HOUSE OF LORDS

Economic Affairs Committee

Finance Bill Sub-Committee

Uncorrected oral evidence: Finance Bill 2018

Monday 15 October 2018

4.05 pm

Watch the meeting

Members present: Lord Forsyth of Drumlean (Chairman); Baroness Drake; Lord Hollick; Viscount Hanworth; Baroness Kramer; Lord Lee of Trafford; Lord Leigh of Hurley; Baroness Noakes; Lord Turnbull.

Evidence Session No. 2 Heard in Public Questions 16 - 36

Witnesses

I: Mike Cherry, National Chairman, Federation of Small Businesses; Sion Lewis, Chief Executive Officer, IRIS Software Group; Paul Morton, Tax Director, Office for Tax Simplification.

II: Lydia Challen, Chair of the Tax Law Committee, Law Society of England and Wales; Jason Collins, Pinsent Masons; Malcolm Gammie QC, Chair of the Tax Law Review Committee, Institute of Fiscal Studies.

Examination of witnesses

Mike Cherry, Sion Lewis and Paul Morton.

Q16 **The Chairman:** Mr Cherry, Mr Lewis and Mr Morton, welcome to the Finance Bill Sub-Committee. We are focusing, as you know, on two things: Making Tax Digital and revenue powers. This session is on Making Tax Digital.

I will begin by asking a general question. How ready are businesses, HMRC and software companies for Making Tax Digital for the VAT regime that will come into force in April 2019, just as we will leave the European Union?

Paul Morton: Thank you for the opportunity to comment. The Office of Tax Simplification is undertaking a review of the business life cycle, looking at the impact of all the relevant taxes and various points in the life cycle of a business. In order to inform that review, in the past week or so we issued a survey and call for evidence to gather information from small businesses and their advisers.

This is very early days, but we asked questions about Making Tax Digital and readiness, and we have some early indications based on a rather limited amount of data. The data that we have so far suggests that 85% of agents understand what is required. At least, they think they understand what is required; from some subsequent answers, we are not sure that they always do. 25% of the smallest businesses have some awareness of Making Tax Digital and 70% of other businesses have some awareness of Making Tax Digital.

The Chairman: What does “some awareness” mean?

Paul Morton: They are aware, without necessarily understanding all the detailed requirements, that something called Making Tax Digital will arrive. Three-quarters of the smallest businesses do not: less than 30% of businesses are confident that they understand what is required, and less than 15% of businesses say that they are prepared. Some people comment that they feel they would deregister from VAT, if they are registered voluntarily, or reduce their activities in order to deregister and not have to be registered.

I conclude this answer, which is slightly longer than perhaps it should have been, by turning back to the fact that 85% of agents feel that they understand what is required, so we can have some confidence that agents will be advising their clients between now and next April.

The Chairman: You are in the Office of Tax Simplification. Do you think it is reasonable for agents to tell people that they have to make all the preparations that are required a matter of six months or so before it will be implemented?

Paul Morton: There will be a variety of circumstances. Many businesses, particularly smaller businesses, truly rely on their agent for all their tax

compliance, and for them I can see this being a normal course of engagement with their adviser. For larger businesses, one might think that they should have a greater level of awareness some six months or less before implementation.

A comment that has been made to us by a number of advisers and businesses is that there will be a need to test the software prior to go-live. The number of full cycles that will be available for testing is obviously very limited in the case of a quarterly VAT return.

The Chairman: Mr Cherry, what do you think about this?

Mike Cherry: I do not believe that the majority of our members, and small businesses generally, have any comprehension whatever of what exactly they have to do to comply with this legislation. There are two riders: the FSB and our members welcome the idea of digitalisation, and I think that most small businesses very clearly want to get it right first time.

In this instance, as Mr Morton has said, we are less than six months away. If you run proprietary software, there is no information yet on the detail that has come through, so far as we are aware. There are pilots ongoing that are due to finish imminently, but nothing is reaching the small business. When you go on to the gov.uk website, the HMRC VAT notice is written in quite draconian terms. The phrase that it uses in various bits is “the following rule has the force of law”, which indicates that there is no genuine will, we believe, to help and support businesses to comply with something that is being legislated on from April. Indeed, if you have to change your software—I will come to the cost of that later, if I may—you would normally do that only at the end of a financial year. We do not believe that our members understand it or are anywhere near ready for it.

Sion Lewis: Perhaps I should come in on behalf of the software industry.

The Chairman: Is this good business for you?

Sion Lewis: Yes and no. An incredible amount of investment is required to create MTD-compatible software, so it depends on which way you look at it. We look after 21,000 accountancy practices in the UK, from the very largest to the very smallest, which spans about 650,000 SMEs. Our software powers around 3 million tax returns and more than 1.1 million documents to Companies House every year. I mention that because we have a broad view.

Of ourselves and other software companies, I think that about 40 or 45 are MTD-for-VAT ready, with a list of about 70—ranging from the very largest companies to companies that nobody has ever heard of—that are providing software for MTD in the long run.

I also note that HMRC and the software companies recognised that lots of small businesses do not have software and love spreadsheets, so HMRC, as you know, has provided the facility called bridging. We have provided,

free of charge to our accountants, software that allows them to take information from a spreadsheet and extract it into an MTD-ready file.

We want to mention two things today. First, the accountants are ready; we had 700 or 800 of them in a room in Twickenham last week, and tomorrow we are in Manchester to do the same—we do the trip every year. They are ready; 65% said that this is the biggest issue facing their practices. However, they also mentioned that the small business owners do not know about it, and that is our biggest concern. Once HMRC is through its control testing, which will be in two days' time, that will afford them the opportunity to talk about MTD. The SMEs probably do not know about it and, with six months to go, we need to ensure that communications start in earnest very, very quickly.

The Chairman: I am interested in your 800 accountants in the room who are all happy with this.

Sion Lewis: I did not say "happy"; they are aware of MTD and feel that they are ready.

Baroness Drake: Are you saying that they are happy or that they are ready?

Sion Lewis: I will make this clear. The software is ready. I do not know whether they are or not, but they are very aware of it.

The Chairman: In the sense that, if you are standing in the middle of the road, you are aware of a bus coming towards you, as opposed to that you are happy to get on the bus.

***Sion Lewis*:** Yes. They are aware of it and it is the biggest issue that faces their practices.

The Chairman: I was going to say that I think that it will go live on our website this afternoon. The evidence that we have had from accountants and others tells a very different story about the costs and inconvenience.

Q17 **Viscount Hanworth:** I have a question; I do not know whether it is appropriate. You said that your software is ready; I think that referred to your own organisation. I looked at the HMRC website and saw something like 70 names, as you mentioned, and one has no indication which are vapourware and which are real.

If you have all those people vying for this opportunity, it will not be very possible for anybody to assess the profitability of making a substantial investment. I understand that you have made a substantial investment, but are you aware of what is happening, on either side of you, with other companies, and what will guide the user to your excellent software?

Sion Lewis: It is the user we need to worry about. They need to become aware and be taught how to use the software.

On your point, Paul, I think that around 70% of the accountants we surveyed suggest that they will continue to do the filing for their

customer. The customer will ask the accountant to step in and make sure that he is MTD viable.

The Chairman: But my understanding—certainly from when I was in business—is that there is a gateway site and you plug the numbers in. You did not need your accountant to do that and it was perfectly straightforward. HMRC is withdrawing that gateway system, leaving people to try to find an alternative. If people are using their accountants, will that not add to their costs?

Sion Lewis: Yes and no. We believe that going digital will save the SMEs time in the long run and they will become more efficient at running their business. There are statistics to back that up.

Baroness Noakes: What statistics are those?

Sion Lewis: Another company—Sage—has just done some research and it believes that the small business owner will save time by adopting digital solutions.

The Chairman: Is that Sage, the people who provide software?

Sion Lewis: Yes.

Viscount Hanworth: This is clearly going to be a bonanza for the accountants in the short term, but if I understand correctly, HMRC's intention is to have people submit their invoices, the details of their expenses and so on almost in real time and eventually to cut the accountants out. Is that a fair assessment of the ultimate objective?

To prolong the discussion, does HMRC wish to be privy to all the information regarding expenses, invoices and so on, or can some of that be held back and submitted only at the end of the accounting period? Does it want to have an oversight of what is going on in real time?

Sion Lewis: It has said that in the initial release there will be bridging software, so that an aggregate level of information will be passed through.

Viscount Hanworth: It is the ultimate objective that I am interested in.

Sion Lewis: If you look around the world, that is in place. A frictionless digital economy is ultimately a goal, but I am not the HMRC; I cannot speak for it.

Viscount Hanworth: Will the information come to the HMRC cloud in real time, so it will be privy to it as it arrives? Or how?

Sion Lewis: I do not know about real time. That has not been defined yet.

Paul Morton: To offer a few observations on that question, at this point Making Tax Digital is simply digitisation of the process that currently

exists, which is quarterly submission of key information and data relating to the VAT return.

At the Office of Tax Simplification we have done some strategic thinking as to how the technology might improve the user experience in tax administration in the longer term. We have observed that in some countries real-time information is now a key part of the tax administration strategy; transactional-level data is provided in real time to the tax administration, which enables real-time calculation of profit.

We see that as long term, while Making Tax Digital is very much about the short-term digitisation of the VAT return quarterly process and not the transactional level.

The Chairman: I think that the Committee wants to focus on what happens in April next year.

Lord Turnbull: I just want to clarify that we are talking solely about the VAT stage, not the bit that was postponed, which we may come on to later. Therefore, these are all businesses with a turnover of £85,000 or more. In other words, they are not the smallest. Also, if you are in that category there are a number of simplified schemes that you can enter into. If you are a consultant for software or something, you can choose from a list. It seems to me that they are taking something that is pretty simple and making it more complicated.

The evidence that we have had is that they do not believe the figures and that the costs to the users—for the initial set-up and for the running costs—exceed the benefits that they are likely to get. In other words, something that is not too bad is being made more expensive for the user, although it may save them revenue money, and it will require a lot of costs for professional advice.

What is the gain from this, given that for people with a business of, say, £100,000 or £200,000, the VAT bit is not a big one?

Sion Lewis: The research from the Sage software company, which I only read over the weekend while preparing for this, suggested that 10 or 20 days per annum could be saved by a small business adopting the benefits and efficiencies that digital book-keeping provides, which would outweigh any cost.

The Chairman: Mr Cherry, what do your members say about that?

Mike Cherry: At the moment they would probably say that they disagreed with it. Coming back to Mr Morton's point about the long term, of course digitalisation could be good, but businesses need to be brought along with it.

We are in a perfect storm at the moment on domestic issues to do with increased costs to businesses. We have gross uncertainty at the moment about Brexit: whether there is to be a cliff-edge or a transition from the end of next March. We simply do not know what Making Tax Digital is

going to require. It is very easy to say, “It is only about your VAT return”, but that is not the initial inference that HMRC stated.

HMRC said that it wanted to remove the year-end tax, so is it all the detail, every quarter, that every business must submit for a profit and loss account? We do not know. Nothing on the software has been sent out to our members so far on something that is simple and easy. Referring to one of them, I have some information here.

I will read out a paragraph: “You will need to use software that is compatible with HMRC’s Making Tax Digital programme, in addition to keeping digital records relating to your VAT. The software should be able to communicate with HMRC’s computers so that you can file your VAT returns. This is something referred to in technical language as connecting to HMRC’s APIs.”

That is great, but nobody really understands what on earth they are talking about. At this stage—less than six months, as I said in my opening remarks—surely to goodness, HMRC, despite the deferral of 12 months, could have used the time far more productively to help businesses understand exactly what the detail is. Is it a profit and loss account every quarter or is it simply a VAT return?

For those small businesses, many of which are microbusinesses, that are just about able to comply with the VAT regime, which is one of the most costly tax regimes that they have to deal with, this is going to take a huge amount of their time away from coping with all the additional problems that they are facing at the moment relating to costs, Brexit and everything else. That seems quite bizarre.

Q18 **Baroness Kramer:** An £85,000 turnover is not really a big company. The profits that are generated by that are extremely thin for many firms, so any additional cost is usually challenging. I am somewhat confused that the Office of Tax Simplification is looking at a system that requires those firms to take on a professional accountant when they have not required one in the past, and to provide extensive training for various members, and that it sees that as part of a simplification process. To me, it is adding layers, which equates to complexity. I am quite disturbed by that.

I am also quite disturbed by everything that I read about the bridging software or the absence thereof. That applies not just to these more modest companies but to larger companies. When it comes to Brexit I have talked to a number of large firms that say that if we leave the VAT area, which looks as though it is part of the plan, their ability to pay VAT at the right time and in the right place is going to be extraordinarily difficult, because none of their existing accounting systems gives them that internal flexibility. For example, if there are delays at Calais so that they have to shift an export to Rotterdam, their system will not allow them to do that.

So where are we on bridging software, where are we on bridging to the regime that will exist in a post Brexit environment, and are we are about to put a lot of companies into a rather fatal trap?

Paul Morton: Perhaps I could begin with a short word about the Office of Tax Simplification. We are an independent office based in the Treasury and our role is to offer advice to the Chancellor and the Government on ways of simplifying the tax system. We are not directly connected to HM Revenue and Customs. It is HMRC that is delivering the Making Tax Digital programme.

The Chairman: The Committee understands that. Please just answer the question.

Paul Morton: We are not putting forward any recommendations that would impact adversely on large numbers of companies. Perhaps I did not understand the question.

Baroness Kramer: Perhaps I am completely naïve, but I assumed that it would be your responsibility internally to challenge any system that provided additional complexity. Is that a false assumption on my part?

Paul Morton: No, that is our role. We have engaged extensively with HMRC. We have done so in terms of both the overall architecture of what is planned and the specific aspects. We are challenging HMRC and we are taking Making Tax Digital into account in the reports that we produce. For example, I mentioned the VAT report that we published in November 2017. One of the observations we made in that report is that it is necessary to simplify the VAT system as far as possible before moving to Making Tax Digital. We made a number of recommendations in the report. For example, there are the schemes that Lord Turnbull mentioned, but some of those still involve a certain complexity which calls for businesses to maintain spreadsheets.

The Chairman: Does that mean that you are against bringing in Making Tax Digital for VAT in April?

Paul Morton: We do not see it as our role to be either for or against Making Tax Digital.

The Chairman: I thought that you just said that you did not think that it should be done until the system was simplified.

Paul Morton: We think that the VAT system should be simplified as much as possible. We have made a number of recommendations; some of those have been actioned, some will take longer and some will have to wait until after Brexit has allowed the freedom to make the changes that are not currently possible. That is being actively progressed.

Baroness Noakes: Are there regulations that you said should be delayed prior to implementing Making Tax Digital?

Paul Morton: No, we said that the greater the extent to which the VAT system could be simplified prior to implementation, the easier it would be to implement.

Q19 **Lord Lee of Trafford:** I want to go back and try to establish the fundamental relationship between the software providers and HMRC. If I heard you correctly, you said that there are something like 45 firms that are up and ready to go and a number of others that no one has ever heard of. Are we in a situation where it is satisfactory for software providers simply to register their interest or is there any form of approval or certification by HMRC? If there is no such system, as someone in the industry would you favour that approach?

Sion Lewis: There is an approval process—to get on the list that I talked about how a provider has to have been approved by HMRC.

Lord Lee of Trafford: What does that actually mean?

Sion Lewis: It means that the provider's software works with HMRC's gateway—to use a phrase from earlier—and that the calculations are correct. There are two lists on HMRC's website, one of 70 or so providers for MTD in general and a shorter list of just over 40 providers for the VAT element which, as you know, goes live in April.

Viscount Hanworth: In 2017, witnesses to our inquiry suggested that the costs of mandatory digitalisation for businesses might be greater than any benefits that they would see. What further evidence has emerged since then on the preparation for businesses for April 2019? What are the costs and benefits of moving to digitalised systems that will be compliant with MTD? The text of my question also asks about some of the things that we have been discussing, but we would like to hear more on this point.

Sion Lewis: I can add one or two observations. In the course of our work, we have spoken to many advisers and businesses. Some advisers say that they are taking MTD as an opportunity to encourage—and in some cases, require—all of their clients to move to a digital form of bookkeeping that is compatible with their systems. That speeds up the work and results in efficiencies all round. On the other hand, some businesses have said to us that because of the complexities of the VAT system, they need to maintain significant numbers of quite complicated spreadsheets to deal with partial exemption, capital goods and other things. We have asked them whether it would be possible to build automated systems to do such things and feed directly into the Making Tax Digital software. One response has been that whatever the interface between the adviser or the business and HMRC, it may not be economically possible to build a system that could deal with those complicated issues given that it is a single process which changes from time and time and is executed only once a quarter. The use of spreadsheets in the current form is the only economically sensible way of doing it.

I am perhaps addressing only one or two aspects of the question. We are hearing a number of different things, all of which suggest that to some extent the current compliance processes will continue to be appropriate for many businesses.

Viscount Hanworth: I understand that the ambition of MTD is to provide feedback from HMRC to clients, whether they be the agents or the businesses directly. Is that in prospect and will it be of assistance in the short term?

Sion Lewis: I do not know the answer to that question.

Mike Cherry: To answer Lord Hanworth's question about costs, in March 2017 the FSB engaged CBR to carry out an independent review of our ideas on the costs of MTD. At that time, we did not believe HMRC's impact assessment and estimate of the costs and we came up with a figure of about £2,770, which was based pure and simply on the time of the business owner and their staff. That was further corroborated by CBR going back to examine the figures in a slightly different way. The figure came out at well over £2,000. That was purely based on the business time that would be required to comply with MTD.

In addition, the evidence that we are now receiving is that there are cost increases for a business to update its software—either for an add-on module or for other variations—of anything between £300 and £2,000. That also presupposes that the business's hardware is compatible or indeed that the business has computerised software to enable it to submit and do what HMRC may require—when we know what it is that businesses are supposed to be doing.

Viscount Hanworth: I believe that the software provision is moving to a subscription basis rather than a one-off purchase.

Mike Cherry: So I understand, my Lord. That would obviously tie a business into a particular software provider.

Viscount Hanworth: I expect that that would mean increased expenditure on software.

Mike Cherry: One would presume so.

Lord Leigh of Hurley: There seems to be a disconnect. On the one hand, Mr Lewis is saying that, by and large, accountants understand what needs to be done, but on the other hand Mr Cherry is saying that his members have not got it. That disconnect might be because his members see an accountant only once a year for accounts preparation or audit, so that might be regularised. I think that the FSB is saying that the benefit of going digital needs to be used elsewhere in its members' businesses. Is there a mismatch because accountants are not communicating enough with their clients so as to get them ready?

Sion Lewis: Our accountants are trying to communicate, but little has been heard about MTD in general. That might be because HMRC has not

finished its controlled “go live”, which will happen in a few days’ time. As I mentioned earlier, HMRC spoke at an event that we attended last week and it implied that it will start to communicate with our citizens. But, yes, communication is absolutely critical.

Baroness Noakes: Do you think that five months will be long enough to communicate it?

Sion Lewis: They will not have finished what they are calling a controlled go live for another couple of days.

Baroness Noakes: They may not be ready, but is it long enough for the unsuspecting world of small businesses that need to comply by next April?

Sion Lewis: If they move very quickly, yes.

Baroness Noakes: If small businesses move quickly?

Sion Lewis: Sorry, if HMRC starts to communicate with small businesses.

Baroness Noakes: Is that still okay for a small business at a time when Brexit is looming and accountants have a year-end peak in terms of being able to support their clients with tax returns and so on? Is that feasible? Is it realistic, in your experience?

Sion Lewis: I think it is. Not every accountant has a peak so if they are using software to organise themselves and their customers, the peaks tend to be levelled out throughout the year. It is true that lots of us leave our tax returns to the last minute but that is not everybody. The timing is clearly tight and communication is critical at this stage.

Q20 **Baroness Kramer:** I want to push on the issue of bridging software. The conversation has been around the core software and yet for many firms, as Mr Morton has just said, the only logic is to find bridging software. I am not clear that that is mature and available or that firms understand what will happen to them if it is not available by April. Presumably almost every firm is unique in this area.

Sion Lewis: We provide software for accountants to service their customers. I think your question is about an SME that does not have an accountant.

Baroness Kramer: Yes, that is a serious issue, but I am talking about the whole bridging software issue. One can develop a total package that is used from beginning to end, but bridging software is far more complex; it has to interface. I am really unclear about the status of bridging software.

Sion Lewis: I think there is bridging software available where it guides you in a template and a spreadsheet; you type in the figures and it does all the hard work. The small SME could use a spreadsheet to do that.

The Chairman: When you say “I think”…

Sion Lewis: This is why I caveated it by saying that I provide software for accountants.

The Chairman: If you do not know, given your background and your industry, how is the small business owner to know?

Sion Lewis: I do know that there is spreadsheet software that can plug in and do that for you, sorry.

Viscount Hanworth: Has HMRC provided you with any algorithms or have you had to provide these completely from your own resources?

Sion Lewis: No, we have a great relationship with HMRC. Our technicians and its technicians meet weekly. I meet Jacky Wright every three or four months. It has been a collaboration.

Viscount Hanworth: It has provided algorithms, the code, and so on?

Sion Lewis: We provide the code but it has provided us with the logic required, yes.

Viscount Hanworth: Has that been a successful relationship or have there been difficulties?

Sion Lewis: We are in a good place now, yes.

Lord Hollick: Listening to your responses, it is difficult to come to any conclusion other than that the dialogue you are having with government is a dialogue of the deaf. Indeed, in today’s *Times* the Minister for Small Business, Kelly Tolhurst, says that she backs the Treasury and that she supports resisting calls for any further delay. Indeed, she goes so far as to say: “My dad has been a member of the FSB since the 1970s, but I never have. I’m determined to do my best to represent the true voice of business. That means everyone, not just the stakeholder groups”. You have been getting the cold shoulder, have you not?

Mike Cherry: No, we have not been given the cold shoulder. We were one of the first organisations to try to engage with HMRC to understand what it was telling us that all small businesses—initially—were going to have to do, and we made the very pertinent comment that you need to have something that businesses can see is going to be beneficial and to bring them along with you, rather than having legislation imposed on them at a time when they cannot all absorb it and are going to be subject to draconian penalty systems. I emphasise that this is not necessarily about accountants—this is where I disagree with Mr Lewis—it is down to the capacity of the business to deal with the problem that it will have to face in legislation, with penalties, come April.

Lord Hollick: The report in the *Times* makes no reference to her taking on board the concerns that you all have expressed about this process.

Mike Cherry: You will have to ask the Small Business Minister herself that question.

Lord Hollick: So you feel that the dialogue you have had has been satisfactory.

Mike Cherry: We have had very good dialogue with the Small Business Minister since she came into post in July, and we continue to have that dialogue.

Q21 **Baroness Noakes:** New penalty provisions are being introduced to support—I think that is the correct term—Making Tax Digital, which have been the subject of consultation. Do you think these proposals are satisfactory? Specifically for Mr Morton, do you think they achieve simplification?

Paul Morton: Yes, we have been engaged in discussions with HMRC about the design of the penalties. We think that the direction is sensible and appropriate. During the first year of implementation of MTD, it will be very important than an appropriately light touch is applied, for all the reasons that we have discussed. One area I would mention is the penalties for late payment. There is no penalty if either payment is made or a time to pay arrangement is entered into within the first 15 days; then there is a half-penalty up to 30 days, and then a full penalty beyond that. We have heard concerns from some businesses about the 15 days and the fact that if an issue arises, it may not be drawn to anyone's attention or the businessperson may not be aware of it in the first few days, which leaves a rather short time to take the appropriate action.

Baroness Noakes: Do you support that? We have had that evidence as well.

Paul Morton: We can certainly understand that but if HMRC, as it has planned to do, takes a reasonable and appropriate approach in dealing with those cases, we could see that being a perfectly sensible regime overall.

Baroness Noakes: You think it is appropriate to set up a regime and then rely on HMRC using a light touch? Do you think that is the right way to approach a penalty regime in law?

Paul Morton: A light touch during the first year of implementing something new seems appropriate.

Baroness Noakes: If the problem is that 15 days is not long enough, that will need a permanent light touch.

Paul Morton: What I mean by that is that where there is a reason for delay taking place, it should be given the appropriate weight. But, having seen the summary of the responses and having had some engagement during and after the consultation, we think the regime itself seems reasonable.

Mike Cherry: We would have some concern about any period of 15 days because it presupposes that the business owner would never go on holiday.

Sion Lewis: I am probably the wrong person to comment on this, although we would like clarity so that we can make the software as good as possible.

Baroness Noakes: What sort of clarity do you need?

Sion Lewis: Some key facts are missing. We do not know what the penalty amounts would be for either late filing or failing to pay tax. We do not know exactly which taxes will be affected and when. We do not know fully how appeals will be handled.

Baroness Noakes: And that affects the way in which you provide software to your customers?

Sion Lewis: Yes.

Q22 **Baroness Noakes:** Does HMRC have a responsibility to inform and educate taxpayers about this new regime, which is, I think, unprecedented in the existing battery of powers HMRC has to interact with taxpayers who are not 100% compliant with the rules?

Mike Cherry: We certainly hope that it will take that type of line when it is bringing in such a change to the tax system. We were concerned at the outset when the penalty regime came out more or less at the same time as the initial information. We believe that the better way, for the taxpayer and the business, is help and support to encourage people and help them to comply because then it is a win for both government and the business.

Baroness Noakes: How do you think that should take place? Should HMRC rely on accountants to do this job for it, or should it be helping taxpayers directly?

Mike Cherry: No. I believe that they have a primary duty themselves to make sure that the information that they give to businesses is easily understandable and written in plain English so that any taxpayer, if we are going to digital, should be able to do it by themselves in a very simple and easy manner which brings the benefits that the Government and HMRC are estimating could be delivered. At the moment we are not seeing the cost savings, we are seeing penalties, and that inevitably is going to lead to many businesses falling foul of something that they do not yet understand.

Q23 **Viscount Hanworth:** Does HMRC have the resources to provide individual advice? If not, will it be able to put businesses in touch with relevant authorities which will give them advice?

Mike Cherry: If I am correct in my understanding, there was an indication back in 2017 that HMRC was going to provide more of a

bespoke service to business customers so that they could be better informed and supported.

Viscount Hanworth: Individual advice rather than simply the website?

Mike Cherry: I would hope that if it is going digital, it can make that available digitally as well.

Lord Lee of Trafford: Mr Lewis, you mentioned this seminar in Twickenham with 800 accountants or tax authorities.

Sion Lewis: There were 800 attendees, 90% of whom would have been accountants.

Lord Lee of Trafford: And you are holding a similar one in Manchester.

Sion Lewis: Manchester tomorrow and Glasgow in two weeks.

Lord Lee of Trafford: Right, so you have a series of these major events. Is HMRC participating in any of these or is it sending observers in any sense?

Sion Lewis: That is a really good point. HMRC staff are attending. We asked the audience what was the biggest issue concerning the accountancy industry and it came back as MTD. Yes, they are fully supportive and we do it in two ways. Part of my keynote is when we talk about industry trends, and they talk about why they are doing MTD and the technology behind it. Then we have a secondary, more of a working session, where they are joined by one of our product managers and they spend between 40 minutes and an hour teaching an accountant how to use the MTD element of our solution.

The Chairman: What you are describing is really a marketing exercise by your firm?

Sion Lewis: The three events are not marketing events, they are information events. We do not charge people for them, but we tell them what we are doing.

The Chairman: But you hope that they will use your software presumably? There is nothing wrong with that.

Sion Lewis: No, absolutely. We need to tell them about MTD because it is the number one topic. The second largest topic concerning our customers is GDPR. Those two things are the elements keeping accountants awake at night.

Paul Morton: At the risk of appearing to be advertising, I just mention that a week and a half ago, we published a report on guidance because we think it is extremely important that guidance is provided as clearly as possible, both to individual taxpayers and their advisers. We recommend a more strategic approach to the way guidance is provided.

The Chairman: But do you not think it is extraordinary that we are

hearing from your own research that most businesses do not know what is about to hit them or how they are going to achieve that?

Paul Morton: That is absolutely true, but most advisers do seem to be aware of it. At least those businesses that have an adviser have a route to being informed, but those businesses that do not have an adviser will need to be informed very quickly.

The Chairman: You should do well in your seminars.

Q24 **Baroness Drake:** Apart from knowing that income tax and corporation tax will not be mandatory for business until 2020 at the earliest, there is no clarity on the longer-term plans for Making Tax Digital. Is this uncertainty a concern for software developers, small businesses or the Office of Tax Simplification, or is it simply a welcome deferral?

Sion Lewis: From a software company's perspective, clearly there is concern about not having access to the longer-term plans for MTD, and it would be incredibly helpful to understand those plans in order to develop what we call a product road map so that we can share it with our customers and our employees. We will know where the industry is going and ensure that everybody thrives in the digital economy. So, yes, we are concerned and we would love more access to the longer-term plans for MTD.

Baroness Drake: What lead-in time would you need on your software preparation, testing and development rollout in order to comply with this extension to income tax and corporation tax?

Sion Lewis: How long is a piece of string?

Baroness Drake: But people are going to make decisions on the basis of these opinions.

Sion Lewis: Yes. We like to plan in detail 12 months in advance.

Baroness Drake: Right, a minimum of 12 months?

Sion Lewis: In an ideal scenario, but clearly we could react to something that happened tomorrow.

Q25 **Lord Leigh of Hurley:** How do you respond to the submission, admittedly by Sage which has an interest in the matter, that what the Government are doing here is pushing small businesses to become digital, forcing them to go along a path which, at the end of the day, must be the right path?

Mike Cherry: I have already made the point, I believe, that digitalisation is welcome, but that you have to bring businesses along with it. You have to show them the benefits of it and you have to enable them to comply with it. At the moment, we do not believe that that is the case, yet they are going to face a penalty regime that will come in in April. We need more information. We need a greater understanding of what it is. I am slightly worried by Baroness Drake's question because the answer seems

to imply that there is a lot more down the track that will add inevitable additional cost.

Lord Leigh of Hurley: There will be the income tax and corporation tax—that we know—so businesses will really have to go digital, faced with MTD all over the place.

Mike Cherry: We have no problem with businesses going digital. We do have a problem with the significant increased costs that that will impose, both pure costs and in the time of a business owner when we are all looking at questions around productivity gaps.

The Chairman: I do not know, Mr Cherry, whether you are familiar with the report that was done under the chairmanship of Lord Hollick, which resulted in the Government delaying the implementation and deciding to concentrate on VAT and corporation tax, but it is very striking when you read that report how the circumstances are exactly the same, and the arguments are exactly the same for VAT as they were then.

Lord Hollick: That was the point I was trying to get at. It seems to me that the Government still do not get it. We have made representations to the Government. The Institute of Chartered Accountants says that 40% of affected businesses were unaware of the change, which is consistent with what you are saying, and that 25% have only paper-based systems. So to rush this in with very derisory estimates of the costs and indeed the turbulence that it is going to cause, seems to be a recipe for a bit of a car crash.

Mike Cherry: If you want an answer, you will have to ask HMRC. I come back to the fact that the best way for the taxpayer and for business is to make sure that everybody has something that is easily compliable with, easily understood and written in plain English.

The Chairman: So you are in favour of delay?

Mike Cherry: At this moment in time, unless the communication is exceptional—and we are less than six months away from April—I would certainly advocate a delay and a cessation of the penalty scheme until businesses are better able to comply.

The Chairman: Do you disagree with that?

Sion Lewis: A little, yes. I think that the software is ready for MTD. There is a communication issue with the SME environments, but my customers and the SMEs that use our software ultimately save time and money by using digital tools. To thrive in the current economy you need to be as efficient as possible. While yes, I am in favour, I have two caveats. We absolutely have to communicate this to SMEs pretty much immediately and we need to continue testing the system.

The Chairman: If you are right about that, why do you have to compel them?

Sion Lewis: It is not my decision to make it mandatory, I am just saying that I think the industry is ready and we as a country have to get digital.

Baroness Noakes: Every single person?

Sion Lewis: Not every single person, but as many as possible, to make us productive and efficient.

Paul Morton: I have a couple of observations. We have recently seen many demonstrations of software that is going to be made available to businesses to run every aspect of their business finances with very simple, easy-to-use user interfaces, available on a smart phone. The technology seems to be developing very rapidly indeed and, looking to the timescale for the introduction of MTD for income tax and corporation tax, one could imagine a great deal happening with technology between now and then. In the meantime, we certainly have the impression that basic software is ready, basic bridges will be available, and this is really a matter of communication to the people who are going to have to use the software, and there is time for communication. There will be some businesses with more complicated affairs for which it will be a challenge to test and implement technology, but for many, by various different routes and provided that the communication is strong, the path seems clear.

Viscount Hanworth: Can we see some sales brochures or manuals from your firm regarding this software—something substantial? I looked on your website and I could not find very much.

Sion Lewis: Sorry about that: I will have a word with the website manager.

Viscount Hanworth: Could you direct it to the Committee?

Sion Lewis: Absolutely, yes. We would welcome that.

The Chairman: Okay, thank you so much.

Examination of witnesses

Lydia Challen, Jason Collins and Malcolm Gammie.

The Chairman: Welcome to the Committee. We do not have a lot of time, but we have a number of questions. I do not know whether you have had a chance to see any of the evidence that has been presented to us. We will start with a question from Lord Turnbull.

Q26 **Lord Turnbull:** Over time, a number of changes have been made to powers in legislation, and there have been changes in the way in which HMRC uses them. There are fears about two things: one is the cumulative effect of all this, and the other is that the burden of proof is being reversed, in that HMRC wants the money from deposits, and to be able to take it from bank accounts and so on, whereas the taxpayer is not

fighting on a level playing field.

I would like to hear from the three of you your concerns about the general atmosphere on such powers, and where they have got to.

Lydia Challen: From the Law Society's perspective, we have general concerns about the number and extent of the accretions to the Revenue's powers, which you have mentioned. I counted at least 12 separate provisions that have been introduced since 2014, plus two criminal offences. It feels as though each one is an encrustation on the side of a boat that in itself does not affect its stability, but once they are all taken into account the vessel starts to lean rather dangerously away from the conventional taxpayer freedoms that we are used to. Therefore, our concern is not uniquely about any specific measure but about the general direction and number of measures.

We have a particular concern about ensuring that legislation upholds the rule of law. From that perspective, the most concerning of the measures is the introduction of follower notices. Where a decision has gone against one taxpayer in relation to a set of arrangements, such notices not only allow the Revenue to ask for the tax up front in relation to another taxpayer who has done the same thing—those are called advanced payment notices—but, having done that, it can then penalise that taxpayer for continuing its appeal.

Therefore, it is effectively a penalty for accessing the courts. It applies only if the taxpayer is ultimately unsuccessful, but the risk of that is inhibiting access to the courts. That is in a situation in which there is no risk to the Exchequer, because it has already had the tax on account in those circumstances. It is purely saying to the taxpayer that they have to settle or else they will be liable for a penalty. That is the only example that I have been able to think of in which the counterparty to a litigation can tell the other side that they have to settle or they can be directly penalised.

Lord Turnbull: It seems to be a bit like the position with parking fines. A fine might be £100, but someone might be told that if they pay, say, £60 now, that will be okay, but that if they want to argue about it they will be talking about £100. However, in this case we are talking not about a few tens of pounds but about thousands of pounds, so while one might be a bit dodgy in law on parking fines, when it gets to that scale it seems to me to be a different question.

Lydia Challen: Yes.

Lord Turnbull: There are two things missing here. You said there was an accretion of barnacles, or barnacles upon barnacles. To whom is HMRC accountable for this? Who looks at the overall position?

Secondly, as someone gets deeper and deeper into a case, are the rights of appeal being chiselled away?

Lydia Challen: On your first question, I think that, at the moment, no one other than Parliament has oversight of the powers that are given to HMRC.

Lord Turnbull: Us, in other words.

Lydia Challen: Indeed. On your second question, I am afraid that I have just lost my train of thought.

Lord Turnbull: One was about whether there needs to be a body that could comment on this. The other was about rights of appeal and whether the Revenue could start to do things and people's ability to appeal against them could become less and less.

Lydia Challen: Yes, that is the case. The follower notice is a good example of that. There are others in relation to other types of penalties for which appeal rights have been curtailed.

The Chairman: Mr Gammie, do you have a view on this?

Malcolm Gammie: I certainly agree, in that I would not necessarily pull out one particular measure: it is the drip, drip effect of further measures that we have seen every year, certainly since 2010 or 2011. As Ms Challen says, it all adds up to something that disturbs the overall balance in the system between taxpayers' rights and the Revenue's powers.

In relation to something like advanced payment notices, which in a way go in tandem with follower notices, we can see that there is a decision to be made as to who holds the tax while a dispute goes ahead. However, in relation to follower notices I certainly agree that there is no appeal as such: someone has to engage in judicial review if they want to challenge the Revenue's issue of such a notice. Of course, although they have an appeal right on the substantive issue, thereafter they will inevitably be significantly discouraged from pursuing that.

Lord Turnbull: So if someone thinks that they are not in the same category as the judgment in one case, they then have nothing other than judicial review.

Malcolm Gammie: There has been a very recent decision of the Administrative Court, following judicial review proceedings, which I noticed had been reported only at the end of last week—certainly in the official *Simon's Tax Cases*—although it was obviously available back in July. It was in relation to a particular film scheme arrangement, which had already been litigated through the courts. As far as I can see, the taxpayer wanted to raise a different point, about whether the scheme was effective, and so sought judicial review against the issue of a follower notice, but so far he has been unsuccessful, and his judicial review was rejected.

So as far as I can see he is trying to raise a different point from the one that was put before the court initially, but because it is in effect all the same scheme the Revenue issued a follower notice, and so far the court

has said that they are entitled to do that. I must say that I did not think that was the objective of the particular provision when it was introduced.

The Chairman: Could you just elaborate on that?

Malcolm Gammie: I should declare an interest perhaps, because I represented the Revenue in the original case, about which this is a follow notice, although I did not act for the Revenue in relation to the judicial review that has just been reported. The initial case concerned whether or not the film scheme partnership was trading. It went as high as the Supreme Court, but the last substantive decision was by the Court of Appeal: the Supreme Court did not have to issue a substantive decision because it agreed with what had happened up to that point.

It was decided that the film scheme partnership was not trading, it was carrying on a business. As I understand from reading the report, the point that has now arisen is whether the taxpayer concerned is entitled to interest relief for borrowings that he made to invest in the partnership, which was not a point that was ever argued in the original case.

Q27 **Baroness Noakes:** We have had this gradual accretion of powers. Have we got to the point where it is seriously out of balance, as between the taxpayer and the Revenue? Are we approaching that? Since it is Parliament that gives the Revenue its powers—actually it is the other place and not this House, because we do not have confidence in fiscal matters—how can Parliament detect this shift in balance going forward? It just comes in successive Finance Bills.

Malcolm Gammie: This is a difficult job for Parliament, which tends to look at measures year by year as individual measures. One change that has been made, where one might think that Parliament might detect or question whether it is appropriate, is in relation to our general anti-abuse rule, which was introduced in 2013, surrounded by a variety of safeguards because of the scope of the anti-abuse rule. I am now going to forget whether it was 2015 or 2016 when a penalty was attached to the general anti-abuse rule. You might think that Parliament would wonder whether that actually tipped the balance against what had been a very carefully constructed rule in 2013, balancing the interests of the Revenue to counteract what is frequently regarded as egregious or unacceptable tax avoidance, and to which a GAAR panel was attached to review matters before that procedure was implemented.

Then you get a situation where Parliament subsequently attaches a penalty to that, which means that if you wish to appeal beyond a certain point in the GAAR process, you are at risk of a 60% penalty. I have to say, I am not quite sure that I know any taxpayer who would take that risk with that type of arrangement.

Q28 **Lord Lee of Trafford:** I want to ask about schemes generally. Clearly, the film scheme has attracted probably the most publicity, particularly because of a range of high-profile personalities, but would you say, as a generalisation, that there has actually been a proliferation of schemes in

recent years? Do you have an idea of the numbers of people involved in the film scheme, for example?

Jason Collins: I would say that there has not been a proliferation of schemes in the last few years—quite the opposite: there has probably been a drying up of tax avoidance schemes, because HMRC has hardened its position. We have the advance payments notice system, which means that if you do a scheme and it is registerable as such, you have to pay up front, which takes away much of the advantage of doing the scheme in the first place.

In terms of numbers, when the advance payments notices were brought in they said that there were about 60,000 people whom the advance payments notices would hit. That is just off the top of my head, but it is roughly those sorts of numbers.

The Chairman: Mr Collins, do you want to address the question that was asked by Lord Turnbull?

Jason Collins: Yes, absolutely.

Lord Turnbull: Do you have a general view about where the balance lies?

Jason Collins: Just to emphasise the points made about the drip, drip, drip, or the fact that the creep of all this legislation is concerning. You mentioned parking fines and that if you try to challenge a parking fine you might have to end up paying double. The follower notice system is probably slightly worse, because at least with parking fines if you do challenge you get the option to pay half if your challenge fails, whereas with the follower notice, if you fail you are paying an additional amount of tax by way of a penalty on top.

The question was asked what Parliament could do to address the tipping of the balance in favour of the state here. Reading many of the responses to the consultation by professional bodies or professional services firms would help.

The consultation process does stop some of the more—to use a label often used against tax avoiders—egregious powers that HMRC seeks. A recent example is in this Finance Bill, where you have the anti-profit fragmentation rules, which are essentially about highly skilled individuals who may be able to say that part of their activity is outside the UK and part inside, and try not to pay tax on the part outside. The initial proposal for that was that HMRC will introduce a new basis for charging tax on that activity, but it wanted to underscore it with an advanced payment notice system as well. There was quite a lot of concern or disquiet among the professions about that, and thankfully HMRC agreed with the provisions that came forward in the draft Finance Bill to drop that aspect.

So HMRC does occasionally listen. I would say that there was a problem with the payment notice system that reversed that burden of proof, as Lord Turnbull labelled it before. The problem we saw when that first came

in was that the genie was out of the bottle at that point: once you start reversing the burden and say “pay now and argue later”, where do you draw the line between what should fall within that type of payment scheme versus the ordinary course, which is that you self-assess what you think you owe and it is for HMRC to challenge that, and ultimately, if it disagrees, to assess you itself? Of course, you then have a right of appeal to the tax tribunal and only at the end of that would you actually have to pay.

Drawing the line between those two situations is becoming harder. The professions tend to say that when something comes out that seems to be over the top, this is probably going too far. That would probably be a good place to start.

Viscount Hanworth: May I ask a question to clarify my understanding, or would you direct me towards another question? Have I understood correctly that one cannot indemnify oneself against penalties simply by paying up front in advance of contesting a case? That is to say that if you lose your case you will be penalised for having made the appeal? Is that so: that you cannot indemnify yourself simply by giving the money up front?

Jason Collins: If you lose on grounds that were set out in previous cases that were found against those other taxpayers, yes.

Viscount Hanworth: So I put the money up front because I want to indemnify myself against any penalties, but it does not work because I have lost the case anyway, and I will be penalised at 60%?

Jason Collins: Yes. Well, 60% is the GAAR penalty. The follower notice is up to 50%, I believe.

Viscount Hanworth: So it is an utter discouragement to contest something.

The Chairman: The point that is being made is that it is in effect a tax on access to justice.

Q29 **Lord Leigh of Hurley:** Mr Collins, your CV shows that you have international expertise. This may be a difficult question to answer, but can you give us an overview of how you see HMRC powers and the movement in the balance, as you put it, compared to other countries—particularly Anglosphere countries, because Napoleonic law is different. Where do we sit on this?

Jason Collins: In relation to many European countries, we are probably a little more benign than others. I am not sure that I should start singling out countries, but in Italy and France, with corporates for example, if there is a question about whether an international company has been operating within their borders without declaring itself liable for taxes, they tend to take rather a heavy-handed approach. They will often start with a dawn raid in order to establish what is going on. The Revenue here would probably start that process with a letter.

Lord Leigh of Hurley: A polite one, I expect.

The Chairman: Does that apply to domestic taxpayers?

Lord Leigh of Hurley: Are we beating ourselves up over something which other countries have long since settled?

Jason Collins: The culture here is that people tend to be a little more compliant with the rules. You do not really need such aggressive powers with people who are culturally quite compliant generally.

The Chairman: Right. No aspersions on the Italians, of course.

Q30 **Lord Hollick:** We have received a considerable weight of evidence, or opinion, from taxpayers—perhaps unsurprisingly—the professions and tax advisers that the incremental increase in the power of HMRC has indeed tipped the balance in its favour. Two or three areas in particular have come out of the evidence. One is that there is now considerable confusion over whether there is a real distinction between tax evasion and tax avoidance. Indeed, a new term has crept into this: aggressive tax avoidance. Is it not incumbent upon HMRC—and this does come out in some of the practices it has now, which is why a lot of these schemes have dried up—to make it clear at an early stage whether something is tax evasion or avoidance and whether or not it is going to proceed against it? That is one area of confusion.

Another one which has already been touched upon, is the real difficulty of taking up a point with HMRC. It is very expensive. With advance payment notices, you are already out of the money. How does one address that? The time lapse is another issue. Once HMRC has received an advance payment, there is really no incentive for it to see the case and the merits of its decision through unless somebody chooses to go against it. Is there not a case for timetabling? You have to put the money up within so many days otherwise over time the fine doubles, as Lord Turnbull pointed out. Should there not be some requirement on HMRC to address matters in a timely fashion, which is what the IRS has to do? Those are the concerns that have been raised. It would be interesting to hear your thoughts on how to redress the balance in these areas.

The Chairman: Mr Collins, is this one for you?

Jason Collins: No.

Lord Hollick: Do you want to declare an interest?

Malcolm Gammie: You are absolutely correct that avoidance and evasion now get talked about in the same breath. Whether you are looking at the Revenue's publications or the Finance Bill, you can see that tax avoidance and evasion are grouped together in the way in which they are addressed. In doing so, what is implicitly being suggested is the aggressive end of avoidance—even though we know it is very difficult to draw a line between different types of avoidance and the boundaries move. As to how much difference that makes in the way the Revenue

deals with things, it might indicate that the Revenue is going to take a much harder-line attitude towards what it considers to be aggressive avoidance. But the reality is that there is still the difference between avoidance and evasion in that one is legal and one is illegal. Therefore, in that sense, the powers available to the Revenue are different depending on what it can prove to be the case in a particular taxpayer's situation. I am not quite sure to what extent it makes an absolute difference other than perhaps flagging up what the Revenue is going to be more aggressive about in its response to particular forms of avoidance, more so than it has been in the past. However, if it cannot actually prove that someone has been evading tax, criminal law or similar sanctions are not available to it.

I certainly agree that now the Revenue holds the money in a lot of cases, one might detect a sense that it does not have to do much to advance things and it is very much for the taxpayer to push things forward if he really wants to resolve things. As a practising barrister, I am always slightly reluctant to draw lines from what I see because I see very particular cases in my position and they are very much the tip of the iceberg. But I certainly see a number of cases where the Revenue is not fast enough at progressing things through and ultimately a taxpayer can force matters into a tribunal, assuming we are not talking about those sorts of cases where there is a penalty attached just to pursuing it, like with follower notices. But that is actually quite a costly and difficult decision for a taxpayer to take when what they really want is for the Revenue to progress their inquiries rather than litigate immediately, which generally speaking taxpayers are not keen on doing if they can avoid it.

The Chairman: On that point about going to a tribunal, is that going to a tribunal to require the matter to be settled within 12 months?

Malcolm Gammie: The normal situation is if the Revenue has opened an inquiry, you can go to a tribunal to force the Revenue to close it if it has been going on for a long time.

The Chairman: Within a set period?

Malcolm Gammie: Generally speaking, the Revenue has to open an inquiry within 12 months but then the inquiry can continue ad infinitum. There is no time limit attached to it beyond the taxpayer going to the tribunal to get the inquiry closed.

Jason Collins: Typically the duration is within three months. It is a rarely used power, but it is there for the taxpayer to use. Over the years there has been for some reason a slight reticence with regard to forcing the pace and getting a closure notice. I have never quite understood it myself because I quite like going to court, although I am a litigator so you might expect that.

Going back to the definition of the difference between evasion and avoidance, really the difference is just a state of mind. An evader is

someone who knows they have a tax liability and has chosen—they may have a devil-may-care attitude—not to pay it. An avoider is somebody who looks at the legislation, perhaps with the benefit of professional advice, and thinks that they do not owe the money, but the Revenue comes along and says, “Well, we think you do”. I always say that if you were to ask the person on the street questions about Jimmy Carr or the others, they would say, “Didn’t they owe the tax anyway? How come that is legal?” If the tribunal has decided that all that tax was payable, how is that legal compared with evasion? The difference is purely that they have an honest belief that they do not owe it, by looking at the legislation. It may ultimately be proved wrong but they have that belief. The Revenue’s attitude to evasion and avoidance is always the same. If on this side you are all evaders and on this side you are all avoiders, HMRC would say, “You both owe us the money”. It is just a question of getting it in.

The Chairman: Is there any evidence that the Revenue deliberately singles out people in the public eye in order to encourage others? No one wants to answer that.

Malcolm Gammie: Of course a lot of the schemes that were done in the past—film schemes being the obvious example—were taken up by a whole variety of celebrities, not necessarily in full knowledge. Most of them would have had financial advisers who had said, “Look, this is being sold. Why don’t you do it? It will save this tax”, and they signed up to it. As we have seen, over the years the Revenue has used its participation in these schemes when they have come to court to—

The Chairman: I was thinking of the naming and shaming, for example.

Malcolm Gammie: I do not think that that is quite the same as naming and shaming. There are specific naming and shaming powers in the Act. I think this is more a case of when something has gone—

The Chairman: No, it is a culture point. If the idea is that you will name and shame people to encourage the others and you want to tackle the film scheme or whatever, it is probably quite handy from the Revenue’s point of view if there is someone who is high profile—if that is the culture.

Malcolm Gammie: Yes, I think that is fair enough.

The Chairman: Which of course would be unjust because it should treat everyone the same, should it not?

Lydia Challen: I am not sure there is a difference in the way the Revenue treats the participators as opposed to the way that the press treats the participators.

The Chairman: So the media are to blame.

Lord Hollick: Do you think we have reached a point where the balance of power has tipped so far in one direction that a review should be carried out?

Malcolm Gammie: I certainly think that the accretion of powers at regular intervals, and indeed the continuing pressure on the Revenue each year to try to come up with something else that is targeted at avoidance, would merit someone standing back and looking at where the balance currently lies.

Lord Turnbull: Even if one accepts that the Revenue is right to say occasionally, “This may be legal but it is an abuse because it is so contrived”, in effect it is saying, “You have misclassified this transaction”. What is unclear is does it then say, “From now on, this will be treated as income and taxed as income”? It says that but it also says, “We want the money for X years back”. The Revenue seems to have almost unlimited powers to go back even though it did not say at the time that it was interested in this. Is that a form of retrospective taxation that we should avoid?

Malcolm Gammie: I am not quite sure that I recognise entirely your description. It is certainly true that in relation to advance payment notices, follower notices and the like that a great deal of the heat which has been generated in this area has been around the fact that it has been retrospective. For example, whether or not you made a return under what is called the DOTAS—the disclosure of tax avoidance schemes—legislation, which at the outset was very much a reporting mechanism for the Revenue to get to know about things at an earlier stage, the fact that you made that and might have made it on a precautionary basis has then later been used and attached to other provisions to identify whether it is something for which an APN or a follower notice can be issued. That element of retrospection has caused a great deal of dissent among taxpayers who feel it is unfair that they are now being penalised by having to pay tax up front or suffer the risk of penalties because of the notice they served years before when that was not the law.

Lydia Challen: Perhaps it goes back to the distinction between aggressive avoidance and tax planning. That is an area where the goalposts have really moved. Matters which might have been seen as tax planning disclosed on a precautionary basis under DOTAS are treated as being egregious avoidance. There are other examples of where the Revenue introduces legislation to do exactly what you say—to change the position going forward of something that has been an established practice in the past. It is not trying to open up the past, but despite the fact that some of these arrangements are well established and have been known about by the Revenue for many years, when the legislation is introduced they are presented as anti-avoidance measures. So the language around legislation has changed. I think that affects the type of scrutiny that the legislation gets because politically it is difficult to ask probing questions about things that are purported to address avoidance.

Lord Turnbull: If you are in one of these schemes where you do not take income but get a loan and then the Revenue says, “Actually, that should be treated as revenue”, but it is not saying it should be treated as revenue from now on, it is saying, “You have been in the scheme for 10

years", you might say, "You did not protest it at any point so how can you say we now have to pay you the back money?"

Lydia Challen: There is a distinction to draw between situations where, on a construction of what the taxpayer has done, the courts can legitimately say, "Actually, this never achieved what you thought it achieved". There are lots of examples where the courts have done that and situations where the planning clearly worked and the Revenue wants to change it for the future. Sometimes the way in which the courts have decided that structures do not achieve what a taxpayer asserts have arguably been rather heroic interpretations of the legislation. Nonetheless, the courts have decided that that is what the legislation means and that the taxpayer was not able to get themselves within whatever it was they were trying to do.

Q31 **Baroness Kramer:** On the one hand there are the powers and then there are the ways in which HMRC chooses to use the powers. Those are two separate issues. We have had quite a lot of evidence from people who feel that there has been a fundamental change in the culture in the way in which those powers are exercised: the presumption of guilt being much more aggressive, HMRC being far less interested in whether or not there was an innocent explanation, et cetera. Do you have comments on that and any thoughts on whether or not there is any check on HMRC from a cultural perspective in the way that it exercises those powers?

Lydia Challen: I should preface this by saying that the Law Society engages with the Revenue a lot on matters of policy. We have a very constructive relationship with the Revenue, particularly at a policy level. However, we do have reports from members that indicate precisely what you are saying: that there is a more aggressive attitude; that the existence of powers gives the Revenue the ability to pressurise taxpayers into settling positions; that there is a reluctance to believe that the taxpayer is acting in good faith; and there is often a difficulty in getting reasons for the Revenue's challenge to a taxpayer's position until quite a late stage in the proceedings. So, yes, we have reports from a number of our members which indicate that that is the case and that it has become more like that over the past five years. Moreover, there have been difficulties in having concerns about that escalated.

Baroness Kramer: A number of people have suggested that that is an argument for an oversight body. Could you add that into your comments?

Jason Collins: I think that would be the correct way to go. With any power, there are first of all the design principles about what power should be given to any organisation. The second question is about how those are used in practice. I would say that 99% of the time HMRC is using its powers appropriately and proportionately but there will be instances when it does not. In my own practice area I occasionally see things that I would call try-ons—using a power probably not in the way that it was intended but if you look at the statute there is enough to justify using it in a particular way.

For example, I have seen a letter which is drafted like a formal notice—it is a very formal-looking letter—referring to the old Data Protection Act and quoting a particular provision from it. If you go to that provision, it says that the person who is a data holder is permitted to disclose information provided it is in connection with the assessment or collection of tax. However, it is a permission—the data holder is permitted to disclose it if they choose to—but HMRC writes a letter referring to the provision in a way that makes the reader of the letter think that they are being required to hand the data over.

It is that type of instance which makes you wonder whether the letter was written without realising what the provision actually says or whether the letter is there to try to require someone to provide information, bypassing the current tribunal mechanism. We see this with third parties that hold data.

Baroness Kramer: Is there any check on that? Should there be a check on that? It sounds extremely worrying to me because it is virtually deception.

Jason Collins: Only when the person who receives the letter takes some professional advice and looks into it do they realise that the letter is telling them only that they are permitted to disclose this data, not that they are required to do so.

Malcolm Gammie: I agree with the previous comments. The short point is that if you give a body powers, those powers are likely to be used. One of the criticisms, of course, of some of the recent powers is that they have been drafted extremely widely. One is effectively relying upon the way they are operated by the Revenue to provide the appropriate application of powers which could be read as being much wider. I certainly agree that in the vast majority of cases the powers are used appropriately. I do not think I could cite you evidence to suggest that there is widespread misuse by the Revenue of powers, but if you have given a body powers, my view is that that should be subject to some sort of oversight. At present, there is no oversight.

Baroness Kramer: The public would frequently argue—tell me if you think this is right—that this is not used against the big corporations which have ways of getting away with all of this, but it is the little guy who is the target; he is more vulnerable and less able to fight back. Is that your perception as well?

Lydia Challen: I am not sure that there is a specific distinction, but obviously the big corporates are in a position either to have expertise or to take advice very early on in the process. The amounts that are involved in exposures for certain types of penalties mean a lot less to a big corporate than to an individual, so the consequences for them are probably proportionately less, while for the individual they are disproportionately more.

An example arose in a recent case in the tribunals where a man's taxes were collected under PAYE and the Revenue had paid him back too much money and wanted to collect it. Instead of collecting it over time through the PAYE system, it issued a requirement to complete a self-assessment return. This was a man who had never completed a self-assessment return, he did not have a large income and he ignored it because he did not know what to do with it. By the time it got to the tribunal he had ignored it for long enough that the penalties for not filling in the return were more than £5,000, whereas the tax at issue was £800.

In that case, the tribunal held that the Revenue did not have power to issue that notice, but there have been a number of these cases in the tribunals. Four out of five have gone against the Revenue and I understand that the others are under appeal. That is an example of the Revenue not wanting to use the powers it clearly had and trying something else. For the taxpayer, that is a lot of money.

Q32 **Baroness Drake:** Mr Collins, you said that in your view in 90% of cases the Revenue exercises its powers appropriately, which suggests that you think that if there is a problem it is in the construction rather than the application of the power. What about the difference between the larger corporates and smaller businesses? Smaller businesses have fewer resources and less sophistication to push back. Do you think there is an equal balance in the treatment by the Inland Revenue of businesses in that situation, or is there a more partial approach?

Jason Collins: In the balance of power, if you think of most individuals dealing with any central government agency, HMRC is probably the one they are most likely to come across, and if you get a request from HMRC for information, it is probably something that will terrify most people, particularly if they are being asked for a long list of information. I occasionally Google accountancy chatrooms. They talk to each other about things they are seeing in their client base and they ask what the best advice should be. What I often see is quite commonplace. It is someone saying, "My client has been asked to produce all their personal bank statements; what should I do? Is HMRC allowed to do this?"

The legislation says that anything reasonably required to check the tax position has to be handed over. The advice often ends, after a long chain of discussion about a particular point, with the advice being ultimately to just hand them over because ultimately what are you going to do? The Revenue is not going to go away if you do not hand over the personal bank statements. You have to recognise that with any power system, once an individual comes up against the state, if the state says, "Give me something", the individual is likely to comply.

So you need to have much more control about when the state asks for information. Just because there is a power to do so does not mean it is appropriate to ask. In those circumstances it is a bit like the police powers on stop and search: yes, a policeman has the power to stop and search somebody, but it should not be abused. There is control and rigour over when the police actually use that particular power. I think we need a

bit more rigour around what HMRC is doing, particularly in the small to mid market.

Baroness Drake: In summary, you could say the smaller the company, the greater the case for controls on those powers.

Jason Collins: The case for control over HMRC's powers? Yes, I would say so. The bigger companies can take a stand.

The Chairman: That takes us quite neatly on to the time limit issue in the Finance Bill.

Q33 **Lord Leigh of Hurley:** As you know, the Finance Bill extends HMRC's time limit for dealing with offshore matters to 12 years. I would be interested in your views on whether that is proportionate. I guess that is probably going after the larger companies, the larger taxpayers, who are likely to have more complex offshore affairs. Perhaps you might also extend Baroness Drake's point, which I do not think you really answered, which is the perception that the large companies are not tackled under the existing HMRC powers. Either HMRC does not have the resources to understand the complex matters or it is simply frightened off by sophisticated advisers and put things in the "too difficult" box. Is this what the 12-year time limit is about? Perhaps you could answer both together.

Jason Collins: No, the 12-year rule applies only to income taxes, inheritance tax and capital gains tax, which apply to individuals. The extension of powers is just for individuals.

Lord Leigh of Hurley: So ultra-high net worth is presumably what they are after?

Jason Collins: You do not have to be ultra-high net worth to have something offshore. An example might be somebody who has a holiday home somewhere in France or Spain. You might see a situation where it is owned jointly. Perhaps one of the spouses has not been recording their half of the share of the income, for whatever reason. Under these new powers I suppose that that would be open for up to 12 years, even if it is innocent.

Lord Leigh of Hurley: Where one spouse is non-dom or something like that?

Lydia Challen: Non-doms are another category of people who could be affected by this. Everybody assumes that non-doms are all wealthy, but of course there are lots of non-doms in this country who are far from wealthy. Anyone who has come here within the last seven years and who does not intend to stay will be a non-dom and may well have income sources abroad that they do not bring into the UK. All of those kinds of people can be caught by this.

Malcolm Gammie: It is important to note that this extension does not involve any default by the taxpayer. Of course, if there has been some

form of deliberate fault—fraud or anything like that—the Revenue can already go back 20 years. Generally speaking, if you have been careless, it can go back six years. The question is whether 12 years is proportionate, and I would say that it is not.

The sort of disputes I deal with tend to be long-running ones, so I quite often deal in court with disputes where it is at least six, seven, eight or even 10 years since the events that you are having to deal with. Documents and evidence are not necessarily available and the burden of proof is on the taxpayer to disprove the assessment. It seems to me that if the Revenue can sit on its hands for 12 years and then suddenly raise an assessment, the taxpayer may well be in a position where the evidence and documents will not necessarily be there, or at least matters will not easily be proved.

Lord Leigh of Hurley: Does this apply in respect of the new disclosure of information between revenue organisations worldwide?

Malcolm Gammie: That is one of the bases, if I remember rightly, on which the Revenue said that because it now has access to a lot more information it may not come to its notice at an early enough stage, or it may need longer. But going from six years for careless to 12 years for no fault at all seems a rather disproportionate response.

Jason Collins: The policy justification is that it takes the Revenue longer to establish facts when the facts may be overseas rather than in the UK. But trebling the time limit in cases of innocent mistake from four years to 12 seems a little excessive. I do not know where it got 12 years from. We were talking among ourselves earlier about when HMRC has ever relinquished any of its powers through a consultation process. Funnily enough, it did do so in the powers rewrite in the mid-2000s that came out in the Finance Acts 2007 and 2008. It used to be the case that if a taxpayer was negligent, HMRC could go back 20 years to recover the tax, and it agreed as part of the powers review to reduce that to six years. That was quite a big cutting back of its time limits, but I think it has regretted that decision ever since. You can see that in the extension of offshore matters to 12 years and the number of times when HMRC tries to argue that something is into the 20-year period.

The language was changed in the mid-2000s from “fraudulent conduct” to engaging in “an error which was brought about deliberately” and “negligent conduct” to “an error brought about carelessly”. Everybody understood what “fraudulent conduct” meant. It is quite a thing to say to a taxpayer, “I think you have been engaged in fraudulent conduct”. Once the language changed to “an error brought about deliberately”, it is a much easier thing to say as an official speaking to a taxpayer than accusing them of fraud. Since then we have found that HMRC has been trying to push the boundaries of what a deliberate error actually means because it lost that ability to go back 20 years.

The Chairman: I am muddled as to what exactly an offshore investment is. If you have shares in a US company and are receiving dividends,

would that count? You mentioned overseas property such as a holiday home in France or whatever.

Jason Collins: A holiday home in France which has been let out.

The Chairman: And the dividend income from foreign equities?

Jason Collins: And from foreign equities, yes: anything where the asset itself is outside the UK.

The Chairman: If you invest in a fund that has equities which are overseas, would that bring you within this 12-year thing?

Jason Collins: Yes, it would.

The Chairman: That is quite a lot of people, is it not?

Jason Collins: Yes, there are lots of international investment funds which are structured outside the UK.

The Chairman: Is the power limited to looking at that aspect—that house or that fund—or does it open up your tax affairs for 12 years?

Jason Collins: No, it is just the offshore element of your affairs that would fall within this.

The Chairman: So it cannot go on a fishing expedition?

Jason Collins: That is a very different question. If it finds something around your offshore investments, that does not mean that it can bring your onshore investments into scope if it missed them at the time.

Q34 **Baroness Noakes:** Clause 35 of the Finance Bill extends the security tax liabilities to corporation tax and the construction industry tax deduction scheme. Do you have any concerns about the extension of this power?

Malcolm Gammie: I do not know enough about it. I could not tell you one way or the other, other than I have a sense that, again, this is one of the powers where you have to rely on the way the Revenue operates it rather than the terms of the legislation. From that point of view it is a matter of whether or not there is effective oversight of the way in which it is operated.

Lydia Challen: At the moment it is a regulation-making power. Without the regulations, you cannot comment effectively on whether or not there will be constraints around how it is used. The Revenue has said that it does not intend to use it just where an insufficiency of funds might result in a shortfall of tax; there have to be other reasons. One concern we would have is that the power should not be used to tip otherwise viable businesses into insolvency earlier than might otherwise have been the case.

Baroness Noakes: It is a difficult area. These are very wide powers and it is about how they are used, but there are no checks and balances or

safeguards—or are there?—to ensure that the powers are not used inappropriately.

Lydia Challen: Not unless they are contained in the regulations.

Jason Collins: No, they tend to be operated within parts of the Revenue that are trained in relation to that particular measure. There is a distinct part of the Revenue that deals with solvency but also bad behaviour, as Lydia mentioned. Often it is through the training of the officers concerned that the safeguards are there.

On the legislation itself, it is difficult to make a case against the extension of these powers when they are already in place for things such as VAT and other taxes. Corporate tax is possibly slightly different because the taxpayer is charging that tax as VAT; it is not your tax, you are charging it to the person you are dealing with. There is a case for saying there should be security measures in place to make sure you do not disappear with the money. Corporation tax tends to be a tax on what you have made after all your expenses are taken into account. If you are establishing a new business and having to put some money on account for what your corporation tax liability might be, it seems slightly counterintuitive that you pay before you have even made any money.

Q35 **Viscount Hanworth:** A new penalty scheme and interest regime have been proposed to tie in with MTD. Is this to be welcomed? Is it an improvement and, if so, in what respect?

Lydia Challen: I think we are in agreement that the penalty points aspect of it is an improvement. Beyond that, I do not have a comment.

Malcolm Gammie: If I am allowed to make this admission, I have not followed Making Tax Digital closely. Certainly, I agree that the penalties side looks sensible, but I have not been involved. On the basis that I am a VAT payer and it is supposed to be starting in six months' time, I have yet to hear anything from the Revenue to tell me what I should be doing.

The Chairman: We will add you to the list.

Baroness Noakes: You are not alone.

Jason Collins: This move to a penalty points system is to be welcomed. I am not sure if anyone has tried to read the legislation itself on how the system works. The complexity is quite astounding. One part of it is about trying to bring past transgressions into the new system, which brings about some of the complexity. As a system or a design principle, the idea that you are not penalised immediately for the first transgression or even the second or third, and you look at it in the round over a period of time, has to be the correct way to deal with it. But it is a very complicated system.

Viscount Hanworth: If you have been compliant for a certain length of time I believe that the penalties are wiped out—is that the case? Is that desirable?

Jason Collins: All points disappear after 24 months, full stop. If you have had a few points and have managed to get back on an even keel and everything has been filed that needs to be filed and the most recent returns are on time, the whole thing resets. You do not have to wait 24 months for that.

Viscount Hanworth: Did that characterise the previous scheme or is that an innovation?

Jason Collins: It is an innovation.

The Chairman: You may want to make those points about complexity to the Office of Tax Simplification, which gave evidence about an hour ago indicating that it thought it was an opportunity to simplify the tax system as we move to a digital system.

Q36 **Lord Lee of Trafford:** In answer to the Chairman's question about investments overseas, you referred to funds that are "structured" overseas. Is there a difference between terms structured overseas as compared with, for example, a taxpayer in this country investing over here in the "First Vietnamese Tiger Fund" or whatever it might be?

Jason Collins: No, if you are investing directly in a share in a foreign company, that would be caught. I was making the point that sometimes investments are structured through funds where you go through a collective investment scheme, and those are often themselves incorporated outside the UK. It does not mean that all the investments in that fund are outside the UK. The fund structure itself may be but not the underlying investments. But absolutely, direct investment would be caught.

Lord Leigh of Hurley: What is HMRC's attitude to excess reportable income in offshore funds?

Jason Collins: Its attitude?

Lord Leigh of Hurley: What is going on with the excess reportable income, forcing people to pay tax with 24 hours' notice in respect of the current year-end? Have you picked that up? Do you know what I am talking about?

Jason Collins: No, I have not picked that up.

Lord Leigh of Hurley: The recent change in excess reportable income and offshore funds means that you will have to pay UK tax in respect of previous income.

Jason Collins: On a dry basis, whether you have received it or not?

Lord Leigh of Hurley: Exactly. If it accumulates in funds offshore, you now have to pay tax in the UK. HMRC is suddenly sending out assessments to everybody—you have not picked that up?

Jason Collins: No.

The Chairman: Right. Has anyone got any other questions? We have kept you quite a long time. Thank you so much for helping us with this knotty issue. We look forward to producing a report in due course. I have been amazed by the number of representations we have had from accountants around the country, with real live examples. It may be worth having a look at the website because they are of interest.