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The Rt Hon. the Lord Forsyth of Drumlean
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Dear Lord Forsyth,

Draft Finance Bill 2018

I am writing to thank you for the opportunity to give evidence to the House of Lords Economic Affairs Finance Bill Sub-Committee on the Draft Finance Bill 2018. You requested some further information, and our responses are set out below.

Making Tax Digital for Business

The Committee requested a full list of organisation types that will be given a six month deferral to mandatory MTD for VAT.

The six month deferral will apply to around 3.5% of mandated customers who fall into one (or more) of the following categories: trusts, ‘not for profit’ organisations that are not set up as a company, VAT divisions, VAT groups, those public sector entities required to provide additional information on their VAT return (Government departments, NHS Trusts), local authorities, public corporations, traders based overseas, those required to make payments on account and annual accounting scheme users.

The Committee requested the working behind the average cost figures, including the full expected distribution of costs for organisations in different situations.

We published an updated Statement of Impacts on 1 December 2017. We can provide more information about the underlying segmentation data on administrative burdens and benefits to business. This is not available in an accessible format that we can readily share this week, but we can provide a detailed response on this point within the next two weeks. Further information about how we approached the impact assessment is at Annex A.

Customer compliance

I can confirm that HMRC is assessing all the evidence collected by your Committee. Our approach is also being informed by discussion with external groups, including at HMRC's Compliance Reform Forum. The Chartered Institute of Taxation, who are members of the Forum, have been invited to discuss the issues and examples they have raised with you there. We will also continue to engage with other stakeholders. In addition, HMRC's Board is establishing a Customer Experience Sub-Committee to strengthen oversight.

The Committee asked how many settlements have been agreed over 5 years, and for a more detailed breakdown of the terms on which the first 5,000 settled.

In July 2018 HMRC simplified the payment process for disguised remuneration scheme users who wish to settle their tax affairs ahead of the loan charge. Scheme users who currently earn less than £50k, are no longer in tax avoidance and settle before the loan charge arises can agree a payment plan of up to five years without any detailed paperwork.

For those who require longer to pay or with income of £50k or more, payment arrangements are still available, but we would require more details before agreeing an arrangement. There are no minimum or maximum time periods for payment arrangements, and we will consider each on an individual basis.

To settle their affairs before the loan charge comes in on 5 April 2019, scheme users were asked to register and provide the required information by 30 September 2018. To date, over 24,000 scheme users have registered. We have committed to respond by 30 November 2018, and are prioritising issuing settlement calculations to give clarity to those who gave us the information required by 30 September. These include scheme users who currently earn less than £50k, and we are in the early stages of processing payment plans on simplified terms for this group. We expect that receipt of settlement calculations will give more scheme users the information they need to understand if they require instalment arrangements. HMRC is working hard to bring all live cases to an appropriate conclusion.

We are not currently in a position to provide a detailed breakdown of income distribution across different groups. We expect to be able to refine our analysis as more settlement information becomes available.

Budget and Autumn Statement 2016 documents show the expected yield from this measure to be £3.2bn by 2020-21, with 75% of that yield coming from employers. Our records show that, of those who have settled their case so far, around a quarter are employers, and they account for 90% of the recorded yield. The average settlement yield for these employers is £525k. About one third of the employers have settled for £100k or less and almost one third have settled for £300k or more.

The Committee was concerned about HMRC's powers in respect of 'Follower Notices' and the penalties that could be incurred.

We wanted to provide some additional context. A person will incur a penalty in relation to a follower notice where they fail to take action in response to the notice to give up their use of particular arrangements. A person is liable to a penalty of 50% of the tax advantage for a failure to take action on time. This can be reduced for cooperation to not less than 10% of the tax advantage. Cooperation is in relation to the follower notice itself and is defined in legislation. A person may appeal to the Tax Tribunal against the decision that a penalty is payable and/or the amount of that penalty. Specific grounds of appeal against the decision that a penalty is payable are set out in the legislation, and include that it was reasonable in all the circumstances for the person not to take action to remove the tax advantage.

I hope that this further information is helpful.

Yours sincerely,

Ruth Stanier

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Annex A: Making Tax Digital for Business – further information about the estimates set out in the updated Statement of Impacts

The model we use to calculate administrative burdens takes into consideration only the costs and savings strictly related to compliance with MTD and meeting tax obligations. It does not consider the wider benefits to businesses through improved record keeping, better business management and a streamlined, digital experience. These benefits may offset wholly, or in part, any compliance costs.

Standard Cost Model methodology was used to estimate administrative burdens impacts and steady-state costs. To estimate savings and costs, the VAT population with turnover above £85,000 was initially segmented by size, reflecting the differing costs and requirements for small, medium and large businesses.

Each of these groups was further segmented to reflect the differing processes currently employed to manage their VAT affairs, anticipated change with MTD and their use of agents / accountants. Four segments considered those businesses that largely managed their VAT affairs in-house (although adjustments for use of agents were factored in), and a fifth segment considered businesses that completely rely on agents to manage their tax affairs. The primary segments were:

- Businesses using paper-based accounting moving to MTD software
- Businesses using spreadsheet-based accounting processes retaining spreadsheets, but using 'bridging' software
- Businesses using spreadsheet-based accounting moving to MTD software
- Businesses already using accounting software
- Businesses outsourcing all VAT work (using agents)

Savings were estimated by considering the obligations a business fulfils in meeting its tax obligations, from recording of sales to submission of a VAT return. Following consideration of the current time taken on each obligation and the nature of the burden, we ran impacts workshops, in which policy leads, HMRC VAT experts and operational colleagues estimated percentage changes in time taken for each obligation through operating MTD. Estimates were applied as appropriate within each of the segmented groups.

Findings of the workshops were shared and tested with external stakeholders, including the independent Administrative Burdens Advisory Board who advise HMRC and their Customer Experience Working Group. An optimism bias reduction was also applied to the estimated time savings.

Estimated costs were based on a combination of qualitative and quantitative analysis; taking account of estimates provided by consultation respondents, commercially available software products, internal customer insight and stakeholder discussion. These costs were applied as appropriate across the segmented groups.

HMRC expects most businesses to incur some transitional cost in moving to the new requirements. Those businesses already using accounting software or who currently outsource VAT work to an agent or accountant are anticipated to see lower costs than those moving to software systems from paper-based or spreadsheet systems. Four primary components make up the transitional costs estimate:

- training and familiarisation time for both new digital tools and new processes (including opportunity cost of lost time to business)
- purchase of new hardware or the upgrade of existing hardware
- additional agent or accountancy costs (HMRC will also be providing guidance and support to help businesses move to the new processes)
- upgrading existing software and apps.

Estimated costs, with variances applied relative to the segmentation, were calculated with reference to both qualitative and quantitative evidence. These variances reflected both the complexity of the process change and the complexity of the business.