most chartered accountants and chartered tax advisers will be well equipped to advise their clients, and I am sure that in that regard the changes will produce more work, particularly around the whole question of whether it is worth an individual becoming a company. There might also be increased demand for a lower-cost tax return service if individuals find it much more difficult to deal with their personal tax affairs on their own.

Realistically, there is an inherited tax regime that itself is very complicated. When I studied for my tax exams, I had two volumes of legislation about that wide. Now, if I had wanted to bring it with me today, I would have needed a wheelbarrow because it is about eight volumes and about that wide. Tax legislation is inherently complicated, but the world we live in is inherently complicated, so I do not know whether we are right in our expectations for simplification, with a person working out their personal tax with a calculator and a piece
of paper. In 2016 the question may be, “Will HMRC provide me with adequate tools to work out my tax position?”

Q55 Baroness Wheatcroft: It seems that there has been talk from government and HMRC over recent years about a different way of forming tax policy that involves more consultation and road maps, et cetera. Do you think they are sticking to their word on this, or does the current legislation seem to you to be rather piecemeal and abandoning a lot of consultation?

Keith Richards: I am not sure where the consultation or engagement came in initially. I think that the changes are very well intended, and we are now trying to catch up and understand what the unintended consequences might be. We saw a very similar approach of no consultation prior to the announcement of the pension reforms, and we are very much doing a catch-up job there. It is very difficult not to see where the Government are coming from and why they have implemented those reforms. To answer your question, prior consultation might not have changed the outcome but we might not have been trying to catch up after the announcement.

Dermot Callinan: It seems to us that there has been a lot of consultation across a broad range of measures. Certainly with regard to my own subject area, substantial resources are devoted to responding to consultations that are presented to us, and we welcome that opportunity. I suppose that there will be occasions when government does not perceive consultation as so much of a priority, depending on the measure being brought before us. Our preference would be to have the opportunity to consult on each and every occasion, but I am not sure that that is always possible.

Lord Teverson: Perhaps I could quote from HMRC’s research in 2015. It said, “Awareness among higher rate tax payers of the requirement to declare and pay additional tax on savings interest, following the initial deduction of 20% under TSDI, was very low”—i.e. the awareness. What are the implications of this finding, as we are only some eight or nine weeks away from the start of the regime of simple assessments of tax liabilities based on third-party information? Can the institutions, or indeed anyone else, do more, or is there coordination of any sort between HMRC and the institutions? Are we going to win through here and keep the customers aware, if not happy, so that at least they know what they have to do?

Keith Richards: I do not think the findings will surprise anyone. People often find tax affairs quite daunting, and as a result they probably do not pay quite as much attention to them as they should. One could argue that that is not a lot different from how it was in the past. People generally have to catch up. The industry can do more with HMRC’s support, for example with some generic quick-reference guides and some simple material. Firms are communicating with consumers all the time, so finding ways of simplifying the information and bringing it to people’s attention would be a good start. Going across the whole industry—whether it is banks, building societies, insurance companies, advisers, tax advisers or wherever there is a regular communication path—having a generic form of information that helps to inform people of the changes and explain what they might mean to them would be a good, consistent starting point. The more you use consistent language and terminology, the easier it is for people to understand.
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On top of that, we need some form of simplification. I have mentioned the financial advice market review probably three times, but it means reducing the number of access points where people can get information with the fear of it crossing the line of regulation. Tax planning within saving is a very important aspect. More needs to be done to encourage the FAMR output to increase the number of access points where people can get simplified advice, including on tax changes and their implications. That would be another very positive step forward.

**Dermot Callinan**: Our perspective might be slightly different, because the awareness point is met by people consulting us. If an individual is unsure, they will ask, so the adverse consequences of a lack of awareness are not so apparent to us. My experience of individuals, especially highly intelligent and successful business people, is that they are very seldom experts on tax and therefore need advice. If they do not have it, the more complex the system, the likelihood of error must increase.

**Lord Teverson**: What are the implications if there is no greater awareness? I accept entirely that the people you are dealing with be aware because they are dealing with you, but what about the other people you are talking about? Will there be a crunch, with something going wrong down the track in 15 months’ time?

**Dermot Callinan**: If the concern is awareness, the answer must be communication. When I was preparing for today, I did not see a very large amount of communication about these tax changes and how they will affect individuals. If we ourselves were running this as a business process, we would want to increase the amount of communication so that people could understand how it affected them. Complexity itself is not necessarily the problem; the problem is how you deal with it. If there is an adequate level of communication—with worked examples, tools, explanations and access points—then complexity can be absorbed.

**Lord Teverson**: In these days of social networking and all sorts of other technologies and apps, do you have a feeling that there are better ways of disseminating this information, or are we still in the 20th century as far as this is concerned?

**Dermot Callinan**: To give you an example, you would associate firms such as KPMG with larger corporates, because historically KPMG has undertaken more complex work. It is a large organisation with over 13,000 people in the UK and we do not necessarily act for all the individuals at the margins whom you may be concerned about. However, we recognise that there is a market for accounting services if, to an extent, they can be automated and centralised, and we have embarked upon that. So we have a small business accounting service and it operates successfully in 2016, but only because of technology, whereas it would have been impossible in, say, 2000. With technology, we have been able to enter this market and provide the opportunity for self-employed individuals and small companies to gain access to our systems, enabling them to be compliant taxpayers and compliant accounts preparers. So it is possible to face complexity on a large scale with modern solutions.

**Keith Richards**: The challenge with technology is that a whole number of mechanisms and mediums need to be employed. The question is whether there is going to be an issue further on with people who are caught at the margins and who do not use online tools because they do not realise, or even recognise, that they have a tax liability that they should
have been budgeting and planning for. That is the unintended consequence for people who are just caught: some time later, they find out that they did not plan in a liability that they should have been aware of. The problem lies with people who do not pay too much attention and do not Google something unless they have a need to do so. Technology, the online tool systems and the simplification work really well when someone is alert to the issue and they are searching for the challenge. People are becoming increasingly aware that they can use technology to ask simple questions and find the tools to help them through. But there is the issue that if you are not aware of that, you will not be looking for it.

**Lord Teverson**: Are you saying that awareness is the only problem and that afterwards everybody will know because they will either have done it right or have been told off?

**Keith Richards**: That is subject to whether everything stays the same, but change is constant. If change has an opportunity to become embedded and common language is used, the chances are that more and more people will become acutely aware of it and it will become far less of a problem. In the short term, there are a number of mechanisms that can be used. Every individual should be written to with a simple guide to help them decide whether the change affects them and what they should be alert to, and there are a whole range of other things that industry can join in. A lot of this has to be driven by HMRC with key messages that are very consumer-centric and help to raise awareness, and which then drive people to the right sources if they need more information. You should never underestimate the challenge of getting the message out to a large number of people.

**Lord Teverson**: I have one last quick question on this. From my own experience, the people who know most about my financial circumstances are HMRC. I deal with a tax adviser. I presume that HMRC has my email address, but it normally writes to me rather than email me, which is infuriating. Could you not just communicate through email with most of the people who will be affected by this?

**Keith Richards**: HMRC has over time encouraged people to sign up to e-communications. I am not quite sure where it is on the percentage of people who have done so, but bearing in mind that a number of older people will not necessarily be so familiar with technology, that could be a challenge.

**Lord Teverson**: So there would be a certain number whom you could not get to.

**Keith Richards**: Yes.

**Lord Teverson**: Thank you.

**Q56 Lord Turnbull**: We live in a three-tier world in which there are large numbers of people who do not necessarily pay large amounts of tax but their affairs are largely looked after by their employer or tax is deducted at source. At the other end are people with quite a lot of money, from income or wealth, who are advised, and in the middle there is what might be called the DIY market—people who can prepare their own tax returns in relation to income, pensions and investments. However, what seems to be happening is that the looked-after world is getting bigger because of these new allowances and no deduction at source, but the DIY world is getting squeezed. How much simplification should we aim at? Should we not aim at a world in which a reasonably intelligent and reasonably well-organised person is
able to prepare their own tax return? We are getting to the point where that looks less and less popular. If you are not in the looked-after world, you are almost getting forced into the IFA world, which has costs. I have known of cases where people have gone to an IFA and the fees—I am not saying that they were unreasonable—have absorbed a very large amount of the extra benefit that people got from taking that advice. It is a very frustrating position to be in. There is so much going on around the £40,000 or £50,000 income level, with all sorts of allowances beginning to disappear or getting clawed back. There are different allowances for different kinds of income to the point where this “middle class” can no longer, without paying for advice, look after their own tax affairs. I regard that as rather regrettable.

Keith Richards: Complexity has increased the need for advice, but it does not just sit around one concept of tax return. For example, optimising tax through the most tax-efficient vehicles can in itself more than pay for the cost of advice—and some. There is a perception that you are paying for something that is spent rather than something that could save you several thousand pounds and puts in place a very effective investment strategy, optimising the current tax regime. That is not well understood. Those who are advised rarely step away from the advice because they can quantify the true value versus the cost. The bigger challenge is for those people who you said are caught in the middle ground and who do not always understand the benefit of seeking professional services. They feel quite confused about exactly what is going on and sometimes feel powerless to do anything until someone helps them. This comes back to the point about simplifying information that empowers people to make better-informed decisions. That may well mean helping them to understand where the benefits of receiving professional advice and services lie, versus being directed to a simplified online self-serving system with a few tools. With this simplification, there are a lot of people who could well fall outside having to complete tax returns. The risk is for those who do not understand when there is a need to declare additional tax liability.

Lord Turnbull: I confess that I did not know about TDSI and the other thing that we are talking about. I have not heard a peep out of HMRC on this, and I have not seen a lot in the press about this. Clearly a lot of people will probably find out about it when they come to do their return later in the year, but some of these changes in the portfolio ought to be taking place at the start of the year. There is a big gap between what reasonably informed citizens ought to be allowing and what they are not giving.

Keith Richards: I think that is correct. It is a case of trying to separate out the public in all demographics rather than just those who are under advice. Those who are under advice very often do not understand the changes that are coming in, but to some degree that is because they rely on the fact that they are paying for services that protect them, guide them and help them understand the changes.

Lord Turnbull: By the end of the year, once they have been through one round of an annual review, they will get that.

Keith Richards: Of course. That is the point that is being made. People who are not under advice will not necessarily realise that they should get some advice because they do not understand what is happening. They have not heard the news yet and they do not understand what is happening. That is where we have a responsibility.
Lord Turnbull: I suspect that this is around the position in the income distribution where there are quite large numbers of people.

Keith Richards: That is quite possible.

Q57 Lord Turnbull: The other question concerns the TDSI and non-TDSI sources of interest. You referred to bonds and so on and the complications that there might be from collective investments, with a bit of interest coming through one stream and a bit coming through another. What priority do you attach to getting greater convergence so that the scheme covers a much wider range of interest sources?

Dermot Callinan: As I said earlier, there is a value in consistency—not just in the context of these changes but internationally. For example, Eurobonds do not carry a tax deduction at source, but you could be investing in an authorised investment fund in the UK that has, underneath it, bonds that do. Ironing out the inconsistency seems to us to be a good thing. I take your point, Lord Turnbull, about the complexity for those in the middle. One would hope that the communication would enable them to understand that interest is not being deducted at source and that the personal savings allowance is there for them.

Lord Turnbull: You say “the communication”. What communication?

Dermot Callinan: The sort of communication that I have in mind would be from HMRC to help individuals to understand the changes.

Lord Turnbull: Is HMRC planning any? Has it consulted you on any draft leaflets?

Dermot Callinan: I am not aware of what HMRC’s plans for a campaign are. Maybe that is a question for HMRC.

Q58 Lord Teverson: Our clerk very usefully circulated an HMRC myth buster to us before this meeting. The first myth was that businesses will need to do four tax returns a year. HMRC responded by saying that this was completely untrue. It says, “The new digital accounts will integrate all the different information businesses already provide to HMRC into a simple, streamlined system. Instead of one big, onerous tax return each year, once a quarter businesses can check that the information they are collecting digitally is correct, and simply click send to update HMRC”. From your point of view, is that not totally naive in that anything anyone sends to HMRC they are going to check and double check? If you are like me and you have an accountant who checks just to make sure that everything is absolutely squeaky clean, you are going to end up doing that four times a year rather than one.

Keith Richards: It seems so.

Dermot Callinan: I am quoting the Financial Times here, which perhaps I should not do, but I think that comment is attributed to Mr Gauke. It says, “This is not going to feel like doing four tax returns a year ... adding that the updates will be ‘far less burdensome than the tax returns of today’ because they will be less complex and will be generated from existing digital records and information passed directly to HMRC”.

Lord Teverson: But you are going to get someone to make absolutely sure that they are right, are you not?
**Dermot Callinan:** Let us hope they are.

**Baroness Drake:** I think the point that Lord Teverson is making relates to the behavioural response of people. It is all right for the Government to assert that it is all going to be very easy to do this quarterly, but people will be anxious about sending information to the Revenue with the click of a button. The person, not the Revenue, is going to be anxious and therefore will invest more time, money and effort in checking the veracity of that information. So it is the behavioural pressure on the individual rather than the perception of HMRC that is the point.

**Lord Kerr of Kinlochard:** I am amazed at your moderation—I have to admire it. It seems to me that our witnesses say that complexity is not the problem; it is what you do about it. I am reminded of Emperor Akbar and the Mughal horde looking down on the rich plains of India. It has to be the accountancy profession that will gain from all this. You guys are going to do extremely well from this. As we have been bringing out, this is quite complex for the individual taxpayer. We have been talking about the taxation of individual income up until now. When you look at companies and quarterly reporting by companies, it seems to me that the requirement for expert advice is going to be even greater. The one clear gainer from this Finance Bill is the accountancy profession. Is that right?

**Keith Richards:** I am not in the accountancy profession.

**Dermot Callinan:** It might be a question for me, then. The accountancy profession is very diverse. You cannot really look at KPMG and say that it is the accountancy profession. The accountancy profession is all the individual members of the Institute of Chartered Accountants in England and Wales, and the Institute of Chartered Accountants of Scotland. Will sole practitioners operating in high streets be busier as a consequence of this? They will be, but will it make them richer accountants? Probably not. If you look at the operation of an independent accountant, he or she will have to learn these new rules, which are complicated. That will require extra training, commitment and research, and they have to practise it before they can bring it to their individual clients. Their individual clients have to appreciate the value, and quite often in practice they do not see the value in compliance work. They see it as being a burden which they have to deal with but they do not particularly welcome it. So I am not sure that anybody really wins in a situation like this.

**Keith Richards:** I would say yes.

**Lord Forsyth of Drumlean:** Is not the answer to Lord Kerr’s question no? The sort of people who are going to be in difficulty and confused are the people whom Lord Turnbull highlighted. You do not want their business because they are not going to be able to pay the fees, but they are going to be muddled in the middle.

**Keith Richards:** Yes, quite. I think that is right. That is the population that we ought to focus on, making sure that more generic, straightforward information is provided to them so that they can make better, informed decisions. It has to start with the Revenue. A letter directly from the Revenue will very often get people’s initial attention. To complement that, a range of communications can go out from other mediums in partnership with HMRC.
**Lord Forsyth of Drumlean:** Do you think that the Revenue has a handle on the extent of this? Lord Teverson has been talking about the myth buster leaflet. To me, it reads as though it has been written by somebody from another planet. I am very concerned about people who are not digitally skilled—for example, elderly people, quite a lot of whom will be in this category, or small businessmen who turn up at their local accountant’s and hand them a box of paper that has to be sorted out, which is extremely difficult to do. This leaflet says, “Myth: This does not consider those who are not digitally excluded. There is no question of forcing those who cannot go digital to do so. Help will be available for businesses who struggle to use digital tools. People who genuinely can’t use digital tools will be offered alternatives, like nominating someone else to update their information for them, or giving information by phone”. Yet we read that the Revenue is so stretched that if you ring them up you listen to Vivaldi or something for several minutes. Do you think the Revenue really has a handle on this?

While I am talking, may I apologise to you, Mr Callinen, regarding a question I asked earlier? I implied that businesses with 15 properties would be able to claim interest relief. I was muddled. I was referring to the fact that they would be exempt from the 3% additional stamp duty. That was the point.

**Dermot Callinan:** I understand. Thank you. The success of this must depend on HMRC’s ability to deal with people who are not able to comply with digital systems. Again, it is a question for HMRC as to whether or not it truly is able to do that.

**Q59 The Chairman:** Coming back to small businesses, I think you were saying, Mr Callinen, that there are a number of choices now facing small businesses, or completely self-employed people who should become small businesses as they would then be advantaged from a tax point of view. Lord Turnbull’s muddled middle includes a lot of people who either sit in small businesses or are self-employed—one of the fastest-growing sectors of the economy. Until we get to the promised land of simpler taxes, those people are going to be faced, are they not, with much greater complexity and costs, which, quite properly, you will seek to pass on for providing advice and help in addressing that complexity. Will your small businesses and self-employed customers not incur greater cost in doing business going forward?

**Dermot Callinan:** Clearly any change that is a consequence of a change in legislation is not a change caused by the adviser. The adviser may well seek to recover the cost, but, as I mentioned earlier, it is not necessarily the case that all the costs will be passed on. That does not automatically follow. This complexity is not new; generally there is complexity every year with the Finance Bill. We are just considering this year’s complexity. Much of the complexity results in the adviser having to absorb an element of the cost of training.

Smaller businesses—we do not represent many smaller businesses, apart from through our separate small business accounting system—may well find it difficult to access instant information about these changes unless their accountants are all very proactive in explaining the changes to them. The only thing I can predict is that that cannot possibly be consistent throughout the whole profession. There will be lots of areas of good response to clients and there will be lots of busy accountants who do not have the time.
The Chairman: You mentioned communication, and clearly it falls to HMRC to communicate as crisply and clearly as possible. From both your experiences, does phoning HMRC with a query in which you seek to understand some of the complexity here tend to yield a very positive result in the sense that people come away saying, “I think I now understand it”? Is that quite a difficult route?

Dermot Callinan: To be honest with you, my staff have not raised issues with me about how calls are dealt with by HMRC, but that may be more to do with the nature of the interaction that we have than the source of the information that you are referring to. That, although I do not know, may relate to smaller cases. I could not put before you evidence that there is a problem when we have not experienced it.

Keith Richards: I would echo that. In fact, the feedback generally is that, when you can get through, HMRC is helpful. Communications sometimes confuse people because they use language that is not always consumer-centric, and therefore uncertainty creates confusion. But HMRC does seem to have a reputation for generally positive feedback: when clients ring it directly, they tend to understand. Most people’s concern is a fear of the tax system and a fear of getting it wrong. Whenever change comes in, older clients in particular tend to worry because people do not want to get their tax position wrong; they do not want the burden of that. Very often, once they investigate or an issue is explained to them, they find that it is not quite as complex as they first thought. That is often the starting point. People say that once they have got their head around it, it is not quite as daunting or as complex as they first thought. For some reason, human nature being what it is, we tend to fear the unknown, and tax has always been one of those subjects that people are generally quite fearful of. We generally find that small businesses will engage an accountant simply because they do not want to get their tax position wrong and not account for, or budget for, appropriate tax liabilities into the future.

Dermot Callinan: We observed that in the summer Budget statement under the heading “Reform and Sustainability” and the section relating to dividends tax, the abolition of credit, the £5,000 allowance and increasing the effective rates by 7.5%, collecting tax from the prior year was expected to yield an additional £2.54 billion in 2016-17. So maybe HMRC will be able to afford some resources to improve the delivery of these services.

The Chairman: On that cheerful note, I thank you both very much for a very helpful session.
Submission to be found under Tax Aid and Low Incomes Tax Reform Group – Oral Evidence (QQ 25-37) (FBBOE0002).
1 Introduction

1.1 We welcome the opportunity to respond to the Committee’s call for evidence for its inquiry into the draft Finance Bill 2016.

2 About Us

2.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT’s primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Clauses 1 and 4

Personal savings allowance and ending of deduction of income tax at source from interest

3.1 We broadly welcome these changes. The savings allowance will offer most individuals a fairly substantial exemption in addition to ISAs. In addition, the combination of the savings allowance and the ending of deduction of income tax at source is likely to simplify the position for many individuals with modest amounts of savings income as it will produce the correct result in the majority of cases.

3.2 Hitherto, people on low incomes have been expected either to register with their bank for interest to be paid gross if they are not liable to tax, or to reclaim any tax deducted

3 Using form R85
at source for which they are not liable.\textsuperscript{6} Registering to be paid gross brings with it an obligation to notify the deposit taker – and HMRC – if the individual becomes liable to pay tax, while making a claim for repayment of tax over-deducted involves working out the difference between the tax deducted at source from and the tax payable by the individual. This might mean having to undertake the difficult calculation to establish whether the individual is entitled to the starting rate for savings, and if so on how much of their income. In many cases, people simply do not know that they are entitled to a rebate, or to opt for their interest to be paid without tax deducted, and consequently routinely overpay tax on their savings. The reforms brought about by these two clauses, combined with the reduction of the starting rate for savings to zero per cent with effect from 6 April 2015 (previously 10%), should therefore bring about a worthwhile simplification for individuals on low incomes.

3.3 Our main concern is that the mechanism to achieve this simplification is itself highly complex. In particular, the interaction between the starting rate for savings (now 0%) and the new ‘savings nil rate’ is likely to cause confusion. The starting rate for savings is itself subject to a complex calculation and is not well understood. Superimposing another zero-rate band for savings income above the starting rate limit could be equally poorly understood and therefore result in mistakes being made. Such errors are likely to be perpetrated as much by HMRC as by taxpayers, and to involve too much tax being paid as too little.

3.4 We are also concerned about how well taxpayers – particularly those who are unrepresented – will be informed about these changes. Banks and building societies ought to assist in this process, particularly as they will undoubtedly receive many queries about the changes – but they have tended in the past not to provide accurate or up-to-date information for their customers on the deduction at source scheme, how to register to receive interest gross, and how to reclaim over-deducted tax.

3.5 Before taxpayers can understand the changes, they need to actually be aware of them. Research last year commissioned by HMRC showed that higher rate and additional rate taxpayers had low awareness about their responsibility to notify HMRC of savings interest.\textsuperscript{7} There is arguably even less likelihood of unrepresented taxpayers on lower incomes knowing that they must now notify HMRC if their interest exceeds £1,000 in a year.

3.6 Information and guidance given to taxpayers on the changes must be accurate, comprehensive and comprehensible, and be readily accessible to all – not just posted on GOV.UK as a great many of the taxpayers affected will be digitally excluded.

4 Cl 2 and 3

Dividend nil rate and abolition of the dividend tax credit

4.1 The abolition of the dividend tax credit will for the first time expose any basic rate taxpayer with dividend income of over £5,000 to a tax liability on their dividend income above that amount. There could also be unwelcome effects on low paid workers the

\textsuperscript{6} Using form R40

\textsuperscript{7} See https://www.gov.uk/government/publications/awareness-and-understanding-of-taxation-of-savings-interest
engagers of whose labour require them to work through personal service companies – previously, no basic rate taxpayer was required to pay any further tax on a dividend to which a tax credit was attached; from April 2016, however, dividend income in excess of £5,000 a year will attract a tax liability. There is also a danger that such workers will be attracted by schemes intended to ‘avoid the new dividend tax’ which are already beginning to be mooted.

4.2 The same considerations will apply to the interaction between the dividend nil rate, the savings allowance and the starting rate for savings as set out in paras 3.3 to 3.6 above: there must be very clear explanations and guidance, equally accessible to those with and without access to computers or the internet.

4.3 There is a potential trap for donors to charity. Any donor using the gift aid scheme is required to pay during a tax year at least the amount of tax notionally attributed to the gift they are making. A dividend tax credit can count towards tax paid by the donor for this purpose. Consequently, anybody who gives to charity under gift aid, and who uses tax credits attached to their dividend income to ‘frank’ the tax attributable to their gift, must review their charitable giving when the dividend tax credit is abolished in case they are no longer eligible to use gift aid. In fact, anyone who pays less tax as a result of the changes to income taxation coming into effect in 2016/17 will be in the same position. Any donor using the gift aid scheme whose tax bill is less than the amount of tax attributed to their gift is liable to pay HMRC the difference, and we have seen cases in which this rule has been enforced.

5 Cl 71

Simple assessment

5.1 We generally welcome this facility to assess individual taxpayers with straightforward affairs without putting them into self-assessment, particularly pensioners whose only taxable income is the state retirement pension (on which DWP will not operate PAYE), and others with insufficient PAYE income to enable collection of tax they owe.

5.2 We are however concerned that figures provided by HMRC might be erroneous, particularly if relying on third party information, and yet there is a strong risk that an unrepresented taxpayer might accept without question whatever emanates from HMRC and disregard their own records even if accurate.

5.3 In particular, an unrepresented taxpayer may not be able to identify reliefs, allowances or claims they are entitled to make that will reduce their liability. We suggest that such simple assessments should identify the main reliefs and claims that might be considered – for example claims for mileage allowance, professional subscriptions and the marriage allowance (take-up of this last relief has hitherto been low). In addition, taxpayers need to be made aware where any claims might be made in relation to employer error or HMRC error.

5.4 When a simple assessment is issued, the taxpayer does not have to complete a tax return unless there are other income and gains not included in the assessment. In order to do this, taxpayers will need to be given detailed information. For example, providing
a composite figure for interest received would require the taxpayer to undertake considerable work to substantiate the figure if they held more than one interest-bearing account. HMRC will be furnished with that information by the relevant banks and other financial institutions and it makes sense, therefore, for the assessment to contain details both of the institution(s) involved and the relevant account number(s) as well as interest paid.

5.5 It is not clear how these simple assessments will interact with the new digital tax accounts. It is crucial that taxpayers understand this and that non-digital options remain. According to HMRC’s own research,\(^8\) 15% of the UK population are digitally excluded, equivalent to over 7 million adults, while almost 2 in 5 of the population are ‘assisted digital’ (ie require help with using computers and accessing the internet). That is a very substantial minority, and Government would be failing in its duty if it did not ensure that those people had equal access to information about their legal obligations and entitlements as those who are digitally competent.

6 Cl 83-87

Office of Tax Simplification

6.1 We very much welcome making the OTS permanent and putting it on a statutory footing. Simplification generally benefits the unrepresented population as a simplified part of the tax code is *ipso facto* easier to understand for those without access to professional advice.

6.2 That said, the OTS can only realise its full potential if the Government does what it recommends. Clause 8 of the Finance Bill (trivial benefits provided by employers) and provisions in last year’s Finance Act which enacted OTS recommendations about taxation of employees are and were particularly welcome because they did what the OTS recommended.

6.3 It has not always been so. For example, the OTS devised and recommended a simplified cash accounting method for the smallest businesses on a low turnover of £30,000 a year. The OTS recommendations were indeed simple and very much in line with what businesses of that size tended to do anyway. The Government, however, decided that the simplified method should be made available to businesses with a much higher turnover – twice the VAT threshold in some cases – which necessitated a set of complicated rules about allowable, non-allowable and partly allowable deductions, computation of loss relief, who may and may not elect for the cash basis to apply to them and when, treatment of capital receipts, anti-avoidance provisions, and so forth – 20 pages of complex new law. It is not thought that many businesses have found the new set of rules sufficiently simple or attractive to opt for them.

6.4 Similarly, the OTS’s very useful reports on the taxation of pensioners were practically disregarded except for one idea taken in isolation – the abolition of the age-related allowance – which meant that a golden opportunity to simplify the tax system for a great many taxpayers in retirement was missed.

6.5 We hope that the OTS’s new permanent, statutory status will bring with it sufficient standing to encourage the Government to take its recommendations more seriously than on some occasions in the past, and that it will be sufficiently well funded by the Treasury to carry on its useful work over a greater part of the UK’s tax code – which has never stood in greater need of real simplification than now.

LITRG

1 February 2016
1 During the oral evidence session on Wednesday 27 January 2016, the Chairman asked the witnesses Caroline Miskin and Robin Williamson what would be the reporting obligations of companies in respect of dividends and dividend vouchers when the new regime in clauses 2 and 3 of the draft Finance Bill (dividend nil rate and abolition of dividend tax credit) enters into effect. The witnesses agreed to provide a note for the Committee.

2 Under Corporation Tax Act 2010 (section 1104 ff.), a company must provide a tax certificate to the recipient of a dividend. Currently, this includes the requirement to note the amount of the dividend and the amount of the tax credit. The tax credit is a deemed amount of tax (1/9 of the net dividend), based on the fact that the company has paid corporation tax. So, if a company pays someone a dividend of £90, the taxpayer does not declare £90 to HM Revenue & Customs, they declare £100 (£90 plus £10 tax credit).

3 Accompanying the dividend nil rate is a change to the taxation of dividends – there will no longer be a deemed tax credit (clause 3 of the draft Finance Bill 2016) and the rates of tax will change. So, from 6 April 2016, if a company pays a dividend of £90 to someone, that is the amount they have to declare as their income. In addition, companies will have to change their dividend tax certificates slightly, as they will no longer need to show a tax credit, simply the amount of the dividend.

4 Companies will no doubt continue to have the obligation to provide a dividend voucher, so they will need to amend their templates (draft clause 3 does not suggest that this requirement is to be removed). It is however a relatively minor change and one which will hopefully ensure that taxpayers receive the information they need to get their tax correct.

LITRG

TaxAid

3 February 2016
Finance Bill Sub-Committee

Inquiry on

DRAFT FINANCE BILL 2016

Evidence Session No. 4  Heard in Public  Questions 60 - 69

WEDNESDAY 3 FEBRUARY 2016

3.35 pm

Members present

Lord Hollick (Chairman)
Lord Bilimoria
Baroness Drake
Baroness Noakes
Lord Teverson
Baroness Wheatcroft

Examination of Witnesses

John Whiting, Chief Executive, Office of Tax Simplification, and Chris Sanger, Adviser, Ernst & Young

Q60  The Chairman: Mr Whiting, Mr Sanger, good afternoon. Mr Whiting, I understand you had a practice run yesterday in front of the Treasury Select Committee. I cannot promise that we will detain you for quite as long.

John Whiting: I was rather hoping you would not detain me for quite so long, my Lord Chairman, and I am sure that your fellow members are hoping that as well. It was over three hours. It was too much of a good thing.

The Chairman: Thank you very much for joining us. We expect you to be extremely well-briefed. Can we start with your observations on the Office of Tax Simplification? It has now been in existence for five years. You have published a summary of how the Office of Tax
Simplification recommendations have been progressed. However, what we cannot tell from that very helpful summary is the importance, as it were, of those that have been accepted and those that have not been responded to. It would be quite interesting if you could give us a qualitative analysis of that. More generally, could you give us your thoughts on the progress so far and the extent to which you feel you are being listened to and action is being taken on some of the rather more important recommendations that you have made?

**John Whiting:** There is quite a lot in your question, my Lord Chairman. I always say that the first period after we were set up was something of an experiment: was tax simplification was worth it, was it was possible, and could we achieve anything? I would like to think that we have at least proved that we are worth it, that we can make progress and that it is worth investing in, as evidenced by the fact that we are being made permanent and being given slightly greater resources. I think we have achieved something. As you say, the sheer numbers do not really say what we have achieved. I make no bones about it: if you ask the man or woman in the street they would say that tax has become more complex. Indeed, as I came through security here, somebody spotted that I was from the OTS and sounded off about having just completed his tax return, “And it certainly wasn’t simple”, so what was I doing.

It is difficult, but I think we have made an impact in certain areas. I will give a few examples. We looked at share schemes, which produced a lot of technical changes, which obviously do not impact many people, but company share schemes run more smoothly, and it has paved the way to online filing. We have looked at and done a lot of work on employee benefits and expenses. With that, a programme is now under way that will reduce the number of P11D benefits forms from 4.5 million a year to 45,000 if it is all carried through. That is not instant, but it is in progress. We recommended a cash basis for the smallest businesses. That has come in and it is used by 1 million businesses now, so that is simpler.

On the other hand, undoubtedly there are things we have recommended that have not been taken up as much as we would have liked, and, of course, we have only looked at certain areas. I suppose the gentleman I saw this morning would say that life has become more complex. I can do no better than use the analogy that was used by a late and very well-known former Member of this House, Lord Howe, who said that our job is like repainting Brighton pier while somebody else is extending it to France. I think that analogy is as good as ever. We are making an impact but it is a small impact. I would like to think that if we are, as we hope we are doing, moving to OTS mark 2, with greater powers, we will achieve more.

Perhaps the last thing I would say, although you may have follow-up questions, is that one of the possible reasons why we have not achieved more is that Members of the House of Commons and the House of Lords have not taken as much interest as we had hoped and have not really got behind a number of our recommendations. I like to think that the way we operate is a pretty good model of gathering evidence and really finding out the implications. We talk far and wide to frame our recommendations, so that when we hand them over we can honestly say, “Chancellor, Minister, this is telling it like it is. These really are evidence-based recommendations”. I would like to see parliamentary Committees getting hold of that and really questioning why they are not taken through.
The Chairman: In one sense, is one of the difficulties that the ship has already sailed by the time you look at the detail? Is there not a difficulty that because you are not involved in the discussions on the preparation of legislation, you cannot therefore inform that debate before the ship sets sail?

John Whiting: Indeed. Our constitution so far has been very firmly that we can look only at what is on the statute book. That is our brief. As time has gone on, one has naturally begun to look a little more widely. We looked at partnerships at a time when partnership tax law was changing, so we could not fail to bring that sort of thing into account. We are looking at small company taxation and the advent of the Making Tax Digital announcements. Inevitably, if we talk to a group of businesses, they want to factor that in as well. We are beginning to talk a little more about current changes, but our emphasis is always going to be looking back, if you like. Undoubtedly, I would like to look far more at what is en route being brought into policy discussions, either with formal power, but to be honest it is a challenge for us to get to the stage where policymakers actually want to involve us. An MP in a Committee or a member of this Committee might say, “Well, did you think simpler? Is there a simpler way of making this change? Have you talked to the OTS about whether this really is going to be the best way of making this change?” That is the ideal.

The Chairman: You have developed an index of tax complexity. Presumably that can be used in a generic way to inform the taxes that are currently on the statute book and those that may come in the future. Has that helped you to have a forward-looking discussion?

John Whiting: As you might imagine, it was a challenge to us: “You are looking at simplicity, but can you define complexity? Can you help us measure it?” We worked at this index, and after deal of toing and froing and refinement we came up with 10 factors, and it reduces to a number. We designed and used the index to look at areas of the tax code, in particular to help us to decide what we should look at next. I have had some discussions with policy teams in the Treasury as to whether we could adapt it slightly to look at legislation that is being brought in and to see whether we can give a measure for some of the other things that you are looking at, such as dividend taxation. It is a little more difficult because our measure of complexity looks at things such as how much guidance and legislation there is, all of which are a little bit up in the air when you are developing it, but the principles are there. It is possible at least to apply some of the thought processes and methodology to assess the complexity.

I will give one other example. As you might imagine, we have met lots of other countries and compared notes. I was given a very good example from France, where, certainly until recently, when new tax legislation came in, the equivalent of the Chancellor had to give it a star rating of one to five; one is when everybody can understand it, and five is when you need a double espresso to be able to contemplate it. It is very subjective, but at least it is a sort of measure that says, “This is something we ought to look at”.

If we apply our complexity index to something that is being developed, I do not think it would ever get to the stage where something would pass or fail, but it might be a good debating point as to whether it could be done a little simpler.

The Chairman: Looking at it from a different perspective, Mr Sanger, how would you rate the Office of Tax Simplification’s progress to date?
**Chris Sanger:** It is very fair to say, as John has said, that the OTS has made some real progress. We have seen simplification and simplicity being talked about inside government far more than it would ever have been if the OTS had never existed. That is a great step forward.

There have been some challenges along the way. Previously when I gave evidence to this Committee in relation to partnerships, we had the OTS review of partnerships at the same time as legislation alongside it. When the OTS is doing work and the Government are doing work, that could be better organised to make sure that the work is consistent and the two work well together.

One of the great successes of the last four years has been the consultation framework, which has helped to ensure that some of the policies being put forward by the Government go through the five-step process and are clear. However, the OTS is completely missing from that framework. There could be a prospective policy role whereby the OTS could feed directly into that framework and so provide that kind of challenge function.

As John mentioned, the OTS has been set up as an independent body to the Treasury, which is right and which limits it from being at the table in the internal policy discussions at the Treasury. However, the lessons that the OTS is learning from all its discussions need to be embodied in Treasury thinking, so that we pre-empt the less-than-ideal legislation coming out of Treasury almost by having simplicity champions inside the Treasury. That is not a role the OTS can play, because it would contravene its independence, but it needs to be kind of “teaching” into Treasury, so that you get that real challenge function on simplicity inside Treasury. More fundamentally, in relation to the overall approach to simplification, so far we have seen the simplification of individual taxes or individual measures—or indeed, as John has mentioned, a list of all the measures—and working out which ones are no longer necessary and eliminating them.

One thing that would really favour the UK would be a different way of approaching the whole of tax reform and looking at simplification from a taxpayer perspective. As an individual taxpayer, I want to know how much tax I am paying. I really do not mind whether you take it away in income tax or national insurance; I need to make sure that I am paying the right amount of tax. Therefore, one way to look at simplification now is to take a taxpayer perspective and ask whether there are ways in which we could do a radical simplification that steps away from the incremental approach of simplifying this bit of legislation or this bit, while we are still getting many more pieces of legislation coming in as the statute book gets ever longer. If we could achieve that type of approach and use the OTS as a way of forming that kind of thinking, that would be very attractive.

**John Whiting:** Can I pick up on one aspect? As I am sure you have seen with some of our recommendations, we try to come up with short-term ones that can be put through easily—they are often tagged quick wins—and some longer-term structural ones, so we try to come up with a bit of both. The advantage of short-term quick wins is that you can make some progress, because, when all is said and done, the big things take a lot more doing. I totally endorse what you are saying, Chris; the difficulty is how long it is going to take to make a major shift. It is clearly a bit of a challenge to whoever is guiding us what they want out of us as the system. Do they want the big structural thinking or some improvements as we go? My answer is that we probably want a bit of both.
Q61 Lord Teverson: Mr Sanger, you have quite a bit of international experience. I am interested to know how the UK tax complications compare with other OECD countries. Are we particularly bad? Is this why we need this self-criticism from inside the Treasury, or what?

Chris Sanger: We constantly see the comparison between the length of our legislation and that of others, with ours being the longest ever, overtaking India and places like that. Sometimes that is not the right comparison. In the US, there is a huge amount of form-filling and guidance, which makes their system far more complicated than it would be on that same kind of measure. We have a complex system, there is no denying it, and some of the changes that we will talk about later today will make it more complicated, and some of the policy changes that we have seen have made it more complicated. Simplification is not embedded in the way we think and in the way we do policy, and that has made it more complicated.

The UK has a habit of legislating a lot more than other countries, so whereas some of the countries on the continent will have some protections within the law based on abuse-of-law principles, the UK historically has sought to legislate to make sure that what is in the remit of the legislation and what is not is absolutely clear. We have, by our culture, created a far more complex environment. Given that is our culture, I do not think we could have done that in the old way. Maybe now that we have a general anti-abuse rule, in some of those changes in the future we might see a shift that would allow us to be less prescriptive in legislation and more purposive, leading to less complex legislation.

John Whiting: We have certainly been asked by a number of other countries for our experience and whether we could assist them, and as we do our work we will always look around the world for examples of how we can do it better. Of course, we get ideas on certain aspects from various countries. New Zealand is often a very good example. I would hasten to add that we do our researches by email and phone call rather than visiting, as I trust you would expect. Australia, America, and a lot of countries have much more complex systems because of the interplay of state and federal. We have been drawn into discussions in Canada, because it is setting up a tax simplification project. I saw a French delegation last week, effectively a parallel to your own Committee, which wants to try to start simplifying. I am afraid that complexity seems to be a worldwide disease.

Q62 Lord Bilimoria: I declare my interest as a member of the alumni council of Ernst & Young. You have explained the difficulty with the Office of Tax Simplification, using Lord Howe’s analogy. Some people would say that the Office of Tax Simplification is an oxymoron because it is not simplifying anything. It is trying, the intentions are good, everyone thinks it is a good idea for it to exist, but how effective is our tax system, particularly given the Google situation? A couple of years ago, this Committee looked at GAAR and anti-avoidance. Is our tax system effective? Is corporation tax in the right proportion, let alone
our tax policy, and how is simplification linked to the effectiveness of our tax system on the whole?

**John Whiting**: I should also say, my Lord, that I am a non-executive director of HMRC, but, without splitting hairs, you will understand that I answer as the OTS. I think our tax system is effective. You cannot get away from the fact that it raises well over £500 billion a year, and 93% or more comes in without too much trouble. All right, there is a certain amount of policing and effort from HMRC, but our tax gap, for all that it is a big number, is much smaller than that of most other countries. You have to put on the credit side the fact that it is basically working in many ways.

Where is it failing? Clearly, there are gaps. People are managing to avoid or evade, but that happens in any system. That needs more policing. Part of the reason why people avoid, evade and make errors is because we have a complex system. There is plenty of good evidence that if you have a simpler system people are more likely to comply, and of course find it easier to comply, and the tax authority finds it easier to manage the system. Our system is effective, but it has problems.

You mentioned Google, which I was talking about yesterday to the other place’s Committee. To my mind, the corporation tax system suffers from the fact that it was devised in the first half of the 20th century, or the 19th century even, for a 21st century economy. It had manufacturing and physical trade in mind and here we are trying to tax, in effect, a very ethereal thing as to where the value is created and taxed. It is evidence that we need to keep working hard at simplification—you would expect me to say that—but also at keeping the system up-to-date.

**Lord Bilimoria**: Do you think corporation tax needs to be reformed wholesale?

**John Whiting**: You can bring in lots of analogies and you could say that it needs sticking plaster. I think it needs a bit of surgery, but, as I said elsewhere, we need to contemplate that corporation tax may be a dying tax and look to see whether we can make it work better, which might need some quite drastic surgery for the economy that we have nowadays.

**Lord Bilimoria**: I would be interested in Chris’s view.

**Chris Sanger**: In relation to the question of corporation tax, we now have a corporation tax rate that is 20% and going down to 18% by the end of this decade. I think we have seen some significant changes in the whole essence of corporation tax. We have also seen the motivation of multinationals change in relation to the UK. The UK’s rate is the equal lowest of the G20 at the moment and will be the lowest by the time we move even one percentage point down. We are seeing that attract businesses here. Another thing to take into account is the fact that the OECD identifies corporation tax as the most growth-damaging tax, so the question of how we do our tax mix is something we really need to address as a country. We get almost 50% of our taxes from income tax and national insurance, and then we have VAT and duties, and together that takes it up three-quarters. Corporation tax is now a small proportion, only a small bit larger than business rates. We need to look at the burden. John is right that the tax system itself was designed with a different mindset.
The work that the OECD and the G20 have been doing through the BEPS project will change the whole nature of corporation tax and will try to remove some of the distortions that have allowed what they would call double non-taxation, but it means that corporation tax is trying to address something that was designed in the past.

If we look at other ideas that are out there from the EU, we have the common consolidated corporate tax base, which has a basis of formula apportionment, which allocates profit by means of people, turnover and assets, but only physical assets, and there is no obvious reason why that is better than the system that we have right now. These are the right discussions for us to be having, but if there was an easy answer out there as to what would be a better system we would have moved to it a long time ago. The OECD has tried to make the system we have now more sustainable and bring a level of simplicity because you have the same rules applying in multiple countries. They are not simple rules, but at least they are the same ones in theory. The real challenge for all of us in the tax community is to make sure that countries are delivering it in the same way and we do not end up with the rules being similar but not similar enough to give us the simplicity that we need.

Q63 Baroness Wheatcroft: It is clearly unsatisfactory when we are left with a system which seems to involve voluntary contributions from the likes of Starbucks and Google. The OECD is trying to come up with an answer. Lord Lawson is one of many who have suggested that the answer is to get rid of corporation tax as such and move to a tax on sales. Have you done any work on that? Do you think the UK might be a net gainer or loser from that?

Chris Sanger: There are a couple of things. First of all, I am not sure I recognise that there is a voluntary contribution. I know that one company volunteered to pay some, but in all other cases we have the HMRC enforcing the law as it is. Our experience of HMRC is that it is very good at undertaking that. It is important to be clear that this is not a case of companies paying it if they want to and if they do not they can do something about it. The law of the UK applies.

Baroness Wheatcroft: I think you would have to accept that was the case with Starbucks.

Chris Sanger: That is indeed what they said, but you included Google in your comment and I was going to draw a distinction between those two. In relation to a tax on sales, we already have VAT. VAT is value added tax. A point I always make when I am lecturing and talking is that value added is almost the same as profits. It is basically the profits that you have made except for the costs that you have on either the funding of the business or your employees, so by having a tax on value added we are already a long way towards a sales tax. What it does not apply to, of course, is tax exports. The whole intention of the VAT regime is to stop the taxing of exports. With a tax on sales, again you end up imposing a burden on business, and that could be growth limiting in the same way as corporation tax. It also means that if you have one business that has a very tight margin and another one with a very big margin, you are taxing them the same, which does not seem to fit with the ethos of taxing profit or what you have at the end. Ultimately, the price will be passed on to consumers, shareholders, employees or suppliers. To work out where you want to impose the tax, you have to look at all this in the round. Ultimately, a tax on sales, as a straight turnover tax, has a number of problems and would mean that it would not necessarily be any better than the system we have now, and could create even more distortions in the corporation tax system.
**John Whiting**: In an earlier project, the OTS looked at the idea of a turnover tax for smaller businesses rather than internationals and whether that could be a different way of taxing unincorporated and incorporated businesses and whether it would be simpler, for some of the reasons Chris has given, including how you manage losses and so on. We have rather gone away from it. We did not think it had a lot of mileage, so we did not pursue it. In fact, that was what gave rise to the cash basis: let us stay with going for profit, but on a slightly different, simpler measure. The idea that Lord Lawson has floated is the sort of debate that needs to be had as to the future of how we tax businesses. I come back to my central feeling that corporation tax is decaying. It can be kept going with surgery, but we have to contemplate, in simple terms, where we are going to get the money from in the future.

**Chris Sanger**: The other thing to remember with corporation tax, as we discussed, is that it is in place in many other countries, so if we did not have it, all the other countries and the way our tax systems fit with theirs would need to be looked at. If other countries are imposing corporation tax, there are benefits for us in doing the same.

**Baroness Wheatcroft**: Is it your understanding that the OECD is looking at other options as well as the narrow corporation tax type of issues? Is it looking at multinationals?

**Chris Sanger**: Action one of the Base Erosion and Profit Shifting project is looking at the whole essence of the digital economy and what other answers there could be. It concluded that digital is indeed a fundamental part of everyday business nowadays, but it also looked at whether there could be VAT or other options to reduce the pressure on corporation tax.

**Q64 Lord Teverson**: If we could perhaps move on to a bit more of the detail, as you know the 2014 and 2015 Budgets announced very significant changes for savers, including those in the draft Finance Bill, which introduces a new personal savings allowance and abolishes the existing tax deduction scheme for interest. Although I am sure the Treasury would like to see them as simplifications, we are trying in this Committee to get at whether they are really that and whether they are coherent within a broader strategy of trying to achieve tax simplification.

**John Whiting**: I suppose the OTS can claim a certain amount of credit for at least starting this ball rolling, because we did a project on pensioners, and obviously a lot of pensioners’ tax issues apply to the entirety. One of the things we looked at was, of course, the whole taxation of savings, which is a big issue for pensioners. One of our recommendations was getting rid of the 10% savings rate, which is little used, even less understood and hugely complex to administer, and improving the process for tax deduction at source, but really questioning how we did it. In many ways I welcome this simplification, because I think it is a simplification for most people. I question how exactly it is being done. Among other things, the 10% savings rate is still there, and I have to question whether it is really worth keeping if you are doing this. This is a simplification, but as with so many things it will only work if people really understand what is going on. I know HMRC is already thinking through the publicity campaign and things are starting, but there is a big effort needed so that people understand it.

It will simplify savings interest for most people, but there is certainly a cadre, some of whom have been writing to us already, for whom it becomes more complex because they are in
this category of having just over the £1,000 of interest and previously they were only basic-rate taxpayers. They may well be pensioners.

**Lord Teverson**: Is there a typical personal profile of these people?

**John Whiting**: The ones I have heard from so far are pensioners. They have a modest amount of pension income but they draw a lot of income from savings. Currently, they are below the higher-rate threshold, so they have no tax bill, but because they are now facing £1,000 or more of interest, they will have a tax bill. The complexity comes in because suddenly they get drawn into the tax system and will have to cope with how they will pay tax, or, of course, HMRC has to manage it through coding notices and adjustments. This works for the majority and I think it is good, but it is not a complete win across the board. Of course, if you go up the scale, you can come up with some great examples of people who, because they are just on the higher-rate threshold, suddenly get a pound of extra interest and that tips them just into the higher-rate threshold. As drafted, that drops the savings allowance from £1,000 to £500. That extra pound of interest is very expensive. I hope that one is cured, because at the moment there is this curious cliff-edge way of doing it, which brings in some complexities. You can look at this and say that it is seven out of ten. That is quite a good mark for simplification, but it is not a complete win in the simplification stakes.

**Lord Teverson**: Is the sort of person who might be affected in that way a person who might find it most difficult or stressful to find their way around it?

**John Whiting**: Indeed. You could say that if somebody is getting well over £1,000 in interest on top of whatever they get with ISAs, they have quite a lot of capital in this day and age, but they need catering for. At the same time as they are being brought in, we have to accept that there are quite a lot of people, in many cases higher-rate taxpayers, who have a bit of bank interest and who, strictly, have to pay higher-rate tax on it, who are going to drop out of the system, which is why in many ways this is a simplification, but there is this cadre for whom it is not a simplification. Sadly, in the simplification game there are often winners and losers.

**Chris Sanger**: As John says, even if it fixed the sudden drop from £1,000 to £500, if it fixes it in the same way as we have seen in other cases, there will be a taper, which again will mean that you will have a different marginal-tax rate for another level. It is why we have a 60% marginal-tax rate at £100,000 and personal allowances being withdrawn. These kinds of allowances, which are based on how much you earn, create complexities in the system overall. It is a compromise if you have an allowance for everybody and accept that it goes all the way up the earnings scale. That is clearly the simplest way to do something, but it means that people who you may not intend to get the relief will get the relief. It would have been far simpler if it was £1,000 for everybody, but it would have been more costly. That is at the heart of the question of simplification and where the UK is. Sometimes we choose to go for targeting more than we do for simplicity. Until that balance is put the other way, we will continue to make the tax system more complicated.

**John Whiting**: It is often said that fairness and simplicity pull against each other. One of the things I often come back with is that a system can be fair only if it is simple enough for people to understand it and operate it.
Lord Teverson: Does it start to undermine ISAs, or do they sit well together, or does it make the choice of what you do with your cash more complicated?

John Whiting: You could say that for an awful lot of people this means that it is less of an issue of putting it into an ISA or the non-ISA sector because interest relief is not taxable. I would simply go back to the need for people to understand it. Choice brings complexity, and you can only understand which way to go and make an informed decision if you really get the message, and that comes back to the challenge of communicating what is going on.

Chris Sanger: If we are talking about trying to improve the savings ratio, the Post Office cash ISA now pays a return of 1.75%. That means that you would need to have £57,000 in a cash ISA for it to be worth being in the cash ISA rather than just getting your allowance if you are a basic-rate taxpayer, in which case what is going to incentivise me to put money into an ISA rather than keep it in a bank account? It may well change the incentives. You have to ask whether at the moment that incentive is there in reality to put money into a cash ISA in the first place.

Q65 Lord Bilimoria: The Finance Bill 2016 also proposes significant structural reforms to the taxation of dividends, including the removal of the remains of the imputation system. Do you agree that these changes simplify and modernise the structure of the UK tax system? Will they also be effective in achieving the policy aim of addressing the situation where private companies pay less tax and national insurance contributions by structuring payments as dividends rather than salary?

Chris Sanger: When we look at the complexities in the dividend system, at the moment we have dividend tax rates of 10% and 32% for the basic-rate and higher-rate thresholds. That came in back in 1997, 1998 and 1999 when we were looking at changing our tax system in relation to our double tax treaties. Ultimately, we have a different tax rate applying to dividends than we do on every other form of income. The Government could achieve this by just taxing those dividends at the current marginal income tax rate rather than having a new lower-tax rate or the 7.5% or special tax rate. That would deliver a 10 percentage point increase in tax for those on the basic rate and 7.5% for those above the basic rate band. The difference could be offset by a dividend allowance. You could have returned to what I would say is a simpler tax system by maintaining the imputation of 10% but have dividends taxed at the normal income tax rate. That would have given you a simpler outcome than the one that is here. The choice has been made of getting rid of imputation at the cost of having new tax rates that again are more distant from the income tax rate. That is one simplification, but I do not think it will be particularly helpful.

The dividend allowance will take many people out of this. The Government state in the summer Budget Red Book that this means that if you have shares worth £140,000, the dividend allowance covers you. That is a slightly unfortunate way of quoting this, because that would imply that it is designed for people to make sure that they can have up to £140,000. It is more about a £5,000 limit, and when equity rates return to the 5% level on which the pensions community budgets and we do not need to see that £5,000 increase, I think we will end up with a £5,000 allowance.

In relation to your last point about the targeting of tax-motivated incorporation, the increase in dividend taxation, whether through the system I have just mentioned as an
alternative or this one, clearly will affect that. The Budget document itself showed that it reduced the incentive by £500 million from £1.6 billion to, with the offsetting amounts, just over £1.2 billion. There still is an incentive to incorporate, so it has not gone the whole way. You could have made that more targeted. If your concern was tax-motivated incorporation alone, you could have chosen to focus on the closed companies—so those with five or fewer participants—rather than imposing this as a burden on everybody. This has two different objectives, which have been blended together and not necessarily in the simplest manner.

John Whiting: I would add that it is a simplifying measure in that a lot of people will no longer have to worry about tax on dividends. Then again, they did not anyway in most cases. The simplification in some ways is more subtle because they will understand it better, and rather than having to explain 10% and one-ninth credits and whatever, which is where I think Chris started, this is getting to a simpler, more understandable system, and, going back to my scales, that is on the positive side.

I agree with Chris that it could have been done in a simpler way, but I think it is going in the right direction to being a simpler system. Echoing Chris’s point, I am still not sure what the real driver is here. Is it simplification, in which case, yes, it has some gains, or is it taxing the tax-motivated incorporation, in which case I would have liked to have thought about whether this was the simplest way of doing that?

Q66 Baroness Drake: Could I go back to the point about people understanding the changes that you were speaking about? We are going to see the introduction of a new power for HMRC to assess individual tax liabilities using information supplied by third parties, and we are going to see the abolition of TDSI, which could mean significant changes in the taxpayers’ experience. In your view, what kind of customer support will HMRC have to provide, given that this is going to come into effect in April 2016? Do you think it has the necessary resources to provide the requisite levels of support and information that need to be delivered?

John Whiting: I have to be slightly careful about how I answer your question, Baroness Drake, if you will forgive me. I wholly believe that this is all going in the right direction. In a sense, reflecting on other questions, we are getting into a digital economy and therefore making use of information. For HMRC to use information that it already has and use it to potentially pre-populate returns, rather than asking you or me to put that information in again, process it again and potentially introduce errors, is going in wholly the right direction. The vision of being able to send you and me our draft tax returns, which have all sorts of things in them, including interest that we have received and paid, and which we just have to review and confirm is right, I am sure is a good direction to be going in.

Then, of course, it translates through to the support that you and I or the average taxpayer needs. First, I come back to needing information. I need to understand what I am being asked to do. That is quite a challenge, because we all know that there is a brown-envelope phobia; whether it comes in a brown envelope or a metaphorical brown-envelope email, people tend to put off doing things with tax. There will be a great need to get over to people that this is easy and not threatening. They just need to look and confirm and perhaps add one or two things. There will be a real hump to get over to get people switched on to this new way of doing things.
The benefits, though, are clear. It is very necessary that we take this step and that HMRC, as I say, uses the information that it has, and the powers in the draft Bill are necessary to enable it to do this. In an odd way it takes us back to the system that some of us in this room are old enough to remember, when it was the Inland Revenue’s job to assess and give you the data. There is a curious parallel with that.

Has it the resources to do it? Of course it is a big digital exercise, because this is not people in the Revenue just adding up whatever John Whiting has in his records and sending it to him. It is making sure that the IT feed from the banks paying interest, from the companies paying dividends and from the employers all tie together and give the right answer. That is clearly a big system challenge. I know there is a great deal of effort going into it and there are some extremely able people working on it, but I do not think anybody would say anything other than it is a huge challenge to make sure it works.

Baroness Drake: When we took evidence from the banks and insurance companies, there was a recognition that they had to do quite a lot of work to provide their customers with a certain amount of information and inform them. Clearly, that was a challenge. For a pensioner who suddenly gets their interest gross, they may have to take an action that they have never had to take before. They may not know where to go to pay tax. It is simple questions such as that. We were trying to understand what work is being done between the industry and the Revenue so they are joined up in the support and information going to the taxpayer, given that this is going to kick in in April 2016.

John Whiting: There is a great deal of work going on with industry, software houses and other people in trying to make sure that the information flow is correct. There is a great deal of work going on with taxpayer groups testing out what are often termed “customer journeys” and what will have to be done. Clearly, provision is being made for calls to the helplines. You make some very good points. This harks back to some earlier questions dealing with the bank interest issue. If, because you are over £1,000, you suddenly might have to make a return and pay some tax, you have to understand what you have to do. It is a challenge to try to get over to people what is really happening, and in some cases to understand that they are not actually out of pocket; they just have to do things in a different way.

Q67 Baroness Drake: Given the comment earlier about the OTS needing to feed more into the consultative framework, some of these changes to income and the savings allowance were not subject to consultation. Would they have benefited from being subject to consultation?

Chris Sanger: Yes. I sit on the Tax Professionals Forum, and one of our roles is to help the Government and call them to account on how they operate their framework for consultation. This will no doubt feature in our next report. Our last one was published in December. It is exactly these kinds of changes that it would have been sensible to set out upfront as a set of principles so that we can have the debate we had only a moment ago about the best way to deliver simplification or the reform that the Government want to deliver.

Over the last five years, the five-step consultation process, when it has been abided by, has really delivered proper and constructive discussion, allowing the Government to disagree
but meaning that the taxpayer has understood why the Government disagreed and why the Government were proceeding with something. I think that has been really beneficial. These kinds of proposals could equally have benefited from that type of discussion. The Treasury will sometimes say that it will not consult on rate changes and anti-avoidance. I am not sure that really includes this. Even in those cases, there is more of an opportunity to consult, and as much as there have been concerns about consultation fatigue, on items as fundamental as this, some early consultation can really make a difference. To be fair, we are in a period of consultation—it closes today—on the Finance Bill itself, and clearly that involves HMRC, so you could argue that is a period of consultation, but we are already quite a long way down the journey and it could have been dealt with and we could have had that feedback in a lot earlier.

John Whiting: It is about getting consultation in when there is a chance to make a difference when it is being formulated.

Baroness Drake: Would you care to nominate an illustration of where these proposals could have been improved had there been prior consultation?

Chris Sanger: To pick up the point that we were just talking about on the dividend side, some of the choices about the rates and how you achieve this could, to my mind, have aligned it to the normal income tax rate, and we could have had a proper debate about whether that simplification achieved the Government’s own objectives.

Baroness Drake: Do these changes, whereby HMRC will pre-populate an individual’s liabilities, signal a more fundamental change to the individual’s responsibilities in the tax system?

John Whiting: Potentially, yes. It does not in one sense, in that we are in an era of self-assessment, so it is up to us to self-assess and put it in, and HMRC will check, but it alters it more subtly. This is getting us to an era where we are being asked to review and check rather than put it all in, but the underlying responsibility on us to get it right is still going to be there. That will be one of the challenges to get over.

To go back to my brown-envelope syndrome, we know that many people, if they receive an official letter, will think, “They must have got it right”. We need people to take their pre-populated return and look at it sensibly with whatever records they have to confirm that it is right rather than blindly accept it. Of course, there will be a prompt that the return cannot know any rental income that you might have, so you have to put that in, and you might need to put some freelance earnings in, but you still have to look at other things and make sure they are right.

Taking it a little further, you can see that this saves you some effort, because some are clearly right, but in an ideal world it would go further and come out with a prompt saying, “You had rental income last year. We would expect to see rental income this year. Can you check it?”, and, “By the way, we notice you have been doing such and such. Have you considered claiming such and such relief?” You might not quite get into the sales pitch of “the people who bought this bought that”, but at least it would be doing a bit more prompting interactively and, frankly, making it a more helpful process both ways. It will take some time to get there, but we have to try to get people to see this partly as a citizenship
duty—I accept that—but not a terribly burdensome one, and something they would want to do to make sure that their affairs are right.

**Baroness Drake:** It is a challenging journey for the ordinary taxpayer.

**John Whiting:** Totally.

**Chris Sanger:** With digital there are two key aims, one of which is to reduce costs to HMRC by having all the information readily available and to make it easier for it to enforce the tax system, and the other is to provide the taxpayer with an easier way of filing tax returns and completing their information. As John was saying, the essence of, “The HMRC has done it for me already, so it must be right. Do I really need to look at it?” is a dangerous concept, because unless it is very clear where the information comes from that fits into it, it is going to take quite a bit of effort to work out where the numbers have originated. The taxpayer is going to need to be able to say, “I see the number on the form, but I know it comes from five different sources. Where are they?”

Coming back to your earlier question, in order for HMRC to be able to help the taxpayer we need a system that is robust enough to show the workings behind all the numbers, otherwise we will end up with people thinking, “It is so much effort to work out where the number came from, I will just believe HMRC”.

**Baroness Drake:** That leads us on to the issue of small businesses, but I am conscious of the number of questions I have already asked.

**Q68 Baroness Noakes:** Can we shift to digital tax accounts, upon which I know you are going to be consulted later this year? When the Financial Secretary wrote to the OTS chairman, and indeed to you, last summer, he said that his vision was for the OTS “to provide challenge on its important digital agenda”. Could you outline how you see that challenge operating as the digital tax account idea is taken forward?

**John Whiting:** In one sense, we have had that challenge all along in that given the direction of travel, with so much of the tax reform being digital, we have been encouraged—we would have gone there anyway—to consider digital ideas in whatever we came up with. Eliminating P11Ds has incorporated payroll by using digital means to sidestep all that. If we are going to reform small company taxation—we are looking at that now—we want something that will fit the digital agenda.

**Baroness Noakes:** What is your initial view on whether quarterly reporting is going to be achievable and whether it can be described in any sense as simplification?

**John Whiting:** We have already begun to have regular meetings with the group taking that forward in HMRC and the Treasury. Fundamentally, that is exactly our challenge: how is this going to be simpler, looking at it overall? I see the vision, as I think we all do, of an automatic uploading of data, but what has to be put in? Clearly at one end of the spectrum, when this was first announced, people heard it as four full tax returns a year. Clearly it is not intended as that.

**Baroness Noakes:** What is it going to be on this issue of information?
**John Whiting:** That is what we are discussing. Of course, it links into changing tax payments and whether we are bringing the payment of tax closer to when it is earned and what tax it is. This probably comes back to how accurate we want this to be, because if my company needs to put in four lots of information a year, which generates an accurate quarterly tax payment, I cannot see, certainly under the current system, how that can be simpler than one lot. On the other hand, if my company is asked to put in basic data that is already available in my system and, harking back to Baroness Wheatcroft’s question about a possible turnover tax or something, a sort of marker tax amount is payable that drops out of the system easily, that becomes more possible. One of our previous recommendations, which I suspect we will repeat, is that we can get rid of a vast number of the sundry adjustments that traditionally have to go on to move accounting profit to taxable profit, not least because, as the tax rate is going down towards 18%, the value of them is minimal. If accounting and taxable profit get much closer together, things become easier. I can see the direction of travel, and as with everything I will endorse it, but, to come back to Baroness Drake’s point, we see a very difficult route for a lot of this, and the challenge is whether this is really going to be simpler.

**Baroness Noakes:** Is the digital agenda being driven by HMRC coming to collect tax in a way that is simpler for it, or is it being driven by a bigger notion of simplification of the system?

**John Whiting:** That is a question that you would have to pose to them. Where I am coming from, and where my interest is, is in whether it is making it simpler overall. Clearly, HMRC sees this as having a benefit in perhaps tackling some of the tax gap, but exactly what the benefit is and where it comes from is a question you would have to ask it. I think HMRC is coming before you and no doubt you will ask it that. Certainly coming back to your basic question to me, as the OTS we are trying to stay well involved with the Making Tax Digital team, and we want to pose the challenge, which you rightly pointed to, which the Financial Secretary has in a sense given us the power to make.

**Chris Sanger:** Digital taxation in this way offers two real benefits to HMRC. It offers it the ability to get a lot more data from sources. The Finance Bill also includes provisions that enhance its ability to get data from other sources. It also allows it to provide a much better service to its customers, as it refers to taxpayers. There is a benefit on both sides. If we can get to a system where the preparation of your tax return becomes a lot less burdensome, because most of the information is already pre-filled for you, and if that could be coupled with some of the simplifications I talked about at the beginning in relation to easier tax returns, whether that is based on a few key facts rather than having to undertake a detailed tax return every quarter, I can see why HMRC would want to get this information. In order to provide the simplification, we need to do some of the policy reform at the same time. If we only go down the route of digitalising what we have right now, we will end up embedding the complexity that we have today into a computer system that will be very difficult to change. We need to make sure that the policy change is driven at the same time as the digitalisation of this.

**Baroness Noakes:** Do you think it is feasible to achieve that across the complexity of small businesses as they present at the moment?

**Chris Sanger:** There would be a real advantage in HMRC looking at segmenting the different businesses into the different segments and trying to think about what is relevant for each
type of taxpayer. If it can do that, it can create a simpler system, and with a simpler system it would be far easier for it to put it in a digital form and ask the taxpayer to provide the little bits of information that it needs on a regular basis. If we end up with it as it is today, we are just going to be embedding complexity into a digital system, which will be hard and expensive to change.

Q69 The Chairman: Following on from Baroness Noakes’ question, tax simplification is clearly a very desirable objective. There may be a couple of ingredients. One is that the tax itself is relatively simple and straightforward, but for most people the issue is how well it is explained and communicated. In your reports to the Treasury on tax measures, do you look into how it is communicated? Do you look into the material that is sent to taxpayers? Do you look at what is available on the website so you can form a judgment as to whether it is relatively simple for somebody who is a lay person?

John Whiting: The short answer is yes. We try to look at all aspects. When we were set up, the vision was that we would tackle the technicalities and metaphorically tear pages out of the tax code. Very quickly it became apparent to me that the administration—and by administration I include everything from how you file your return to the information that is made available—is at least as important. If the underlying law is complex and the interface easy—a computer analogy—you can manage and achieve it. When we make recommendations, we certainly make them to simplify the technicalities and the law, and we are very mindful of whether we can simplify the interface, if I can call it that, what the form is and whether we can make it simpler or make the procedure simpler.

To go back to our discussion on interest, we made some fairly basic recommendations about the R85 form that has to be filled in to get your interest paid gross—which of course will become redundant—because that was fairly crucial, and about how the taxpayer gets at the form and what information they were given with the form. So, yes, so far as I am concerned it is all part of our ambit to make the system easier for everybody involved. That means businesses, individuals of all types, advisers, and of course HMRC itself.

The Chairman: It is one thing when you are changing the rate of tax, which people come to expect and it happens with a degree of frequency. It is another when you are changing the structure of the way people actually have to make their tax return, with interest and dividends. It is much more complex, particularly if you add in the fact that there are some investment decisions that might need to be made, so communicating all that in a simple, straightforward way is quite a challenge. We wish you well with that. The evidence we have heard suggests that this will baffle quite a lot of experts and quite a lot of taxpayers.

John Whiting: We are certainly not going to be out of a job any time soon, I would guess.

The Chairman: We shall follow your lead. Thank you very much indeed for joining us.
WRITTEN EVIDENCE TO THE ECONOMIC AFFAIRS COMMITTEE

FINANCE BILL 2016 SUB-COMMITTEE

1. EVIDENCE

1.1 As PRISM represents service providers operating within the temporary workers market we will restrict our comments to the impacts within this sector, our area of knowledge and expertise.

1.2 Rather than address each question specifically we would like to comment on the broader direction of the tax system and would pose the question:

1.3 Does the current tax system accurately reflect, and work within, the current fast changing shape of business and employment?

• The UK tax system, in relation to workers, was created to recognise two distinct groups; the self-employed and employees. At the time the framework was created these two groups were easily identifiable. As the world of business changes with increased reliance on technology and the need for flexibility, these lines have become blurred resulting in many layers of complex legislation. This has left many workers unable to assess, or apply, their tax with certainty or accuracy.

• Every Government seems to recognise that certainty, in relation to taxes, which generally is the driver for many of the costs in business, is the cornerstone that supports confidence resulting in investment and growth. Where there is uncertainty within the tax framework this becomes a huge constraint. The uncertainty adds a layer of complexity that, when coupled with the normal day to day uncertainties of market conditions and market forces, constrains the modern business.

• PRISM believes that the tax framework has failed to keep pace with the changes in both business models and employment models which is resulting in a ‘sticking plaster’ approach to new legislation and creating levels of unnecessary complexity across our sector.

• We also believe that government does not fully understand the new business and ‘employment’ models used by UK businesses to very good effect. This lack of detailed understanding is resulting in a ‘perceptions’
approach to the rules rather than a ‘fact based’ approach. These changes are often being driven by media stories highlighting issues rather than being part of a longer term strategic roadmap.

- To ensure UK plc continues to outperform other countries, it is essential that a detailed understanding of new business models and structures, as well as the way the business wants to engage workers, is essential. Without this detailed level of understanding it is likely that the current perpetual cycle of change will continue resulting in a more complex tax system.

- PRISM believes that a strategic plan for the sector is required to help government to deliver a framework for the sector that ensures the workers are correctly categorised and have the right package of tax and benefits aligned to their categorisation; it is not just a tax answer.

- We also believe the only way to achieve this is through a wider strategic review with full engagement with end users of the workers, something that has failed to happen so far. In recent consultations less than 10 end users of the workers responded. This lack of engagement with the end users means that legislation often misses the mark or becomes unenforceable, an admission HMRC has made recently in relation to IR35.

- Only once this sector is fully understood, and it currently represents over 10% of UK plc working population, will we be able to create a strategic plan and ensure that the legislation is targeted correctly and appropriately. This will provide certainty to the sector for the users of the services, the workers, the recruitment companies and the support providers. This certainty will bring confidence and allow the market to invest and grow whilst at the same time maintaining UK plc’s competitive advantaged gained through this flexibility.

- Without a strategic review, we fail to understand how this cycle will be broken.

- One of the specific questions you ask is in relation to the Office of Tax Simplification [OTS]. The wide strategic review we are suggesting above would seem to fit well within the remit of the OTS. We also believe that the OTS, as opposed to HMRC, is likely to be able to engage more fully with all the sectors using flexible workers and provide a more rounded response.

- This strategic review needs to bring in multiple government departments as it needs to look a regulations within BIS as well as fully understand benefits available to workers; as we have said it is not just a tax review.

2. **Finance Bill 2016**
2.1 There are current proposals on the table that are widely expected to be implemented through the Finance Bill aimed at restricting a temporary workers right to tax relief on costs of travel and subsistence.

2.2 Many workers will be denied relief on expenses incurred from travelling to carry out temporary work as a result of these proposals.

2.3 Many temporary workers have specialist skills and have to travel to where those skills are required. Until now, they have been able to offset those costs against their tax which has made the assignment worthwhile.

2.4 The result of these changes will be a less mobile flexible workforce and increased costs of engagement.

2.5 The Government is one of the largest users of these types of workers, who support our schools and hospitals and fill gaps as and when they arise. It is therefore logical to assume that they would have fully understood the impact of these proposals on these workers prior to pressing ahead, with this legislation.

2.6 We asked that specific question of various government departments, including Health and Education, and all confirmed that they had not considered the impact of these proposals on their departments. This lack of understanding suggests they lack knowledge of either cost or supply implications across key sectors, including health and education, that are currently under extreme pressure financially as well as already facing challenges in providing adequate resourcing.

2.7 PRISM believes and supports the concept of ensuring the right workers pay the right taxes, however we disagree with the current methodology and resulting tests.

2.8 We believe this further illustrates the need for the review so a framework can be created that reflects current business and ‘employment’ models.

2.9 As the impact of these changes has not been fully understood by Government, we would suggest that the implementation of these changes is delayed until the strategic review reported.

2.10 By delaying implementation it would ensure that any changes required had been considered in the wider and longer term context and break the cycle of perpetual change leading to increased complexity.

2.11 PRISM is happy to provide any support it can to assist in carrying out the strategic review.

3. **About PRISM**

3.1 PRISM is a not for profit trade association that represents
service providers offering support services to workers operating as temporary workers and contractors.

3.2 Our members include payroll service providers, umbrella companies and accountancy firms with specialist offerings to workers operating through their own limited companies, often referred to as PSCs.

3.3 One of PRISM’s main objectives is to create a stable, orderly market that promotes high standards and compliance to the rules that apply across the sector. In achieving this it will provide our members with a high degree of certainty and confidence allowing them to develop long-term strategic plans and invest in the growth and development of their businesses.

3.4 Our accredited providers have already made significant investment into their businesses to support HMRC compliance. They have trained and developed expense teams to monitor the expense claims and ensure only those expenses that meet the rules are allowed as well as internal compliance monitoring functions. There has also been significant investment made in to achieving independent verification of their compliance through reviews such as Professional Passport.

3.5 In providing this response PRISM has not only considered the position of the providers and the impact on the services offered but also the wider implications across the market including the end clients, recruitment companies and the contractors. The aim is to provide a rounded and balanced response based on a wealth of knowledge, experience and expertise.

12 February 2016
Q25 **The Chairman:** Ms Miskin and Mr Williamson, welcome to the Finance Bill Sub-Committee. I believe you have already received a note of the issues that we want to discuss today. I start by asking your views on the quite far-reaching changes that have been made to the personal savings allowance and the tax deduction scheme for interest. Do you generally welcome these changes and do you have any particular concerns that you would
like to share with us about how well they are going to be understood by taxpayers, particularly unrepresented savers? Ms Miskin, would you like to start?

Caroline Miskin: The personal savings allowance came as a bit of a surprise and was unexpected. The only impact on the vast majority of savers will be the saving of up to £200. The vast majority—95%—of savers will not receive savings income in excess of the limit, so will have no additional compliance burden on them. Of the remaining 5%, the vast majority will have any tax they owe collected either through adjustment to their tax code or because they are already under self-assessment. My understanding is that there is a very, very small number of people—there are some—who will have an additional compliance burden either by filling in a self-assessment return or by receiving a simple assessment.

We very much welcome this move because of its impact on low-income savers, who will no longer have to complete R85 forms with their bank, or think about whether they need to or not. Many more will no longer have to fill in annual R40 forms to reclaim tax. This will address the issue that many savers do not reclaim tax to which they are entitled. At a stroke, there will no longer be anybody falling into that category.

Our concern is the accuracy of the data feed from the banks and HMRC’s ability to link it up. With ISAs, the banks hold national insurance numbers and that is part of the feed of information to HMRC. It is a more difficult task for HMRC to match up data for other savers. In particular, there might be joint accounts, trust accounts, that sort of thing.

The other main concern is about the understanding. Although 95% of savers will not owe any tax, we think there is going to be an awful lot of confusion. It is going to be very difficult for them to understand their position and how to arrange their affairs to properly use the allowances that are involved. There is the combination of the nil-rate band for savings, ISA allowances, the new personal savings allowance and the dividend allowance. There is also the cliff-edge effect when you go into the higher rate and the interaction with the marriage allowance. Further up the income scale you have the interaction with the high-income child benefit charge, which we believe is going to make it very difficult for taxpayers, and even tax professionals, to calculate. The idea of being able to do calculations on a piece of paper using a calculator is almost going to have passed. We think there are going to be a lot of people who will need advice and will need to understand what is going on, even if, in the end, they do not actually owe tax and they have no additional compliance burden.

Robin Williamson: We would certainly agree with that analysis. It is a generally welcome development. Having people whose savings income is relatively modest taken out of tax is a simplification, if it is well handled, and welcome in itself.

On the ending of deduction of tax at source, I pick up the point made about the numbers of people who at the moment overpay tax involuntarily simply because they never register with their bank or building society to have their interest paid gross if they are not liable to tax at all, or they do not reclaim the tax which they are not liable to pay if it is being deducted at the basic rate and they are, for example, liable on their savings income at the starting rate for savings, simply because they perhaps do not understand what the starting rate for savings is all about and do not realise that it is possible to reclaim this money. Up until now those people have been generally overpaying and there have been quite a few of them at the lower end. Our colleagues at Tax Help for Older People see this quite a lot. Over
the last 15 years or so there have been various attempts to publicise this fact through tax-back campaigns, but inevitably they can only reach a relatively small proportion, however well run the campaign.

**Baroness Noakes**: Have you any idea how many people might be involved in not claiming back tax?

**Robin Williamson**: I would have to look into that. I can probably get some idea from Tax Help for Older People. We could probably extrapolate and see how much of its client base is in that position and for which it has to do reclaims.

**Lord Forsyth of Drumlean**: You said that there was a very small number of people who would be affected. There will be people who are basic taxpayers who at the moment do not need to think about it because the basic tax has been taken off. They will need to know that they have to declare the tax. I do not know—I am just guessing—but in my mind I have a lot of elderly people, with smallish pensions perhaps, who will be told that they owe this tax, and then of course there is digital movement forward. Are you not concerned about that group of people and the impact on them, or are they very small in number? Is that why there is no concern?

**Caroline Miskin**: A lot will happen automatically because there will be an adjustment to their tax code. Yes, they will see an adjustment to their tax code and they may end up with underpayments, but I do not see significant numbers having to go into self-assessment.

**Lord Forsyth of Drumlean**: So they will not have to do anything; it will happen automatically.

**Caroline Miskin**: It will happen automatically. The other thing is that by definition, certainly at current interest rates, they would have to have interest income of over £1,000, so they are not the least well-off pensioners who would have to do anything. If they have interest income under £1,000, they will never need to do anything.

**Lord Forsyth of Drumlean**: That is not the point. I am thinking of people who have that income who are perhaps frail and elderly and not computer literate. You are saying it is not a problem because their tax codes will be automatically adjusted.

**Caroline Miskin**: Simple assessment, which we will probably come on to, will solve some of that, the digital piece aside. I am sure that those numbers are very, very small, but there will be some, and they will need help.

**Q26 The Chairman**: On Monday, when we met the representatives of the industry bodies, they were unanimous in their view that the changes were complex and potentially rather baffling, and that there was going to be a need for quite a lot of hand-holding. Who is going to do that? Does HMRC have the resources and the capability for doing that, or are people going to have to reach out to their accountant, if they have one, to try to make sense of this?

**Caroline Miskin**: HMRC is intending to make a calculator available, but there will be some people who need advice, and that was exactly my point about the complexity, and particularly the interactions. It seems very complex to have a nil-rate band for savings, so
you have one particular relief there, and you have separate personal savings and ISA allowances. I absolutely agree that people are going to struggle with understanding rather than necessarily with the compliance and having to fill in forms and having to interact with HMRC. It is just that they will not understand them. It is not clear where they will get that information from; one imagines they may go to their banks. I am aware that HMRC is enlisting the help of the banks in communicating this information to taxpayers. However, there was a report in one of the newspapers this week on a mystery-shopper exercise that indicated there was some way to go on that.

**Robin Williamson:** The banks have not been great at informing their customers about the existing arrangements. It is not unusual for them to have out-of-date forms in their branches. This opens up the wider question of how HMRC, or these days the Cabinet Office and the Government Digital Service, is going to present the information on this essentially fairly complicated structure to those who want to know and are likely to be affected, particularly the small number Lord Forsyth referred to who, instead of having tax deducted automatically, will now have to have their self-assessment adjusted or have to pay additional tax through the PAYE system. At the moment, all information goes on GOV.UK and there is not a great deal, or indeed anything, available for those who cannot visit GOV.UK because they do not have a computer, or, if they have access, they do not know how to use it or their internet connection is poor or non-existent. By HMRC’s own research, there is the equivalent of approximately 7 million adults in the UK in the position of being digitally excluded, and it really needs to do something for them as well.

**The Chairman:** Going forward, they would receive a tax demand from HMRC—please tell me if I am right or not—that would say, “We have now received this information about your income and you owe us this”, or, “You don’t owe us anything”. How do they understand it, and how do they check it? The level of anxiety when people get a letter from HMRC is potentially quite high, and even higher if you cannot make sense of it.

The other point that was made when we met on Monday was that there are a number of types of savings, peer-to-peer lending for instance, where no information is provided to the lender, or at least not currently. What steps are being taken to ensure that the interest on those kinds of instruments is actually going to be communicated to the taxpayer and to HMRC?

**Robin Williamson:** Dealing with the point about how to check HMRC’s information, which it will present to you in pre-populated form, I think that is going to be a big problem for our constituency, because there is a big risk that they will look at an official form, see the figures on it, and assume that the figures, which may be incorrect on the form, are in fact correct, whereas the records which they themselves have kept, which may be accurate, must be wrong because they conflict with the form. This is going to be a considerable danger, and the only way in which HMRC is going to be able to overcome that is by emphasising the message that HMRC’s data is not necessarily correct and must be checked by the taxpayer.

**Lord Kerr of Kinlochard:** The problem you describe will lead to reduced revenue, because if the numbers on the form are higher than the individual believes is right, the chances are he will challenge them, but if the numbers are lower than he thought, he will think, “Oh well, they must have got it right. I’m wrong”, and he will not challenge them. The risks are for the Exchequer in this confusion.
Robin Williamson: Among the client group of Tax Help for Older People, I think the reverse might be the case: they would be more worried if they thought they were underpaying tax and very worried if they felt they were going to be in debt to HMRC at any stage.

Lord Teverson: Can I come back to a couple of points that Caroline Miskin made quite strongly? One is people’s ability to understand these changes and manage them or take advantage of them in the right way. Another is the matter of cliff edges that are introduced. I am particularly interested to understand whether you think there will be behavioural changes that might be good or bad and have unintended consequences. Classically, in other areas we have people who restrict the number of hours they work in order to not to cross thresholds and things such as that. Will these measures on savings have any potential effect that way or any unintended consequences that you can see?

Caroline Miskin: I cannot see too many unintended consequences. It is a population whose incomes are slightly above those of our client base, but potentially if people are on those boundaries, as on similar cliff edges, they will look at options such as making gift aid contributions, pension contributions, that sort of thing, to try to make sure they stay below those. You are looking at people who are on the boundary with the higher-rate band, so I would not have thought generally they would be the sort of people who would try to drop hours.

Q27 Lord Turnbull: We are told by the Government there are categories of people who will be better off and there will be others who will pay no more than they did before. The advantage for people who are paying under present arrangements is that for those who are not going to be paying any more, the right tax is being deducted at source from pensions or incomes by the banks. There is also a category of people who may not be any worse off, but now have to get involved in a process they did not previously have to get involved in. It may not simply be a matter of what the Chairman says: that they will get a demand. They will just get a number, so instead of getting 9576, they will get 8039, and they will not have the faintest idea why they have this lower coding number, so they will have to check it because there is a possibility that it might not be right. Previously, under this very simple scheme it was deducted at source by the bank, employer or pension provider and you were pretty sure it was right. The anxiety quotient is going to go up even if people are not losing money.

Caroline Miskin: People may have thought it was right, but in an awful lot of cases it was not and they should have been reclaiming tax, and in another significant number of cases they should have been paying additional or higher-rate tax. HMRC produced a research report last year on people’s understanding of the current system. At the moment there are an awful lot of people who think that the 20% that has been deducted at source is right, but for an awful lot of them it is not.

Lord Forsyth of Drumlean: What is wrong with the current system? Going back to my rich 90 year-old lady who has £40,000 of savings and is therefore above the savings threshold, if she is getting 3% and she has invested it for four or five years, or whatever, under the system as it is now she would be sent a certificate by the bank or another organisation that said, “This is the interest that has been deducted”, and because she was a basic-rate taxpayer she did not have to do anything at all. I am not sure how the tax coding or PAYE will work in that case because she is not employed by anyone. She gets this letter from HMRC saying, “You owe me £35”—it will be a small number. You have experience of dealing
with these people; I only have the experience of relatives. They go into a blind panic if they get a letter from the Revenue saying they owe money, particularly the older generation, which dislikes the idea of owing anybody money. You must have experienced that. Is this not adding a whole degree of complexity? It also means, of course, that the Revenue does not get money in advance and has to collect it, so it is not in the Revenue’s interests either. But you are very enthusiastic about it.

_Caroline Miskin_: I do not really understand the motivation for it. What I am saying is that it saves people up to £200 and that the degree of complexity that it introduces is less significant and affects a smaller number of people than those for whom the current system is complex because they need to fill in forms and reclaim tax. Those are exactly the sorts of vulnerable pensioners you are talking about. I agree that there will be unexpected demands for some, but that is a smaller group of people than the group of people who are not at the moment reclaiming what they are entitled to.

_Robin Williamson_: It is also worth mentioning that if you have £1,000 in savings income, that does not necessarily mean that you are a rich person with large amounts of capital. They may be bits that you have put away—

_Lord Forsyth of Drumlean_: For your funeral.

_Robin Williamson_: —at a rate of £1,000 or £2,000 a year over the course of a working life, added to perhaps by some modest inheritances from parents and so forth over the years, and this goes to supplement your state pension. Your total income is probably still under the personal allowance, so the £1,000 of savings income, plus any additional bits of savings income you might have that might otherwise be taxable, might anyway be covered by the personal allowance at that sort of level.

_Lord Turnbull_: Could you provide a profile of the kind of thing they produce after Budgets: this type of person with this kind of income? Going a bit further up the income scale where instead of £1,000 you only get £500, is that at an income where lots of other clawbacks begin to come into effect? What does that group of people look like?

_Robin Williamson_: You get very high marginal rates of course at the point where you become a higher-rate taxpayer. At an income level of £43,000 you get a savings allowance of £1,000 and at £43,001 you get £500, so that is a marginal rate of tax of 500-odd per cent.

_Lord Turnbull_: Does the marriage allowance not start coming off at that kind of level?

_Robin Williamson_: Yes, and the marriage allowance as well. You have to be a basic-rate taxpayer in order to get that additional £200.

_Lord Turnbull_: This is a position where the income distribution is really thick with people, is it not? There are lots of people around £40,000.

_Robin Williamson_: Indeed, there are cliff edges and high marginal rates at that sort of point. There are also a lot lower down because of the interactions with the benefits system: universal credit, council tax benefit and so forth.
Q28 Lord Kerr of Kinlochard: Can we move on to dividends? I should declare two interests. I am a director of two dividend-paying companies, so I receive dividends, and I fill in my form manually. What are we going to be required to do as companies when we issue dividends? Currently, we send out the tax voucher to the shareholder. That is going to stop. Presumably, we are going to have some new reporting requirement to the Revenue. Is it clear what that is?

Robin Williamson: I am not sure on that point.

Caroline Miskin: Not at the moment. I understand there will be a consultation document on third-party reporting requirements later this year, which would include that. I suspect there is an intention of a reporting requirement for third-party dividends, but there is absolutely no detail on that at the moment.

Lord Forsyth of Drumlean: Does this happen in April?

Lord Kerr of Kinlochard: This is applying to the tax for this year.

Robin Williamson: The dividend?

Caroline Miskin: Yes.

Lord Kerr of Kinlochard: In this tax year.

The Chairman: 6 April.

Lord Forsyth of Drumlean: Yes.

The Chairman: The tax year ending in April 2016.

Caroline Miskin: No, it starts in April.

The Chairman: 2016-17.

Caroline Miskin: Yes, 2016-17.

Lord Forsyth of Drumlean: You are consulting later in the year. How is that going to work?

Baroness Noakes: It affects the direct taxation year.

Lord Kerr of Kinlochard: Presumably, as companies we are meant to go on sending out tax vouchers for the moment until we hear something to the contrary. Is that right?

Robin Williamson: I suppose that any dividends declared for the current year, whenever they are declared, will carry a tax voucher.

Caroline Miskin: There will still be a tax voucher but without a tax credit on it.

Lord Kerr of Kinlochard: If we are going to stop doing that in the next tax year, which starts in April, we should surely be saying now in our annual reports and communications to shareholders what is going to be happening next year.
Caroline Miskin: Yes, I would have to check. I am not sure what the reporting requirement of companies to individuals is going to be from April. What is being consulted on is the information that a company may have to provide directly to HMRC. I would need to check whether the requirement to provide something equivalent to a dividend voucher but without a tax credit continues after April. It may do.

Lord Kerr of Kinlochard: I cannot help feeling that we ought to be saying something in annual reports that are being drafted about now.

Robin Williamson: My guess is that you would continue to give dividend holders a dividend voucher but without the tax credit attached to it.

Baroness Noakes: There would be no legal requirement. At the moment that derives from having to give tax information.

Lord Kerr of Kinlochard: I do not know. I think it would be very helpful if you could give us a little note on that.

The Chairman: As far as you understand it, the rules on reporting, both to HMRC and to the individual taxpayer, are going to be consulted upon over the coming months and it will be clear by the beginning of the new tax year.

Caroline Miskin: I think the consultation is on the information to HMRC. I would need to check exactly what the requirement is on information to individuals.

The Chairman: I think that would be very helpful.

Q29 Lord Kerr of Kinlochard: Looking now from the shareholder point of view, this is all designed to make life simpler for the taxpayer, but I think it is going to make it more complicated. It is rather nice to have these tax vouchers. When the company sends you a consolidated total at the end of the year, it is quite good when you are filling in or checking your tax return. I think it is going to be more difficult with the introduction of the PSA and these curious rates of tax once you have gone over the £5,000 and it has been taken into account. Is life not going to be quite difficult for the taxpayer if his dividend income is more than very modest and comes under the £5,000?

Caroline Miskin: Yes.

Robin Williamson: There is no change for anyone whose income is under £5,000.

Lord Kerr of Kinlochard: Exactly, but supposing it is more than that, his life is going to get more difficult.

Robin Williamson: They will have to pay tax which they did not have to pay before if they are basic rate taxpayers.

Lord Kerr of Kinlochard: What is this going to do to his behaviour, apart from making him worried? Is he going to decide that the simplest thing to do is to make sure he uses his maximum ISA allowance? Would that be the behavioural change that you would expect?
Caroline Miskin: The first thing to appreciate is that this measure has not been introduced as simplification; it has been introduced as a fairness and anti-avoidance measure. The changes on the rules on dividends are driven by that and not by simplification. Certainly very few of our clients who have portfolio shares will have dividend incomes of more than £5,000. For people who do, it may push them towards ISAs, but it will be very difficult for the unrepresented taxpayer to get that information.

The main impact of the dividend measures and the main behavioural changes are going to be for those people who are trading through personal companies. Most of those are represented, so they have access to advice, but that is where you are going to see very significant winner and losers. The changes are very complex and they will change when the corporation tax rate drops to 18%. They may change again if the class 4 national insurance rate goes up. I think you have already been sent Rebecca Benneyworth’s paper for the ICAEW, which sets out very clearly exactly who the winners and losers will be in those different scenarios.

Robin Williamson: A colleague of mine who keeps an eye on these things tells me that there are already avoidance schemes in development at the moment, particularly for contractors of their own companies, on how to avoid the new dividend tax. As Caroline says, some are fairly bog standard, such as ISAs and equalising dividend holdings between spouses and that sort of thing. Others might be more intricate and they might not necessarily work, so there could well be another group of victims of the promoters of tax avoidance schemes at that end of the market.

Lord Kerr of Kinlochard: I will leave personal service companies to somebody else. I have one other question on ISAs. Why do you think the Chancellor did not increase the ISA allowance, as he and his predecessors have tended to do down the years except when things were very bad? The ISA seems to me to be the thing that most of the punters out there really understand now, and they rather like it. I understand what you are saying about the motivation behind all this, but do you think we have seen the end of a steady increase in ISAs? Is it frozen for ever? What is your feeling about where this is going to go?

Caroline Miskin: I am not quite sure where the ISA is going, but I think the £5,000 dividend allowance was an attempt to mitigate the additional complexity of these rules for a significant group of taxpayers who have dividends of less than £5,000. If the dividend tax rates had been changed without the introduction of the £5,000, that would have brought a huge number of additional people into the system. I suspect any decision about ISAs is independent from the decision about the dividend allowance.

Robin Williamson: Also, the personal savings allowance and the ending of the deduction of tax at source scheme have to be seen as a package, and presumably the cost of that would have restricted the amount of money the Chancellor would have had to spend on increasing ISAs. The other thing he did at the beginning of this current tax year was to reduce the starting rate for savings from 10% to 0%, which is another cost. In future, I do not see why that should necessarily cause further restrictions in the rate at which the ISA limit will increase.
Lord Forsyth of Drumlean: For your poorer clients is there any point in ISAs? If you have an allowance plus the allowance for dividends of £5,000 plus your starting allowance, you have a bigger allowance than applies to ISAs, so why would you bother with ISAs?

Caroline Miskin: There is no financial advantage.

Baroness Noakes: If you are not a higher-rate taxpayer there is no particular reason to use an ISA.

Lord Forsyth of Drumlean: Does that undermine the ISA itself as far as people with fewer savings and less income are concerned?

Robin Williamson: There is probably less point now in having an ISA than there was before at that sort of level of income, although of course not everybody has access to the best advice and not everybody will necessarily appreciate that.

Lord Forsyth of Drumlean: That is my point. There is an expense in having an ISA and setting it up and it is not going to be in your interest. It has taken me about two weeks to work that out in my own head, so perhaps I am not very bright, but I think most people’s eyes glaze over, so there is quite a lot of work to be done here.

Lord Turnbull: Once you have bought an ISA, that adds to an accumulative limit and you always have it; you can buy more ISAs each year and sell previous ISAs and put the money into other ISAs, so you always have that amount of protected income. If you decide that you are not going to bother with ISAs, you do not have that protection. That is the only incentive.

Lord Forsyth of Drumlean: Yes, but I was thinking of the client base of our witnesses. They do not think, “What am I going to do with my £16,000 every year, and how can I put it in a safe place?” I am thinking of people who are looking to get the best return and pay the least tax. It seems to me that ISAs suddenly become not as attractive.

Lord Teverson: Given this move, as you say, to tackle tax avoidance by people taking dividends rather than salaries in their own businesses, was there a policy option that you just make those dividends to natural persons subject to national insurance? Is that not an easier policy option that stops all the distortions?

Caroline Miskin: There are all sorts of policy options, but even with the introduction of this rule, there is still a benefit to paying dividends. This measure has not taken away all the benefit of the dividend route.

Lord Turnbull: Going back to this thing about companies, there are many year-end plcs that will declare their results in the next six weeks or so and say, “This is the final dividend”, and then they get it approved at the AGM in May. Am I right in thinking that that dividend is not going to be within the rules?

Baroness Noakes: It is.

Lord Turnbull: It is?
Baroness Noakes: It will be paid in 2016-17.

Lord Turnbull: So it is when it is paid, not the year to which the dividend relates. I suppose they all know about it, do they?

Lord Kerr of Kinlochard: I do not think they do.

Baroness Noakes: They have nothing apart from the normal year in which incomes are assessed.

Caroline Miskin: There is certainly an incentive in paying dividends. There are personal companies looking at paying dividends before the end of this tax year to avoid this move. That is certainly the case.

Lord Turnbull: But there is a lot pressure on companies to boost the dividend and then to cut it the next year.

Baroness Noakes: For a normal plc, no.

Robin Williamson: I can clarify that by looking at the commencement provision, which my colleague has brought along. She is well prepared. It is for the tax year 2016-17 and subsequent tax years. If the dividend is declared for last year it will be subject to existing arrangements. Any dividends declared for 2016-17—

Baroness Noakes: No, it is when they are paid.

Caroline Miskin: Dividends are taxable when they are payable.

The Chairman: We will get clarification on that from our specialist advisers. Let us move on to the next question.

Q30 Lord Turnbull: You have partly dealt with the next question. This started as an anti-avoidance measure. There are still incentives to incorporate, but at the level of sole traders, small shopkeepers, mom and pop businesses, how are they affected by all this?

Caroline Miskin: At TaxAid we do not advise people who trade through limited companies, because they are generally unsuitable for people who cannot pay for ongoing advice. On income of up to about £20,000, the new rules have almost no impact on the decision whether to incorporate or not. The rules make some changes to the decision as to whether it is worth incorporating or not. That is also detailed in Rebecca Benneyworth’s paper.

Baroness Noakes: Do we have that paper? Has it been circulated?

The Chairman: Yes, we do.

Lord Turnbull: Are the collective bodies representing small businesses, retailers, builders or whatever likely to welcome this, or will they think, “I’ve now got these funny rates like 7.8 and 32.1”? Are they going to find that difficult? The old imputation system was not the simplest thing to understand. Are your small corporate, as opposed to small personal, clients going to find that difficult?
Caroline Miskin: We do not advise small corporates.

Lord Turnbull: Or a small trader.

Caroline Miskin: Even small corporates need advice and will find it difficult to comply with their obligations without advice. It is not going to be popular, because in the vast majority of cases it is an additional cost to people trading through limited companies.

Robin Williamson: I suppose it could make a difference at the minimum wage level, where people are told that they are self-employed, not employed, and made to incorporate themselves when they work for, say, a particular construction company or another engager of their labour.

The Chairman: Do you advise the self-employed?

Caroline Miskin: We advise the self-employed; we do not advise those trading through limited companies. We do see occasions where people incorporate in circumstances when they should not. I admit I have not thought this through, but there is a risk that a £5,000 dividend allowance could possibly push some people on low incomes into incorporating in situations where they would struggle to deal with the obligations. I will have to think that one through more.

Q31 Lord Teverson: Perhaps we could come to Clause 71, which I know we have talked about a little, which concerns using information from third parties. In a way it sounds very Big Brother-ish, which it already is. It should be easier for ordinary taxpayers, but I wonder if that is the case. I am interested particularly in how comprehensive that will be. There must be sources of income that HMRC cannot merely grab out of systems that are there, such as foreign earnings. I have no idea what other things there might be. How comprehensive is it? Is it a simplification for people or likely to start with a large number of errors? Will people be able to check that themselves from those originating organisations?

Caroline Miskin: I would start by saying that we already have 30 million taxpayers, and only approximately 10 million are in self-assessment. The main third party that HMRC is getting information from is employers, which it has been doing for years. In our view, this power is about five years overdue, because we have had the situation for the last five years that HMRC has been putting very significant numbers of people into self-assessment when all they have is employment, pension, state benefits. Very significant numbers have been going into self-assessment and getting caught up in late-filing penalties. It has been a huge amount of work for us and Tax Help for Older People in dealing with this in the last few years. Informally, we have been pressing for HMRC to have such a power. At the moment, if the individual does not make a voluntary payment, HMRC’s only option under the law is to issue a self-assessment tax return. The fact is that instead of somebody being sent a PAYE calculation at the end of the year, they will be sent something that is very similar, hopefully in a much better format and with a lot more detail, not unlike what they are already getting, but it will be enforceable. At the moment, they are sent a P800 and it is either collected through their tax codes or they are asked to pay. Our clients already have the problem of checking these PAYE tax calculations when they get them; it is nothing new. There is another very significant group of people who will not have
to go in, and that is people who have a state retirement pension that is more than the personal allowance, and the only way HMRC can collect it is by issuing a self-assessment tax return. The fact that it puts a stop to those two categories of people being issued with self-assessment returns is a huge benefit to us.

Obviously the power has been brought in with a view to digital tax accounts and being able to do other things. Part of the issue is that HMRC has not explained what it intends to use this power for. Informally, we know that it is intended for these PAYE underpayments and people claiming state pension, but HMRC has not made a public statement or put anything in writing as to exactly what it intends to use it for. It is probably the first legislative provision to support digital tax accounts.

Regarding third-party data, there is going to be a consultation later in the year as to what those sources are. The main one will probably be savings. I think HMRC would say that the people with foreign income, and there are other sources of income, do not have simple tax affairs and they are already in self-assessment. This would enable HMRC to take significant numbers out of self-assessment, but there will still be a significant group. No, it can never be comprehensive.

Robin Williamson: The question of whether it is going to be easier for people to check will depend very much on how HMRC presents the information. If it gives a sort of composite interest figure to somebody who has more than one bank account bearing interest, so they are going to have to check that it matches up with all the different interest figures, that is going to be more complicated.

Lord Teverson: That is a very important point. Is there any indication whether that will or will not happen? Do we know?

Robin Williamson: No yet, but, as Caroline says, there will be consultation on all that. Also, of course, we need to persuade HMRC as part of this to draw particular attention to any reliefs or allowances that people might be eligible for so that they do not end up overpaying tax, which is the problem we have at the moment, because they are unclear of their reliefs.

Lord Teverson: That is a very good point. We know that HMRC has gone through quite significant manpower cuts over the last few years, as have other departments. Its customer interface at the moment is under some criticism. Does it have the ability to catch the information and put it out in a sensible and understandable form to its clients? Is it capable of doing that?

Robin Williamson: It puts out information on tax credits, which generally speaking it consults on, and by the time it has been fully consulted on it is okay. Whether other parts of the organisation have the kind of resource to devote to explaining new law and new practice otherwise than on GOV.UK, where it gets hijacked by the Government Digital Service, is another question. The kind of demographic Caroline was describing is very often people who will not have access to GOV.UK, where digital exclusion is fairly prevalent. It will be necessary to produce good explanatory material and guidance in paper form, as they do with the current PAYE coding notices, which are improving in clarity. That is probably the most important ingredient of the success of this new initiative.
Lord Teverson: Caroline Miskin, you were saying that you think it is very important that HMRC communicates this within a future context of where it is going. Are you saying that needs to be a lot better?

Caroline Miskin: Yes. I do not believe that there has been sufficient explanation of what this power is intended to be used for. We are very concerned about the accuracy of the data from third parties and HMRC’s ability to match it up, which for interest data has historically been very poor. We are concerned particularly that taxpayers do not end up in the situation, which they sometimes can if their employment data is wrong, where HMRC tells them to go to the employer, the employer tells them to go back to HMRC, and they end up in a circle that they cannot cut through.

We are also concerned that there are only 30 days for individuals to dispute this with HMRC, which is a very short period. Typically, it is quite unusual for clients to come to us within 30 days of having received their tax bill from HMRC, because they worry about it for a while, try to phone HMRC, then maybe go to a front-line agency such as Citizens Advice, and only then do they find us. It will be a real struggle for people to check these and be in a position to challenge them within 30 days. If they go into self-assessment — this is a totally unsuitable mechanism for these people, but if they do — you have quite long periods of time to amend self-assessment tax returns and to claim overpayment relief if you have made a mistake and paid too much that way. There is a risk that after a short period of time the options could be much more limited and potentially end up with the tribunal being the only option, with a fee.

Q32 Lord Forsyth of Drumlean: I am going to ask about the 30 days, because it is not clear to me. You get this notice from HMRC that says “You need to pay £500 in tax”, and you think, “No, I don’t owe them £500 in tax”, and you look at the information and find that it is duff. From your own experience, how often is the information duff? How often do they get it wrong? Is it a tiny proportion or a reasonable proportion? You think it is wrong, so you ring them up and listen to Vivaldi for two hours and eventually speak to someone. Does the fact you have reached them mean it all goes back to zero? My information is that HMRC has the power to suspend a simple assessment if the taxpayer disputes it, but it is a power and it does not have to suspend it. Is that right?

Caroline Miskin: It does not have to suspend, but it has that option. I would anticipate HMRC suspending it for that period if somebody disputes it.

Lord Forsyth of Drumlean: For which period? Is it another 30 days? Is your point about how long it takes you to sort it out?

Caroline Miskin: I do not believe it is another 30 days.

Lord Forsyth of Drumlean: At the back of my mind is the fact that it has this power now where it can take the money out of your bank account. Perhaps I am suspicious. You have asked, “What is this power for?” It would be jolly convenient, would it not, if it could send something saying, “The banks tell us you have had this money”, you ring up and say, “I haven’t”, and it says, “We will take it out of your account and you can sort it out”? Are we moving towards that situation, or do you think there are enough safeguards?
Robin Williamson: It is not allowed to use deduction directly from the accounts if it has had some communication from the taxpayer, which it will have done if the taxpayer has disputed it. It will then have to go through the prescribed appeal processes.

Lord Forsyth of Drumlean: I understand that, but what happens if you do not do anything within the 30 days?

Robin Williamson: If you do not do anything within 30 days?

Lord Forsyth of Drumlean: You have 30 days to dispute it.

Caroline Miskin: So you are confused about the paperwork or you are out of the country, or whatever?

Lord Forsyth of Drumlean: Or you have just panicked and you have put it with a bill for the electricity because it is too worrisome to think about.

Caroline Miskin: It is not actually due for a minimum of three months or 31 January.

Baroness Noakes: Does it become conclusive after 30 days?

Caroline Miskin: The payment date is longer.

Baroness Noakes: Does the amount become conclusive after 30 days?

Caroline Miskin: Yes, that is the risk if people do not. In the legislation it is 30 days or such longer period as HMRC may allow.

The Chairman: Can we come back to the first point that Lord Forsyth made? Is there any data available about the error rate of assessments made by HMRC?

Baroness Noakes: Yes, there is.

The Chairman: Can we look at some trends so that we can see the scale of the problem that currently exists?

Robin Williamson: We can find out certainly, because periodically I go to Tax Help for Older People and ask how many PAYE coding notices have been checked and found to be incorrect. That is something which we could certainly dig out.

Lord Forsyth of Drumlean: You are dealing with these people all the time. From your experience, how often is there actually an error? Anecdotally, is it one in 100, one in 10?

Caroline Miskin: Anecdotally, the number of P800—PAYE calculations—that have incorrect information on them is very, very small. There are two areas where we look particularly at the data. The worst offender is the data that comes from the DWP. The data on state pensions is by far the greatest source of inaccuracy on P800s. There have been a few RTI teething troubles. Even going back to when the calculations started to be issued in the autumn of 2010, the number of calculations that are incorrect is very, very small; it is tiny. We had lots of them where we were disputing whether the taxpayer should be held liable, but a smaller proportion of ones where the figures were wrong.
Lord Forsyth of Drumlean: What I am describing is not going to be a problem.

Robin Williamson: It could be more of a problem for pensioners because of the inaccuracy of DWP data occasionally, and at the point where it kicks in during the year of retirement, where there is quite often an underpayment or overpayment which they never quite manage to catch up with.

Lord Kerr of Kinlochard: The key may be your point in answer to Lord Teverson, Mr Williamson, when you talked about the difficulties for the taxpayer if the numbers that come out of the Revenue machine are composite. I strongly agree with you. Under the present arrangements they are composite numbers, but as we move to this new regime, do you think there is a chance that they will come out disaggregated from what makes up the number in each section, interest, dividend, whatever, as well as the total? That seems to me highly desirable if you are moving to this different system where the taxpayer is going to have to do a lot more thinking for him or herself. It is going to be a lot of checking. It is going to be quite important to see how they got to these numbers and how the total is made up. Do you think that is going to happen, or are we going to stick to the composite?

Robin Williamson: What worries me is that it might well happen for those with digital tax accounts. For those who do not have digital tax accounts, they might have to make do with second best, which might be however the composite figure is made up.

Caroline Miskin: We are already there. There is a new format P800 which the HMRC is going to issue—it may even have started—which is not going to have composite figures on it but is going to list each employment and each pension separately. That is happening any day.

Lord Kerr of Kinlochard: In future, will interest payments and dividend payments be separate?

Robin Williamson: I think we are still some way off that potentially. That may have to come in a digital account.

Lord Turnbull: If you just get a figure saying “bank interest” and you in fact have several accounts—HSBC, et cetera—if you are not told which bank paid what, one recourse is to go back to the bank and see whether they agree with the number, but you will not be able to check it. They will say, “That is what we were told”. It may not be an HMRC error, it may be further back, but if you are not told which bank paid it, whether they paid it into the right account, or whatever, you cannot check. You need to know bank by bank.

Caroline Miskin: The whole area of any other third-party information, other than employer information, is still in its early days, and we do not yet know what information HMRC intends to supply the taxpayer. As Robin pointed out, we rather suspect that it will be through a digital account, and those who are not able to log on to a digital account are second best.

Baroness Noakes: This applies now. It is saying that simple assessment is going to affect 2015-16.

Caroline Miskin: It is not going to affect 2015-16. There was an error on the front page. It is 2016-17.
Baroness Noakes: That is 2016-17 as well.

Q33 Lord Bilimoria: You have mentioned digital tax accounts quite a lot. Simple assessments have been put forward as a way of moving towards digital tax accounts and replacing the old system altogether. There is going to be a consultation on this. Are your clients going to be able to cope with this change? I believe the LITRG, with the help of TaxAid, has conducted a digital capability survey. Could you tell us more about this when it comes to using government websites, and what the responses are to this survey so far?

Robin Williamson: HMRC’s survey was put out in September last year, so it is fairly recent. It tried to divide the population into those who are digitally excluded, those who are never going to be able to cope with computers and the internet for various reasons, and the digitally assisted, who would be able to cope with assistance. Among the digitally excluded, the figure quoted was about 15% of the population at large, equal to about 7 million adults. Moving down to businesses, there was a gap between those with employees, roughly 2% of whom were digitally excluded, and those without employees who are sole traders, a very much larger proportion of whom were digitally excluded. Two out of five of those were within the digitally-assisted category. There is quite a large number.

Caroline Miskin: I think you were talking about our old survey and Tax Help for Older People’s survey of our clients?

Lord Bilimoria: Yes.

Caroline Miskin: That is still ongoing. We have no concrete results yet. We have major concerns about clients’ capabilities. Tax Help for Older People probably has more concerns than our clients, but even though our clients may do some things online, the complexity and trust involved in dealing with their tax affairs online is another matter. We are supportive of increased digitisation. We intend to adapt to help people in that world.

I would draw a distinction between people who are not currently within self-assessment, or who can be pulled out, and the self-employed and landlords. The digital tax account is going to give most PAYE taxpayers access to an awful lot of information and services that they do not have at the moment, and if they are digitally excluded they will have difficulty accessing them, but in many cases it is giving them something that was not there before. We have much greater concern about the self-employed and landlords. I am not going to get into the controversy of whether they are quarterly tax returns or updates, but it is mandatory electronic accounting records. At TaxAid, we have never come across a single client who has ever kept electronic tax records, because an Excel spreadsheet is not sufficient. We simply do not have one. We do not necessarily dispute the direction of travel, but the Big Issue sellers, actors, people in the construction industry, gardeners, and the very smallest businesses, where all people are doing is selling their own services, do not keep electronic records and do not find it necessary for their purposes. It is going to be a huge shift. By 2018 they are going to have to have electronic records. It will be an additional something that they will have to do for HMRC purposes, but they will not see any benefit.

Lord Bilimoria: Building on that, what about the plans of the new system that will require the self-employed and many landlords to report income quarterly rather than annually? Are they going to be able to cope with this? Is this a step too far?
Caroline Miskin: We are going back a stage further, because they will not have the electronic records. One can debate pressing the button four times a year or once a year, but they are not even at the stage where they are going to keep their records electronically.

Lord Bilimoria: What is an electronic record? If it is not a spreadsheet, what is it?

Caroline Miskin: It is not a spreadsheet. It needs to be a piece of accounting software.

Lord Forsyth of Drumlean: If you sell honey at the bottom of your drive, are you saying that you have to have a piece of software on your computer?

Caroline Miskin: An app on your phone might be sufficient. HMRC has indicated its intention that there will be free apps and free software for those with simple tax affairs. As I said, our concern is that our clients are so far behind the curve on the idea of using that. We do not yet know what HMRC will produce. It might produce something, but it might be so simple that it does not cover all possibilities. We already have the situation where our clients are prevented from filing their tax returns online because HMRC’s software does not cover all the possibilities. It does not cover partnerships and residence. At the moment, HMRC is not covering the needs of our clients.

The Chairman: They are not compliant, let alone the taxpayer. Is HMRC not yet in a position to receive all this data online?

Caroline Miskin: HMRC can receive it. I am talking about the software that HMRC makes available to taxpayers to file their tax returns online.

Baroness Noakes: It is not very sophisticated.

Lord Teverson: Is there not a contrary argument? A lot of people in business have to do health and safety. In the freight industry, which I used to be in, they have to have tachographs. I put this forward as a proposition. Will this benefit people who do not manage their businesses very well at all because they do not keep proper accounts? One of the lessons I see from the small businesses I deal with is that if they managed to get to a monthly P&L of some sort, for the first time they get control of the business. Maybe this will be a way in which small businesses will be regenerated and become properly managed at last. I just put that forward as an idea.

Caroline Miskin: Possibly. They are not our clients.

Lord Forsyth of Drumlean: They are not real people.

Caroline Miskin: Our clients are much more akin to employees. They are people who are in self-assessment and they would not recognise the term “business” a lot of the time. They call themselves “freelance”, “contractor” or similar.

Lord Teverson: That is a very good rebuttal, and I accept it.

Q34 The Chairman: Can we come back to the quarterly reporting, which is some way out? If you have a very cyclical income pattern, as a lot of self-employed people do, will you have to pay tax quarter by quarter, or will there be an annual estimation, rather as there is with
PAYE, and the ups and downs are dealt with at the end, or do you have to do that every quarter?

Robin Williamson: I dare say we shall find out when they issue the consultation paper. What information is going to be reported every quarter is one of the big questions. Tax is annual and involves accruals and various other accounting concepts, which mostly work on a yearly basis. What exactly is going to be accounted for every quarter? A representative of a farmers’ organisation asked me the other day how an arable farmer was going to account for the stock in trade every quarter when the plants were still in the ground and it was nowhere near harvest.

Lord Bilimoria: Let alone the Revenue being able to cope with having to deal with this information coming in four times a year. Does it have the resources to deal with that, as opposed to once a year? This puts more burden on the Revenue as well.

Baroness Noakes: It is digital.

Lord Bilimoria: Somebody has to monitor it, analyse it, and act on it.

Lord Forsyth of Drumlean: I should declare an interest; my wife runs some holiday cottages, which we own. If you were doing it quarterly, in the winter you would have no income, but you would have expense. Every year she gets me to do this and it is a complete nightmare, because you have to work out all the costs and everything else and send it in. It takes forever. If you have to do it quarterly, that is a huge burden. Also, what is it going to tell the Revenue, because you may have expenses in one quarter and not very much income in another? Is this about getting the money in earlier? What is the point of this?

Robin Williamson: I suspect that a lot of it is movement towards sort of cash reporting. We started with the famous cash-reporting schedule in the Finance Act 2013, and we are continuing with universal credit, where self-employed people are going to have to report to DWP monthly, not quarterly. If they do not have any income in the winter, because they are in the tourist trade, but they do have expenses, they are not going to have their loss recognised for universal credit purposes and are going to be subject to a minimum income floor, which says that even if they have not had any income they ought at least to have earned what is equivalent to the national minimum wage. That is an example of the kind of mentality that seems to be seeping from the DWP through to HMRC. One of my fears is that this will be reflected in what we are expected to report under the quarterly reporting arrangements. Caroline might have more insight into this.

Caroline Miskin: It does not really seem to make much sense. There does not seem to be a rationale for doing it if more regular payment is not expected. We would love more information. We do not know what the intentions are about making more regular payments. There is no detail on exactly what information is going to be provided, but one imagines that some of the motivation behind it must be—and there have been some indications—that it is more real-time payment of tax liabilities. I suspect there is also an element of more data enabling HMRC to do more risk analysis for compliance purposes. There will be more data going into its systems for its Connect system to use.
Lord Turnbull: Surely, if the HMRC wants to get revenue more evenly through the year, it can do that already. If you are self-employed, you make an annual return and pay the tax. Then there is the calculation of payment on account that you pay in the spring, and come the end of the year you have to balance all those up. Some would say that it is quite complicated, but it gives it two dollops of money rather than one. The problem arises when your income either goes up or down sharply and it does not adjust very quickly. HMRC does not need to ask for the details of the business more often in order to get a steadier flow of income.

Baroness Noakes: I suspect it is related to what you are saying about having the data to analyse so that it can then focus its compliance activity.

The Chairman: This brings us neatly on to the Office of Tax Simplification.

Q35 Baroness Noakes: We have had the Office of Tax Simplification for five years. It has produced quite a lot of reports, but relatively few of its recommendations have been implemented. What is your view of the effect of the OTS so far? Why do you think so many of its recommendations have effectively been ignored?

Robin Williamson: It is an interesting question. The Low Incomes Tax Reform Group has been very keen to help the OTS as much as it can, because we think that a simple tax system, or a simpler tax system, is better for unrepresented taxpayers who do not have advisers to explain it all to them. Yes, there has been a poor record of the Government accepting its recommendations. I suppose it varies from report to report. If you look at the report on the cash-basis regime, for example, the OTS vision was to provide a very simple means of accounting for businesses with a very low threshold—a turnover of about £30,000, I think it was. When the Government looked at this there seemed to be two thought processes going on. The first was, “This is a very good idea. Why can’t more businesses do it?”, and they pushed up the threshold so that it became equal to the VAT threshold. For universal credit claimants, they thought it ought to be double the VAT threshold, but they thought, “Quite a few fairly sizable businesses are now going to be entitled to the cash basis, so we had better put in some anti-avoidance provisions, and we might want to restrict loss relief carried forward and the deductibility of bank interest and make various prescriptions about expenses and so forth”. So we have the two schedules consisting of 20-odd pages in the Finance Act, which is completely contrary to the OTS’s initial vision.

We also worked with the OTS on the pensioner taxation report, which had one recommendation that was famously accepted, which was to abolish the age allowances on the basis that the personal allowance would eventually catch up, which it did. There were a lot of other much more useful recommendations, such as the DWP operating PAYE on the state pension, and then pensioners would be paying the right amount of tax on their state pensions. It would have been a very useful reform had the DWP accepted it, but it did not. HMRC has been doing its best since to try to provide work around it, and the consolidated coding notice which Caroline described is one step forward. It worked better with the OTS on the employment income reports, which fed into the 2015 Act last year and into the clause on trivial benefits in kind this year.
I noticed a document that came out in which the number of recommendations in the employment status report, which the Government have said they will accept, is 17 and the number of rejections is four, so we are probably moving in the right direction. If we have this permanent and statutory body, which is consistently funded by the Treasury, that may give it the extra standing necessary to persuade the Government to adopt more of its recommendations.

Baroness Noakes: Do you think that is likely?

Robin Williamson: One can only hope. I certainly hope very strongly, because we are helping at the moment with tax and NIC alignment, and that is certainly a field that needs simplification.

Baroness Noakes: Ms Miskin, do you have any views on that?

Caroline Miskin: I would make similar comments to Robin, and a couple of additional points. Change in itself adds complexity, and the fact that it is taking time for some of the fruits of its work to come through is not necessarily a bad thing, particularly where it is tackling the difficult areas, such as small company taxation and NIC alignment. I would also say that an awful lot of complexity is being added at the same time as there is an attempt to remove it. For example, we had a change in class 2 NI contributions being collected through self-assessment. Now the Government are looking at the possibility of abolishing class 2 and bringing in contributory class 4. That could be followed not that long afterwards by any proposals that might come out of the possibility for alignment, so you might end up with a series of three changes.

On savings, you have the nil-rate band one year and the personal savings allowance the next year, and things such as the high-income child benefit charge and the marriage allowance add huge complexity and take huge amounts of HMRC resource.

Baroness Noakes: Is there any real hope that we will have a simpler tax system?

Caroline Miskin: Great political will would be required, because there are always going to be winners and losers. To make real changes, the Chancellor of the day would have to accept that. It would perhaps have to happen in a situation of growth so that you can eliminate the effects as you grow, or the Chancellor of the day would have to be ready to take some very hard political decisions on winners and losers.

Baroness Noakes: If the opportunity comes to put the OTS on to a statutory basis, which it is not at the moment, would it enhance the possibility of getting more simplification out of it?

Robin Williamson: Yes, if the OTS is considerably strengthened in numbers and resources so that it can get to grips with a larger part of the tax code than it has been able to do so far.

Baroness Noakes: It is nothing to do with whether it is in statute; it is whether it is well resourced.

Robin Williamson: Whether it is well resourced by the Treasury.
Caroline Miskin: And inputs into new proposals, not merely looks at what is already on the statute book.

The Chairman: Does the Office of Tax Simplification invite you on a regular basis to give your views and feedback?

Robin Williamson: Yes, indeed. It puts out consultation documents and invites not only representative bodies but the general public to input, and it goes out and interviews people.

Caroline Miskin: It comes out to discuss.

Robin Williamson: It invites us to sit on its consultative committees. Colleagues of mine sat on the pensioners consultative committee and I am on the NIC alignment consultative committee. Yes, I think there is a lot of interaction.

Lord Forsyth of Drumlean: Is the problem with the OTS that it is not involved in these new wheezes and ideas before they are announced and therefore does not have an input into new ideas?

Robin Williamson: That could well be it. I suppose its remit is fairly narrow in that it is to simplify parts of the tax system once legislation has been enacted. It might be better if it was involved more in policy-making at an earlier stage.

Q36 Lord Forsyth of Drumlean: Does the Finance Bill that we have now reduce or increase the burden borne by taxpayers in complying with the tax code?

Robin Williamson: In one line I would probably say that for taxpayers who are digitally literate, it will probably reduce the burden in time. For those who are not it could well increase the burden, because those who can will have to become digitally literate and those who cannot will not be able to get access to the same sort of information that is available on GOV.UK as those who are. That is a very brief summary.

Caroline Miskin: I would say there will be a marginal reduction in the burden because of the people who are not going to be put into self-assessment who are in it at the moment, and the people who will no longer have to reclaim tax on their savings. I would say that it marginally reduces the burden but adds to complexity in understanding the system. The two things are slightly distinct.

Lord Forsyth of Drumlean: Why do you say that? All my life I have been able to work out roughly in my head what my tax is going to be. As I got older perhaps I needed a calculator a bit more, but broadly speaking I could do that. Now you have to solve a quadratic equation because of all the steps that are being made in different allowances.

Caroline Miskin: That is why I am drawing that distinction between people’s burden in interacting with HMRC and dealing with their tax affairs and having to fill in forms. It reduces the burden there, but because of the addition of the different allowances and whatever, it probably makes understanding the tax system more complicated. A lot of that understanding will be by people who, once they do understand, will not owe tax because of the savings allowance, the nil-rate band, the dividend allowance and ISAs. There will be a lot
people who do not owe tax, but trying to get their heads around it all will make it more
difficult.

**Lord Forsyth of Drumlean**: Let me ask the question in another way, because you have not
really given the answer I expected.

**The Chairman**: There is a clue in that.

**Lord Forsyth of Drumlean**: How important do you think it is to have a tax system that is easy
for people to understand and they can know what their liability is, as before, and they do
not have to log on to a computer or look retrospectively at events? Is the price of moving
away from more form filling and more complexity a price worth paying?

**Caroline Miskin**: I think it needs to be simpler. I would very much like there to be fewer
rates and allowances and for it to be much simpler so that people could do their calculations
on a piece of paper with a calculator. I would very much like to be in that situation. It would
make life for a lot of people an awful lot simpler, and this is a move away from that. It is
almost as if HMRC believes that because of digital accounts, and because the information
will be there and people will have access to that information, yes, it is more complicated
with all these different things but it does not matter because they are not going to owe tax
and will be able to see all the information in the digital account. I do not think that is right.
People are still going to wonder and want advice about how all these different bits and
pieces work.

**Lord Bilimoria**: Building on that, in reality in practical terms you advise individuals; they
come to you for help. How many people can actually deal with all this even as the system
exists now, let alone the small companies and sole traders that you have talked about?
Most people running businesses will have an accountant who helps them, but the people
you are talking about do not have access to that, so how do they manage? Do they need
organisations such as yours to help them fill out the forms?

**Caroline Miskin**: Yes. If they want advice, it is from us. To be fair, the HMRC Needs Extra
Support service does a lot, and it provides a better service than the old enquiry centres. It is
difficult for people to access, but once they get there it is helpful. However, if they want real
advice or if there is any dispute with HMRC and they cannot afford an adviser, the option is
the tax charities really.

**Lord Forsyth of Drumlean**: I have one last question. You have talked about the people who
are digitally excluded. By that, do you mean perhaps elderly people or other people who are
horrified by computers, or do you mean all these people who live in rural areas, and in some
urban areas, who do not have access to effective broadband? One of the problems with
what you said earlier about people doing it on digital and having access to a whole load of
information is that it implies that you have a reasonably good broadband connection so you
can download the material and respond accordingly.

**Robin Williamson**: The digitally excluded category involves those and others.

**Lord Forsyth of Drumlean**: How many people are in that category?
Robin Williamson: According to HMRC’s own research, some 7 million adults in the UK. They include older people who never learned computers at school and who have not got used to them since; people with disabilities who find it difficult or painful to use computers or the internet—a wide range of disabilities can have that effect; and people in remote areas—if you are in the Brecon Beacons, for example, and your nearest public library is a 60-mile round trip by road, it is the middle of winter and there is no broadband connection, there is no way you are going to be able to do a quarterly report at the end of January. To be fair, the Government have said that they will make other arrangements for those who really cannot manage computers.

We were involved in a case before the First-tier Tribunal (Tax) a couple of years ago, which basically said that all these particular categories of people had a measure of protection under human rights law and that HMRC had to make adjustments for them if it was going to mandate. The signs are that HMRC will make adjustments. We just have to make sure that it makes the right ones.

Lord Forsyth of Drumlean: Seven million out of how many?

Robin Williamson: Out of the entire population of the UK. I think the percentage figure was about 15% in that report.

The Chairman: Of taxpayers or total population?

Robin Williamson: Of the general population. For taxpayers it is slightly less. They estimated that 10% of taxpayers were digitally excluded.

Q37 The Chairman: We are going into a period of consultation, and much of the evidence that you have provided today, and which we have heard before, is clearly going to be put to HMRC on what is needed to help it to provide the service and the support that taxpayers need, and indeed expect. If we fast forward a year, and there is nearly a year of experience of doing this, are you satisfied that the independent oversight of HMRC’s performance is adequate and suitably transparent to enable you to assess effectively how well it has performed and what additional measures might be needed to enable it to perform to your satisfaction, and in particular to the satisfaction of the people whom you represent?

Robin Williamson: Let us look at the independent oversight of HMRC. Of course, there is the non-executive board, which provides advice but cannot make any decisions, so HMRC is free to disregard whatever the non-executive board tells them. There has always been a charter advisory committee, but there is now a new charter committee reporting directly to the non-executive board, whose job is to make sure that HMRC in carrying out its functions adheres to its values as set out in the charter: treating taxpayers fairly and that sort of thing. There is of course the electorate, which will have a say in five years’ time, but that is rather more of a political than an administrative oversight. We are very reliant on HMRC telling us and being transparent about its own data and figures, what it is up to and consulting genuinely, which on the whole it is very much more inclined to do now than, say, 10 or 20 years ago, but ultimately it is in a fairly privileged position as far as government departments are concerned.
The Chairman: It is possibly quite accountable to itself in the sense of how its performance is being measured.

Robin Williamson: And of course accountable to parliamentary committees.

The Chairman: Indeed.

Caroline Miskin: Undoubtedly, there must be additional things that it should be measured against in a dramatically different environment. Somebody needs to look at what it is measured against. It could be something as simple as how long it has taken to respond to webchat rather than how long it has taken to respond to a letter, and similar factors.

The Chairman: Thank you very much indeed. It has been a very interesting session. I presume that you will be making public the advice that you will be giving and the feedback on the consultation.

Robin Williamson: We shall indeed, yes.

The Chairman: Thank you very much. Thank you for joining us today.