

Economic Affairs Committee

Finance Bill Sub-Committee

Corrected oral evidence: Draft Finance Bill 2021-22

Thursday 21 October 2021

5.20 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. 4

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Questions 45 - 57

Witnesses

I: Rebecca Benneyworth, Member, Administrative Burdens Advisory Board; Mike Cherry OBE, National Chair, Federation of Small Businesses; Andrew Chamberlain, Director of Policy, Association of Independent Professionals and the Self-Employed.

Examination of witnesses

Rebecca Benneyworth, Mike Cherry and Andrew Chamberlain.

Q45 **The Chair:** Good afternoon and welcome to this second panel of the Finance Bill Sub-Committee. I am very grateful to our witnesses for joining us this afternoon. Could I ask them to introduce themselves?

Rebecca Benneyworth: I am a chartered accountant, and I am here on behalf of the Admin Burdens Advisory Board, which advises HMRC about the burdens the tax system puts on small businesses.

Andrew Chamberlain: I am the director of policy at IPSE, the Association of Independent Professionals and the Self-Employed. We have around 12,000 members currently. They are a mixture of incorporated and unincorporated businesses. It is those that will be impacted by what we are discussing today.

Mike Cherry: Good afternoon. I am the national chair at the Federation of Small Businesses.

Q46 **The Chair:** As I am sure you are aware, a number of tax bodies wrote to the Financial Secretary back in August expressing concern about the

timetable for introducing basis period reform and Making Tax Digital for income tax. As you know, the Government have announced a one-year delay. Can I ask each of you, just briefly, as there are three of you, to tell us your views as to whether that delay is sufficient or whether we are still going to see too much change too quickly, given the introduction of Making Tax Digital, and anything else that your members are experiencing?

Rebecca Benneyworth: The delay is very welcome. As a practising accountant, I am very relieved to hear about the delay because it gives me more time to support my clients. From ABAB's point of view, we have been concerned about the need for small businesses to get themselves on to digital records and to prepare. There is still a little bit of a worry not so much that there is not enough time to get ready by 24 April, but that there still is a lot going on at the same time. I understand the desire to try to simplify ready for Making Tax Digital, but it still means that we are trying to get through an awful lot of change in a relatively short period of time.

Andrew Chamberlain: Very much like Rebecca, we welcome the one-year delay. We have noted that this proposal on basis period reform and indeed Making Tax Digital for income tax self-assessment are all part of a raft of changes in the tax system. Some of them have already been implemented; others are proposed and in the making. It is causing a lot of uncertainty for business. There is a lot going on all at the same time.

We are not against much of it, but the timetable has always been a cause of tension between industry and the Government. With Making Tax Digital, the Government have always wanted to push ahead a much faster timetable, with industry suggesting, "Could we slow this down a bit and do this at a considered pace?" We wonder whether we could hit the pause button for a bit and think about whether we have enough time to do everything. Some businesses will be affected by basis period reform. I am not quite sure that we have really considered how we are going to square that circle at the moment, so a bit longer than one year's delay might be welcome.

Mike Cherry: From our own 2021 tax survey, we found that 70% of small businesses have so far switched to MTD: 60% through the VAT requirements and 11% optionally. Given that the remainder of small businesses will be required to file through MTD in 2022, pushing back the ITSA by one year is a good start. We have always said on any tax changes that small businesses require a longer transition period, particularly at the moment, when they are coming out of Covid and all the other issues that they are faced with. As I am sure you are aware, they do not have dedicated tax teams within their businesses.

The costs of MTD so far are also quite high. Our survey shows that it takes 52 hours a year, at a cost of over £4,000, to complete their tax liabilities. Additional tax burdens only take away more valuable resource from less productive activities and running their own businesses. Further delay would certainly be welcome, and that would give time for

businesses to fully understand and be able to comply simply and easily with the new requirements.

Q47 **Baroness Harding of Winscombe:** What difference would it make to Making Tax Digital if basis period reform did not take place?

Rebecca Benneyworth: The regulations that we have, which were issued about two or three weeks ago, are written on the understanding that basis period reform has not yet been legislated for. We have a structure. I am involved in supporting accountants to understand what these new rules are going to involve.

It is not a particular barrier to MTD. I understand that Government's idea is to simplify and make it even easier, but if basis period reform does not happen, it will not really damage the implementation of MTD. The structure of the regulations allows for a non-fiscal basis period, and it is reasonably clear. Of course, when we are thinking about accountants looking after small businesses, they are used to non-fiscal basis periods. They do not have to make a change in those terms. Obviously, MTD is filing digitally, but the relationship between the profits and the year in which they are taxed is the same as it is now.

I cannot honestly see that it will disrupt MTD, but I understand that the idea is about smoothing the way. That would be the argument that the Government would make.

Baroness Harding of Winscombe: Does it smooth the way?

Rebecca Benneyworth: If I can answer that in a slightly indirect way, there is a lot of merit in encouraging businesses to adopt a fiscal year basis for their accounting. Under MTD, it will be clearly logical. The quarters that they file for will relate to their basis period and the tax year. There are some significant barriers for some businesses, and that is where my worry is. For a lot of businesses, it is fine and does not really make any difference. For some businesses, it is quite a big issue.

Andrew Chamberlain: The only thing that I can think of that could cause a problem is with the software. Of course, Making Tax Digital requires businesses to have certain software that links up with HMRC's APIs. I do not know whether there is a technical problem there if a business does not have the tax year basis for its accounts. I do not know that that is the case; I am really speculating. Otherwise, it would not prevent the rollout of MTD if the basis period was not reformed.

To echo Rebecca's comments, it might make things neater for businesses. According to the consultation document, 93% of small, unincorporated sole traders use the tax year basis currently, so they will be fine and it will be a neater thing for them to adopt Making Tax Digital. The 7% who do not presumably do not have that basis for a good commercial reason, and so the challenge is understanding why they do not have those terms and whether this reform makes life difficult.

Mike Cherry: Basis period reform in theory adds to simplifying the tax system, which we are all in favour of, and the requirements of filing. FSB has always argued for reform so that small businesses can streamline

and ensure greater compliance. From our 2021 report, a third of small businesses find that tax is the most burdensome regulation they face. If the basis period reform does not take place, it means that businesses that are shifting or have shifted to Making Tax Digital to pay their income tax will just be paying it in the same way but at additional cost.

Baroness Harding of Winscombe: I wonder if you could just explain that a bit more. Are you saying that not doing basis period reform would present an added cost to the businesses that are moving their tax year to fit Making Tax Digital?

Mike Cherry: We are saying that any further complexity around Making Tax Digital and not moving the basis would certainly add to the costs of businesses able to comply.

Baroness Harding of Winscombe: You are in favour of doing basis period reform changes before the rollout of Making Tax Digital for income tax.

Mike Cherry: Everything that simplifies tax for small businesses should be beneficial and should not add cost or complexity.

Q48 **Baroness Noakes:** This is a question about the way in which businesses need to prepare for the change, assuming the basis period reform goes ahead. For those businesses that are affected, what needs to be done to raise awareness of the change and help businesses prepare for that?

Mike Cherry: For any changes, whether they be tax or regulatory burdens, businesses need to have the communications and understand how they are supposed to comply easily, simply and well in advance of any changes coming through. Most small businesses, as I mentioned, want to comply simply and easily in getting their tax affairs right first time. Therefore, government must ensure that the communication is effective, is constant and is put out through all necessary channels, including using third parties, whether it be FSB, accountants or tax advisers, to get as much coverage as possible.

Rebecca Benneyworth: Once it has been decided, if it is decided to go ahead with this, small businesses that do their own tax returns and look after their own tax affairs need to be warned when they are completing their tax returns before the change, so that that is flagged up to them. When they are filling in their return on the old rules, they should be told, "In a year's time or in two years' time, this is what you will have to do". Delivering it in that way gives it the immediacy that it will then pop up again, and they will be reminded when they come to do it the new way.

For represented businesses, accountants have their communications channels, whether they are a member of a professional body or whether it is through HMRC's communications with agents. There is not too much to worry about there because it is mainly in the bit that the accountant does rather than the bit that the client does that this will take effect.

Andrew Chamberlain: Not an awful lot needs to be done for the 93% of businesses that use the tax year basis now, because they will not notice too much of a difference. It will not make much difference to them. There

will have to be some effort to find the 7% that do not have that basis and speak to them about the barriers that they will face. It could make a difference to their cash flow, for example, because in the transitional year it will potentially bring forward some tax payments for them. They will need to be aware of that because it could be a big difference to their business.

There is something in place. You can pay that over five years. It is about identifying businesses that do not use the tax year basis, understanding the impact it will have on them and helping them to mitigate against those impacts.

Baroness Noakes: What should be the role of HMRC in communicating and helping taxpayers who want to shift their accounting period to the tax year or 31 March?

Andrew Chamberlain: HMRC has to inform the businesses that this is going to happen. Most businesses that we work with would then probably go to independent advisers, accountants, et cetera, to help them to understand this and make some changes to their tax year if they were going to do that. They might not go to HMRC, expect HMRC or even want HMRC to help them with that, in our experience.

HMRC's role is just to inform these businesses. It has to make a real effort to reach out to them and let them know that they are in a minority of businesses that are going to be impacted by this in some way and that it would like to speak to them about those impacts. The businesses can then be in a position to make the changes that they need to.

Rebecca Benneyworth: There is a key role for HMRC in this process, in that a business that does not have a fiscal year basis for its accounts will have what are called overlap profits. Those overlap profits are generated when the business starts up. They are taxed on a multiple. At the moment, the rule is that the overlap profits are deducted when the business ceases. If we go through the basis period reform and businesses move to a fiscal basis, whether they change their accounting date or not, because the rules allow that, "If you stay on September, we will work it out between the two", there will be a release of overlap profits in the year of transition.

Lots of businesses do not know what their overlap profits are. Their overlap profits could date back to 1994. I certainly have a problem because I had a computer meltdown at one point since 1994 and I do not have a record of overlap profits for my longstanding clients. That was one of the things that was lost.

I am advised that HMRC has records going back to 1994, which is pretty impressive, but HMRC is going to have to surface that data for every single business that does not have a fiscal year basis. That is a big job. HMRC is going to have to put a team on to that to provide that information, whether it is providing it direct to small businesses or to its accountants or tax advisers. That is quite a resource-intensive thing to have to do. If this change is being pushed through, with the best will in the world, somebody is going to have to command a team and say,

“Right, let’s get all this information ready and deliver it in the easiest way possible”. That is quite a big component of it.

Q49 **Lord Monks:** The justification for this, which the Government have professed on more than one occasion, is that the existing rules are very complex and there are many thousands of tax return errors that they are trying to handle all the time. Is that your experience? Is this an error-strewn process that needs correcting, or is it perhaps not as bad as the Government are presenting it?

Mike Cherry: We are not as aware as HMRC necessarily is. It has the data about the issue you raise. Our concern is with the overall complexity of the tax system because it has just been added to over many years, or problems that have arisen have had sticking plasters put over them, almost.

I come back to the overriding point that I wished the committee to take on board: small businesses generally just want something that is simple, that is easy to understand, that does not cost increased money or time, and with which they can then make sure that they comply first time. If the errors are simple ones, that is an area that should be addressed by this. We have always been in favour of Making Tax Digital, so long as it was rolled out in the right way. That includes giving business enough time and the information to be able to change their systems, if that is required, at minimal cost and effort, so that they can ensure that they comply in the right way and help the Government meet their own savings targets.

Lord Monks: Would either of the other two like to comment on that? Are there thousands of tax return errors? Has this been exaggerated?

Andrew Chamberlain: I am afraid I do not know. Rebecca may have a better idea on that one. We think that the overlap reliefs are quite complicated. Most business owners do not understand them, but their accountants do. It works; that system has been working. You have the complexity of change in and of itself. You have a system now, which might be a bit complicated but it just about works and businesses are used to it. That is the concern about making the change. It is quite complicated, so I can understand why the Government might want to address that, and we would support any pushes for simplification. The danger is that you create something else that also has its own complications.

Rebecca Benneyworth: I agree that the basis period rules are complex. I have spent many years teaching new accountants about those. I would not be surprised at all if unrepresented taxpayers found them a bit impenetrable and did not really land in the right place. I would accept that, although one wonders how many errors there can be when such a large majority of businesses already have a fiscal year basis. If you have a fiscal year basis, by definition, you do not have any overlap profits.

However, I agree that it would be a welcome simplification. My reservation is that there are some businesses for which moving their accounting date to 31 March or 5 April is not really a sensible thing to do.

I am very uncomfortable with the new complexity that we will introduce with apportionment and all the rest of it. I am not convinced that we are getting rid of complexity. We may be exchanging some complexity for some different complexity.

Q50 **Lord Butler of Brockwell:** My question follows on from that, so perhaps I could start with you, Rebecca Benneyworth. Overall, do you regard the basis period reform as a simplification?

Rebecca Benneyworth: Overall, in one word, no. It simplifies the overlap profits, as I have said. That is welcome, but requiring businesses that cannot change their accounting date—businesses for which that is not sensible—to apportion their profits between two periods just adds fresh complexity. Overall, on balance, we are not going to get to a simpler position in the end.

Andrew Chamberlain: Overall, no. For most businesses, it is not going to make any difference because they are already using the tax year, as we have said repeatedly. For those that do not, there is a reason why they do not. That is what needs to be addressed: why are they not using the tax year? They might have very good reasons for not using the tax year basis, and this is probably going to cause them some relatively significant difficulties. What we have at the moment might not be completely simple, but it works; it is there, it is in place and people are getting on with it.

Lord Butler of Brockwell: Mr Cherry, do you agree with those two views?

Mike Cherry: I do. I would just like to add that I do not understand why a business should have to change what is perfectly right for the business just to meet the changes to the tax system.

Q51 **The Chair:** This is very interesting indeed. Can I just pick up on Rebecca Benneyworth's point on HMRC's preparedness for this? To each of your knowledge, how well prepared is HMRC? Is it gearing up for these changes to the extent that you, Rebecca, were talking about, to surface this data, given the enormity of the changes? Although the people are saying that this is only applying to 93% of businesses, the 7% plus all the partnerships is several hundred thousand businesses. Is HMRC gearing up internally, to your knowledge? Has it been approaching your organisations to say what needs to be done? Is that work under way?

Rebecca Benneyworth: No, not to my knowledge. However, there is no reason why I would be particularly sighted on that. In the response to HMRC and the Treasury that I wrote on behalf of the Admin Burdens Advisory Board, I highlighted that. In some of the other work I do with HMRC as a volunteer, I am somewhat banging on about the fact that they will need to have a team to do this. I am in a position where I am involved as an external adviser or to give an external view. If this goes ahead, I will be banging on about it until I hear that there is a team, a process, a special phone number or an area on the internet where you can put in your details and get that stuff coming back to you.

It is fair to say that I do not have a lot of doubt that they will do it, and the fact that they may not have started yet will not mean that it cannot be a success.

The Chair: Do either of the others have anything to add to that?

Mike Cherry: I am not sighted on that particular element of this. I would say that we have had ongoing and good engagement with HMRC throughout the MTD agenda.

Q52 **The Chair:** Farming, agriculture and tourism have been pointed out to us as sectors that are going to be particularly hit. Have any of you had any experience of this?

Rebecca Benneyworth: I have clients with furnished holiday lets in rural areas. You have heard from Bill Dodwell, who I know very well. Bill will have talked about the sorts of issues that will arise for farming businesses. I do not have arable farmers. Farming arable is the key one because you have growing crops. It is not such a problem here on the top of the hill in Gloucestershire where we tend to have sheep and cows.

With tourism, unfortunately, it is about the timing of Easter. You can end up with a year with two Easters in or a year with no Easters in, and that is going to affect your profits quite materially. That is the main area there.

The other one, which perhaps I have slightly less sympathy for as a small firm of accountants and interested in small businesses, is the big firms of lawyers who are affiliated to US firms, where there is a mandatory 31 December reporting date. That is going to give them internal problems agreeing exactly how they go about this with their affiliated firms. It would be impossible for them to change accounting date, so they are going to be left with this dreadful apportionment trouble.

Q53 **Baroness Harding of Winscombe:** Additional profits will be brought in to charge in the transitional year, and there is an election to spread those additional profits over five years. Is this enough to mitigate the effects on taxpayers' liabilities? If not, what more is needed?

Mike Cherry: Small businesses obviously do not have dedicated tax teams. Most are conducted by the business owners. As such, the longer the transition period can be, the more time it gives those business owners to adjust and understand any new processes.

The problem that you have, as I said at the beginning, is that this is all at the same time as businesses will be paying off Covid debts, such as BBLS or CBILS, at the same time as this, if it is implemented. It will just add complexity. The longer the term for businesses, the better. I would have my doubts as to whether five years is enough for some businesses.

Andrew Chamberlain: We do not have a concrete view on this one, but our instinct is that five years might be enough to mitigate the cash flow problems that could arise from bringing forward the tax payments. It was mentioned before that agriculture is a big area that could be impacted by this because it does not adopt the tax year basis. I am afraid to say we

do not have very many farmers in our membership; I wish we did. It is not an area that we are completely aware of. We do not have a very clear sight of the tax liability that is likely to be created here.

Baroness Harding of Winscombe: Rebecca, is five years the right time period? If not, what should it be?

Rebecca Benneyworth: Five years is the right time period. To give you a better understanding of the quantum of the extra tags, when the overlap profits are released, the relationship between the current level of profitability and when the overlap profits arose at the beginning of the business is where you will get this lump in tax. Clearly, if you started up in 1994 and you are going to have your overlap profits coming out in 2024, you have 30 years' worth of inflation. It may be that the business is bigger or in the run-down to retirement.

The other bit that affects how much extra tax you will pay is how early in the tax year your year-end is. If it is April, you will have a big lump of extra tax. If it is December, you will have only three months' worth of extra tax coming in. After March, December is the most popular year-end.

This is not something I have in my client base—I have all my clients on March year-ends, because it is so much simpler—but my gut says that five years is probably going to be about right. The very big firms of lawyers that have massive profits—it may be a big number—all have tax reserves anyway. We ought to be worried about the smaller businesses, and five years feels about right. You do not really need longer.

Q54 **Baroness Kramer:** As Andrew said, change is always complex. If I could turn to you, Rebecca, we have quite often heard concerns that tax advisers are stretched to utter capacity. As you said, it is the unrepresented that are caught, if they are in the 7%, and may face the biggest complexity, especially with Making Tax Digital coming along at the same time. Do we have the capacity in our tax adviser cohort to be able to deal with this problem? Are we just overstressing the system at this point?

Rebecca Benneyworth: It is going to put them under a lot of extra strain. Let us say that basis period reform goes ahead in the year before Making Tax Digital. Tax advisers will do this extra set of accounts calculating the overlap profits and the spreading once Making Tax Digital has started. They will be doing this new system and filing stuff quarterly, and meanwhile dealing with the outcome of the basis period reform. Although it is timed immediately before the start of Making Tax Digital, you will not magic those accounts out of the air on that day. You will be putting them together and preparing them while the first year of MTD is going on. It is going to place extra pressure. Having said that, the extra year is going to help. Some advisers may well move their clients' accounting years to March in between now and then, earlier than the law will require them to, just to get themselves a little bit of a head start ahead of it.

The concern about the age of population is fair. I have colleagues who are planning to retire rather than deal with it. We probably have a little bit of a shrinking population there, and that may well be a concern. You are right that it is an issue that we ought to be aware of.

Baroness Kramer: Does the system have the capacity to take in those unrepresented firms that may turn to tax advisers for the first time, given this process of change—or are they out of luck, quite frankly?

Rebecca Benneyworth: They may be out of luck.

Q55 **Baroness Noakes:** I am going to just shift on to the technical issues that are outstanding. They were listed in the July consultation, but no period was given for how they were to be dealt with. These are things like the interaction with pension reliefs. They obviously have to be sorted out before basis period reform can go ahead. What is a reasonable timetable for sorting those issues out? I suspect that Ms Benneyworth is the best person to start on this.

Rebecca Benneyworth: In fact, HMRC or the Treasury, whichever put the condoc together, listed out quite a long list of areas of what would be affected. When I was putting my response together, I thought a lot of those would just follow naturally. A vast amount of time is not going to be needed, and I would imagine that some of the professional bodies, such as the Institute of Chartered Accountants in England and Wales and the Chartered Institute of Taxation, would probably have had a look at those and raised anything they thought was worthy of comment and needed any attention in their responses.

They will follow naturally because a lot of those things are based on what your income for the tax year is. For some businesses that do not have a fiscal year, their income for the tax year is going to shift. It is still going to be their income for the tax year; it is just going to be a different number than it was under the previous rules. When I looked at those, I could not see anything that I thought was really challenging. I did bring up some other areas in my response in relation to things like inquiry into accounts. If you are apportioning two sets of accounts to come out with the fiscal year basis, at the moment, the inquiry window relates to a particular year.

A question I was posing to HMRC to think about was whether we are going to have two sets of accounts that are open for inquiry, because each tax return, as it were, will have two sets of accounts on it. Are we going to have a much longer period during which the taxpayer does not have certainty that things are all looked at and finished? How is all of that going to pan out? That was not raised in the consultation document. I would like HMRC to come back and fill in how it sees that working. Is it expecting to have not a one-year but a two-year inquiry window because we have two sets of accounts? Some of that needs answering.

Baroness Noakes: When does it need answering?

Rebecca Benneyworth: It needs answering before we get the legislation passed.

Mike Cherry: I would just add that any technical issues surrounding this basis period reform must be addressed before the finalised date of the transition, so that small businesses understand it and have clarity. That goes without saying.

Q56 **Lord Monks:** The changes that we have been considering so far are really to be put in some kind of longer-term context. HMRC has a 10-year strategy to modernise the administration and the tax system that we have in this country. There is a call for evidence. I am just wondering whether any of you have formulated your view yet about any of the essential elements of that framework for the future.

Mike Cherry: I want to go back and almost repeat what I said earlier on something. The UK tax system is in dire need of reform and simplification. It is currently built on a system in which decades of incremental change have resulted in a very opaque, complex system that small businesses struggle to navigate. Reducing complexity, cost and administrative burden should be the central aim. That sits absolutely with where the 10-year strategy needs to be put.

Andrew Chamberlain: Overall, we support the 10-year strategy. We welcome the fact that there is a 10-year strategy with a clear timetable. There are a lot of moving parts to it; at times it feels as if it has not been particularly well co-ordinated together. That really brings us back to the initial timetable for Making Tax Digital. It has changed around so much, and indeed this new delay, which is welcome, is another step in the road for Making Tax Digital. It has always been this contested issue. Business would love the certainty of knowing that there are not going to be any further big changes and that we are going to look at the changes that are proposed here and plan them out in a co-ordinated fashion. Let us not put the cart before the horse. Let us do one stage at a time.

Rebecca Benneyworth: I would just like to say that, in the context of my work with the Admin Burdens Advisory Board, we are very supportive of the strategy and what it says. We are certainly very keen to see HMRC take up more digital channels to communicate with taxpayers and to make the delivery of tax much easier and simpler, and open for taxpayers to just do what they need to do on a mobile phone app if they possibly can. We welcome it and we see some interesting ideas. We just would quite like HMRC to have some more funds to do it even quicker.

Q57 **The Chair:** Just to wrap up, we all support a simpler tax system—I think we all agree on that—but given everything else that is going on in the big wide world, and the pressure that businesses, many of which you represent, are under, should we press ahead with this basis period reform—yes or no?

Rebecca Benneyworth: No, not in the current form. The Government considered an alternative, which was to start here and say, “Everybody do March from now on”. I would support that.

Andrew Chamberlain: No, unless there is some reason that we have not yet been made aware of why this is absolutely imperative to the smooth rollout of Making Tax Digital.

Mike Cherry: This is a simple one: no.

The Chair: That is very clear. Thank you all again very much for joining us and rearranging your schedule to be able to be with us. It was very clear evidence. With that, we will end this session.