

Economic Affairs Committee

Finance Bill Sub-Committee

Corrected oral evidence: Draft Finance Bill 2021-22

Thursday 21 October 2021

4.10 pm

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Members present: Lord Bridges of Headley (The Chair); Lord Butler of Brockwell; Baroness Harding of Winscombe; Baroness Kramer; Lord Monks; Baroness Noakes.

Evidence Session No. 3

Heard in Public

Questions 29 - 44

Witnesses

[I](#): Malcolm Gammie QC, Member, Tax Law Review Committee; Bill Dodwell, Tax Director, Office of Tax Simplification.

Examination of witnesses

Malcolm Gammie and Bill Dodwell.

Q29 **The Chair:** Good afternoon and welcome to this hearing of the Finance Bill Sub-Committee. I am very grateful to our two witnesses who have come to give evidence to this panel. Would you like to introduce yourselves, please?

Bill Dodwell: I am the tax director of the Office of Tax Simplification.

Malcolm Gammie: Good afternoon. I am a barrister in practice, but I am also a member of the Tax Law Review Committee. I was its chairman, but I have now handed over to Professor Judith Freedman. I remain a member.

Q30 **The Chair:** Thank you both for coming. I will kick off on basis period reform. Maybe I can address this to Mr Dodwell first and then to Mr Gammie. Can we start by taking a bit of a step back? Could you just explain how you see proposals for basis period reform, Making Tax Digital for income tax, the call for evidence on timely payments and the OTS's study on changing the tax year all fitting together? Is there a necessity, if

they are to be coherent, to approach this in a certain way, with a certain structure?

Bill Dodwell: Thank you for that. That is an interesting question. I think the way to look at it is that Making Tax Digital for income tax requires two things: first, that individuals in business or residential landlords should keep records digitally; and, secondly, that they should upload those records to HMRC every quarter. That is all there is to it, really. There is nothing else within it, and the ambition of HMRC in designing this is really to reduce the tax gap through error or carelessness, because it is hoped that, by people keeping their records on a timely basis and keeping them digitally, there will be fewer errors creeping through into the tax system.

One of the issues for it is how exactly you bring this in when many self-employed people and residential landlords do not currently keep their records digitally. Many do, but we are talking about a population of something like 4.2 million individuals here. Many of them will not currently have digital records. Quite a lot of people, including the Office of Tax Simplification, have made the point that, if you are going to take on a software package, or accounting system if you like, to help you do this, it is so much easier to do your counting by reference to a calendar month-end rather than by reference to the UK's idiosyncratic 5 April year-end.

The question is how best to achieve that. People started making these comments, and the Office of Tax Simplification thought it was a good idea to look at whether the UK should change its tax year. The biggest point I want to make up front is that we do not think it is possible to change the tax year from 5 April to either 31 March or 31 December before the start date of Making Tax Digital for income tax. We published our report just before the year's deferral was announced, but that year's deferral makes no difference to our conclusion. We do not think there is enough time, given the planning and the systems changes that would be needed, both in the public sector and in the private sector, to allow for that change to take place beforehand.

Our report on the tax year-end did not recommend specifically that the Government should change the tax year. We have very much left that to the Government, because although it is obvious to all of us that 31 March or 31 December would be much more logical and much easier year-ends to accommodate in the tax system, the cost of change and the transitional provisions needed to do that are sufficiently complicated and would take quite a lot of planning, so you cannot just say, "Let's go for the simple answer of picking one of two of those straightforward dates", without taking account of the difficulties in making the change. That is why we have left it to the Government

But we also believe very strongly that it cannot be done before Making Tax Digital for income tax, and it probably should not be done until quite a few systems changes have worked their way through, such as HMRC's planned single customer account, which is an online tax account for

everybody in the UK. It is best for that sort of thing to be implemented before we get into the issues with changing that.

If we then move to the question of basis periods, this is something that was sprung probably on everybody by HMRC, with very little notice and a very short time indeed for any form of consultation. It has one or two good points, but, overall, my view is that it should not go ahead in the way in which it has been announced so far by HMRC. The disadvantages of the plan outweigh any of the possible advantages, generally.

The disadvantages are essentially that anyone who was using a tax year other than 31 March or 5 April would, under the proposals, have to apportion their profits. That means that if you are trying to work out your profits for a tax year, you would take a slice of the profits for the accounting period that ended in the tax year and a slice of the profits for the period ending after the tax year. That has a massive disadvantage, in that the tax year would come to an end and anyone with this different year-end would not know what their taxable profits are for the tax year. As a matter of principle, that is entirely wrong. It is complicated and it is quite unnecessary, too.

For some year-ends, when people came to put in their tax return, they would not even have the figures for the second accounting period, so they would have to estimate. Then within a year later, they would have to do an update, too. Again, that is a complexity that is far too unnecessary for what we need to do.

We have different ideas as to what we would reasonably do instead, but those are the two biggest disadvantages of the basis period reform currently proposed.

There are also all sorts of difficulties with the transitional periods but, given that in principle I would rather it did not go through, I will leave those for later.

The Chair: That is very kind. That is a very fulsome answer. Mr Gammie, would you like to comment on the overall picture and where we stand with these different components of change?

Malcolm Gammie: I will say a few words. It is not an aspect that the Tax Law Review Committee has looked at specifically, so my comments are purely my own experience as a taxpayer who has to make both VAT and income tax returns.

The principal consideration is that, to the extent that there are these changes, there is sufficient time given to adapt to them, because there is sometimes an assumption on the part of the Revenue that people spend all their time thinking about how they should deal with these things rather than actually earning their livings. These are not always straightforward changes to adapt to.

Speaking purely personally, I am now on Making Tax Digital for VAT, and it takes me more time and costs me more money to do it than when I was previously submitting my own VAT return, so I do not have a particularly favourable view of Making Tax Digital from a VAT perspective,

but, to the extent that it is extended to income tax, my principal consideration would be that you do not end up having to make separate returns for VAT and income tax at different times in the year. For example, my year-end is 31 March; I make up my accounts to 31 March. But that does not correspond to my VAT quarters. So to the extent that Making Tax Digital is extended to income tax, my principal concern will be that it is made uniform with VAT, so I do not end up having to make eight returns during the year rather than four.

The Committee suspended for a Division in the House.

Q31 **Baroness Kramer:** I have to confess, Mr Dodwell, as I listened to you and thought about the potential further changes, I became extremely worried about the turbulence. We know now that the transitional year for basis period reform will be 2023, followed by Making Tax Digital now in 2024. Frankly, can businesses, especially small businesses and the self-employed, cope with this constant cycle of change, or do we need periods for the new systems to bed down before we make yet a further change?

Bill Dodwell: There are a number of points to make. The first is that the majority of self-employed people currently prepare their accounts to 31 March, like Mr Gammie does, or to 5 April. The Office of Tax Simplification has proposed that the Government should formally enact that 31 March should be deemed to be the same as 5 April. In other words, you should not have to do a funny five-day split or something like that just to deal with tax, but, as I say, the majority of people already use that tax year. They will not be affected by the basis period changes in the same way that others with different accounting year-ends will be affected.

It is a minority of people. It is probably worth saying that there are a lot of partnerships that will be affected. The UK is one of the leading economies for professional services. Many of the large international professional service partnerships have a very significant UK presence. Almost all of those would be affected. A US partnership will almost certainly use the 31 December year-end, as would a German partnership. The larger professional firms, such as PricewaterhouseCoopers and Deloitte—I was formerly a partner there, I should declare—use year-ends like 31 May, 30 June or something like that. All of them would be really badly affected by this.

There are a number of individuals who have 30 April year-ends. Thirty or 40 years ago, it was sensible to start with a year-end like that, because it would defer the time when you had to pay some tax. You will probably recall that inflation at the time was 15%, so deferring payment of a debt, your tax bill, was perfectly sensible advice at the time. Today far fewer people go for that sort of thing; 31 March is actually the easiest for a small self-employed business individual.

Having said that, if the basis period changes go through as currently set out, there is not enough time to deal with that fairly. There is too much of a burden on HMRC, as well as on accountants, tax advisers and the individual businesses. They would need at least an additional year in the process to get through this quite safely.

You will know at the moment that, because the Government have not decided whether to go ahead with basis period reform—as I say, I hope they will make some changes to it, for the reasons that I have just covered—it is really hard for people producing accounting software to know what exactly they should be doing, how they can set up the system and all that sort of stuff.

Baroness Kramer: Would it be accurate to say that there are a lot of businesses in the hospitality and tourism sector, and indeed a lot of the retailers, that, particularly because of their business cycle, choose to have a different year-end? Are we looking at the very groups that have been greatly whacked by the whole Covid experience having more a more difficult challenge?

Bill Dodwell: Yes, and I would put in agriculture. An awful lot of farming businesses do not use 31 March as year-end. Some do, but an awful lot do not because they want to know what sort of harvest they have. It does not make sense to draw up your accounts on 31 March when your crops are still in the ground and you have no idea how to reasonably value them. You do not know what the weather effect will be and all that sort of thing. Yes, lots of businesses use these things for perfectly sensible commercial reasons.

Baroness Kramer: I just wondered, Mr Gammie, if you thought that the timetable of change was too tightly packed for us to make change.

Malcolm Gammie: Certainly when the original proposal was made it struck me as amazingly short, particularly looking back. I was involved in the move to self-assessment in the early 1990s. That was a process, although maybe a larger process, that took five, six or seven years from beginning to end to work it out. It seems to me that you need these longer periods, particularly for the reasons that Mr Dodwell identified.

A lot of these businesses are in retail, which traditionally have 31 January year-ends, or in farming and so are tied to their particular crops or the like, and professional partnerships, which are frequently governed by international considerations. Australia has a 30 June year-end for its tax year and America has 31 December, as Mr Dodwell indicates. All these things take a huge amount of planning and software adjustment to be able to deal with them.

The Chair: Thank you very much. I think Lord Butler's question will flow very nicely from what we have just been hearing.

Q32 **Lord Butler of Brockwell:** Yes. Pursuing the question of the connection between these things, what difference would it make to Making Tax Digital if basis period reform did not take place at all?

Bill Dodwell: It would be simpler to do. There would not be the significant issues with making a change. If basis period reform were to happen, some people would do their best to change their accounting year. That is an issue of complexity as well. Not having basis period reform would make it much easier to land successfully Making Tax Digital for income tax.

Malcolm Gammie: I would agree with that. Most of the larger businesses run their businesses fully digitally anyway, so the non-digitalised part of the economy is, I suspect, far more the smaller businesses and the like, which may not be so much affected by basis period reform. The large ones, where all the complications will arise, will be fully digitalised already, so I assume they will cope reasonably well with the introduction of Making Tax Digital.

Lord Butler of Brockwell: To which would you give priority, Mr Dodwell, if you were the Inland Revenue?

Bill Dodwell: There is a real issue here. If the Government are absolutely committed to basis period reform, then logically it would be best to adopt that before digitising the accounts and rolling forward into that new system. As I say, I think that would require additional time to do compared to the current timetable. If the Government decided not to go ahead with aspects of basis period reform or did it in a different way, you could easily keep to the existing timetable, I would have thought.

Malcolm Gammie: I have not given it a great deal of thought, but that seems realistic. I suspect a lot of this is to do with how you adapt existing accounting systems and the like. I suspect it might be more logical to do basis period reform so that accounting systems can be adapted to that new timetable, and then Making Tax Digital follows on from that, but I am sure Mr Dodwell has given this a lot more thought than I have.

Bill Dodwell: Can I just add one clarification, which is that the Government's proposal is that partnerships should not join Making Tax Digital until 2025, so one year later? It has no timetable for the largest and most complicated partnerships. All the partnerships would be affected by basis period reform, but some will have an extra year for Making Tax Digital and some do not know what the timetable is, if at all.

Q33 **Baroness Noakes:** My question was going to be about the balance of simplification on the one hand in getting rid of opening and closing year rules compared with the problems of estimation, but, Mr Dodwell, you were pretty clear earlier that the estimation problems are very significant for those who do not have accounting years that are coterminous with the tax year. That implies, and I think you said, that you would keep the basis period. You did say that you had some ideas about how that could be dealt with. If they are not hugely complicated, could you outline them to us now?

Bill Dodwell: Yes, of course. There are two possibilities. The first is to mandate, or give very strong encouragement, that individuals starting up in business should use the tax year, to get as many people as possible who would be most affected by this to use the 31 March accounting year.

That would be simplest for them, would be the easiest thing to adopt in the system and is what most people currently do anyway. Mandating would not be the end of the world. You would have to exclude from that businesses coming to the UK. If a new US partnership comes, of course you would not want them to have to find a new special tax year for the UK alone, but a UK individual starting up could go along those sorts of routes.

You are probably aware that what happens is when you start up in business if you have an accounting year that ends in the first tax year when you started, that is fine; that is what you report. If you do not have anything, you have to do an allocation of the profits earned in that very first tax year and then you tax all profits in the second year. That is the overlapping or the double tax of the same profits, if you like. There is part of tax in year one and the whole lot of tax in year two. It is that overlap that gives rise to this additional overlap relief, as it is rightly known, which is offset against your retirement profits when you come to an end.

A different approach might be not to have a tax reporting, if you like, in the first year, and simply to go with whatever your accounting year was in year two and deal with that. You would have to have some provisions to make sure that your accounting year had to end in the second year. You could not have a five-year accounting period or something contrived like that, but you could do something like that.

It is important if you look at that to separate the question of payment of tax from drawing up your accounts and sending in your tax records for that. There is no reason why you should not be asked to pay your tax a bit earlier, closer to when you are actually earning the profits. Certainly, the work of the OTS shows that some of the very smallest and lowest paid do not like having these large bills twice a year. They would much rather pay more frequently and be more on top of their tax affairs. It would be important, as I say, to separate payment from tax assessment.

Baroness Noakes: Thank you. I do not know whether you would like to add anything to that, Mr Gammie.

Malcolm Gammie: No. I am happy with Mr Dodwell's reply.

Q34 **Lord Monks:** Could I just probe this a little further, particularly with Mr Dodwell? To what extent is the basis period reform a simplification? The way you just outlined it in response to Baroness Noakes seemed to me, as very much a layman in this matter, rather a liberal approach. New firms could be treated rather differently from established firms. Arriving American partnerships could get some special treatment and so on. That sounds very complicated and very tricky to administer if people are claiming some bespoke treatment of some kind.

Bill Dodwell: It is worth bearing in mind that the self-employed population is, as I say, about 3.5 million, and I think there are about 700,000 residential landlords, which leads to that 4.2 million people going into Making Tax Digital for income tax. The vast majority of those self-employed individuals do not earn a great fortune. They are people

working on their own. They are commonly tradespeople. One of my daughters is a chef. Occasionally, she has done some self-employed work. That is an example.

Treating people with very simple tax affairs in a different way from those with very complicated tax affairs is a perfectly sensible way to do it. It is something which the UK tax system and tax systems generally do: suit the rules to the complexities or otherwise of the business you are considering.

Lord Monks: Is that not extremely difficult for HMRC to administer?

Bill Dodwell: I do not think so. We already have a bunch of different rules that apply if you are a small business compared to a larger business. I would readily agree that around the boundary it is always possible that there could be one or two hard cases, but so long as you have a clear definition of who is in what, it is not very hard to set up a system that works differently for micro businesses compared to large businesses.

Lord Monks: Mr Gammie, is there anything that you would like to add?

Malcolm Gammie: No, but on your final point about the Revenue, I would say that of course the Revenue is having to run a variety of different systems where you have these different elements, and it is very much for the Revenue to decide how it handles that and whether it can cope with it. From the individual's perspective, they merely have to run the system that they are involved with and, as long as they have clear and straightforward rules, for the vast majority it is as straightforward as tax can ever be.

Q35 **Baroness Harding of Winscombe:** I would like to take you to the transition arrangements. Mr Dodwell, you alluded earlier to your concern about the time available for transition, but the basis period reform transitional year will bring significant additional profits into charge. What is your view of the transitional provisions in the round? Do they do enough to mitigate the additional liability?

Bill Dodwell: In general, they do not do enough, because they do not deal with some of the more complicated affairs. How, for example, would you deal with a partnership where some of the partners retire? In most partnerships, partners retire every year. How would you deal with that, because income tax is a liability of the individual, albeit it is often paid on their behalf by the partnership? I am not sure that there is an easy answer for that.

First, the overlap relief and the saved-up relief is offset against the profits brought into charge and it is the excess that is then spread over five years. But, as I say, the complexity comes because of retirements and stuff like that within partnerships, and how exactly that is going to be dealt with just is not clear. I know that some of the people working specifically with professional partnerships have made some suggestions to improve the transitional provisions generally. They are the sort of

detailed changes that are best worked through with HMRC if it is going to go ahead.

- Q36 **The Chair:** Just quickly, before I turn back to Baroness Kramer and Lord Butler, this change has been positioned as one of simplification, but if you are a farmer or a very well experienced group partnership in the City, say, you are not involved in your current accounting arrangement because it is foisted upon you. You are doing it because you choose to do so. Also, if you are a farmer or any of these partnerships, you will probably have been doing so for a number of years. So I cannot quite see why this is something that has been positioned as a great simplification of the system as opposed to what it clearly is, which is just an effort to close the tax gap in what strikes me, given what you are saying, as rather a clumsy way. Is that fair, Mr Dodwell?

Bill Dodwell: Overall, I do not think it is a simplification, no. Anyone who wants the simplest tax affairs and starts up in business today would be best advised to do their accounts to 31 March. None of the issues we have talked about of basis periods and overlap relief would affect that individual at all. It would all be simple and straightforward for them. We currently already have means of simplification, and most people adopt them already for new people starting up in business. For anybody currently in business with a different year-end from 31 March, it is a massive complexity.

- Q37 **Baroness Kramer:** Could I just follow up on this issue of global partnerships, because the accounting and law firms are a very significant underpinning to financial services and other major sectors in the UK? Would your view be that it will be a nuisance, it will be costly and it is terribly annoying, but they will simply suck it and take it because the UK is such an attractive place in which to locate yourself, or will they start to say, "Look, enough already", and use it as a spur to look elsewhere. Will it have an impact?

Bill Dodwell: Do I think that businesses will leave the UK? No, I do not. Businesses are here because the UK is one of the largest developed economies, and if you have an existing business here I cannot really see that it would make sense for you to take it somewhere else, so I do not think that will happen. What I think you will find is significant cost and complexity. That is the problem from all this, not emigration.

Baroness Kramer: Would it discourage those who are deciding where to locate, or is this just such a marginal issue that it really would not affect the decision?

Bill Dodwell: Let us say there is a US law firm that does not have a presence in the UK and is thinking of coming to London. They will probably still come, because the fact is that English law is recognised around the world. It is a really important market for them. They will not be happy about the costs and complexities that they face and they will certainly have to pay a lot of people to help them through all that.

Particularly for an overseas firm, or indeed one of the UK-based firms with overseas operations, there will be challenges and probably double tax, because the way in which the UK rules work will not align sensibly with the way in which overseas rules work. Everywhere else overseas does not have this weird idea of apportioning profits from two different accounting years to a tax year. They do it in a different sort of way.

Baroness Kramer: Do you have any additional thoughts, Mr Gammie?

Malcolm Gammie: Merely that it depends very much on the type of business. Professional services firms, in the sense of legal and accounting services, need to be here because that is the market in which they are practising. If you looked at, for example, investment managers or other hedge-fund-type financial business of one sort or another that conduct themselves as limited liability partnerships or ordinary partnerships, it is a factor to take into account, but I could not say that it would drive them away.

Q38 **Lord Butler of Brockwell:** Mr Dodwell, I ought to know this and I apologise that I do not. I know that the Office of Tax Simplification gives independent advice to the Government, but are you set up by the Government?

Bill Dodwell: We were originally invited into being by the coalition Government in 2010. Then we were given statutory authority under the Finance Act 2016. We are an independent office of the Treasury. That means that we have a largely independent board, the majority of whom are independent, but we include one person from the Treasury and one from HMRC. Our services are provided to us by the Treasury, which is handy because there are only about a dozen of us generally, but we are independent in that sense.

Lord Butler of Brockwell: I do not want to be offensive, but listening to the evidence, it strikes me that the Treasury and HMRC do not take your advice quite as you were set up to give it. Particularly, I ask this in relation to the issue of basis period reform, which you first raised as long ago as 2014 and on which the Government consulted in 2016. Why, in your view, have they delayed this change so long and introduced it at a time when it interacts very uncomfortably with other changes they want to make?

Bill Dodwell: You would have to ask someone from HMRC why this plan has been devised at this very late stage with so little time. There is a suspicion—it is nothing more; I have no evidence to support this—that there may be some complexity in programming the HMRC systems for Making Tax Digital for income tax. We would have thought that overlap relief and basis periods are not so hard to deal with, so we would be surprised if that was the true reason. It was produced in a real hurry. It has not met any of the sensible hallmarks of making tax policy. It is something else that was introduced in 2010 by the coalition Government and it has just come out of nowhere.

Lord Butler of Brockwell: Are you disappointed that your advice is not taken more precisely?

Bill Dodwell: We are an adviser. I spent my career as an adviser formerly in the private sector, where I was a partner in Deloitte. As an adviser, you do your best to persuade, but ultimately you are not the decision-maker. In this case, the decision-maker is the Chancellor and the Government. We will do our best to encourage the Government to make some changes on this particular issue and adopt some of our recommendations, but some of them are entirely decisions for the Government. It is also worth acknowledging that there are elements of matters of opinion in how best to approach certain tax issues generally.

Lord Butler of Brockwell: I understand. I have a lot of experience of that.

The Chair: Can I just clarify something, just picking up on Lord Butler's point? I should know the answer to this question, Mr Dodwell. When something like this proposal is first mooted within HMRC, does it, as a matter of course, on other issues—not this one—beat a path to your door and say, "What do you think about this?" and, in its submission to Ministers, have your view attached to the submission? Is that what is meant to happen?

Bill Dodwell: No, there is nothing formal that requires that any proposal should come to the Office of Tax Simplification for a view. As a matter of practice, on occasion—and it is on occasion—we are asked for some thoughts and comments, and if we have some evidence or a basis to help, we will make some sort of private comments, but that is all it is. Our job as the Office of Tax Simplification is really to look at the systems we have rather than get involved in the budget process and stuff like that.

The Chair: Thank you very much for that. That was very useful indeed. Let us turn to uncertain tax treatments. We will probably focus most of our questions at Mr Gammie, but we will also be very interested in your views, Mr Dodwell, where appropriate and where you want to offer them.

Q39 **Baroness Noakes:** The Financial Secretary to the Treasury told this committee last year that the proposals for notifying uncertain tax treatment were being withdrawn to allow for further consultation to get the policy right. How far has that been achieved, Mr Gammie?

Malcolm Gammie: It has not really been achieved at all, in the sense that the policy has always been rather opaque. It has been presented as there being an element of the tax gap figures that is attributable to legal interpretation of the tax rules. Of course, there are very good reasons why you calculate or try to work out what the tax gap is to work out how successful your measures are, but as a basis for proposing something such as this notification requirement, it does not seem to be a very sound policy basis to start your thinking. In my view, your thinking starts from identifying your compliance problem, because if you can improve on compliance, hopefully you will close some of the tax gap, but that does not mean that you start from the tax gap and work out from there.

The Revenue, to my mind, has never seriously articulated the problem that they have identified which this measure is designed to address. One

can make guesses as to what they might think the problem is, but that has never been satisfactorily articulated, which is why the proposal really should have started at the first stage of consultation, where you actually set out the problem and make proposals as to how you might address the problem, rather than starting, as it did, at stage two, which is where you are looking at what you want to do rather than addressing what the problem is and how you might address it.

Really, we have just continued from stage two onwards into legislation, and without that sound policy foundation for why you are making this proposal, it is very difficult to assess whether it is a satisfactory response—indeed, whether there are better alternatives for dealing with the problem that you have identified—or whether this is really the only way to address whatever the Revenue feels is wrong with the current system.

I see those flawed policy foundations as the major problem with the proposal. When I say that we have not resolved that particular problem, in some ways you could say that a bad idea does not become a good idea just because you tinker with the detail of it. There has been a certain amount of tinkering with the detail of this proposal, which you might say has improved it, but if it was a bad idea to start off with, it does not make it a good idea at the end of the day.

Baroness Noakes: Last year, you said HMRC had failed to give an explanation of the policy and you say that it has failed again now. You said also that it needed to go back to square one and start again, which it did not do. It has changed the proposals, so it has had some active consultation. Having changed the proposals, despite these fundamental flaws that you refer to, are the proposals better?

Malcolm Gammie: Again, I could express it in the way that I just have. They are better in the sense that they are less bad. HMRC has responded to the consultation and I must acknowledge that, but one of the fundamental issues, apart from identifying the problem and whether this is the best way to address it, is that you can see that this is imposing a requirement on all business, however compliant a business is.

When the vast majority of the larger businesses at which this is targeted are fully compliant, they will want to comply with this further compliance obligation that is being imposed on them. That inevitably has a cost for the businesses concerned. So although you might identify certain benefits that flow from it, a cost-benefit analysis does not necessarily mean that what it is costing productive businesses to engage in wholly unproductive activity—such as employing people like me, accountants, lawyers and so on to work out whether the Revenue has a clear view about any particular issue that you are being asked about—is helpful to productive business.

The Chair: Mr Dodwell, you were nodding at certain points there. Before I bring in Lord Monks, I just want to ask you to say what you think about this proposal as it currently stands.

Bill Dodwell: The first thing to say is this is not the core business at all of the Office of Tax Simplification. We do not spend our time with large business, by and large. I would simply say that, when these proposals came out a year ago, my reaction and some of my colleagues' was one of surprise, because we were not aware that there was a problem and we could not see from the proposals what the problem is, just as Mr Gammie has elucidated.

There may be a small number of businesses that do not provide sensible information to HMRC. HMRC may be trying to reduce the effort required from its tax offices and customer compliance managers dealing with the large businesses, but my first reaction was, "Why aren't the customer compliance managers getting this information already? Where is the issue?" That was my biggest and most important reaction.

As Mr Gammie said, there is nothing to give any further sense as to what the problem is and the scale of the problem generally, so it remains a bit of a mystery. I absolutely agree about the cost of implementing. One of the dangers with measures of this sort is that they do not necessarily fix the very small minority who are not completely helpful and straightforward, but they impose a burden on the vast majority who are doing their best.

Q40 **Lord Monks:** Mr Gammie, I very much take it that you are basically now saying that, despite the changes that have been made, the definition of uncertain tax treatment is not sufficiently certain and lots of problems remain.

If I can link that to another point that you made, I take it that you were saying that, with the need for experts to be brought in on a number of angles, it is not possible to easily identify where HMRC is on a particular thing, and that its known position, as it is called, is unknown to very many people and looks as though it will continue to be so.

Malcolm Gammie: Yes. One only has to read the draft legislation and how it defines uncertain tax treatment to see that it is exceptionally difficult to fix exactly the scope of the obligation. The Revenue has published a substantial amount of guidance to try to explain how it will operate this.

Theoretically, if the Revenue chose to apply it in a very liberal way and soft manner, it may not present too much difficulty and it would not impose as much cost as one fears that it might. On the other hand, businesses, particularly compliant businesses, have to look at what the law says. The simplest way of illustrating it is to say, "They may come and ask me what my view of the law is. They'll now have to ask what me what my view of the Revenue's view of the law is. For that I will have to trawl through vast amounts of Revenue guidance on different legislative provisions, which may be entirely opaque".

Indeed, just picking up a point that Mr Dodwell made, compliant businesses want to be sure that they have complied with this obligation and that they are not at risk of the Revenue turning around at a future

stage and saying that they are subject to a penalty for having failed to tell them something. For businesses that are slightly less concerned about these matters, it is all too easy to say, "The Revenue guidance on this issue is not clear, so actually there isn't a known position for the Revenue". You really have conflicting aspects of all this, which do not add up to a particularly happy place.

Apart from whether something is known to the Revenue, also assessing whether there is a substantial possibility that a tribunal may or may not agree with your view of the law is again a pretty impossible test to try to comply with. About the only element, I suspect, within the current rules or definition of uncertain tax treatment that has some better or more solid foundation is the reliance on accounting practice.

I am sure Mr Dodwell, as an accountant, will tell me that accountants can reach many different views as to what you should or should not provide for, but there is at least some element of objective certainty about what companies will provide for in terms of uncertain tax treatments, and there are accounting standards to deal with that, so that element may not be too difficult. But what is a known position for the Revenue and what is a substantial possibility that a tribunal may or may not agree with you are completely vague concepts.

Bill Dodwell: At the March Budget it was announced that HMRC's large business directorate would consult on ways of trying to enhance business certainty. I believe that it has carried on this consultation over the following months. We may well see something announced about this either at the Budget or maybe at the tax day that follows the Budget, assuming we still have one, as we did last time. That sort of approach could be aimed at helping to ameliorate some of the challenges here, but we will just have to wait and see what comes out of that.

Q41 **Baroness Harding of Winscombe:** The proposals include a specific exemption where areas of uncertainty have already been discussed between the business and its customer compliance manager. Will that be effective in reducing the burden of this measure on businesses that already share with HMRC? If not, what else would you need to do?

Malcolm Gammie: The legislative provision is very bald. It just says that dealings with the Revenue by or in respect of the company or partnership may count effectively to avoid the notification obligation. This will depend very much on the way in which the Revenue publishes the detail of the notification requirements—in other words, what details have to be given and, therefore, the extent to which communications with the customer compliance manager actually counts as notification or at least removes the notification obligation.

There are really two particular aspects. Apart from the way in which the Revenue chooses to administer this, I suspect that large companies that wish to be compliant will want to put matters on a formal basis so that they actually know that they can rely upon what they have told their customer compliance manager. These people do not stay the same; they change, and if you told the previous contact that you had something, you

want to be sure that it is on the file so that his successor takes it over. There will, I suspect, be a greater degree of formality that will creep in on this.

At the same time, large businesses will still need to review, when they submit their returns, that they have covered everything that they need to do to ensure that they are covered either by the exemption or have complied with the notification obligation. At one level, it is how the Revenue chooses to administer it, but, at the other end, compliant businesses will still need the assurance that they have done whatever they need, whether that is talking to their manager or formally notifying.

Baroness Harding of Winscombe: How well do you think businesses that do not have a compliance manager will cope? What should we be doing to support them?

Malcolm Gammie: Again, that depends a little on what the Revenue is putting in place. It may be that Mr Dodwell will recall where that stands. In the second consultative document, the Revenue said that it would consider putting in some measures to deal with businesses that are in that position, but I am not sure whether anything more has been said since as to what systems will be in place for that.

Bill Dodwell: I am afraid I cannot add anything to that. I do not know the answer to that one either.

Q42 **The Chair:** Mr Gammie, last year during the inquiry you said that the compliance costs for businesses could significantly exceed the expected Exchequer yield. Is that still your view? Related to that, given your extensive experience in this area, were this proposal to be enacted in its current form, how would it affect our international competitiveness? Would it make any difference at all? Is it completely at the margins? Will compliance teams say, "This will heap even more on to costs here and could make a material difference"?

Malcolm Gammie: In relation to the first part of your question, a figure has been put on it in terms of the supposed saving in the tax gap. So far as I am aware, no specific methodology has been suggested as to how the Revenue has arrived at that figure. In my written comments I suggested that it was probably just a matter of guesswork. The Revenue does not necessarily have a brilliant track record in anticipating or predicting these sorts of costs, and how they have arrived at it is a mystery, in the sense that they have not explained their methodology.

In terms of compliance costs, you can actually work that out relatively straightforwardly. This was almost the approach that we adopted in looking at the previous proposals. You take what the Revenue say is the Revenue yield, which might be pure guesswork, divide that by the number of large businesses out there that have to comply with this, and work out how much per business is involved.

Actually, you find out that large businesses, a lot of which will have large professional firms and large accounting firms acting for them, will not have to incur very much in terms of professional time to comply with this

and to find that it is more than the yield that is anticipated. Ultimately, it will all just get wrapped up in the general compliance costs, so it will be very difficult to identify a single figure, but undoubtedly there is a cost to that.

I have not thought specifically about competitiveness. Of course, the complexity of a tax system, what international businesses thinking of coming into the UK will have to do to comply with it and the way in which the Revenue administers the system are all very important considerations and may impact upon a choice to come here. This is not necessarily a significant addition to those sorts of factors.

Q43 **Baroness Kramer:** Tell me if I am wrong, but if I understand our experts correctly, the position would be that HMRC is seeking to answer or solve a problem that does not actually exist to any significant degree, in the hope that somehow this will produce a significant contribution to closing the tax gap. If there really is no underlying problem of any significance, will it see the kind of closing of the tax gap that it anticipates and argues for, or is that just wishful thinking?

Malcolm Gammie: I would have thought that it is impossible to identify how much of the tax gap it has closed. There is no relationship between this proposal and the tax gap in the way in which it is presented.

There may be a number of large businesses out there that take views of the law and report their tax liabilities on that basis in a way with which the Revenue would disagree or might want to challenge if it knew about it. If the Revenue does not know about it, it does not know what the problem is anyway, because you cannot know what you do not know, if I can put it in those terms.

Assuming that there are a number of businesses doing that, it is completely unclear to me why that necessarily means, as the Revenue asserted in its second consultative paper, that things will get cleared up quicker and there will be fewer disputes before the courts. You would have thought that it would add to the number of disputes before the courts. If there is one thing that takes a long time, it is taking a case to court. Many of them may settle, but all this is complete guesswork.

Q44 **The Chair:** This has been a fantastic session. Thank you both very much. Both these proposals in their current guise strike me, given what you have been saying, as adding complexity to the tax system. We are, again, seeing HMRC and its masters pursuing them with haste, without really taking into account how these proposals will be implemented and the damage that they might cause to businesses. Is that a broadly fair summary?

Bill Dodwell: I would be very keen that HMRC thinks again about aspects of basis period reform and finds better ways to deal with the objectives here. That would be a really good idea. A longer period hopefully will give some choice of that. I would feel much more comfortable with uncertain tax treatment if we had a better understanding of the rationale for it. Otherwise, it seems just a burden.

Malcolm Gammie: They address different aspects. The uncertain tax treatments are a compliance obligation. The basis period reform is on the administrative and tax computational side. They both add to the burdens and, to be justified, they need to be better explained. I would not disagree with what Mr Dodwell says about the basis period reform.

The Chair: Thank you both very much indeed. Thank you also for adjusting your diaries to fit in with us. We are most grateful to you both. With that, we will end this first panel.