



Making Tax Digital for VAT: Treating Small Businesses Fairly (House of Lords Paper 229)

Government Response

Contents

1. Summary.....	2
2. HMRC's preparations for Making Tax Digital for VAT	4
3. Taxpayer Readiness.....	6
4. The Making Tax Digital penalty and interest regime.....	10
5. Revisiting the case for Making Tax Digital.....	12
Annex: communication and support systems	13

1. Summary

Recommendation 1.1: *Defer the introduction of mandatory Making Tax Digital for VAT by at least one year, while encouraging businesses to join voluntarily (Para 29).*

The Government does not accept this recommendation.

There are no plans to defer the introduction of mandatory Making Tax Digital (MTD) for VAT. There is a growing appetite for HMRC to deliver a modern digital service that is effective, efficient and simple for all taxpayers and MTD will help to achieve this.

HMRC is already encouraging businesses to join voluntarily in advance of mandation, as part of the pilot, and the service will remain voluntary for the 1 million businesses whose turnover is below the VAT threshold.

The original plan for MTD, outlined in 2015, proposed a phased implementation across ITSA, VAT and CT. A revised timetable was announced in July 2017, confirming in a Written Statement that MTD would only be mandatory for businesses with a turnover above the VAT threshold, and then only to meet their VAT obligations.

Recommendation 1.2: *Plan a staged transition for businesses to join Making Tax Digital for VAT and future stages of Making Tax Digital which allows for businesses, not just HMRC, to be fully ready (Para 31).*

The Government accepts this recommendation in part.

We have already staged the transition for businesses to join MTD. The Government announced in July 2017 a revised timetable for the programme that slowed down the pace of mandation of MTD – this gave smaller businesses more time to prepare. Only those businesses with annual turnover above the VAT threshold (currently £85,000) will be required to join MTD in April and even then, only for their VAT. The Government has committed that mandation will not be extended to other taxes or to those below the VAT threshold until the system is shown to be working, and not until 2020 at the earliest.

HMRC recognises that businesses will require time to become familiar with the new requirements of MTD for VAT. During the first year of VAT mandation, HMRC will not pursue filing or record keeping penalties where businesses are doing their best to comply with the law. HMRC will continue to take action to safeguard VAT revenue, and sanctions will remain possible in cases of deliberate non-compliance.

Recommendation 1.3: *Wait until at least April 2022 to implement the next stages of Making Tax Digital, to allow time to learn lessons from the implementation of Making Tax Digital for VAT. (Para 35)*

The Government accepts this recommendation in part.

When we announced in July 2017 that the pace of mandation of MTD was being slowed, we were clear that the scope of MTD will not be extended before it has been tested and shown to work. This remains the case. That will not be before 2020.

One of the reasons for the changes made to the timetable for MTD was to enable us to take a balanced view on the best way forward for the introduction of MTD for further taxes, allowing HMRC time to assess the evidence from the pilots and early stages of mandation to inform those decisions.

***Recommendation 1.4:** Publish a plan for the long-term development of Making Tax Digital, to encourage businesses to choose digitalisation for productivity, efficiency and modernisation reasons rather than just tax compliance. (Para 34)*

The Government accepts this recommendation.

We set out our vision for the modernisation of the tax system through MTD in 2015 and this vision remains unchanged. In response to concerns about the pace of change, particularly for the smallest businesses, we have slowed the pace of mandation to give businesses more time to prepare. As announced by Written Ministerial Statement in July 2017, there will be no further MTD mandation until the system has been shown to work well and not until 2020 at the earliest to give businesses certainty.

2. HMRC's preparations for Making Tax Digital for VAT

Recommendation 2.1: *We recommend that HMRC reviews and learns lessons from its Making Tax Digital for VAT experience. It must fully consider the practicalities affecting underlying business and accounting systems before Making Tax Digital is extended to other taxes. (Paragraph 26)*

The Government accepts this recommendation.

HMRC has robust internal governance processes in place around the MTD programme. The Programme Board meets monthly and is chaired by the Programme Senior Responsible Officer (Director General, Customer Strategy & Tax Design). HMRC Change Assurance, Investment and Transformation Portfolio Management, as well as Infrastructure and Projects Authority and Her Majesty's Treasury, are key members of the Programme Board and actively engaged in the range of Assurance Reviews, both as scrutineers and Programme Board members. This is supported by a range of Project Boards and a Working Group, which enables discussion with and challenge by a range of internal and external stakeholders.

The MTD programme regularly undertakes lessons learned exercises at key points, for example, some of the lessons learned from the early stages of the MTD Income Tax pilot, which began in April 2017, informed their approach to the VAT pilot that started in April 2018.

We have been clear since July 2017 that MTD will not be extended until it has been shown to work well, and not before 2020 at the earliest. Any decisions made on extending MTD will take into account the lessons HMRC has learned through both the VAT and Income Tax pilots and also through the full VAT service once it is mandated. HMRC will be closely monitoring the take up of the service to continue to iterate and improve it in light of business and agent experiences. HMRC remain committed to delivering these important changes in a way that works for business and agents.

Recommendation 2.2: *We recommend that HMRC urgently publishes full details of how its communication and support systems will meet the needs of taxpayers and agents across different levels of digital capability and skills. (Paragraph 39)*

The Government accepts this recommendation.

A copy of HMRC's plans for communication and support is enclosed.

HMRC is in the process of writing to all businesses to ensure they are aware of the MTD changes and direct them to more information on how to prepare. They have already written to over 400,000 businesses and will be writing to every mandated business by early February.

HMRC's Customer Support Model guides taxpayers to the most appropriate support, whether that be through HMRC, a software developer or their agent. HMRC has a range of support options for customers, catering to their different needs, from signposting to guidance for digital services, webinars and YouTube videos, light-touch support and more intensive, one to one support.

HMRC is also working with software developers to produce a comprehensive support package that covers software usage, technical issues, as well as straightforward tax enquiries. Many software developers have already developed customer support packages which include, email and telephone support, training packages and video guidance.

Ultimately, if a customer cannot go digital, they will not be required to do so. In these circumstances, the customer may apply for an exemption.

***Recommendation 2.3:** We recommend that HMRC develops guidance on the practicalities of claiming digital exemption with the representative bodies and publishes it as a matter of urgency. HMRC should notify taxpayers in writing of its guidance and claims process for digital exemptions when it invites them to join the pilot. (Paragraph 42)*

The Government accepts this recommendation in part.

HMRC have been clear from the outset that those businesses that are unable to go digital will not be forced to do so. Those businesses already exempt from VAT online filing will continue to be so under MTD, so they do not need to take any action.

As MTD introduces additional requirements beyond online filing, there may be customers who are not exempt at present but may be eligible for exemption under MTD. However, the Government expects that there will only be a small number of VAT registered businesses with taxable turnover above the VAT registration threshold who are likely to qualify.

Exemption on grounds of digital exclusion is fact-dependent and must take account of all individual circumstances; for example, the age of a customer alone will not determine the decision, therefore it is not simply a case of specifying how old a customer must be to qualify for exemption.

The application process for claiming an exemption under MTD is based upon the existing process which is already in place for claiming exemption from online filing for VAT and therefore has the benefit of being 'tried and tested' as well as being developed and guided by tribunal decisions. Each case will be assessed on its own merits in discussion with the applicant. HMRC will take a decision on what it considers to be the most appropriate method and format for sharing guidance with stakeholders, and will ensure an appropriate level of detail is contained within guidance.

HMRC has developed internal guidance for its own staff about how to handle claims and road-tested it to ensure we provide a fair and efficient process. Customers can contact HMRC via telephone or in writing to discuss their claim for exemption.

3. Taxpayer Readiness

Recommendation 3.1: *We recommend that the Government urgently provides a support package for software system selection to businesses going digital for the first time and their agents, independently from the software industry. (Paragraph 20)*

The Government accepts this recommendation.

HMRC is committed to helping businesses choose the right software for them and recognises the importance of supporting them to identify software with the right functionality and features to suit their needs.

HMRC has already published a list of MTD compatible products that are available now for VAT on GOV.UK. The Software Choices page lists a limited number of features for each product along with a link to the specific products webpage where the user can find out more information. The products are listed alphabetically and HMRC does not promote or recommend one product over another.

HMRC are enhancing this page to allow the taxpayer to 'choose' from a number of specific features presented to them in order to generate a 'shortlist' of products that are tailored to their needs. HMRC have been testing their plans for the page with external stakeholders to ensure it meets their needs. This page will be launched shortly.

HMRC is also working with software developers to produce a comprehensive support package that covers software usage, technical issues, as well as straightforward tax enquiries. Many software developers have already developed customer support packages which include email and telephone support, training packages and video guidance.

Recommendation 3.2: *We recommend that HMRC, as its software selection tool is developed, makes provision for establishing and certifying which software options are compliant with Making Tax Digital for VAT. (Paragraph 21)*

The Government accepts this recommendation.

HMRC does not certify, accredit, kitemark or endorse products. However, it does have a robust product and developer recognition process. Every developer and product that is currently listed on the Software Choices page has gone through that process.

HMRC will continue to work with the software developers, building a strong, collaborative relationship throughout their development process. As part of this, HMRC views the products to ensure they are MTD compliant and that they integrate correctly with HMRC's systems and ensures they have been tested in their test environment. Only after these steps have been undertaken will a developer's product be launched as a 'live' MTD product and go onto the Software Choices page for customers to be able to select. The products that are shown as 'in development' are those HMRC's expect to complete the recognition process prior to mandation, in April 2019.

No products are listed on the Software Choices page until HMRC are satisfied they have gone through the steps listed above.

Recommendation 3.3: *We recommend that HMRC increases the communication and support available to agents, and listens to agents' concerns. Within that communication strategy, HMRC needs to address how it supports unrepresented taxpayers. (Paragraph 91)*

The Government accepts this recommendation.

HMRC will continue to increase communications with all stakeholders in the lead up to April 2019. HMRC has been engaging extensively with stakeholders, particularly agents, since MTD's inception - formally on the design of MTD during the MTD consultations in 2016 and informally on an ongoing basis. HMRC attend a range of large and small event with agents to talk about preparing for MTD, listen to their views, and host regular agent facing webinars on MTD for VAT.

In addition, representatives of MTD regularly attend HMRC's forums that include agent representative bodies, including the Administrative Burdens Advisory Board, Virtual Communications Group and the Joint VAT Consultative Committee and the views of these groups, and from HMRC's wider stakeholder engagement, have been instrumental in shaping the design and implementation of MTD.

There is a collection of MTD support material available on GOV.UK including specific products designed with and for agents, which includes a Communications Pack that was launched in July to support agents in communicating with their clients about preparing for MTD.

HMRC recognises that not all businesses within the scope of the MTD for VAT requirements are represented by an agent and is working to ensure the right support is in place to support them in transitioning to MTD. They are writing directly to all businesses within scope to ensure they are aware of the MTD requirements and signpost them to support in preparing for the changes. This includes a series of bite-sized YouTube videos to provide step by step information on what they need to do.

HMRC are also identifying supplementary approaches to raise awareness of MTD with unrepresented taxpayers, such as targeted messaging through trade press, and working with small business teams in high street banks. Awareness of MTD within this group is a little better than in the wider business population and the majority of unrepresented taxpayers believe the move to digital record keeping will be straightforward. Almost all of them have access to a computer and regularly use the internet for business, so digital capability is highly unlikely to pose a barrier to transition. MTD prompts via existing communications channels, such as GOV.UK and messaging on the Business Tax Account, will also be used to reinforce messages to those within this group.

Recommendation 3.4: *We recommend that the Government defers the date for mandating Making Tax Digital for VAT by at least one year, while encouraging businesses to join voluntarily. This will enable further development of a competitive software market and specialist sector products, permit HMRC's systems to be fully and appropriately tested, and allow taxpayers to prepare fully for implementation of new systems. (Paragraph 29 & 95)*

The Government does not accept this recommendation.

HMRC recognises that MTD represents a significant change for some, which is why we announced in July 2017 that we were slowing the pace of implementing MTD, delaying the introduction of MTD for ITSA and CT. This will give smaller businesses in particular more time to prepare.

The year-long VAT pilot started in April 2018 with a private testing phase where volunteer businesses and agents were invited to join to ensure everything was working, before it was opened up more widely in October. Around half a million businesses with turnover above the VAT threshold were able to join the new service at that point to begin familiarising themselves with it. HMRC continued to deliver and test the functionality to allow other customer types to join the pilot and it is now open to all businesses who are mandated to use the service from April.

There is already a competitive market in MTD compatible software. Over 300 developers have told us they are interested in developing MTD for VAT products and there are already 70 fully tested products available as part of the live pilot. This includes 21 'bridging' products to allow businesses to choose to continue keeping their records in a spreadsheet and a number of free and low cost products. We have had 63 developers confirm that their current software will be upgraded, for existing customers, to allow for MTD functionality at no additional cost. There are also a number of specialist products for specific sectors.

MTD will be a key tool in tackling the tax not collected due to error and carelessness which has risen to over £9 billion a year, not only costing the Exchequer, but also causing cost, uncertainty and worry to taxpayers when HMRC is forced to intervene to put things right.

But we recognise that taxpayers will require time to become familiar with the new requirements of MTD. During the first year of mandation, HMRC has committed that it will not pursue filing or record keeping penalties where businesses are doing their best to comply with the law. However, HMRC will continue to take action to safeguard VAT revenue, and sanctions will be considered in cases of deliberate non-compliance.

***Recommendation 3.5:** We recommend that HMRC plans a staged transition for businesses to join Making Tax Digital for VAT, and future stages of Making Tax Digital which allows for businesses, not just HMRC, to be fully ready. As part of this, HMRC should provide more information on their plans for Making Tax Digital for Business and Making Tax Digital for corporation tax. This will allow businesses to make informed long-term decisions about their software selection. (Paragraph 31 & 97)*

The Government accepts this recommendation in part.

The original timeline for the implementation of MTD was already staged, starting with Income Tax and then extending out to VAT and Corporation Tax in subsequent years. We announced in July 2017 that the pace of mandation would be slowed to give businesses, particularly the smallest businesses, more time to prepare.

HMRC have committed that the scope of MTD will not widen beyond VAT until the system has been shown to work, and not before April 2020 at the earliest. This will ensure that there is time for HMRC to test the system, businesses to prepare and for digital record keeping to become more widespread. The introduction of MTD for Corporation Tax will first be subject to public consultation to ensure stakeholder views shape the design, and then, based on the responses received, new primary legislation would be needed to put those changes into effect.

We remain committed to delivering MTD in a way that works for both businesses and agents.

***Recommendation 3.6:** We recommend that the Government publishes its plan for the long-term development of Making Tax Digital, including key decision points, milestones and dependencies. This will give greater certainty, and the software industry the information it needs to develop software that will work across each different aspect of the Making Tax Digital programme. It will also encourage businesses to choose digitalisation for productivity, efficiency and modernisation reasons rather than just tax compliance. (Paragraph 34 & 102)*

The Government accepts this recommendation in part.

As announced by Written Ministerial Statement in July 2017, MTD will not be extended to other taxes until the system has been shown to work and not before 2020 at the earliest. We understand that businesses and the software industry will need sufficient time to prepare for any changes.

***Recommendation 3.7:** We recommend that the next stage of Making Tax Digital is not implemented until April 2022 at the earliest. At least two years are required to learn and act on lessons from the implementation of Making Tax Digital for VAT, and a further year will be required for the software industry and taxpayers to prepare. (Paragraph 35 & 103)*

The Government accepts this recommendation in part.

The Government will not widen the scope of MTD beyond VAT until the system has been shown to work, and not before April 2020 at the earliest. One of the reasons for the changes made to the timetable for MTD in the Written Ministerial Statement of July 2017 was to enable us to take a balanced view on the best timing for the introduction of MTD for further taxes based on the evidence from the pilots and the early stages of mandation.

4. The Making Tax Digital penalty and interest regime

Recommendation 4.1: *We recommend that the two-stage late payment penalty system is amended to extend the period of grace from 15 to 30 days. (Paragraph 38 & 121)*

The Government does not accept this recommendation.

Similar concerns were raised by some stakeholders in the consultation on interest harmonisation and sanctions for late payment. The current late payment penalty for VAT (the default surcharge) applies immediately, whilst ITSA penalties apply after 30 days. In creating a new approach that is effective for all taxes, the proposed new penalties will start at half the full rate 15 days from the due date and full penalties will only apply after 30 days.

The summary of consultation responses reiterated that this provides a proportionate balance: fair to those who pay on time, while allowing those who can't pay further time to get in touch with us. At the same time, those who don't want to pay do not unfairly benefit from effectively postponing the due date without repercussion. The summary of responses clarified that where a time to pay arrangement had been made, HMRC will take the date of first contact with proposals to pay as the effective date for late payment penalty purposes, incentivising early contact.

Finally, the reasonable excuse and appeal provisions will continue to provide taxpayer safeguards.

Recommendation 4.2: *We recommend that the Government reduces the two-year time limit for HMRC to assess penalties to no more than one year, so that taxpayers are aware of their exposure sooner. (Paragraph 39 & 122)*

The Government does not accept this recommendation.

Similar concerns were raised by some stakeholders in the recent consultation on draft legislation. All assessment time limits are a balance between providing certainty for taxpayers and providing HMRC with authority to apply the appropriate penalty where it only becomes aware of failure to meet an obligation well after the deadline (for example, where a taxpayer has failed to notify HMRC of their liability to tax).

Recommendation 4.3: *We recommend the draft legislation is amended to remove the restrictions on repayment interest on VAT. (Paragraph 42 & 130)*

The Government does not accept this recommendation.

In the summary of responses to the interest harmonisation and sanctions for late payment consultation, the Government reaffirmed its commitment to making payments to taxpayers as soon as possible. Interest will be payable:

- From the due date of the return (in the current system, repayment supplement, is paid after 30 days);
- On the reduced amount of any claim (in the current system, repayment supplement is not paid if the return is reduced by more than certain limits);

- From the date a claim is received if it is received late (in the current system, repayment supplement is not paid if the return is received late).

The remaining restrictions ensure that reasonable and proportionate steps are taken to ensure that Exchequer risks on invalid claims are mitigated. The Government has further confirmed that, in addition to receiving interest, a taxpayer may make an additional claim for any costs directly incurred as a result of an unreasonable delay or mistake by HMRC.

***Recommendation 4.4:** We recommend that HMRC introduces a communication and support programme to ensure that taxpayers have a clear and timely understanding of the new penalty and interest regime, including the transitional provisions. (Paragraph 43 & 133)*

The Government accepts this recommendation.

HMRC are aware that good communication and support will be key to the successful delivery of penalty and interest reform.

At the Budget 2018, the Government announced that it remained committed to the reform and intended to legislate in a future Finance Bill, to allow for further time to consider the communications needed to underpin a successful implementation.

***Recommendation 4.5:** We recommend that HMRC introduces a messaging system to give timely information to taxpayers of penalty points accruing, in order for the new regime to support taxpayers in timely compliance with their tax obligations. (Paragraph 44 & 134)*

The Government accepts this recommendation in part.

HMRC are committed to ensuring that there is clear communication on the new penalty points accrual process, as this is central to an effective late submission penalty regime.

At the Budget 2018, the Government announced that it would carefully consider effective communications and, to that end, HMRC looks forward to continuing the positive engagement with its stakeholders, as has already been commended and recognised by the Committee.

5. Revisiting the case for Making Tax Digital

Recommendation 5.1: *We recommend that the Government updates the impact assessment to reflect evidence gathered in recent months, including from the pilot. A revised impact assessment should be published alongside the Government's long-term plan for mandating MTD for other taxes. (Paragraph 47 & 157)*

The Government does not accept this recommendation.

The Impact Assessment published on 1st December 2017 remains a credible estimate of costs and savings for the VAT businesses that will be mandated from April 2019. We have seen no evidence to date that it is unrepresentative of the costs that will be incurred across the population. It was developed in consultation with external stakeholders and our methodology has been independently accepted by the Administrative Burdens Advisory Board as producing a realistic estimate of the likely impact upon businesses.

In the software market we are already seeing a choice of free products emerging, as well as low-cost software, starting at an annual charge of £20 for bridging software and around £10 per month for recording keeping software. Many businesses that already use software are seeing their products upgraded for MTD at no additional cost. By not providing its own software HMRC has incentivised the creation of a diverse range of software choices. If one supplier does not meet a business's needs they can visit HMRC's software choices page to help them identify a suitable alternative.

As indicated in our Tax Information and Impact Note (TIIN) at Spring Budget 2017, we will continue to monitor the impacts through information collected from HMRC's MTD processes. We shall, however, seek to update our assessment when formal announcements about extending mandation to taxes other than VAT are made.

Recommendation 5.2: *We request that HMRC writes to update the Economic Affairs Committee every six months until the entire MTD programme is rolled out. (Paragraph 53 & 171)*

The Government accepts this recommendation.

HMRC will write to the Committee every 6 months with a progress update.

Annex: communication and support systems

The Customer Support Model

The MTD VAT pilot is testing the overall suitability of our software and systems, through feedback from a large, diverse group of participating customers. Additionally, it is informing and testing our support including the effectiveness of our guidance and products for businesses and agents, across all levels of digital capability and skills. We have a number of ways that we help our customers:

Partnership marketing and support: We are utilising the support of software companies, trade bodies and agents to encourage members and clients to sign-up; and to adapt MTD guidance within their software, to provide a seamless service. We have also produced a stakeholder communications pack which was sent directly to these stakeholders and published on GOV.UK. This contains key messages, frequently asked questions and links to online help and guidance. We have also delivered a shorter guide for businesses to help them to prepare.

One to many support: We provide guidance and support through each stage of the MTD customer journey, including signing up, choosing software, sending returns and dealing with technical questions. We use multiple channels and formats to do this to maximise customer choice, including written guidance, videos, webinars and e-learning.

One to one support: This is available via the telephone and webchat; and face to face through the Needs Enhanced Support Service. It includes detailed answers to questions about MTD, 'assisted digital' guidance to help customers to use digital services – and a telephone process for customers who think that they are exempt from the MTD regulations.

Wider Communications

Initially our communications were aimed at agent professional bodies, small business representative groups and public bodies. We are now targeting people with VAT obligations, who are above the VAT threshold, to remind them of the timetable for MTD VAT mandation. The communications channels we use include:

- Digital channels such as YouTube videos and webinars
- A social media campaign to remind VAT registered business above the VAT threshold about the need sign-up to MTD
- Messaging on the Business Tax Account and VAT portal
- Direct Correspondence to all businesses with a turnover above the VAT threshold (and) to those businesses that have been deferred for 6 months.
- HMRC's channels (e.g. agent blog, Agent Update and professional bodies and trade organisation forums)
- Media, including press notices and targeting of the trade press, targeting those industries which have a higher proportion of businesses with VAT obligations - Construction, Wholesale and Retail Trade, Repair of Motor Vehicles and Professional Scientific and Technical Activities.