



# HOUSE OF LORDS

Revised transcript of evidence taken before

**The Select Committee on Economic Affairs**

Finance Bill Sub-Committee

Inquiry on

**DRAFT FINANCE BILL 2016**

*Evidence Session No. 4*

*Heard in Public*

*Questions 60 - 76*

WEDNESDAY 3 FEBRUARY 2016

3.35 pm

Witnesses: John Whiting and Chris Sanger

Mike Cherry and Andrew Chamberlain

Members present

Lord Hollick (Chairman)

Lord Bilimoria

Baroness Drake

Baroness Noakes

Lord Teverson

Baroness Wheatcroft

---

### Examination of Witnesses

**John Whiting**, Chief Executive, Office of Tax Simplification, and **Chris Sanger**, Adviser, Ernst & Young

**Q60 The Chairman:** Mr Whiting, Mr Sanger, good afternoon. Mr Whiting, I understand you had a practice run yesterday in front of the Treasury Select Committee. I cannot promise that we will detain you for quite as long.

**John Whiting:** I was rather hoping you would not detain me for quite so long, my Lord Chairman, and I am sure that your fellow members are hoping that as well. It was over three hours. It was too much of a good thing.

**The Chairman:** Thank you very much for joining us. We expect you to be extremely well-briefed. Can we start with your observations on the Office of Tax Simplification? It has now been in existence for five years. You have published a summary of how the Office of Tax Simplification recommendations have been progressed. However, what we cannot tell from that very helpful summary is the importance, as it were, of those that have been accepted and those that have not been responded to. It would be quite interesting if you could give us a qualitative analysis of that. More generally, could you give us your thoughts on the progress so far and the extent to which you feel you are being listened to and action is being taken on some of the rather more important recommendations that you have made?

**John Whiting:** There is quite a lot in your question, my Lord Chairman. I always say that the first period after we were set up was something of an experiment: was tax simplification worth it, was it was possible, and could we achieve anything? I would like to think that we have at least proved that we are worth it, that we can make progress and that it is worth investing in, as evidenced by the fact that we are being made permanent and being given slightly greater resources. I think we have achieved something. As you say, the sheer

numbers do not really say what we have achieved. I make no bones about it: if you ask the man or woman in the street they would say that tax has become more complex. Indeed, as I came through security here, somebody spotted that I was from the OTS and sounded off about having just completed his tax return, "And it certainly wasn't simple", so what was I doing.

It is difficult, but I think we have made an impact in certain areas. I will give a few examples. We looked at share schemes, which produced a lot of technical changes, which obviously do not impact many people, but company share schemes run more smoothly, and it has paved the way to online filing. We have looked at and done a lot of work on employee benefits and expenses. With that, a programme is now under way that will reduce the number of P11D benefits forms from 4.5 million a year to 45,000 if it is all carried through. That is not instant, but it is in progress. We recommended a cash basis for the smallest businesses. That has come in and it is used by 1 million businesses now, so that is simpler.

On the other hand, undoubtedly there are things we have recommended that have not been taken up as much as we would have liked, and, of course, we have only looked at certain areas. I suppose the gentleman I saw this morning would say that life has become more complex. I can do no better than use the analogy that was used by a late and very well-known former Member of this House, Lord Howe, who said that our job is like repainting Brighton pier while somebody else is extending it to France. I think that analogy is as good as ever. We are making an impact but it is a small impact. I would like to think that if we are, as we hope we are doing, moving to OTS mark 2, with greater powers, we will achieve more.

Perhaps the last thing I would say, although you may have follow-up questions, is that one of the possible reasons why we have not achieved more is that Members of the House of Commons and the House of Lords have not taken as much interest as we had hoped and have not really got behind a number of our recommendations. I like to think that the way we operate is a pretty good model of gathering evidence and really finding out the implications. We talk far and wide to frame our recommendations, so that when we hand them over we can honestly say, "Chancellor, Minister, this is telling it like it is. These really are evidence-based recommendations". I would like to see parliamentary Committees getting hold of that and really questioning why they are not taken through.

**The Chairman:** In one sense, is one of the difficulties that the ship has already sailed by the time you look at the detail? Is there not a difficulty that because you are not involved in the

discussions on the preparation of legislation, you cannot therefore inform that debate before the ship sets sail?

**John Whiting:** Indeed. Our constitution so far has been very firmly that we can look only at what is on the statute book. That is our brief. As time has gone on, one has naturally begun to look a little more widely. We looked at partnerships at a time when partnership tax law was changing, so we could not fail to bring that sort of thing into account. We are looking at small company taxation and the advent of the Making Tax Digital announcements. Inevitably, if we talk to a group of businesses, they want to factor that in as well. We are beginning to talk a little more about current changes, but our emphasis is always going to be looking back, if you like. Undoubtedly, I would like to look far more at what is en route being brought into policy discussions, either with formal power, but to be honest it is a challenge for us to get to the stage where policymakers actually want to involve us. An MP in a Committee or a member of this Committee might say, "Well, did you think simpler? Is there a simpler way of making this change? Have you talked to the OTS about whether this really is going to be the best way of making this change?" That is the ideal.

**The Chairman:** You have developed an index of tax complexity. Presumably that can be used in a generic way to inform the taxes that are currently on the statute book and those that may come in the future. Has that helped you to have a forward-looking discussion?

**John Whiting:** As you might imagine, it was a challenge to us: "You are looking at simplicity, but can you define complexity? Can you help us measure it?" We worked at this index, and after deal of toing and froing and refinement we came up with 10 factors, and it reduces to a number. We designed and used the index to look at areas of the tax code, in particular to help us to decide what we should look at next. I have had some discussions with policy teams in the Treasury as to whether we could adapt it slightly to look at legislation that is being brought in and to see whether we can give a measure for some of the other things that you are looking at, such as dividend taxation. It is a little more difficult because our measure of complexity looks at things such as how much guidance and legislation there is, all of which are a little bit up in the air when you are developing it, but the principles are there. It is possible at least to apply some of the thought processes and methodology to assess the complexity.

I will give one other example. As you might imagine, we have met lots of other countries and compared notes. I was given a very good example from France, where, certainly until

recently, when new tax legislation came in, the equivalent of the Chancellor had to give it a star rating of one to five; one is when everybody can understand it, and five is when you need a double espresso to be able to contemplate it. It is very subjective, but at least it is a sort of measure that says, “This is something we ought to look at”.

If we apply our complexity index to something that is being developed, I do not think it would ever get to the stage where something would pass or fail, but it might be a good debating point as to whether it could be done a little simpler.

**The Chairman:** Looking at it from a different perspective, Mr Sanger, how would you rate the Office of Tax Simplification’s progress to date?

**Chris Sanger:** It is very fair to say, as John has said, that the OTS has made some real progress. We have seen simplification and simplicity being talked about inside government far more than it would ever have been if the OTS had never existed. That is a great step forward.

There have been some challenges along the way. Previously when I gave evidence to this Committee in relation to partnerships, we had the OTS review of partnerships at the same time as legislation alongside it. When the OTS is doing work and the Government are doing work, that could be better organised to make sure that the work is consistent and the two work well together.

One of the great successes of the last four years has been the consultation framework, which has helped to ensure that some of the policies being put forward by the Government go through the five-step process and are clear. However, the OTS is completely missing from that framework. There could be a prospective policy role whereby the OTS could feed directly into that framework and so provide that kind of challenge function.

As John mentioned, the OTS has been set up as an independent body to the Treasury, which is right and which limits it from being at the table in the internal policy discussions at the Treasury. However, the lessons that the OTS is learning from all its discussions need to be embodied in Treasury thinking, so that we pre-empt the less-than-ideal legislation coming out of Treasury almost by having simplicity champions inside the Treasury. That is not a role the OTS can play, because it would contravene its independence, but it needs to be kind of “teaching” into Treasury, so that you get that real challenge function on simplicity inside Treasury. More fundamentally, in relation to the overall approach to simplification, so far we have seen the simplification of individual taxes or individual measures—or indeed, as John

has mentioned, a list of all the measures—and working out which ones are no longer necessary and eliminating them.

One thing that would really favour the UK would be a different way of approaching the whole of tax reform and looking at simplification from a taxpayer perspective. As an individual taxpayer, I want to know how much tax I am paying. I really do not mind whether you take it away in income tax or national insurance; I need to make sure that I am paying the right amount of tax. Therefore, one way to look at simplification now is to take a taxpayer perspective and ask whether there are ways in which we could do a radical simplification that steps away from the incremental approach of simplifying this bit of legislation or this bit, while we are still getting many more pieces of legislation coming in as the statute book gets ever longer. If we could achieve that type of approach and use the OTS as a way of forming that kind of thinking, that would be very attractive.

**John Whiting:** Can I pick up on one aspect? As I am sure you have seen with some of our recommendations, we try to come up with short-term ones that can be put through easily—they are often tagged quick wins—and some longer-term structural ones, so we try to come up with a bit of both. The advantage of short-term quick wins is that you can make some progress, because, when all is said and done, the big things take a lot more doing. I totally endorse what you are saying, Chris; the difficulty is how long it is going to take to make a major shift. It is clearly a bit of a challenge to whoever is guiding us what they want out of us as the system. Do they want the big structural thinking or some improvements as we go? My answer is that we probably want a bit of both.

**Q61 Lord Teverson:** Mr Sanger, you have quite a bit of international experience. I am interested to know how the UK tax complications compare with other OECD countries. Are we particularly bad? Is this why we need this self-criticism from inside the Treasury, or what?

**Chris Sanger:** We constantly see the comparison between the length of our legislation and that of others, with ours being the longest ever, overtaking India and places like that. Sometimes that is not the right comparison. In the US, there is a huge amount of form-filling and guidance, which makes their system far more complicated than it would be on that same kind of measure. We have a complex system, there is no denying it, and some of the changes that we will talk about later today will make it more complicated, and some of the policy changes that we have seen have made it more complicated. Simplification is not

embedded in the way we think and in the way we do policy, and that has made it more complicated.

The UK has a habit of legislating a lot more than other countries, so whereas some of the countries on the continent will have some protections within the law based on abuse-of-law principles, the UK historically has sought to legislate to make sure that what is in the remit of the legislation and what is not is absolutely clear. We have, by our culture, created a far more complex environment. Given that is our culture, I do not think we could have done that in the old way. Maybe now that we have a general anti-abuse rule, in some of those changes in the future we might see a shift that would allow us to be less prescriptive in legislation and more purposive, leading to less complex legislation.

**John Whiting:** We have certainly been asked by a number of other countries for our experience and whether we could assist them, and as we do our work we will always look around the world for examples of how we can do it better. Of course, we get ideas on certain aspects from various countries. New Zealand is often a very good example. I would hasten to add that we do our researches by email and phone call rather than visiting, as I trust you would expect. Australia, America, and a lot of countries have much more complex systems because of the interplay of state and federal. We have been drawn into discussions in Canada, because it is setting up a tax simplification project. I saw a French delegation last week, effectively a parallel to your own Committee, which wants to try to start simplifying. I am afraid that complexity seems to be a worldwide disease.

**Lord Teverson:** I fear there will be greater complication because of devolution of taxation, which we are looking at as a Committee elsewhere.

**John Whiting:** I should say that I am a member of the board of Revenue Scotland, so I am well up on that one.

**Q62 Lord Bilimoria:** I declare my interest as a member of the alumni council of Ernst & Young. You have explained the difficulty with the Office of Tax Simplification, using Lord Howe's analogy. Some people would say that the Office of Tax Simplification is an oxymoron because it is not simplifying anything. It is trying, the intentions are good, everyone thinks it is a good idea for it to exist, but how effective is our tax system, particularly given the Google situation? A couple of years ago, this Committee looked at GAAR and anti-avoidance. Is our tax system effective? Is corporation tax in the right proportion, let alone our tax policy, and how is simplification linked to the effectiveness of our tax system on the whole?

**John Whiting:** I should also say, my Lord, that I am a non-executive director of HMRC, but, without splitting hairs, you will understand that I answer as the OTS. I think our tax system is effective. You cannot get away from the fact that it raises well over £500 billion a year, and 93% or more comes in without too much trouble. All right, there is a certain amount of policing and effort from HMRC, but our tax gap, for all that it is a big number, is much smaller than that of most other countries. You have to put on the credit side the fact that it is basically working in many ways.

Where is it failing? Clearly, there are gaps. People are managing to avoid or evade, but that happens in any system. That needs more policing. Part of the reason why people avoid, evade and make errors is because we have a complex system. There is plenty of good evidence that if you have a simpler system people are more likely to comply, and of course find it easier to comply, and the tax authority finds it easier to manage the system. Our system is effective, but it has problems.

You mentioned Google, which I was talking about yesterday to the other place's Committee. To my mind, the corporation tax system suffers from the fact that it was devised in the first half of the 20th century, or the 19th century even, for a 21st century economy. It had manufacturing and physical trade in mind and here we are trying to tax, in effect, a very ethereal thing as to where the value is created and taxed. It is evidence that we need to keep working hard at simplification—you would expect me to say that—but also at keeping the system up-to-date.

**Lord Bilimoria:** Do you think corporation tax needs to be reformed wholesale?

**John Whiting:** You can bring in lots of analogies and you could say that it needs sticking plaster. I think it needs a bit of surgery, but, as I said elsewhere, we need to contemplate that corporation tax may be a dying tax and look to see whether we can make it work better, which might need some quite drastic surgery for the economy that we have nowadays.

**Lord Bilimoria:** I would be interested in Chris's view.

**Chris Sanger:** In relation to the question of corporation tax, we now have a corporation tax rate that is 20% and going down to 18% by the end of this decade. I think we have seen some significant changes in the whole essence of corporation tax. We have also seen the motivation of multinationals change in relation to the UK. The UK's rate is the equal lowest of the G20 at the moment and will be the lowest by the time we move even one percentage point down. We are seeing that attract businesses here. Another thing to take into account

is the fact that the OECD identifies corporation tax as the most growth-damaging tax, so the question of how we do our tax mix is something we really need to address as a country. We get almost 50% of our taxes from income tax and national insurance, and then we have VAT and duties, and together that takes it up three-quarters. Corporation tax is now a small proportion, only a small bit larger than business rates. We need to look at the burden. John is right that the tax system itself was designed with a different mindset.

The work that the OECD and the G20 have been doing through the BEPS project will change the whole nature of corporation tax and will try to remove some of the distortions that have allowed what they would call double non-taxation, but it means that corporation tax is trying to address something that was designed in the past.

If we look at other ideas that are out there from the EU, we have the common consolidated corporate tax base, which has a basis of formula apportionment, which allocates profit by means of people, turnover and assets, but only physical assets, and there is no obvious reason why that is better than the system that we have right now. These are the right discussions for us to be having, but if there was an easy answer out there as to what would be a better system we would have moved to it a long time ago. The OECD has tried to make the system we have now more sustainable and bring a level of simplicity because you have the same rules applying in multiple countries. They are not simple rules, but at least they are the same ones in theory. The real challenge for all of us in the tax community is to make sure that countries are delivering it in the same way and we do not end up with the rules being similar but not similar enough to give us the simplicity that we need.

**Q63 Baroness Wheatcroft:** It is clearly unsatisfactory when we are left with a system which seems to involve voluntary contributions from the likes of Starbucks and Google. The OECD is trying to come up with an answer. Lord Lawson is one of many who have suggested that the answer is to get rid of corporation tax as such and move to a tax on sales. Have you done any work on that? Do you think the UK might be a net gainer or loser from that?

**Chris Sanger:** There are a couple of things. First of all, I am not sure I recognise that there is a voluntary contribution. I know that one company volunteered to pay some, but in all other cases we have the HMRC enforcing the law as it is. Our experience of HMRC is that it is very good at undertaking that. It is important to be clear that this is not a case of companies paying it if they want to and if they do not they can do something about it. The law of the UK applies.

**Baroness Wheatcroft:** I think you would have to accept that was the case with Starbucks.

**Chris Sanger:** That is indeed what they said, but you included Google in your comment and I was going to draw a distinction between those two. In relation to a tax on sales, we already have VAT. VAT is value added tax. A point I always make when I am lecturing and talking is that value added is almost the same as profits. It is basically the profits that you have made except for the costs that you have on either the funding of the business or your employees, so by having a tax on value added we are already a long way towards a sales tax. What it does not apply to, of course, is tax exports. The whole intention of the VAT regime is to stop the taxing of exports. With a tax on sales, again you end up imposing a burden on business, and that could be growth limiting in the same way as corporation tax. It also means that if you have one business that has a very tight margin and another one with a very big margin, you are taxing them the same, which does not seem to fit with the ethos of taxing profit or what you have at the end. Ultimately, the price will be passed on to consumers, shareholders, employees or suppliers. To work out where you want to impose the tax, you have to look at all this in the round. Ultimately, a tax on sales, as a straight turnover tax, has a number of problems and would mean that it would not necessarily be any better than the system we have now, and could create even more distortions in the corporation tax system.

**John Whiting:** In an earlier project, the OTS looked at the idea of a turnover tax for smaller businesses rather than internationals and whether that could be a different way of taxing unincorporated and incorporated businesses and whether it would be simpler, for some of the reasons Chris has given, including how you manage losses and so on. We have rather gone away from it. We did not think it had a lot of mileage, so we did not pursue it. In fact, that was what gave rise to the cash basis: let us stay with going for profit, but on a slightly different, simpler measure. The idea that Lord Lawson has floated is the sort of debate that needs to be had as to the future of how we tax businesses. I come back to my central feeling that corporation tax is decaying. It can be kept going with surgery, but we have to contemplate, in simple terms, where we are going to get the money from in the future.

**Chris Sanger:** The other thing to remember with corporation tax, as we discussed, is that it is in place in many other countries, so if we did not have it, all the other countries and the way our tax systems fit with theirs would need to be looked at. If other countries are imposing corporation tax, there are benefits for us in doing the same.

**Baroness Wheatcroft:** Is it your understanding that the OECD is looking at other options as well as the narrow corporation tax type of issues? Is it looking at multinationals?

**Chris Sanger:** Action one of the Base Erosion and Profit Shifting project is looking at the whole essence of the digital economy and what other answers there could be. It concluded that digital is indeed a fundamental part of everyday business nowadays, but it also looked at whether there could be VAT or other options to reduce the pressure on corporation tax.

**Q64 Lord Teverson:** If we could perhaps move on to a bit more of the detail, as you know the 2014 and 2015 Budgets announced very significant changes for savers, including those in the draft Finance Bill, which introduces a new personal savings allowance and abolishes the existing tax deduction scheme for interest. Although I am sure the Treasury would like to see them as simplifications, we are trying in this Committee to get at whether they are really that and whether they are coherent within a broader strategy of trying to achieve tax simplification.

**John Whiting:** I suppose the OTS can claim a certain amount of credit for at least starting this ball rolling, because we did a project on pensioners, and obviously a lot of pensioners' tax issues apply to the entirety. One of the things we looked at was, of course, the whole taxation of savings, which is a big issue for pensioners. One of our recommendations was getting rid of the 10% savings rate, which is little used, even less understood and hugely complex to administer, and improving the process for tax deduction at source, but really questioning how we did it. In many ways I welcome this simplification, because I think it is a simplification for most people. I question how exactly it is being done. Among other things, the 10% savings rate is still there, and I have to question whether it is really worth keeping if you are doing this. This is a simplification, but as with so many things it will only work if people really understand what is going on. I know HMRC is already thinking through the publicity campaign and things are starting, but there is a big effort needed so that people understand it.

It will simplify savings interest for most people, but there is certainly a cadre, some of whom have been writing to us already, for whom it becomes more complex because they are in this category of having just over the £1,000 of interest and previously they were only basic-rate taxpayers. They may well be pensioners.

**Lord Teverson:** Is there a typical personal profile of these people?

**John Whiting:** The ones I have heard from so far are pensioners. They have a modest amount of pension income but they draw a lot of income from savings. Currently, they are below the higher-rate threshold, so they have no tax bill, but because they are now facing £1,000 or more of interest, they will have a tax bill. The complexity comes in because suddenly they get drawn into the tax system and will have to cope with how they will pay tax, or, of course, HMRC has to manage it through coding notices and adjustments. This works for the majority and I think it is good, but it is not a complete win across the board. Of course, if you go up the scale, you can come up with some great examples of people who, because they are just on the higher-rate threshold, suddenly get a pound of extra interest and that tips them just into the higher-rate threshold. As drafted, that drops the savings allowance from £1,000 to £500. That extra pound of interest is very expensive. I hope that one is cured, because at the moment there is this curious cliff-edge way of doing it, which brings in some complexities. You can look at this and say that it is seven out of ten. That is quite a good mark for simplification, but it is not a complete win in the simplification stakes.

**Lord Teverson:** Is the sort of person who might be affected in that way a person who might find it most difficult or stressful to find their way around it?

**John Whiting:** Indeed. You could say that if somebody is getting well over £1,000 in interest on top of whatever they get with ISAs, they have quite a lot of capital in this day and age, but they need catering for. At the same time as they are being brought in, we have to accept that there are quite a lot of people, in many cases higher-rate taxpayers, who have a bit of bank interest and who, strictly, have to pay higher-rate tax on it, who are going to drop out of the system, which is why in many ways this is a simplification, but there is this cadre for whom it is not a simplification. Sadly, in the simplification game there are often winners and losers.

**Chris Sanger:** As John says, even if it fixed the sudden drop from £1,000 to £500, if it fixes it in the same way as we have seen in other cases, there will be a taper, which again will mean that you will have a different marginal-tax rate for another level. It is why we have a 60% marginal-tax rate at £100,000 and personal allowances being withdrawn. These kinds of allowances, which are based on how much you earn, create complexities in the system overall. It is a compromise if you have an allowance for everybody and accept that it goes all the way up the earnings scale. That is clearly the simplest way to do something, but it means that people who you may not intend to get the relief will get the relief. It would have been

far simpler if it was £1,000 for everybody, but it would have been more costly. That is at the heart of the question of simplification and where the UK is. Sometimes we choose to go for targeting more than we do for simplicity. Until that balance is put the other way, we will continue to make the tax system more complicated.

**John Whiting:** It is often said that fairness and simplicity pull against each other. One of the things I often come back with is that a system can be fair only if it is simple enough for people to understand it and operate it.

**Lord Teverson:** Does it start to undermine ISAs, or do they sit well together, or does it make the choice of what you do with your cash more complicated?

**John Whiting:** You could say that for an awful lot of people this means that it is less of an issue of putting it into an ISA or the non-ISA sector because interest relief is not taxable. I would simply go back to the need for people to understand it. Choice brings complexity, and you can only understand which way to go and make an informed decision if you really get the message, and that comes back to the challenge of communicating what is going on.

**Chris Sanger:** If we are talking about trying to improve the savings ratio, the Post Office cash ISA now pays a return of 1.75%. That means that you would need to have £57,000 in a cash ISA for it to be worth being in the cash ISA rather than just getting your allowance if you are a basic-rate taxpayer, in which case what is going to incentivise me to put money into an ISA rather than keep it in a bank account? It may well change the incentives. You have to ask whether at the moment that incentive is there in reality to put money into a cash ISA in the first place.

**Q65 Lord Bilimoria:** The Finance Bill 2016 also proposes significant structural reforms to the taxation of dividends, including the removal of the remains of the imputation system. Do you agree that these changes simplify and modernise the structure of the UK tax system? Will they also be effective in achieving the policy aim of addressing the situation where private companies pay less tax and national insurance contributions by structuring payments as dividends rather than salary?

**Chris Sanger:** When we look at the complexities in the dividend system, at the moment we have dividend tax rates of 10% and 32% for the basic-rate and higher-rate thresholds. That came in back in 1997, 1998 and 1999 when we were looking at changing our tax system in relation to our double tax treaties. Ultimately, we have a different tax rate applying to dividends than we do on every other form of income. The Government could achieve this by

just taxing those dividends at the current marginal income tax rate rather than having a new lower-tax rate or the 7.5% or special tax rate. That would deliver a 10 percentage point increase in tax for those on the basic rate and 7.5% for those above the basic rate band. The difference could be offset by a dividend allowance. You could have returned to what I would say is a simpler tax system by maintaining the imputation of 10% but have dividends taxed at the normal income tax rate. That would have given you a simpler outcome than the one that is here. The choice has been made of getting rid of imputation at the cost of having new tax rates that again are more distant from the income tax rate. That is one simplification, but I do not think it will be particularly helpful.

The dividend allowance will take many people out of this. The Government state in the summer Budget Red Book that this means that if you have shares worth £140,000, the dividend allowance covers you. That is a slightly unfortunate way of quoting this, because that would imply that it is designed for people to make sure that they can have up to £140,000. It is more about a £5,000 limit, and when equity rates return to the 5% level on which the pensions community budgets and we do not need to see that £5,000 increase, I think we will end up with a £5,000 allowance.

In relation to your last point about the targeting of tax-motivated incorporation, the increase in dividend taxation, whether through the system I have just mentioned as an alternative or this one, clearly will affect that. The Budget document itself showed that it reduced the incentive by £500 million from £1.6 billion to, with the offsetting amounts, just over £1.2 billion. There still is an incentive to incorporate, so it has not gone the whole way. You could have made that more targeted. If your concern was tax-motivated incorporation alone, you could have chosen to focus on the closed companies—so those with five or fewer participants—rather than imposing this as a burden on everybody. This has two different objectives, which have been blended together and not necessarily in the simplest manner.

**John Whiting:** I would add that it is a simplifying measure in that a lot of people will no longer have to worry about tax on dividends. Then again, they did not anyway in most cases. The simplification in some ways is more subtle because they will understand it better, and rather than having to explain 10% and one-ninth credits and whatever, which is where I think Chris started, this is getting to a simpler, more understandable system, and, going back to my scales, that is on the positive side.

I agree with Chris that it could have been done in a simpler way, but I think it is going in the right direction to being a simpler system. Echoing Chris's point, I am still not sure what the real driver is here. Is it simplification, in which case, yes, it has some gains, or is it taxing the tax-motivated incorporation, in which case I would have liked to have thought about whether this was the simplest way of doing that?

**Q66 Baroness Drake:** Could I go back to the point about people understanding the changes that you were speaking about? We are going to see the introduction of a new power for HMRC to assess individual tax liabilities using information supplied by third parties, and we are going to see the abolition of TDSI, which could mean significant changes in the taxpayers' experience. In your view, what kind of customer support will HMRC have to provide, given that this is going to come into effect in April 2016? Do you think it has the necessary resources to provide the requisite levels of support and information that need to be delivered?

**John Whiting:** I have to be slightly careful about how I answer your question, Baroness Drake, if you will forgive me. I wholly believe that this is all going in the right direction. In a sense, reflecting on other questions, we are getting into a digital economy and therefore making use of information. For HMRC to use information that it already has and use it to potentially pre-populate returns, rather than asking you or me to put that information in again, process it again and potentially introduce errors, is going in wholly the right direction. The vision of being able to send you and me our draft tax returns, which have all sorts of things in them, including interest that we have received and paid, and which we just have to review and confirm is right, I am sure is a good direction to be going in.

Then, of course, it translates through to the support that you and I or the average taxpayer needs. First, I come back to needing information. I need to understand what I am being asked to do. That is quite a challenge, because we all know that there is a brown-envelope phobia; whether it comes in a brown envelope or a metaphorical brown-envelope email, people tend to put off doing things with tax. There will be a great need to get over to people that this is easy and not threatening. They just need to look and confirm and perhaps add one or two things. There will be a real hump to get over to get people switched on to this new way of doing things.

The benefits, though, are clear. It is very necessary that we take this step and that HMRC, as I say, uses the information that it has, and the powers in the draft Bill are necessary to

enable it to do this. In an odd way it takes us back to the system that some of us in this room are old enough to remember, when it was the Inland Revenue's job to assess and give you the data. There is a curious parallel with that.

Has it the resources to do it? Of course it is a big digital exercise, because this is not people in the Revenue just adding up whatever John Whiting has in his records and sending it to him. It is making sure that the IT feed from the banks paying interest, from the companies paying dividends and from the employers all tie together and give the right answer. That is clearly a big system challenge. I know there is a great deal of effort going into it and there are some extremely able people working on it, but I do not think anybody would say anything other than it is a huge challenge to make sure it works.

**Baroness Drake:** When we took evidence from the banks and insurance companies, there was a recognition that they had to do quite a lot of work to provide their customers with a certain amount of information and inform them. Clearly, that was a challenge. For a pensioner who suddenly gets their interest gross, they may have to take an action that they have never had to take before. They may not know where to go to pay tax. It is simple questions such as that. We were trying to understand what work is being done between the industry and the Revenue so they are joined up in the support and information going to the taxpayer, given that this is going to kick in in April 2016.

**John Whiting:** There is a great deal of work going on with industry, software houses and other people in trying to make sure that the information flow is correct. There is a great deal of work going on with taxpayer groups testing out what are often termed "customer journeys" and what will have to be done. Clearly, provision is being made for calls to the helplines. You make some very good points. This harks back to some earlier questions dealing with the bank interest issue. If, because you are over £1,000, you suddenly might have to make a return and pay some tax, you have to understand what you have to do. It is a challenge to try to get over to people what is really happening, and in some cases to understand that they are not actually out of pocket; they just have to do things in a different way.

**Q67 Baroness Drake:** Given the comment earlier about the OTS needing to feed more into the consultative framework, some of these changes to income and the savings allowance were not subject to consultation. Would they have benefited from being subject to consultation?

**Chris Sanger:** Yes. I sit on the Tax Professionals Forum, and one of our roles is to help the Government and call them to account on how they operate their framework for consultation. This will no doubt feature in our next report. Our last one was published in December. It is exactly these kinds of changes that it would have been sensible to set out upfront as a set of principles so that we can have the debate we had only a moment ago about the best way to deliver simplification or the reform that the Government want to deliver.

Over the last five years, the five-step consultation process, when it has been abided by, has really delivered proper and constructive discussion, allowing the Government to disagree but meaning that the taxpayer has understood why the Government disagreed and why the Government were proceeding with something. I think that has been really beneficial. These kinds of proposals could equally have benefited from that type of discussion. The Treasury will sometimes say that it will not consult on rate changes and anti-avoidance. I am not sure that really includes this. Even in those cases, there is more of an opportunity to consult, and as much as there have been concerns about consultation fatigue, on items as fundamental as this, some early consultation can really make a difference. To be fair, we are in a period of consultation—it closes today—on the Finance Bill itself, and clearly that involves HMRC, so you could argue that is a period of consultation, but we are already quite a long way down the journey and it could have been dealt with and we could have had that feedback in a lot earlier.

**John Whiting:** It is about getting consultation in when there is a chance to make a difference when it is being formulated.

**Baroness Drake:** Would you care to nominate an illustration of where these proposals could have been improved had there been prior consultation?

**Chris Sanger:** To pick up the point that we were just talking about on the dividend side, some of the choices about the rates and how you achieve this could, to my mind, have aligned it to the normal income tax rate, and we could have had a proper debate about whether that simplification achieved the Government's own objectives.

**Baroness Drake:** Do these changes, whereby HMRC will pre-populate an individual's liabilities, signal a more fundamental change to the individual's responsibilities in the tax system?

**John Whiting:** Potentially, yes. It does not in one sense, in that we are in an era of self-assessment, so it is up to us to self-assess and put it in, and HMRC will check, but it alters it more subtly. This is getting us to an era where we are being asked to review and check rather than put it all in, but the underlying responsibility on us to get it right is still going to be there. That will be one of the challenges to get over.

To go back to my brown-envelope syndrome, we know that many people, if they receive an official letter, will think, “They must have got it right”. We need people to take their pre-populated return and look at it sensibly with whatever records they have to confirm that it is right rather than blindly accept it. Of course, there will be a prompt that the return cannot know any rental income that you might have, so you have to put that in, and you might need to put some freelance earnings in, but you still have to look at other things and make sure they are right.

Taking it a little further, you can see that this saves you some effort, because some are clearly right, but in an ideal world it would go further and come out with a prompt saying, “You had rental income last year. We would expect to see rental income this year. Can you check it?”, and, “By the way, we notice you have been doing such and such. Have you considered claiming such and such relief?” You might not quite get into the sales pitch of “the people who bought this bought that”, but at least it would be doing a bit more prompting interactively and, frankly, making it a more helpful process both ways. It will take some time to get there, but we have to try to get people to see this partly as a citizenship duty—I accept that—but not a terribly burdensome one, and something they would want to do to make sure that their affairs are right.

**Baroness Drake:** It is a challenging journey for the ordinary taxpayer.

**John Whiting:** Totally.

**Chris Sanger:** With digital there are two key aims, one of which is to reduce costs to HMRC by having all the information readily available and to make it easier for it to enforce the tax system, and the other is to provide the taxpayer with an easier way of filing tax returns and completing their information. As John was saying, the essence of, “The HMRC has done it for me already, so it must be right. Do I really need to look at it?” is a dangerous concept, because unless it is very clear where the information comes from that fits into it, it is going to take quite a bit of effort to work out where the numbers have originated. The taxpayer is

going to need to be able to say, “I see the number on the form, but I know it comes from five different sources. Where are they?”

Coming back to your earlier question, in order for HMRC to be able to help the taxpayer we need a system that is robust enough to show the workings behind all the numbers, otherwise we will end up with people thinking, “It is so much effort to work out where the number came from, I will just believe HMRC”.

**Baroness Drake:** That leads us on to the issue of small businesses, but I am conscious of the number of questions I have already asked.

**Q68 Baroness Noakes:** Can we shift to digital tax accounts, upon which I know you are going to be consulted later this year? When the Financial Secretary wrote to the OTS chairman, and indeed to you, last summer, he said that his vision was for the OTS “to provide challenge on its important digital agenda”. Could you outline how you see that challenge operating as the digital tax account idea is taken forward?

**John Whiting:** In one sense, we have had that challenge all along in that given the direction of travel, with so much of the tax reform being digital, we have been encouraged—we would have gone there anyway—to consider digital ideas in whatever we came up with. Eliminating P11Ds has incorporated payroll by using digital means to sidestep all that. If we are going to reform small company taxation—we are looking at that now—we want something that will fit the digital agenda.

**Baroness Noakes:** What is your initial view on whether quarterly reporting is going to be achievable and whether it can be described in any sense as simplification?

**John Whiting:** We have already begun to have regular meetings with the group taking that forward in HMRC and the Treasury. Fundamentally, that is exactly our challenge: how is this going to be simpler, looking at it overall? I see the vision, as I think we all do, of an automatic uploading of data, but what has to be put in? Clearly at one end of the spectrum, when this was first announced, people heard it as four full tax returns a year. Clearly it is not intended as that.

**Baroness Noakes:** What is it going to be on this issue of information?

**John Whiting:** That is what we are discussing. Of course, it links into changing tax payments and whether we are bringing the payment of tax closer to when it is earned and what tax it is. This probably comes back to how accurate we want this to be, because if my company needs to put in four lots of information a year, which generates an accurate quarterly tax

payment, I cannot see, certainly under the current system, how that can be simpler than one lot. On the other hand, if my company is asked to put in basic data that is already available in my system and, harking back to Baroness Wheatcroft's question about a possible turnover tax or something, a sort of marker tax amount is payable that drops out of the system easily, that becomes more possible. One of our previous recommendations, which I suspect we will repeat, is that we can get rid of a vast number of the sundry adjustments that traditionally have to go on to move accounting profit to taxable profit, not least because, as the tax rate is going down towards 18%, the value of them is minimal. If accounting and taxable profit get much closer together, things become easier. I can see the direction of travel, and as with everything I will endorse it, but, to come back to Baroness Drake's point, we see a very difficult route for a lot of this, and the challenge is whether this is really going to be simpler.

**Baroness Noakes:** Is the digital agenda being driven by HMRC coming to collect tax in a way that is simpler for it, or is it being driven by a bigger notion of simplification of the system?

**John Whiting:** That is a question that you would have to pose to them. Where I am coming from, and where my interest is, is in whether it is making it simpler overall. Clearly, HMRC sees this as having a benefit in perhaps tackling some of the tax gap, but exactly what the benefit is and where it comes from is a question you would have to ask it. I think HMRC is coming before you and no doubt you will ask it that. Certainly coming back to your basic question to me, as the OTS we are trying to stay well involved with the Making Tax Digital team, and we want to pose the challenge, which you rightly pointed to, which the Financial Secretary has in a sense given us the power to make.

**Chris Sanger:** Digital taxation in this way offers two real benefits to HMRC. It offers it the ability to get a lot more data from sources. The Finance Bill also includes provisions that enhance its ability to get data from other sources. It also allows it to provide a much better service to its customers, as it refers to taxpayers. There is a benefit on both sides. If we can get to a system where the preparation of your tax return becomes a lot less burdensome, because most of the information is already pre-filled for you, and if that could be coupled with some of the simplifications I talked about at the beginning in relation to easier tax returns, whether that is based on a few key facts rather than having to undertake a detailed tax return every quarter, I can see why HMRC would want to get this information. In order to provide the simplification, we need to do some of the policy reform at the same time. If we only go down the route of digitalising what we have right now, we will end up embedding

the complexity that we have today into a computer system that will be very difficult to change. We need to make sure that the policy change is driven at the same time as the digitalisation of this.

**Baroness Noakes:** Do you think it is feasible to achieve that across the complexity of small businesses as they present at the moment?

**Chris Sanger:** There would be a real advantage in HMRC looking at segmenting the different businesses into the different segments and trying to think about what is relevant for each type of taxpayer. If it can do that, it can create a simpler system, and with a simpler system it would be far easier for it to put it in a digital form and ask the taxpayer to provide the little bits of information that it needs on a regular basis. If we end up with it as it is today, we are just going to be embedding complexity into a digital system, which will be hard and expensive to change.

**Q69 The Chairman:** Following on from Baroness Noakes' question, tax simplification is clearly a very desirable objective. There may be a couple of ingredients. One is that the tax itself is relatively simple and straightforward, but for most people the issue is how well it is explained and communicated. In your reports to the Treasury on tax measures, do you look into how it is communicated? Do you look into the material that is sent to taxpayers? Do you look at what is available on the website so you can form a judgment as to whether it is relatively simple for somebody who is a lay person?

**John Whiting:** The short answer is yes. We try to look at all aspects. When we were set up, the vision was that we would tackle the technicalities and metaphorically tear pages out of the tax code. Very quickly it became apparent to me that the administration—and by administration I include everything from how you file your return to the information that is made available—is at least as important. If the underlying law is complex and the interface easy—a computer analogy—you can manage and achieve it. When we make recommendations, we certainly make them to simplify the technicalities and the law, and we are very mindful of whether we can simplify the interface, if I can call it that, what the form is and whether we can make it simpler or make the procedure simpler.

To go back to our discussion on interest, we made some fairly basic recommendations about the R85 form that has to be filled in to get your interest paid gross—which of course will become redundant—because that was fairly crucial, and about how the taxpayer gets at the form and what information they were given with the form. So, yes, so far as I am concerned

it is all part of our ambit to make the system easier for everybody involved. That means businesses, individuals of all types, advisers, and of course HMRC itself.

**The Chairman:** It is one thing when you are changing the rate of tax, which people come to expect and it happens with a degree of frequency. It is another when you are changing the structure of the way people actually have to make their tax return, with interest and dividends. It is much more complex, particularly if you add in the fact that there are some investment decisions that might need to be made, so communicating all that in a simple, straightforward way is quite a challenge. We wish you well with that. The evidence we have heard suggests that this will baffle quite a lot of experts and quite a lot of taxpayers.

**John Whiting:** We are certainly not going to be out of a job any time soon, I would guess.

**The Chairman:** We shall follow your lead. Thank you very much indeed for joining us.

### Examination of Witnesses

**Mike Cherry**, Director, Federation of Small Businesses, and **Andrew Chamberlain**, Deputy Director of Policy, Association of Independent Professionals and the Self-Employed

**Q70 The Chairman:** Mr Cherry, Mr Chamberlain, welcome. Thank you very much for joining us this afternoon. You heard the end of the previous session, so you have the drift of the nature and concern of our inquiry. Major reforms are proposed to the taxation on dividends. Do you agree with the Government's assertion that this will "modernise, reform and simplify dividend taxation", or is the dividend allowance an example of the proliferation of tax reliefs already in the UK system that adds complexity for personal taxpayers?

**Andrew Chamberlain:** The current system—we might begin to call it the old system in a few months—had a complication to it, because a notional tax credit was applied to dividends that came from a corporate structure. The point of that was to prevent what might be seen as double taxation, because it has already had corporation tax. I have often struggled with the idea of notional tax credit, not being an absolute expert in some of these areas of taxation, which could not be traded in or swapped for actual money, as some tax credits, such as working tax credits, can be.

The proposed new scheme, where there is going to be an allowance that will be a tax relief, is easier to understand. From where I stand, it could be considered to be a simplification.

**Mike Cherry:** Our problem is with the way the announcement came through. There has been no consultation by the Government on this significant change, and our members see it as double taxation. Equally, we have many members who are very, very concerned, because whilst this may indeed be a sledgehammer to crack a nut, and it may close one of the opportunities to legally avoid tax by paying yourself dividends instead of paying yourself a salary, at the very smallest end of those businesses it is the only method by which they can pay themselves and continue to run their businesses. If I may, I will quote from one member, who clearly says, "We have not had a pay rise for many years. We are paying it in dividends if we have enough money at the end of a tax year, in order to keep employing our small workforce". That is one out of many who have a similar view on this.

The lack of consultation on all the other bits and pieces that are now being announced on the digital tax agenda is certainly not helpful. It is seen as tinkering around the edges, when we actually need fundamental tax simplification and policy reform in this whole area. It is

too complex. In our surveys, the majority of our members clearly report that they have to use outside accountants or tax advisers, and we are told that the average cost is around £3,600. It is complex. It is costly. We need to achieve something that is far simpler, far easier, and ensures greater compliance.

**The Chairman:** I am sure that in your interactions with the Treasury and HMRC you have made clear your view that there should be a degree of consultation. You must have done that on a number of occasions, not only in relation to these changes. What has been the response?

**Mike Cherry:** We do indeed have regular consultations with Ministers in the Treasury and other senior Ministers. Part of this is another of the problems that is coming down the track to face many of our members. One of the biggest causes of consternation at the moment is this very disconcerting idea that you have quarterly tax reporting. We have had several discussions with Ministers and a meeting with the officials who are responsible for driving this forward in HMRC. We have always been supportive of moving to a digital economy and a voluntary system that businesses can use if it suits their businesses. Our biggest problem with this whole agenda is the mandating of quarterly tax reporting. Apparently, that has already been decided. The consultation that is ongoing is simply about how we implement that mandate. We hear that it could be through net profit, or net taxable profit. If you have to do that, I question whether that is reporting or whether you need to do a full tax return. Moving that further forward, you heard at the very end of the last session the idea that pre-populating means that the business does not have to do very much work. In fact, it means significantly more work, because the business will not only have to provide its own information but have to check the information that has already been pre-populated.

**The Chairman:** Sticking to the question of consultation, you must have made representations over the years that you would prefer to have a relationship with the Treasury and HMRC where you were going to be involved in a consultation so that you could express the views of your members on potential changes. That has not happened, has it?

**Mike Cherry:** That has not happened on this occasion.

**The Chairman:** That must be a matter of some frustration.

**Mike Cherry:** It is a matter of considerable frustration. If we are able to have these discussions at the outset, even before proposals are put forward, hopefully we can be

constructive, we can point out where the pitfalls may be, and come to something that may be workable in the interests of small businesses more generally as well as our members.

**The Chairman:** When you make these points to the Treasury and Ministers, what is their response?

**Mike Cherry:** It depends on the department.

**The Chairman:** Do you mean that some are more in favour of consultation than others?

**Mike Cherry:** Some are more in favour. Sometimes it depends on the single issue that may be being discussed at that time.

**The Chairman:** So you get warm words, but not a lot of action.

**Mike Cherry:** Our problem with this in particular, of course, is that we understand that there has been no impact assessment, so that is totally unknown. That can only add to complexity. It is not the way businesses work. It is certainly not the way software works at the moment. You can use an iPad for personal use, or indeed for business use, or even do a VAT quarterly return, but that does not mean that your software, or the way you work your business and accounts in your business, can move to quarterly tax reporting even in the simplest form if it is going to be mandated. This does not have to come by 2020; it starts in 2018. There is a whole raft of issues there, not least because there has been no impact assessment. We do not have the infrastructure, broadband in particular, or indeed mobile connectivity, to be able to do this. Alongside the huge issue of cybersecurity, it raises far too many questions and far too much uncertainty, and leads to more complexity. I cannot see at the moment, on all the information that we have and the discussions that we have had with officials and Ministers, how on earth this can be simpler and less burdensome and reduce the regulatory business on small businesses.

**Baroness Wheatcroft:** In what situations do you believe the Government do not have to provide an impact assessment?

**Mike Cherry:** As far as we understand, tax falls outside any need for a formal impact assessment. It does not go through the Regulatory Policy Committee. We are unclear about the scrutiny, especially with regards to the Administrative Burdens Advisory Board. Again, there is a lot of uncertainty about how this decision to mandate has been arrived at and where the consultation can actually go, given the problems that I have already alluded to.

**Q71 Baroness Wheatcroft:** It is an area that perhaps we ought to look at a little more. It has impact. Moving on, HMRC is going to have a new power to provide assessments for

individuals based on information from banks, or wherever. There is some concern that not every individual will be in a position to challenge those assessments. What are your views on that? Do you foresee problems with people paying too much rather than too little tax perhaps?

**Mike Cherry:** I already mentioned the concern that an individual or a small business is going to have to check that for its accuracy—invariably that will be an outside individual, a tax expert or accountant—to make sure that it is correct before they can be satisfied that they are paying the right tax, be that under or over. Having a voluntary system, making tax simpler and being able to make sure you can make it work for your business is surely the easier and simpler way forward. Eventually it will ensure less cost for HMRC, make it easier for businesses, and reduce the administrative burden for businesses. If it was that simple now, businesses and individuals would have already adopted it.

**Baroness Wheatcroft:** Thank you. Mr Chamberlain, presumably by the very nature of your organisation your members are one-man bands on the whole.

**Andrew Chamberlain:** On the whole that is correct; they are usually working through their own limited company.

**Baroness Wheatcroft:** How are they going to cope with this change?

**Andrew Chamberlain:** There are some concerns about the simpler assessments power. As we understand it, it will give HMRC the ability to obtain information from a third party when some income has been generated for an individual, and apply a tax charge to that, which is quite understandable because it may save a lot of time and bother and help it to get the tax more quickly than it does at the moment. We understand that. We are not clear what might happen if, in the process of generating that income, you have incurred some sort of costs, some professional fees. Will that become apparent to HMRC when it looks this up? That is one of the things that is not clear.

**Baroness Wheatcroft:** It is hard to see how it could become apparent.

**Andrew Chamberlain:** I have had one example explained to me in relation to the Land Registry and the sale of an investment property. If an individual has made income in that way there will be a capital gains charge to that, but that individual may have incurred some costs in the sale of that property that would not necessarily come through in the Land Registry figure. Presumably HMRC will have to get back in touch with the taxpayer to check that. They have been doing that anyway through self-assessment. This brings us back to how

much this is going to help that process. As you pointed out, there could be an inability for someone to challenge the calculation that has been made, either because they are not quite sure how to do it, or, as Mr Cherry has said, because they might have to incur a fee to get professional help to do that, which they may not want to do. It throws open the possibility that a miscalculation could slip through the net.

**Q72 Lord Teverson:** Perhaps we could come on to digital tax accounts, which you have mentioned to some degree already, Mr Cherry. We are told that this is a step towards that strategically. I understand that your members are particularly concerned about the proposed requirement for small businesses to provide this. I think you were saying that you want a voluntary system perhaps rather than a mandatory one. As a Committee, we have tried to explore quite strongly the area of quarterly reporting and how difficult that is particularly for small or one-person enterprises. Perhaps I could first ask Mr Chamberlain whether he has similar concerns about this area.

**Andrew Chamberlain:** We share many of the concerns that the FSB has. The primary one is that it appears that this will be more burdensome. You have to do more reporting every quarter rather than every year. I understand that it is for a lesser period of time, but overall it appears to be more burdensome. The business does not seem to be getting very much back in return for this extra burden. That is one of our first concerns.

The other issue is that there are businesses for whom this will be a huge shift, because they will have to move from keeping paper records to digital records. There are those who will not have the skills to do that. There are those who may not have a particularly strong broadband connection, so that is an issue. There are those who do not want to do that. We would much prefer to see a voluntary system brought in, especially at first, and then a longer rollout period to get people more used to the idea. That would be our preferred approach by the Government. We do, however, see it as a laudable aim. Moving everyone towards digital reporting makes some sense, but there are concerns in the short term.

**Lord Teverson:** It seems to me that if someone has earnings that are automatically captured it is a great win, but for the single-person enterprise in particular, or the unincorporated business, would you say that it is like doing a tax return four times a year in effect to make sure that this information is correct?

**Andrew Chamberlain:** We are not sure yet how it will actually look, and we understand that there is going to be a consultation later this year, but that is the fear. When people first hear

about it, I think that is what goes through their mind. We may end up with your having to make an annual year-end adjustment anyway, because you will want to make sure that everything you have put in through the year ticks up at the end. If it works, which I believe is the plan, essentially HMRC will take the information that you have inputted every quarter and then supply you with a calculation at the end, and you will want to do a year end adjustment, which is effectively like doing a tax return, to check that it has done that correctly, or you will ask your accountant to do it. Indeed, you will be asking your accountant to help you do the quarterly returns too, which is a cost. There is a big cost implication here for small businesses. Most of our members use accountants and see this as another opportunity for accountants to bill them some more money. So there is certainly a cost impact here.

**Lord Teverson:** Do you wish to add anything, Mr Cherry?

**Mike Cherry:** There is one further point that needs to be very clearly understood. From a recent survey that we conducted, for around 34% of our members it is either the individual owner themselves or an employee in their business who does a manual tax calculation at the moment. That often seems to be missed by various parts of the Government: that there are still many companies, many individuals, who do things manually and are not even using software packages or simple spreadsheets.

**Lord Bilimoria:** According to the FSB, I believe that members already spend an average of £3,600. You are saying that having to do it quarterly would add to this cost. Microbusinesses are using accountants as well. Would this figure of £3,600 be what they spend?

**Andrew Chamberlain:** That is not far off. We surveyed our members a couple of years ago.

**Lord Bilimoria:** There was an e-petition, which was debated in the other place on 25 January, with over 100,000 signatures. Did your organisations take part in this?

**Mike Cherry:** Individual members would have taken part in that.

**Lord Bilimoria:** Have you seen the discussions, and do you agree?

**Mike Cherry:** I have read through all the discussions, and I found some very interesting and pertinent points. The one thing that was not mentioned so much was impact assessment. The decision to mandate has already been made. There has been no consultation on that. The whole discussion—apart from one Member of the other House—only briefly mentioned the cyber issues and how government is not very good at holding on to data in the first

place. Aside from that, the problems that we all face with cyber moving on from today into the future can only get worse.

**Andrew Chamberlain:** I watched the debate on the live feed. It was very interesting to follow that, and some good points were raised. It did show that there was concern across the House of Commons among different parties on this issue. Clearly, a lot of those MPs have had constituents' correspondence on this. We know that some of our members have been in touch with their MPs.

The point I took from it was that it appears from the Government side that this is coming. That does not seem to be up for debate. That is where the consultation point comes in. We would urge a voluntary approach and to try to allay some of the concerns that are clearly felt. Over 100,000 signatures to the e-petition were needed to get that debate going, so there is obviously quite a bit of concern out there.

**Lord Bilimoria:** Is this an example of your members who are running businesses that make up 99% of this country's businesses, the backbone of our economy, and you have somebody sitting in an ivory tower who comes up with this four times a year without even consulting your members? How could this have happened?

**Mike Cherry:** Clearly it has happened. The decision has been made. We are trying to overturn that decision and help the Government to understand how businesses do their accounts, and the fact that there should be a voluntary system to test, to prove, to make it worth while for businesses. There is no nudge on this either. From the information that we have seen so far, there appears to be a significant cost saving to HMRC of around £652 million. Inevitably, that cost seems to be from placing extra cost burdens on small businesses, aside from the extra administrative burdens. Let us not forget that for micro and small businesses in particular, it is the time spent on administrative duties that takes them away from doing their business and producing profit, hopefully, but certainly away from contributing more to the wider economy in the first place.

**Lord Bilimoria:** Have you done a cost-benefit analysis of the savings the Revenue thinks it is making compared with the additional costs to these businesses and to the economy?

**Mike Cherry:** It would be extremely difficult for us. We do not have the resource to do that full cost-benefit analysis at the moment, because quite frankly we do not know what is in the detail yet. That is the only part that has been consulted on. Nobody knows exactly what this

idea of reporting is going to mean, how the pre-population is going to be checked and what the time spent on all that is going to be for the business.

**Baroness Noakes:** Do not businesses at the moment have to submit their VAT returns electronically, and if they employ anybody they have to use the RTI system for PAYE, which is digital? Even if they have manual records, they already have to do digital interfaces with HMRC for these other taxes. What is so difficult about sending in information about your business results?

**Mike Cherry:** With all due respect, that is a totally different area compared to either using an iPad simply for business purposes or, indeed, filling in a quarterly VAT return. You can do that relatively simply, and you may do it online—indeed, you mentioned PAYE and RTI now being done online. Those are fairly simple bits of software—if you use software, or your advisers use software—that enable that to happen without too much difficulty. To ensure that you have the right details for full quarterly reporting is far more difficult, even with the existing software, and it is not necessarily how a business works. Various reliefs would have to be taken into account, currently at the year end. Most businesses do not do management accounts either monthly or quarterly, which I suspect would also be necessary in order to do proper quarterly reporting. That detail is missing at the moment. We are consulting with government on this.

**Andrew Chamberlain:** Many small businesses will use a payroll company to operate the RTI system for them. That comes at a cost to them, but it is relatively simple. If they had to do something similar on a quarterly basis for all their income and expenditure, and factor all that in with the various tax reliefs, as Mr Cherry has said that is going to increase the cost quite a lot. A lot of this will be pushed on to the accountants, but that will come at a cost.

**Q73 Baroness Drake:** Mr Cherry, the FSB has commented: “The push towards digital must be introduced alongside tax simplification, with businesses able to choose the best tax reporting process appropriate for them”. What simplifying changes did you have in mind when that comment was made? How would they make the changes that you have in mind to make the introduction of digital tax accounts easier?

**Mike Cherry:** We have already put forward proposals to certain parts of the Government in work that we have done with Ernst & Young to ensure that, where possible, the whole area of tax simplification makes it cheaper and easier for businesses to comply. It gives everybody greater certainty of the tax liabilities of businesses. You have more effective tax

incentivisation. It is easier and cheaper for HMRC. I have a copy of that report, which I am very happy to share with the Committee.

**Baroness Drake:** That would be helpful. Could you give us one significant example?

**Mike Cherry:** If I may, I will refer to the document and quote certain parts, if you will forgive me. Basically, it centres on a taxpayer-centred approach to simplification and looks at how it can best support the current review within the OTS so that it is aware of the proposals. It comes up with the idea that you segment it for taxpayers, and those taxpayers should be split so that you can have a taxpayer-centric approach that identifies the differences between start-ups, steady growers, lifestyle businesses, high-growth businesses or, indeed, family businesses or contractors, which is obviously Mr Chamberlain's prime area of concern. There is a lot of detail in this paper. As I say, we have shared it with parts of Government and we are happy to share it with the Committee.

**Baroness Drake:** What response did you get to your submission?

**Mike Cherry:** We have not had those discussions yet.

**Q74 Baroness Drake:** Mr Chamberlain, the IPSE's website states: "IPSE believes the Office of Tax Simplification has the potential to be a positive force in suggesting future tax policy and has been working with the body to develop a simpler tax system". Could you outline the IPSE's experience in working with the OTS? In your view, does the draft legislation establishing the OTS and its functions go far enough in promoting simplification? What is your experience of engaging with it. and does what the draft Bill proposes go far enough?

**Andrew Chamberlain:** We have worked with the OTS on quite a number of its reviews over the last five years or so, since it was formed. One of the first reviews was into small business taxation, including IR35, which is an area of taxation that is particularly troublesome for our members. We worked closely with it on that issue. We have also fed into the current review into small business taxation and its employment status report. We have sat on its consultative committees. We have arranged face-to-face meetings with our own members and staff from the OTS so that they can understand what they are thinking. We have submitted responses to its papers. We have worked quite closely with it.

We fully support the decision to put it on a more statutory footing. We think that the OTS has made a really significant contribution to the simplification agenda. It is a body that sits in between the business community and the government machinery. The business community finds it very approachable and we can have a conversation which can then feed in. It

provides a useful conduit for those conversations on what I think everyone agrees we want, which is simplification of the tax system. Yes, in short, we are very supportive of the decision to put it on a statutory footing.

**Baroness Drake:** Regarding the points of view that you gave to it, how do you feel it responded to them and absorbed them? Was it a positive experience? Do you feel that you still have a long way to go before it sees your point of view?

**Andrew Chamberlain:** Broadly speaking, it is very positive. There are times when it is quite challenging. You had John Whiting, the director of the OTS, in before us. He is a very bright man and sometimes you have to win him over. It will challenge you on your point of view, but it is a very healthy process because it helps you hone your own arguments. Where you think you can genuinely deliver a simplification, it will listen to that. So overall I am very positive.

**Q75 The Chairman:** Mr Cherry, the fastest growing part of the labour force is the self-employed. Do they see you as the organisation that represents them, or is that small businesses as opposed to single self-employed people?

**Mike Cherry:** We are predominantly self-employed and small businesses combined.

**The Chairman:** Self-employed people who traditionally have been able to fill in a tax return once a year on a relatively straightforward basis are now going to be required to do it four times a year. That is going to incur some additional costs, because they would not have had to go to an accountant before, whereas now they might have to do that. Is there a separate and rather largely populated sub-category that for the first time will have to incur costs in making their tax return?

**Mike Cherry:** Again, that is a possibility. Many of them will still continue, as an individual would, to submit their own returns. Equally, as I mentioned a moment ago, we do not know what this reporting is going to mean in detail. Also, it does not seem to take into account the variance at the moment with seasonal fluctuations, which applies equally to the self-employed as it would to any business where you are very much reliant on the seasonability of your sales. You could have a rural business where the majority of its sales could be in the summer, but equally you could have some retailers whose majority of sales will be over the Christmas period. It is how you even out those interactions between that seasonability and the reporting, and when you may get the reliefs and either make the payments to HMRC or indeed get any payments back.

**The Chairman:** So the incidence, i.e. four times a year rather than once a year, will bring some added complexity to those people who have, as you say, seasonal variations.

**Mike Cherry:** Yes.

**The Chairman:** Have you been making those points to the Treasury and to HMRC?

**Mike Cherry:** We are continuing to make these points as clearly as we can to Ministers and officials.

**The Chairman:** Can you give us an idea of how many self-employed people you represent who you have as part of your membership?

**Mike Cherry:** Our membership is around 200,000. Around a quarter of those have at least two businesses. That is a significant number right across self-employed, micro, small, and indeed some medium-sized, businesses.

**Q76 Lord Teverson:** Can I put one argument that I have tried before, not with great success? One of the things about information is that it allows you to manage better. One of the biggest reasons for business failure is that people do not keep up to date with what is going on. Obviously in a smaller business you would expect that. Is there an argument that there may be a raft of people who are not particularly adept at keeping control of their businesses and that this might prompt them to be more successful and see the problems coming somewhat earlier? Does it force a bit more rigour that might make your members more successful?

**Mike Cherry:** I do not think anybody would dispute the argument or rhetoric behind that. In practical terms, that is not how the majority of those businesses work. As I said at the very beginning, if it was that simple and easy they would have already adopted it.

**The Chairman:** Thank you very much indeed.