

# Economic Affairs Committee

## Finance Bill Sub-Committee

### Corrected oral evidence: Draft Finance Bill 2021-22

Monday 11 October 2021

4.15 pm

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Members present: Lord Bridges of Headley (The Chair); Lord Butler of Brockwell; Viscount Chandos; Baroness Harding of Winscombe, Baroness Noakes.

Evidence Session No. 1

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Questions 1 - 12

#### Examination of witnesses

Susan Cattell, Richard Jones, Emma Rawson and Jason Piper.

Q1 **The Chair:** Good afternoon. Thank you very much for coming to this meeting of the Finance Bill Sub-Committee. I will kick off in a moment and ask you to introduce yourselves. Then we will get going on the questions. We have someone joining us on Zoom. Could you introduce yourself, please? I think it is Susan Cattell.

**Susan Cattell:** Hello. I am the head of tax technical policy at ICAS, the Institute of Chartered Accountants of Scotland.

**Emma Rawson:** I am a technical officer at the Association of Taxation Technicians.

**Jason Piper:** I am the head of tax and business law at ACCA, the global body for professional accountants.

**Richard Jones:** I am in the tax faculty at ICAEW, the Institute of Chartered Accountants in England and Wales, dealing with business tax affairs.

Q2 **The Chair:** Thank you all very much for joining us. I will dive in. We are going to spend about 70% of the hour talking about basis period reform. Then we will move on to uncertain tax treatment, depending on how much time we have.

I will ask the first question but, before going any further, I have to do some housekeeping and declare an interest as a senior adviser to Banco

Santander. Having done that, I will start off with a big question.

How important is it to reform the basis period of reform rules before the introduction of Making Tax Digital for income tax? How do these two things interlock? Is one dependent on the other? Could I ask Susan Cattell to start, please?

**Susan Cattell:** We think they are quite closely connected and that, if you want Making Tax Digital for income tax to work, it probably is important to make some changes to the basis period rules before you introduce it. Of course, some problems have been identified and it would be good to try to address them.

However, if it is decided that they are insuperable and full basis period reform does not go ahead, we think you need to extend the equivalence of 31 March and 5 April beyond the opening years of a business and to extend it to property income because we think that, if you do not make that change at the very least, quarterly reporting for MTD will be very difficult. It will be particularly difficult for businesses that have both a trade and a property business. So, yes, we think some changes to basis period reform are essential; if it is not full basis period reform, we would say that you must extend equivalence and legislate for that.

**The Chair:** Excellent. Thank you very much. Emma Rawson, would you like to comment?

**Emma Rawson:** I agree with a lot of what Susan Cattell said. Basis period reform and Making Tax Digital are very closely linked. I do not think you absolutely have to have basis period reform to go ahead with MTD. MTD has been in the works for a while now. Basis period reform is a quite recent stratagem. However, I do think it would simplify things and clean them up. The way I look at it is that basis period reform is about how you calculate your profits for a tax year, whereas the MTD is more about the reporting aspect. If you are going to do both, I think it makes sense to get the mechanics right of how you are working out the taxable profit; to get basis period reform in first and get MTD in after that. I would not want to see it done the other way round.

**The Chair:** Very good. Thank you. Jason Piper then Richard Jones, please.

**Jason Piper:** As Emma Rawson and Susan Cattell have both said, the order of things is important. The software to run MTD does not have the flexibility that other systems might have. Computer software wants a single set of rules. So far, it has been developed to work on the existing periods, and the software houses have been working to that. If reform is going to be done, it will be better to have that in place first so that they can develop one system once and use that. If you change the basis period after they already have a set of software live and running, it means a whole set of changes for the software houses as well as for the users to try to work out how to interact with it. Getting the order right is important.

**Richard Jones:** All I would add is that you might want to leave a longer gap between basis period reform and MTD, just from the perspective that

you have a transitional year for basis period reform and then you are straight into MTD. To give businesses a bit more time to get used to it, it might be useful to have another one or two years' gap, potentially.

**The Chair:** Fine. I think that is a very good starting point. I will now pass over to Baroness Harding.

**Baroness Harding of Winscombe:** Can I pick up on that point? Collectively, your organisations and others wrote to the Government in August expressing your concern about the timetable for introducing MTD and basis period reform. The Government have since announced a deferral to the start date. How far does that allay your concerns? Does the deferral now allow sufficient time for businesses to prepare for the change, both the delay and, as you have just said, Mr Jones, the linked timing? Would you start, Mr Jones?

**Richard Jones:** The deferral certainly helps. The most important thing, now that we have a bit of extra time, is for that time to be used wisely, both by the Revenue, to start publicising to businesses that this is a change that is going to happen and telling them what to do to prepare, and by businesses, to get their accounting records more digital and to start looking at software providers. A year helps, but the longer we have, and the longer businesses have, the more time they have to prepare.

**Baroness Harding of Winscombe:** Do you have anything to add, Mr Piper?

**Jason Piper:** Not particularly. Businesses have a lot else on their plates at the moment, on top of trying to arrange for tax changes. It would help if there could be that little bit of an extra gap to allow other systems in the background to be ready for business when they adopt any new system. We are always going to ask for more time, but it will still be very challenging, even with the year's deferral.

Q3 **Baroness Harding of Winscombe:** Which do you think would be more important? More time for the first phase of change, for basis period reform, or a longer gap between basis period reform and Making Tax Digital?

**Jason Piper:** Unfortunately both. The basis period reform is so fundamental that it needs to be looked at properly. The last time basis periods were changed there was a two to three-year gap between legislation and the proposals taking effect.

**Baroness Harding of Winscombe:** Anyone else?

**Emma Rawson:** I echo what has been said. The extra time is very useful, but it is important that we all make use of it: taxpayers, the agent community and HRMC. It is all too easy to think, "Oh, we have another year to worry about that", but I do not think we can overestimate the amount of work that needs to be done in that time. As I think Jason was saying, we need more consultation and, to my mind, where possible, to try to minimise the negative impacts that this will have on business.

If I had to pick between longer for basis period reform and a longer gap between that and the introduction of MTD, I would go for an initial delay for basis period reform. I do not think it will go well if you bring basis period reform in too quickly. Even an extra year between that and MTD coming in will not be enough to unpick it all and make it work properly.

**The Chair:** Can I clarify something before we go on? Now we have had the delay, do any of your organisations think that basis period reform should still not go ahead? Is there any objection in principle? Is the concern mainly about timing and process? I got the sense from some of the submissions that one of your organisations—I am looking at Mr Jones here—wrote that it should be dropped entirely. Is that still your position?

**Richard Jones:** I will give you a somewhat nuanced answer. I think there are certain things that could be done to have a less adverse impact on business that would make it more palatable. For example, changing from a basis period means that you have to use up your overlap reliefs, if you have some, in order to move from a basis period to tax-year basis. Some businesses might not want to do that. They might want to save that for when the owners retire, for example. You have the transitional provisions, which allow businesses to spread profits over five years, but that might still not be enough. If you have a large profit in a particular year, it could be quite costly for businesses in terms of tax.

It would be preferable for basis period reform not to go ahead in its current shape, but if the Revenue is open to looking at it again and making changes that make it less adverse for business, certainly we would be more than happy to enter into the dialogue.

**The Chair:** It is very useful to hear that. I know that Baroness Noakes wants to pick up on some of these points.

**Baroness Noakes:** Could I pick up first on the point that Ms Rawson raised, which was about needing to allow time for things that might not go well. What might not go well?

**Emma Rawson:** The concept of the transitional year. It will probably be okay for the more sophisticated taxpayers and their advisers, but what we do not have a handle on, and what I worry about, is how many unrepresented taxpayers will have to deal with this themselves. I think it could be quite easy for them to make mistakes in calculating their taxable profits for the transitional year or not claim relief that they are entitled to, and to end up in a position where their tax affairs are not right. Then, to go from that position to MTD is probably problematic.

**Baroness Noakes:** Do we know what proportion of taxpayers would be unrepresented?

**Emma Rawson:** No, we do not, and it is one of things that we would quite like to see HMRC look at and bring to discussions. HMRC needs to get a handle on the make-up of the taxpayer population that will be affected, because whether they are represented or unrepresented means a lot for the education campaign and how they push that out. If the population is mainly represented taxpayers, you can put a lot more energy into working with professional bodies and we can help to get the

message out. If there are a lot of unrepresented taxpayers, that is quite a big hurdle for HMRC to get across with education and support.

**Q4** **Baroness Noakes:** Let me shift to the question that I was going to address. In detail, what needs to happen in the next 18 months to make sure that businesses are prepared and who needs to do what? Perhaps we should start with Ms Cattell, since she did not speak on the last question.

**Susan Cattell:** I did have something to add on the last question, but it will fit quite neatly with this question.

I think there are two things that have to happen in the next 18 months. The first is that HMRC has very poor service levels at the moment, which are causing huge problems for agents and, obviously, for taxpayers. It will be very, very difficult for people to prepare for these big new changes if they cannot get routine bread-and-butter things dealt with adequately and in adequate timeframes by HMRC. We think it is very important that HMRC's poor service levels are fixed as soon as possible. We are getting reports all the time from our members about the problems the poor service levels are causing for them.

Secondly, somebody mentioned earlier that businesses need to prepare and start keeping digital records, but for that to be the case the big software providers have to be ready; their products have to be ready. Partly what has been holding them back is that until there is a definite commitment from the Government that this will go ahead on a particular date, and until they know the exact legislative shape of what is going to happen, what the rules are going to be, they will be very reluctant to produce software. We are getting a lot of feedback from our members that, even when they would like to start getting clients thinking about this, it is very difficult to do it because the range of software products available is hopelessly small. About seven products are listed at the moment on HMRC's software page.

One of the problems with basis period reform is that, although some MTD regulations have now been laid, they have obviously not been laid on the basis of basis period reform going ahead. If the software providers think that this still might change, it is not clear that they will produce the products in good time for people to start preparing.

Those are two things that must be addressed as soon as possible. We need the software providers to produce the software and we need HMRC to get its service levels back to an acceptable level. Both those things are absolutely essential for businesses and agents to prepare for these changes.

**Jason Piper:** I echo what Susan said. It reminds me of the joke about the traveller who asks someone for directions, and the answer is, "If I was going there, I wouldn't be starting from here". If we want basis period reform in 18 months, we are not in the place to try to sort it out now. The order of what needs to be done must start with working out what the rules are going to be. We need the legislation so that the lawyers and the tax advisers can understand what is going to happen.

We also need the flowcharts and software requirements so that the software houses can build something that reflects what the legislation is trying to do and is capable of implementing it effectively. That is the first thing that needs to happen. For that to work, we need to understand the possible pitfalls and difficulties. It is not an easy route and it is certainly not a quick one.

**Baroness Noakes:** Do any of the others want to add anything?

**Richard Jones:** There is a pilot programme at the moment on Making Tax Digital for income tax. We do not know how many businesses are in it, but it is very few. It is essential for that programme to be expanded, so that the Revenue has a good understanding of how its systems will work and businesses will understand how they interact digitally with HMRC in that system. The programme needs expansion and more testing.

**Baroness Noakes:** Can I follow up on the suggestion that businesses might want to align their year ends more with the tax year compared with where they are at the moment, what the implications of that would be, and what HMRC would need to do to accelerate it, if it is a good idea?

**Emma Rawson:** The starting point is that some businesses will definitely move to 31 March or 5 April year ends. It makes sense. It will save them a lot of administrative work if basis period reform does go ahead.

Not all businesses will be able to change. In particular, I am thinking that in the farming industry a March year end is not good for either arable or sheep farming, for example.

Beyond that, one thing that needs to be considered is extending the transitional provisions under basis period reform, which will allow you to spread excess profits over five years. At the moment, the proposal is that, if you change your accounting period before reform comes in, you will not be able to spread any excess profits. We would like to see that people are not disincentivised from deciding to change their year-end now, in anticipation of the reform coming in, because it makes sense for them, for their advisers, and for HMRC.

**Baroness Noakes:** Any other views on that?

**Richard Jones:** Some businesses have a model that works in a particular way in relation to the calendar. Emma Rawson mentioned farming. There is also tourism, and some international partnerships tend to prefer a December year end, just because that tends to align with the tax years in other jurisdictions. There are lots of commercial factors that might make certain businesses decide not to switch their accounting dates.

Q5 **Viscount Chandos:** Can I ask whether there are particular trades and professions that will be particularly affected? If so, which ones, and what is the impact? I would be particularly interested in those where average incomes are not particularly high and where transitional compliance and other costs would therefore bear particularly heavily on the individuals' earnings.

**Emma Rawson:** I mentioned farming. There is a very good reason why lots of farmers have a 30 September year end. They may struggle practically to change their year end, and they would be stuck with the work of having to apportion, and potentially estimate, profits.

Hospitality is another industry for which March is unpopular, because it tends to fall around Easter time. Hospitality businesses prefer to have their year ends in a quieter period. Those are the two areas that come to my mind.

**Susan Cattell:** We have had quite a bit of feedback about fairly small rural businesses that have diversified. They might have a small farming trade but also holiday lets—maybe a bed and breakfast, maybe an unfurnished let—and perhaps some renewable energy. Their first problem is that they probably cannot switch to a 31 March year end. Secondly, they have multiple income sources, trades and property businesses, so they will have to report separately on them for Making Tax Digital, and that will be very onerous.

Because there are those other problems anyway in the existing system—having multiple different sources of income, having diversified—there has been a suggestion for quite a few years that there should be some sort of proposal for a single rural business unit so that you do not have all these issues arising. Quite a lot of these businesses are not earning that much money. We have had feedback about some crofters, small-time farmers, with these other sources of income, who all in all are still not earning much more than the average wage in the UK.

We are not talking about big business here. We are talking about relatively small businesses, without huge profits, having to do a disproportionate amount of admin, which will get worse with Making Tax Digital. That will also get worse because of basis period reform, because they will not be able to switch to 31 March year ends—for the reasons that Emma has mentioned—because they are in the hospitality and tourism sector with things like the holiday lets. The farming does not necessarily fit with a 31 March year end either. We see quite a big impact there, and one thing that we would like HMRC to consider is treating those sorts of businesses as single rural business units.

**Viscount Chandos:** Thank you. That is interesting. Mr Piper, Mr Jones, are there other sectors that we should be worrying about, or do you have any other comments?

**Richard Jones:** We have picked up on most of the sectors. One other point worth bearing in mind, particularly in the transitional year, is that business owners who have a yearly income of about £70,000, and in the transitional year end up getting taxed twice on part of their profits, could end up falling into the next income tax bracket. That would not just affect their tax rate: they could start losing their personal allowance, their pension contribution allowance could be affected, and the child benefit charge could kick in. There could be various kinds of unexpected and potentially adverse impacts that could be dealt with in some way by further transitional provisions. I think HMRC was aware of the problem,

but how to deal with it should perhaps be put out to consultation. I would encourage further discussion about it.

**Jason Piper:** Possibly the only other thing to add is the rolling issue of Easter for hospitality businesses, particularly if you start moving to quarterly reporting and trying to estimate income over the period. Some fiscal years will have two Easter periods, and the adjoining fiscal year will have no Easters at all because of the moveable feast nature of it. We already have tax elections dictated by the phases of the moon because of how the date of Easter is calculated. There will be an ongoing issue with lumpy profits around that festival for some businesses.

**Viscount Chandos:** Interesting.

**The Chair:** We have been talking for about 25 minutes, and a number of the issues that have been raised are ones of transition, process and planning. Your question has just highlighted a sense—correct me if I am wrong—that when Making Tax Digital and BPR come in, these are structural, long-term problems that these sectors will face. In general terms, is that what you are saying to me? It is difficult to disentangle BPR from Making Tax Digital in this, because they fit together, as we discussed to start off with.

Susan, you raised very well the issues for rural businesses. Is HMRC fully alert, though, to this broader structural challenge that businesses will face in light also of the other challenges that they are facing from Covid, and so on? Is this something that you feel HMRC has a grip on? Maybe I could ask Jason Roper.

**Susan Cattell:** Sorry, I thought you were asking me.

**The Chair:** No, please. I am asking it as a general question. I should have pointed to someone, so please come in.

**Susan Cattell:** I do think that HMRC is aware of some of the issues, because these points have been raised in meetings. There are possible mitigations. We have mentioned the possibility of the introduction of a rural business unit approach, and there are other possible mitigations, particularly around the need to estimate profits. If we went for full basis period reform, people particularly with accounting dates that were late in the tax year would end up having to estimate some profits in order to come up with the assessment for the year.

There is a possible mitigation for that. Estimation in itself is a problem, but the other problem is that you would then have to re-file the return, and if your business is a partnership you would have to re-file returns for the individual partners. However, there is a possible mitigation for that, which has been suggested to HMRC: people could be allowed to put through the amended information in the following year, so they would not have to re-file for the current year—they could do the amendments in the next year.

That would improve things in some ways, because businesses would not have to file two sets of returns every year, but obviously it leaves the problem that they would still have to estimate the profits and do the

adjustments. I think HMRC is quite worried that people might deliberately put in low estimates. That would be something else that HMRC would want to look at.

**The Chair:** Does any else have any points to follow up on that point? If not, I turn now to Lord Butler.

Q6 **Lord Butler of Brockwell:** Could I pursue the question of the transition? I understand that some companies will be taxed twice during the transition on part of their profits and that they can elect to spread that over five years. I think it was Mr Jones who said that he did not think five years was long enough and asked whether it should be 10. Can you explain why? It does seem rather surprising to me. It seemed to me that five years would be adequate.

**Richard Jones:** Every case will be different. Some businesses might even suffer a loss in the period, and that brings its own complications about how to deal with it. Does the business lose its overlap relief even though it has not made any use of it because it has changed the end of the period on which it is basing its taxable profits?

Five years is probably a good solution in terms of simplicity. You do not want a transitional period going for too long, because you would then be adding more complexity to the tax system. However, the longer it is, the longer the period over which a business that has suffered double taxation can pay. It is a trade-off. I think we suggested that five years was okay, or could be okay for most businesses, but that the longer the period, the greater the reduction in hardship if there is considerable double taxation. It is difficult to say, because every case has its own merits.

**Lord Butler of Brockwell:** What do other witnesses think? Does anybody else think that more than five years is necessary?

**Emma Rawson:** We felt that five years was probably going to be adequate in most cases. However, you may have some hard cases. I am thinking particularly of businesses with a 30 April year end. What you would be bringing into account there is 23 months-worth of profits in one go. That could be quite material. There could be people who have very successful businesses now but have very low overlap profits to set off, maybe because they were loss making in their early years or just not very profitable. There could be some quite substantial tax bills for some affected taxpayers. We thought that maybe in those circumstances thought could be given to allowing people to ask HMRC for extra time. Therefore, allow up to 10 years but on application and approval by HMRC, so not in every case.

**Susan Cattell:** We suggested something similar. We suggested that five years should be the default position for all businesses, if they need it, but that there would be an option to have 10 years in exceptional circumstances, because otherwise everybody would probably just choose to go for 10 years. "Exceptional" could then be defined by reference to a set percentage increase in the taxable profits, which links to what Emma Rawson said. It is a similar idea, but HMRC would not be able to refuse: if

your excess profits were so great that they crossed the threshold, you would be able to opt for 10 years instead of five.

**Lord Butler of Brockwell:** Thank you. Companies can take advantage of the historic overlap provisions, but it has been suggested to us that not all companies will have the necessary information to take advantage of that. Is that also the case?

**Emma Rawson:** Yes. For some businesses, it will be over 20 years since they incurred the overlap profit. In other cases, businesses may have changed advisers over the years and paperwork may have been lost. The consultation document said that over half the people who are entitled to claim overlap relief do not claim when they cease to trade.

A big factor in that is possibly that they do not know what the figures are. One of the things we said in our response is that, if basis period reform goes ahead, it will be important for HMRC to be able to supply that figure to people. It may require HMRC to go back and calculate it in some cases, but if we are going to force people to use their overlap, we will have to help them in some way to work it out where they do not have the figures.

**Lord Butler of Brockwell:** Thank you. Any other comments on that?

**Richard Jones:** I agree with that.

**Baroness Noakes:** Sorry to interrupt. Does HMRC have those figures?

**Emma Rawson:** We are not entirely sure. Anecdotally, we hear from some members that when they have had to ring up and ask for them in the past, they have been given them, but others have had trouble getting them out of HMRC, so we do not have a clear picture.

**The Chair:** Can I pick up on what is behind Baroness Noakes' question; the bigger picture, I suppose? It was mentioned earlier that HMRC's support needs to be in place for this to come. How confident are you that that support is there? How much contact are you having about what kind of support is required?

**Emma Rawson:** I think that HMRC resources will be critical for this and for Making Tax Digital following on from this. As Susan said earlier, HMRC service standards are slipping at the moment and are in a quite parlous state. We hear from members quite frequently about problems they are having with getting post opened, getting answers out of HMRC. As things stand, I would be very worried that the support is not adequate. There are resourcing issues that need to be fixed before basis period reform comes in. Part of that will be about looking at who in this taxpayer population will be affected. That will depend on how much the agent community can help versus how much HMRC will have to directly support taxpayers.

**Richard Jones:** HMRC's resources will be particularly stretched, and have been over the past 18 months or so, by the coronavirus and the various support packages that have been put in place. That is therefore one factor that, as we come out of the pandemic, may help to enhance the available resource. It would take a positive decision to say, "Okay, now we can use this resource to help with this".

**The Chair:** I think, Mr Piper, that it was you who set out the need for clarity from HMRC. I am sure that, if it were here, HMRC would be saying that it will get clarity once the legislation is passed and the rules are firmer, and so on.

Given the new deadlines and timetable that HMRC, given the referral, is facing, when is the drop-dead date for us having clarity on these points, from the point of view of the businesses this will affect? How much time do we have before it becomes very difficult to implement basis period reform effectively?

**Jason Piper:** The key will probably be the software development. Software developers will be looking at about nine to 12 months lead-in time to develop something and test it. Ideally, we would then have a season of running it in one of the pilot programmes to make sure that it works. That means we are looking at 24 months already to put it through.

**The Chair:** That is quite challenging.

**Jason Piper:** Yes.

**The Chair:** Right. Does anyone else have any points to add to that?

**Susan Cattell:** I agree with Jason. The key is the software, certainly as far as MTD goes. The trouble is that if the software providers think that the basis period rules are going to change, even though the regs for MTD have already been laid they will not be developing the products.

If there are no adequate software products out there, that is a key hold-up in terms of agents getting their clients prepared, or unrepresented clients finding software. In that sense, there is not very much time to make sure that the software is there. Then people will want a full cycle to try out the software to make sure that it works. They will want to get into the MTD pilot, but people cannot get into the pilot if they do not have the software.

Having a full year's worth in the pilot means that there is not that long to go before HMRC needs to open up the pilot to everybody who wants to join it and for everyone who wants to join to have access to suitable software for their business. There is not that much time to make a final decision on basis period reform.

Q7 **The Chair:** That is very useful. I do not know if any of my colleagues want to come in on this final point before we move on to uncertain tax treatment, but, listening to all this, I have a question. Perhaps I could start with you, Mr Jones.

To what extent is this really about simplification and to what extent are we tinkering over here with one thing, which is very important, while at the same time we have the moving plates of Making Tax Digital and other changes to the tax system? Are we going to look back in years to come, when BPR comes through—assuming that it does come through—and say that this was a good move towards simplification, or is it just too confusing at the moment because we do not have clarity on these other

big moving parts, if that makes sense?

**Richard Jones:** For new businesses, this will be simplification in the sense that they will know that their tax is based on the tax year and not on a year that ends in the tax year. It is a kind of semantics, but it does make it simpler.

Therefore, it also means that there is no creation of overlap relief. As we have discussed, businesses sometimes do not keep track of what that is, and we question whether HMRC does, too. However, it also creates complexity, because it creates requirements to estimate profits arising in the second accounting period in your tax year. Overall, certainly the ICAEW view is that it creates more complexity than it simplifies.

**Emma Rawson:** I feel that this is an opportunity for simplification. If we were to start with a blank sheet of paper and design a tax system from the bottom up, we would not have what we have now. The rules are complicated. There is a reason why they are always in tax exams. They are the basic thing that we test people on.

Looking forward to the longer term, this is simplification, but we are balancing overall simplification against complexity for a smaller group of taxpayers. We have to work on that balance and do as much as we can to reduce the complexity for the affected taxpayers.

**The Chair:** Susan Cattell, do you have anything else to add?

**Susan Cattell:** I was going to agree with Emma Rawson. Of course, HMRC estimated during the consultation that 93% of sole traders already make up their accounts to 31 March or 5 April, so the basis period reform will have no impact on them at all. It will certainly be a big simplification for all new businesses. It makes the system far more comprehensible; you do not have all this messing about in the opening and closing years. However, as Emma Rawson says, there will be a small number of businesses—about 7% of sole traders, but a bit more in partnerships—because possibly about 33% of partnerships, according to HMRC, do not use 31 March or 5 April.

Some of those people will possibly change to 31 March but, for the ones who do not, basis period reform is not straightforward. You would want to be looking pretty hard at the mitigations as to how you could make it run slightly more smoothly for them if you decide to go ahead with it. A few suggestions along those lines have been made to HMRC. It is a question of looking at those in more detail to see if some of them could be taken up.

**The Chair:** Very good.

Q8 **Baroness Harding of Winscombe:** A small question for Ms Cattell. A couple of times you have talked about “full” basis period reform being implemented. What would partial, or non-full, basis period reform be?

**Susan Cattell:** That would be equivalence—the proposal to treat 31 March and 5 April as equivalent, not just in the opening years, where it already happens, but all the time, and to extend that to property

businesses. At the moment, in theory, property businesses are making up their books to 5 April anyway, but in practice the Office of Tax Simplification had a look at this when it was considering whether the tax year-end should change from 5 April, and it discovered that quite a lot of people, including property businesses, were informally using 31 March anyway. That is what I mean by it.

Full basis period reform is the full-blown proposal in the consultation. Partial basis period reform would be to bring in equivalence and say that you can make up your books to 31 March and 5 April and that would be treated as being the tax year. It is particularly important to make sure that that is the case for property businesses as well, because, informally, it is quite likely that a lot of property businesses are using 31 March anyway. It would certainly help for MTD to put that on a formal basis, as the Office of Tax Simplification has suggested.

**The Chair:** Very good. If no one has any further questions on that topic, let us move on to uncertain tax treatment, which is a subject that as a committee we have looked at before. I will start with Baroness Noakes.

Q9 **Baroness Noakes:** I know that everybody has been critical of the uncertain tax treatment proposals in the past, so I am told that we now have some improved proposals, but I believe that you still have a number of concerns. What has your view been of the nature of HMRC's engagement with the business community and their advisers in devising their latest proposals? Mr Jones?

**Richard Jones:** I have not been involved in any discussion directly with HMRC. My impression is that, given the changes that have been made and which we have seen in the draft legislation and the guidance, there have been a number of improvements, for example reducing the number of triggers that would cause a notification and having a look at some of the notification thresholds. I would say that those are improvements. Certainly, there has been active engagement. It is not something that I have been involved in, but I think there is still a long way to go to get something that is workable.

**Baroness Noakes:** Does anybody want to add to that?

**Susan Cattell:** Yes. We have been quite disappointed with the way this consultation process has been dealt with. I agree that there have been some improvements in that the number of triggers was reduced—there were also a few other improvements, such as increasing the threshold level from £1 to £5 million—but, unfortunately, although some of the triggers were removed on the basis that they were too uncertain and subjective, this new, third trigger was brought in at the last minute in the draft legislation. The problem with that third trigger is that it is completely unclear. It is less targeted and it is highly subjective. It is not much use getting rid of a few triggers if instead you are going to bring in something that, we have been told, is unworkable.

The other very disappointing thing is that this remains not properly targeted. It seemed clear to us throughout, and we said this in our multiple representations to HMRC, that the projected yield from this,

which was changed slightly between the first and second consultations, is very, very small compared with the size of the businesses within scope and compared with the size of the legal interpretation gap, which HMRC says is largely attributable to large businesses and which, therefore, it is trying to reduce with these proposals.

At its height, a couple of years down the line this is expected to raise only £45 million, but the size of the legal interpretation gap was put at £4.9 billion in the 2020 edition of the tax gaps publication. The size of large businesses that are within scope are businesses with a UK turnover of above £200 million and/or a UK balance sheet of over £2 billion. Our view is that this is obviously aimed at quite a small minority of unco-operative businesses. We have said all along that it should be targeted at those businesses rather than at all large businesses, the majority of which are very open and transparent and want to work with the customer compliance managers in HMRC more or less in real time.

They are already having problems with that because of constraints on HMRC's CCM resources. Therefore, they are very concerned about this, because they will have to put procedures in place to deal with it. That is acknowledged in the responses document. It is accepted that they will do that. Of course, that will be far more onerous for the open and transparent businesses, who already want to discuss things with their CCM and are finding at the moment that it is very difficult to do that in a reasonable timeframe because of the resource constraints.

Meanwhile, there is no guarantee that the people this should be targeted at, the minority of unco-operative businesses, will take the trouble over this that the compliant businesses will take. Therefore, it will weigh far more heavily on the open and transparent businesses, in spite of what is said in the consultation about not wanting to impose burdens on them, than it will on the people who are the real targets. We would have liked all along to have seen this properly targeted at the unco-operative minority, which seems to be where the problem lies.

**Baroness Noakes:** We were told last year that HMRC had not explained why the regime was needed. Is this about it not having explained who it is trying to get at, and it has still not done that? Is that what you are saying?

**Susan Cattell:** We have asked for clarification and it has not been forthcoming, so we are assuming that it is targeted at the unco-operative minority, simply because of what we do know from the impact assessment. HMRC must accept the problem to some extent, because it has said that it has put in the general exemption, which means that, if you disclose all the information to your CCM, you will not need to make one of these formal notifications.

The problem is that the feedback we are getting is that in practice it will not work. The open and transparent businesses will still have to put all the procedures in place to make sure that they are identifying things that they might need to disclose. Then they would need to try to disclose them to HMRC, but they already want to do that anyway. The problem is that they cannot get engagement with HMRC because of the problems

with CCM resources. They are worried that this will make that worse, because HMRC will be getting all these notifications, many of which it probably will not want because it will be the open and transparent businesses disclosing where they think there is any doubt at all and where they have not been able to get confirmation from their CCM that they have made an adequate disclosure through their discussions with the CCM.

That is the big concern: that they will end up possibly disclosing twice, in some cases, because they will get in touch with their CCM, try to disclose, the CCM will not come back to them and confirm that they have given enough information, and then they will just disclose again through this process. HMRC will then be sifting through all these notifications, which will divert resource from what the open and transparent businesses want, which is active, ongoing engagement with their CCMs to clarify matters.

**The Chair:** I am conscious of time passing. This is very useful. Does any other witness want to add to the number of key points made there, before I pass on to Baroness Harding?

**Emma Rawson:** On a higher level, the interesting thing for me is what Susan Cattell was saying about the size of the legal interpretation tax gap versus the expected revenue from this measure. If we are going to tackle that legal interpretation tax gap, which we would absolutely support, we need to look at the more fundamental things. It is driven by the complexity of the legislation, the tax code in the UK, the amount of support that people can get from HMRC, and the quality of guidance. This feels like a fairly minor thing compared to the big job that needs to be done to crack down on the tax gap.

**The Chair:** You are saying—to put words into your mouth, if you do not mind—that we need more simplicity, but this is making it more complex.

**Emma Rawson:** Yes. There is a risk of getting information for information's sake sometimes, I believe, and I do worry that HMRC, as Susan Cattell has mentioned, might get a lot of information in, might just not be able to work through it, and might not be able to target who they want to target.

**Jason Piper:** There is one other aspect that, again looking at things at a much higher level, is potentially a cause for concern. The OECD has been looking at tax morale—what drives people to pay their tax voluntarily and comply well—and has been trying to do work with big business at a global level. We have been involved in some of it.

One of the things that has struck me in the round tables discussing this is that we have the mantra of transparency and accountability, which comes back to business and the Revenue to create these open and honest dialogues. That is all great, but we also need to have public trust in the system. All too often, that kind of dialogue can end up being seen as—to use a phrase that often appears in the press—sweetheart deals.

We need to get the balance right, so that it drives the correct behaviour that is wanted but is also presented so that people understand why the revenue authorities want to do this. As Susan Cattell has already said,

business is also on board with this. Businesses want to pay the right amount of tax at the right time and have some certainty over their affairs. Unfortunately, this new third ground is not going to give them that certainty. The more risk averse they are, the more disclosures they are going to make and the fewer they probably need to make.

**Richard Jones:** I think some great points have been made.

Q10 **Baroness Harding of Winscombe:** Maybe I can drill down a bit more on those trigger conditions for the need to notify, because they have been modified quite substantially. Do they provide objective criteria that can be easily interpreted? You have all implied that they do not. I wonder if you could give us a bit more detail on what the problems are within the changes to the trigger conditions.

**Susan Cattell:** I think there are problems, particularly with trigger 2, HMRC's known position, and with trigger 3. HMRC's known position ought, in some ways, to be fairly easy to apply, but only if HMRC's known position is clearly defined in the legislation and that position can be readily ascertained.

I think the difficulty is that HMRC is still saying, and it is in the legislation, that HMRC's position is taken to be known if it is apparent from guidance, statements or other material of HMRC's general application in the public domain. Unfortunately, that still leaves you with vast amounts of information that you could be required to consider in order to work out HMRC's known position.

We have called several times for HMRC to give a definitive list of what people should have to consult, because otherwise you do not have a level playing field. In particular, in its draft guidance, HMRC has given a little table, but it is completely inadequate. It covers obvious things like HMRC's manuals and revenue and customs briefs, which clearly you should have to consult. They are official published material.

We have also asked several times for clarification on things like the minutes of HMRC stakeholder forums, because HMRC makes a statement about its position at those meetings and the minutes of those meetings are published. We are aware of a statement made in the minutes that was not available elsewhere and did not tie up with some of what was in HMRC's other guidance. That issue was taken up through another stakeholder forum and a note was circulated to members of that forum, clarifying things and changing the position again. That put some businesses at a huge disadvantage, because they would not know necessarily about either of those forums, or they might know about one of them and not the other.

We think it needs to be absolutely clear whether people have to look at things like that, which are published, are in the public domain, are HMRC official statements, because are these HMRC stakeholder forums or not? If they are, HMRC obviously needs to give a list of the forums that people need to consider and where the minutes are published. Basically, we would like to see a comprehensive list of the material that people have to look at.

Another thing that is very unclear and very unreasonable, we think, is that HMRC's draft guidance talks about where it is obvious that HMRC's guidance is outdated or contradictory and where other notification criteria do not apply that notification is not required. It is very unfair and unreasonable to expect businesses to assess whether published HMRC's guidance is out of date or contradictory. We do not think that that is acceptable at all. First, HMRC is not updating the guidance often enough, but, also, if HMRC knows that it is changing its views—it said at a stakeholder meeting that something is changing—it needs to flag the bit of the official guidance that deals with that point, or withdraw it and say, "We're updating this guidance".

We do not think that we can work with this trigger at the moment. That is a problem with trigger 2. Trigger 3 is just uncertain from start to finish, because notification will be required under trigger 3: "The Substantial Possibility trigger will only apply where it is reasonable to conclude that a court or tribunal will find the tax treatment applied incorrect in one or more material respects". There is so much subjectivity in that. Businesses are being asked to assess, and we do not know what "substantial possibility" means.

We understand that HMRC may have given indications in some discussions about the degree of uncertainty it has in mind, but that is not being reflected in the draft guidance. Some of our members have been particularly concerned, because HMRC says that it does not expect legal advice to be necessary. However, a lot of large businesses, if they are forming an opinion about whether a tribunal or court would find the treatment incorrect, would normally get a legal opinion.

**The Chair:** Baroness Harding, do you want to pick up on any of these points?

**Baroness Harding of Winscombe:** No, other than to thank the witnesses. The points are detailed and the examples are helpful.

**The Chair:** I am sorry that we are being pressed slightly for time. If there is any further factual information that you feel the committee should see to back up your points, and you can do so in writing, we would be very grateful. I want to give the others a chance to come in on these points and I will return to Viscount Chandos in a moment, unless Baroness Harding has anything more to say.

**Baroness Harding of Winscombe:** No.

Q11 **Viscount Chandos:** During the inquiry last year we heard the concerns about the cost of compliance under this new obligation. Having listened to you, I am not expecting you to feel that the cost issue has been addressed. Can you confirm that?

**Jason Piper:** Absolutely.

**The Chair:** Very good. That is nice and simple. Lord Butler, is there anything you would like to pick up on there?

Q12 **Lord Butler of Brockwell:** I want to ask you about HMRC support.

Businesses have customer client advisers. Do they have enough and are they going to be adequate to deal with the transition? I think the implication of what you said is that they will not be.

**Susan Cattell:** No, we do not think there are adequate CCM resources. We are already getting feedback that large businesses cannot get the engagement they want because the resources are too strained. In our responses to HMRC, we said, and we will put it in our written evidence to you, that that absolutely has to be addressed. There need to be more CCM resources to make this workable.

**Emma Rawson:** Also, some companies that could fall within the scope of this reform and are not part of that programme will not have a CCM. Not everyone who might be subject to this trigger even has a CCM in the first place.

**Lord Butler of Brockwell:** Yes. Is Treasury going to have to be persuaded to give the HMRC more staff?

**The Chair:** I am hearing that, despite this review, these proposals are still unworkable, even if HMRC had more staff. Does anyone feel that these proposals are workable in their current guise? I am taking silence to mean no.

I find it ironic that it is called "uncertain tax treatment", but it strikes me, from what I have been hearing, that it is just increasing the uncertainty in the current format. Could someone clarify whether the proposals in front of us have addressed the uncertainty that our initial inquiry revealed? I am hearing that we are no further forward on that point. Maybe you want to come, Mr Piper.

**Jason Piper:** Yes. As Susan Cattell started to explain, we have questions about "reasonable to conclude", "substantial possibility", and "one or more material respects". We have three separate grounds of subjective judgment there. It is not helping at all, unfortunately.

**The Chair:** Is anyone saying that it could help? Are we making any progress here? Fine. Do any of my colleagues have any further point they want to raise on this? If not, we will conclude there.

Thank you very much indeed. Let me reiterate that if there are further points on uncertain tax treatment or BPR that you wish to draw our attention to in writing, please feel free to do so. Thank you all very much. Thank you for joining us via Zoom. It is much appreciated. With that, we will end this part of the proceedings today. Thank you.