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Finance Bill Sub-Committee

Inquiry on

DRAFT FINANCE BILL 2016

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MONDAY 8 FEBRUARY 2016

3.35 pm

Witnesses: Brian Redford, Emma Churchill and Cerys MacDonald

Members present

Lord Hollick (Chairman)
Baroness Drake
Lord Kerr of Kinlochard
Baroness Noakes
Lord Turnbull
Baroness Wheatcroft

Examination of Witnesses

Brian Redford, Director of Specialist Personal Tax, HMRC, **Emma Churchill**, Director of Specialist Personal Tax, HMRC, and **Cerys MacDonald**, Deputy Director, Personal Tax, HM Treasury

Q77 The Chairman: I welcome our witnesses this afternoon. Our ranks are a little depleted because of the incidence of inclement weather. People have been blown off course by it. Hopefully some of them will be able to join us during the hearing.

The Office of Tax Simplification was established five years ago, and last year it published a detailed report on how it was doing. It is obviously a numerical calculation, but it would appear that, of the 402 recommendations that they made, some 47% have been implemented or partly implemented, and the rest are under review, there was no response or they were rejected. That is one numerical way of looking at its performance.

We have heard from a number of witnesses that they consider that HMT and HMRC have not sufficiently embedded simplification thinking into their approach to policy-making. Two questions flow from that. First, do you agree with that assessment, or how do you react to that evidence? Secondly, is 47% a good, bad or indifferent score, or is the game still in play? How would you characterise it? In other words, how do you see the performance of the Office of Tax Simplification?

Cerys MacDonald: I assure the Committee that the Treasury and HMRC take tax simplification absolutely seriously, and the creation of the OTS back in 2010 and the decision to put it on to a statutory footing means that in the UK we now have a permanent body leading the public debate on tax simplification, and rightly so; it provides a challenge to the Treasury and HMRC to tackle the complexities that they themselves identify. The Committee has had our memorandum, which confirms the statistics that you referred to. I would like to reassure the Committee in that I do not think you can look at the number of recommendations as a sign of success or lack of success; it is important to look at what has actually happened and what the taxpayers are realising and reaping the benefits of. In my own area, we have made significant improvements to the tax system for the self-employed. The OTS pushed hard for the introduction of the cash basis of accounting in one of its early reports in 2010, and the take-up of that has been a success: over 1 million self-employed individuals have taken up that new system. So it is important to look at what is happening on the ground and what benefits individual taxpayers are on the receiving end of. Of course, the Government, when reflecting on the OTS's recommendations, have to look at tax simplification alongside other objectives which they also seek to achieve through the tax system, whether that is fairness, growth, or the wider fiscal context at each fiscal event, so it is not right to look just numerically at the precise number of recommendations that have been accepted.

I would also emphasise to the Committee that a number of the OTS's recommendations have looked at far bigger strategic areas of the tax code and do not lend themselves to an easy yes or no answer from the Government, but they do inform and shape the work that is done in preparing for future fiscal events.

Brian Redford: My engagement with the OTS over the last five years has actually been very challenging. HMRC has learned a considerable amount from the work that the OTS has done. Cerys mentioned some of the early work on simplification for small businesses, and I recall the discussions at the time. It opened up a line of inquiry and interest that previously perhaps we had not been alive to. My own view of the work that the OTS has done is that it has been very positive. I agree that it is difficult to chunk up the number of recommendations and say that they are all the same weight and therefore a good measure of the contribution that they have made. But certainly in some of the bigger strategic areas, where we are being pressed on savings, assistance to more elderly folk, and work with the small business community, the OTS has been very challenging and has been resourced well to undertake its role.

The Chairman: When the OTS appeared before us, they wanted to feel that tax simplification had been embraced more enthusiastically and more widely—these are my words, not theirs—by your two institutions, but I detected among other witnesses a feeling that a great deal remained to be done and that this tax simplification had not really been clasped firmly to the bosom and acted upon. Do you recognise that criticism, or that frustration?

Brian Redford: There are going to be different views, as Cerys mentioned. The art of each Budget is to maximise interest across the political sphere, whether it is growth or supporting certain areas of the business or personal tax community. Probably everybody would aspire to greater simplification. Sometimes that is a very difficult match to make. Our work going forwardwill be to look at simplification not just of the tax code but in how we can support customers across the tax-paying base through other means: in other words, simplification of the administrative burden that they have to bear and in the way they do business with us, the way they communicate and the way we then assess the tax and make sure that the right amount is paid over. I know that we will come on to some of that in the Committee's questions and in looking at plans for making tax more digital and simplifying the way businesses and other customers interact with us.

Emma Churchill: I would second that. I am relatively new to HMRC, and a lot of the discussions that we have had as we have been thinking about making tax digital, the five-year transformation programme that we want HMRC to put in place and a lot of the drivers have been about simplification for our customers in the administration of the tax system. That has been a very significant driver in the work that we have been doing. I certainly feel that we have been embracing the spirit of simplification in the plans that we have been making.

The Chairman: The Finance Bill places a statutory duty on the OTS to report on its own progress. Would it be more helpful if it were to report annually on the progress towards tax simplification generally?

Cerys MacDonald: The OTS's role is very much to hold the Government to account on in term of progress of tax simplification. Both undertaking quite wide-ranging reviews in some areas of the tax code where it is felt that there might be a case for more progress, often at the request of Chancellor, but it also has the ability to undertake its own reviews. It undertook a couple in the last Parliament on its interpretation of what complexity in tax legislation meant and a piece of work on competitiveness. It can do specific pieces of work where it is making formal recommendations through a policy lens or an administrative lens, and more landscape reviews that paint a picture of how the tax code is developing in terms of simplification.

The content of the annual report which the OTS is now expected to publish remains very much a matter for the chair and the tax director, and it will be interesting to see how it develops the content of that report.

Q78 Lord Kerr of Kinlochard: Would the Office of Tax Simplification do more good if it had a forward-looking role—if it could address the implications for simplicity or complexity of proposed changes rather than looking at the existing tax code and trying to think of ways of cleaning it up and simplifying it?

Cerys MacDonald: I would make a distinction between policies that have been developed before they are announced and the role of the OTS in helping us to develop and design the detail of policies once they have been announced. Of course, currently the OTS does not have an active role in advising on policies that are in development. That is not part of its remit and

Ministers are democratically held accountable for the decisions that they take, not the OTS. However, I would not underestimate the influence the OTS has on how we shape our advice to Ministers on tax policies. We always ask ourselves, "What will the OTS think or say?" Under the new framework, the OTS will for the first time have a formal role in responding to consultations that we undertake on areas of the tax code where the OTS has itself made recommendations. So it will be part of the policy development process as we engage with stakeholders, including the OTS, in turning one line in the Budget document into a fully formed tax policy and tax legislation to be implemented. It has a role to play on the flow of tax policy, particularly once it has been announced and is in the development stage.

Lord Kerr of Kinlochard: It seems that the OTS is in a way neither fish nor fowl. It is not genuinely independent like the OBR. It is embedded inside the Treasury and yet it does not have a role in looking at Treasury or Revenue draft proposals. It does not see what you are thinking of putting into the Finance Bill and have a chance to say "Are you sure? That would be rather complex", or "Would it not be easier to achieve what you want to do in a different way?" Can I ask the Revenue whether it sees any advantage in such a different kind of forward-looking role?

Brian Redford: That is a very good question. The influence of the OTS extends beyond the piece of legislation or the area that it has looked at in one year. Quite often the recommendations and the thinking that come from the OTS colour our thinking on policy development in the next Budget cycle. But in terms of formulating that policy, it is very much for the Chancellor and his Ministers to determine the shape of the entire financial package that they have put together. I suspect that they would be very cognisant of what the OTS views were in the past and are currently in making those judgments. As officials, we would definitely advise with a view to how simple we can make it. What is achievable with the systems that people will have to cope with, and do we place an unnecessary burden on those who have to operate the systems? I think it is fair to say that its influence lingers much longer than in the particular area that it is looking at. It does feel as though the OTS has had a positive impact in that respect. In the same way as we have had in the aim to reduce administrative burdens and a target to do so. It has become uppermost in officials' thinking about we can square all the requirements.

Lord Kerr of Kinlochard: We are about to come on to taxation on savings, where there is quite a complex array of elements, some new and some existing. I suppose under the present rules the Office of Tax Simplification could not be consulted on whether this plethora of rates, terms and cliff-edges is as simple as possible.

Brian Redford: No. I shall ask Cerys to comment on this as well. Under the current system I think the Chancellor would see the determination of the rates and the way in which they should be introduced for different sections of society very much as a Treasury role in setting the Budget for that year. But again, having worked in the area and having seen the advice that was put together at the time, it was very reflective of trying to strike a balance between the aims of the Chancellor in policy-making, any burden that would be placed on business in having to deal with it and customers' ease of use

Cerys MacDonald: I echo what Brian has said. The only other point I would make is that on occasion the Chancellor has asked the OTS to do quite a wide-ranging review, and actually the two reviews that it is currently undertaking on the taxation of small companies and the integration of income tax and national insurance will inevitably lead to informing future decisions taken by the Chancellor in future fiscal events. So I do not think that it is as binary as commenting on stop versus flow. It is a far more iterative process than that. Given that the OTS is a statutory, independent body, it really is having an impact and is influencing policy-making and Ministers' decisions.

Lord Kerr of Kinlochard: If there had been a public consultation on the tax and savings proposals, which there was not, would the OTS have been ultra vires if it had treated itself a bit like a member of the public and commented during the consultation exercise, or on the results of the consultation?

Cerys MacDonald: I do not think it would have been ultra vires. I do not think the OTS is required to make a formal response to consultations on areas of the tax code that it has not made recommendations on, but I am pretty sure I can remember a number of occasions when the OTS has made its view of a particular government proposal part of the public domain. It would not be ultra vires in that regard, but if I need to stand corrected I will obviously let the Committee know.

Lord Kerr of Kinlochard: It is a bit like a poodle, to be honest. It is not a sheepdog it is not out there, and it is not allowed to bark very loud. Would it not be better if it had a louder bark and maybe even some teeth?

Cerys MacDonald: Being on the receiving end of a number of meetings with John Whiting, I can give the Committee a guarantee that the OTS is not a poodle. The amount of work it has got through and the number of recommendations it made in the last Parliament is a real testament to the commitment that it has shown. While it is easy to point to statistics that suggest that fewer than 50% of the recommendations have been accepted, a huge amount of progress has been made that perhaps, absent the OTS, would not have been achieved.

Baroness Noakes: Does it not seem illogical to have the OTS operating within the Treasury and to say, "We will create legislation in our own way"—the Treasury and HMRC with the Chancellor—however complex that might be, and then, "As soon as we have legislated, the OTS can have a look at it"? You have this resource, which is dedicated to and understands the nature of complexity in the many ways it manifests itself in the tax system, but you are seeking to confine it to an ex-post analysis. It seems to me that if you have that resource, it would be an efficient use of the resources available to public policy-making to embed it into that public policy-making.

Cerys MacDonald: There is a judgment to be made about where, in a world of finite resources, one best puts the OTS's efforts and direction. In the run-up to any fiscal event, the Chancellor will consider a large number of possible tax changes before his Budget, so if the OTS was to be involved in every single one of them, that would take up an inordinate amount of time, probably to the detriment of the other work it wants to do. The decision to have it sitting outside the policy development process as a sort of external body leading the debate and doing specific areas of work commissioned by the Chancellor that can then inform a public debate, rather than making policy behind closed doors, is hugely valuable and a good use of the OTS's resources.

Lord Turnbull: The concept that we are missing here is that of the statutory consultee. In many other areas of public life there are certain people who have to be consulted before you can reach a decision. You do not necessarily have to take their view, but making the Office of Tax Simplification a statutory consultee would give it a status so that when things go out for consultation generally—we shall come on later to the areas where that has not been done—the OTS is one of the bodies that you would expect to commission some response from. What is wrong with that?

Cerys MacDonald: I would not argue that there is anything wrong with that. Again, it comes back to what is proportionate, given the resources available to an organisation such as the OTS, and where its efforts are best deployed. As I alluded to in my earlier answer, the OTS has done a huge amount of work over the last Parliament, and I expect it to continue with the same vigour in the next Parliament. It is right that it is tasked with doing thorough reviews of areas of the tax code that have sometimes been a bit intractable in the past in order to try to move the public debate on. The two reviews I alluded to that it has started in this Parliament will do that work justice.

Lord Turnbull: The Government have already taken in some of the intractable areas. That is what the taxation on interest is all about. I cannot see the case for not using this source of expertise. It seems an obvious thing to do. You particularly want to identify where there are big changes affecting large numbers of people. Anyway, you clearly do not agree with that.

Cerys MacDonald: As Brian alluded to, I would not underestimate the influence that the existence of the OTS and our informal relationships and engagement have on the way we approach and think about policy and, importantly, tax administration, where the OTS really has shifted mind-sets and put a focus on these areas that they might not have had before.

Q79 Baroness Wheatcroft: Miss MacDonald referred to policy-making behind closed doors. There is lots of talk about doing the opposite and having a road map that would make it clear to the country and those affected quite where policy-making was directed. We had a road map for corporate tax, which seems to have gone down quite well. There has not been a road map for savings and dividends and it has led to a fair amount of confusion, both among savers and the industry. I wonder why there has not been a road map. Can you explain when there might be one? Can road maps be drawn retrospectively, which seems rather odd? It takes you to the "You wouldn't start from here" place. Could you explain to us why it has not happened in this case?

Cerys MacDonald: Of course. Obviously the decision to publish a road map would be a matter for the Chancellor rather than for public servants. However, the Chancellor has a balance to strike between providing certainty and stability to taxpayers—that was very much at the heart of the decision to publish the corporate tax road map in 2010—and ensuring that he retains some flexibility to be able to respond at each fiscal event to the events, priorities and public mood at the time. While a stand-alone road map has not been published on personal tax, the Government have significantly improved the tax policy-making process and we now have a longer period over which policies are announced, discussed, debated, legislated and implemented.

While there will always be examples in a Chancellor's speech that people will point to and say, "That wasn't expected", I can think of many more examples where the Government have signalled that an area is under review and have started a dialogue on the direction of travel that has then informed future decisions and formal consultation—the taxation of pensions being a good example at the moment. I know that does not specifically answer the question on why there is no personal tax road map, but it does illustrate that it is a more difficult path to navigate for Ministers than the corporate tax road map may have been in 2010. However, there are other things that we are doing to provide more certainty to individuals.

Baroness Wheatcroft: Regarding getting the balance right between giving the Chancellor a degree of flexibility and giving customers some degree of certainty about the direction of travel, do your two colleagues think that the balance is right in this case?

Brian Redford: Personal taxation is very difficult. We would probably say that corporate taxes are equally difficult in another sphere. There has certainly been a move over a number of Administrations to try to release the burden from individuals at lower ends of the taxation spectrum, so to that extent I guess that is what we would describe as a road map. However, as Cerys mentioned, clearly the Chancellor has freedom to determine at any particular point whether the desire of the electorate, which the Administration in power at the time is serving, is best met by particular advantages in different bits of the code. I know we will move on to dividends and the personal savings allowance, but that was a very clear move to, as far as possible, to move a very large tranche of people away from the responsibilities of having to worry about what to do with taxation on the type of savings products that they would hold.

We are caught in a difficulty here. Yes of course it would be lovely to consult on everything, and you would hopefully end up, with something that was acceptable to as many people as possible. However, the reality of policy-making is that there are many areas where the Chancellor will reserve the right to make decisions based on how he sees things at a particular time. I am very happy to explore that further when we talk about dividends and the PSA.

Emma Churchill: On the administrative side, we have sought to give a clear sense of direction, which is why we published the Making Tax Digital road map before Christmas. We are seeking to give both businesses and individuals a clear sense of direction in the way we move forward with the administration of the tax system. As we may come back to later, you can sometimes be criticised for setting things out too early, before you have dotted every "i" and crossed every "t". It is a balance between wanting to show people a clear sense of direction in an area, although that means that you are leaving a lot open for consultation on the way, and giving room for consultation on the administration on both the business and the individual side.

Q80 Baroness Wheatcroft: There has been some criticism that this is all rather piecemeal. In particular, the proposed treatment of dividends is influenced not so much by the direction of travel on savings and investment but on influencing the way people choose to be taxed in their employment. Would you agree with that?

Cerys MacDonald: I think it is fair to say, and most people recognise this, that the reform to the taxation of dividends was well overdue. The system was designed in the 1970s when the corporate and personal tax systems looked very different and the dividend tax credit was very opaque—it did not exactly make the effective tax rates transparent. However, when the Government are considering any changes to corporate taxes, one has to look at the way that system sits alongside the personal tax system.

The Chancellor was clear in the summer Budget that to continue his ambition to reduce the headline rates of corporation tax and to go further than 20% he would need to increase the overall level of taxation on dividends, not just because of the people who were alluded to who disguise their employment through the use of companies but because of the imbalance of taxation between those who are incorporated and those who are not—self-employed sole traders. In the decision to go further on corporation tax and the decisions he therefore took on dividend taxation, an opportunity was sought to simplify alongside that. The introduction of the dividend allowance has enabled us, as Brian said, to take many people out of worrying about dividend taxation and not be affected by the increase in rates, therefore both targeting the tax increase and providing a welcome simplification at the same time.

Lord Turnbull: You said that personal tax is very difficult. I would contend that it is very difficult but that it is also not getting any easier. There was a world once when you added up all your income, you had some allowances and there was a bill to be paid, either through a PAYE system or self-assessment. Now we have a dividend regime with what is sometimes called an allowance but that may in fact be the nil-rate band—that terminology has been used carelessly, in my view. We have done that for dividends and for interest, each with their own set of income tax rates. We have different allowances for capital gains tax, ISAs and pensions, and you have clawback arrangements for child benefit and for the married couple's allowance. So, although things may get simpler at the bottom of the income scale, there is a bit around the middle where things have got very complicated indeed and you have all sorts of tapers and so on. Yet this was all done without clear consultation. Why did you think you could introduce these schemes without a major public consultation exercise? It seems that the only thing that was consulted on—and that was only among the cognoscenti—was what interest should be in the TDSI scheme.

Brian Redford: That brings a whole load of things together. Having been in taxes for quite some time, I like to think that we will still end up with a bill that someone can understand and therefore pays. It should be a fair reflection of the income that they have received from all sources. Each of these measures is targeted to reflect the changes that are happening in the wider society and the economy. Playing back to the start of Pay As You Earn, those who had significant amounts of investments bearing interest or who would have bought shares in companies and had dividends simply would not have been in a landscape that would be recognised in Pay As You Earn. Each of the policies is therefore attempting to target specific areas where we know that individuals have problems and to come up with a way of reflecting what current life is like and our society looklike. So both for dividends or the allowances that are now available on interest, effectively 95% of individuals who receive either will no longer have to worry about them. They will not have to make a return or account for tax. The money they receive will be theirs to do with as they will. That leaves us with the more difficult cases as we move on to those on higher rate taxes or with a complicated mixture of different investment vehicles. Essentially we are trying to improve the administration and take away the worry for very large numbers of the tax-paying public.

With regard to interest, we were trying to resolve two very difficult things for that 95%; that is, very large numbers of individuals were being overtaxed and, despite a number of tax-back campaigns and encouragement by banks and building societies, did not register to receive their interest gross or did not claim back the difference between the nil band or the 10% band as it was. Equally, we have a tax gap, which is certainly greater than £100 million, that runs from individuals who move into higher rate taxation and assume that the banks and building societies have resolved the extra liability for them by deducting tax at source. That is not true. By introducing a 0% rate to £5,000 and then the new savings allowance, we are essentially saying that for many people will now potentially have the first £6,000 of their interest tax free, which we know will be more than 95% of the population. Yes, it will leave us with some rough edges. Of that 5%, the vast majority are already within the self-assessment regime, so they put their information into the self-assessment calculator at the year end. It will calculate their tax and give them the correct answer. We will be left with a small group of people, probably around 7,000 to 7,500 with dividends and around 8,000 people with interest, who will now find that they receive interest or dividends greater than the £5,000 threshold and will not be in self-assessment. As regards interest, they might not have sufficient Pay As You Earn income to collect the tax. We will have to make special arrangements for that group. But when looked at in the context of the very large number who will now have no administration requirements with the department, we can focus our energies on that group.

Lord Turnbull: You making an ex-post judgment there by saying that these people will not pay tax. But they will not know that until some rather complicated calculations have been made. I assume that you are not changing the basis of responsibility in that the taxpayer has to take responsibility for the accuracy of the figures.

Brian Redford: Yes.

Lord Turnbull: We are getting into a situation where some of this money will not be deducted at source but will be covered by a coding. When it arrives, instead of your number being, say, 97466 it is 8394, and you have to work out why that is and whether it is accurate. I do not think you are doing enough to equip people to make that kind of calculation, yet ultimately they have to take responsibility and can be in a lot of trouble if it turns out that you gave them a coding that is wrong, perhaps because something was missing. The idea that people will not pay tax is not the same as the number of people who now have to spend time looking at their figures that either they have collected or HMRC has put to them to see whether they are accurate.

Brian Redford: I agree that an awful lot of this is in the messaging and the support that we give to customers so that they know where they stand. Last week, further information was posted on to the Government's website, and we agreed with the banks and building societies a note of questions, answers and information that they can then use. I know that some of the banks have already started sending material out to those who have deposits with them, and we know that they will use it in their contact centres so that they can give their customers advice. Certainly, anyone who needs to contact us for clarification can do so, but the overriding message that we want to send through the allocation of both the dividend allowance and the personal savings allowance is that the vast majority of people will now no longer have to worry about tax on that income because we will know that their level of income is below both the allowances. We will make a copy of the documents available to the Committee, if that is acceptable.

Lord Turnbull: The weakness in the system is putting it on to a website. We have a note in our papers—it is the first time I have seen it—on abolishing tax on savings, which is quite clear. How was I to know that it exists? I do not go to the GOV.UK website daily or even weekly. All my contact up to now has been that when HMRC has something to say to me, it sends me something. It can then say, "You may need to start looking at this website". But I would need some sort of prompt and I have not seen the prompts in the system. We are eight weeks away from the start, which means that people could be taking decisions now. They may ask, "Do I invest in this kind of bond for that kind of duration?", and so on, which will be affected by this, but millions of people will have no idea that this is about to happen.

Brian Redford: I do hope that the banks and building societies are now engaging with their customers.

Lord Turnbull: What about the HMRC engaging with its customers?

Brian Redford: That would be one direct route, because we know that customers will be going to their banks and building societies to do exactly as you say. They will be asking, "What am I going to do in the next fiscal year, given the value of my investments?" We will change our coding notices for people who currently have to have the bank interest coded out. I am sure that Emma will talk about the personalisation that now goes into those notices of coding to make it very clear why an individual's tax code has changed and what it reflects. It will also provide prompts towards the website. Our balance has been one of: when do we provide as much information as we think is appropriate so that it is not too early so that people forget about? It should come just at the point when they are making their decisions for the coming tax year. That is why the information has gone out in the past week. We will be engaging further with the banks and building societies.

Lord Turnbull: You say that it has gone out to the banks and building societies as well.

Brian Redford: Yes, and they are now using it as a question and answer guide.

Lord Turnbull: There is quite a lot of interest that is not in this scheme, so people are going to have to know how to deal with that.

Brian Redford: Interest that was not previously subject to deduction at source because it was not part of the bank and building society TDSI will continue to be taxed depending on where someone is with their personal savings allowance, so the individual's obligation to get information about that interest and return it to HMRC will not change. Our challenge here is to convey convincingly to the vast majority of people that this is very good news not only because they get an extra allowance but because we are taking away any requirement to have to register for gross interest, to claim back tax, or to worry about whether there is further tax to pay.

Emma Churchill: That is really important. For the vast majority of people, this is not just a better tax position but a reduced administrative burden. For all the people whom Brian was talking about earlier, who under the current system might have had to try to reclaim tax back or by coming to give us the form, saying, "I don't need to pay that tax", that administrative burden is reduced. Many of those people are our most vulnerable customers and we know that some of them were not doing that and so would have been overpaying tax.

Where I agree very much—and I know that some witnesses have raised this with you—is on the importance of the clarity of the communications. I know that our coding notices have been criticised in the past for being couched in HMRC language rather than the sort of language that a normal human being would understand. We have made significant improvements in that. The P2 notice of coding has recently been completely redesigned in co-design with customers and representative bodies. Stakeholders have told us that they think its clarity has significantly improved.

The other important point that you make about the coding notice is that we must be absolutely clear with people which interest we have coded into their PAYE so that they do not have to guess whether that information was correct. I know that the Committee has talked about the importance of disaggregating different types of interest so that somebody can see at a glance when they get the notice from us whether the information that we received was accurate and whether, therefore, they can sensibly be expected to know whether the information that has gone into the system was right. As we go forward, that will be an incredibly important part of everything that we do, whether it is the notices that we will send to people in a traditional way by post or the information that we put into people's personal tax accounts.

Lord Kerr of Kinlochard: I think I understand what is being said, but it seems to me that there is another group of people—perhaps a larger group of people—who are uneasy because they are puzzled by, or will become uneasy when they are aware of, what is in the Finance Bill. The absence of anything on ISAs is probably the thing that will puzzle people most. For a huge number of small savers, the ISA has become the way of doing it. Here we do not see uprating on the tax-free permissible annual investment. Here we see the introduction of the personal savings allowance. It is not clear that an ISA is a sensible investment any longer for the small saver—the basic-rate taxpayer. He might do better by investing direct. He or she is not really aware of that yet, but when they are aware of it I think they will start worrying about it—there will be an uneasiness. For the higher-rate taxpayers, there is probably still an attraction in an ISA, but you have to think about these cliff-edges at the different rates. Coming back to Baroness Wheatcroft's point, are you sure it would not have made sense to provide some sort of road map? Are you sure it would not make sense even now to say something about the future of ISAs?

Cerys MacDonald: The Government have made it clear and the Chancellor has said in a number of statements that they stand behind ISAs and remain committed to the ISA vehicle. Indeed, alongside these changes, reforms are being made to the ISA policy landscape to make them more flexible, so that people can take money in and out throughout the year to serve their purposes. We expect ISAs to remain a very popular savings product, as they are today. Over £400 billion of investment is sitting in ISA prodcuts in the UK and we do not expect this to change that significantly.

Lord Kerr of Kinlochard: If that is your view, could that not be spelt out in some sort of road map, which would explain how these various new elements fit into the existing picture and provide some sort of reassurance to the small investor?

Cerys MacDonald: That is a good challenge. We should make sure that we challenge ourselves to look at the material that is available in the public domain so that it covers the entire landscape and is written through the eyes of a particular individual rather than through the eyes of a particular fiscal event. As Emma has alluded to, HMRC is doing a huge amount of work to improve its communications with customers and to make them more customer-friendly. I think that is a very good challenge and one that we should take away.

Lord Turnbull: The Government are saying, "ISAs are a good thing and we will substantially increase the limits and the flexibilities", which means that they are telling people that this is a recommended form of savings. But for a lot of people it will not be the best form of savings, because they would unnecessarily incur the management costs of whomever they are investing with and who is managing their money for them, when they could do the thing direct, either by owning shares direct or by having savings accounts. With the cash ISAs in particular, why do you need to involve anyone else? Why do you not simply go direct to a bank? The Government should be saying to people, "For a lot of you, the ISA is no longer necessary. You can have all the advantages of it without actually having to have an ISA and all the complications about limits and times and involvement with a provider".

Cerys MacDonald: It is important that we provide the right information to allow people to make those informed choices, but it is not for the Government to direct individuals towards a particular savings strategy.

Lord Turnbull: I am saying that they are doing the opposite. They are not directing people. They are giving them nudges and winks, saying that basically ISAs are a good thing. They are giving information when they should not be. It is called mis-selling.

Brian Redford: I guess that in tax terms we would want to leave the decision to the individual investor, but the one benefit of the ISA over and above the personal savings allowance is the ability to bank investment that will then remain tax-free for as long as you wish to keep it by rolling it and rolling it. For those who are beyond having some thousands of pounds in an account that bears interest that is now going to be tax free under the personal savings allowance, the ISA still fits a very important part of their investment strategy if they want to save for the longer term and still want to benefit separately from their personal savings allowance. As Cerys said, the Government have an ambition to make those products more flexible by introducing different investments that you can put in or, most recently, the help to save ISA, which forms part of the Government's strategy to add in a bonus for personal property ownership. They stand alongside each other. I absolutely understand the question whether this might overly complicate the investment landscape, but not to provide them would overly restrict customer choice.

Q81 The Chairman: There seems to be a considerable amount of change. As Members have said, change brings about anxiety. What steps will HMRC take to communicate? I think this is available if you go on to the website. It is pull rather than push. Are you going to mail a communication pack to taxpayers?

Brian Redford: We do not have a plan at present to mail the whole customer population that might have tax on interest. Our preferred method is to do this through the point at which they generally interact with the system, which is through their bank or building society. There is now further information on the GOV.UK website, including guidance from HRMC that was produced on Budget Day to explain the changes that were being made. Further guidance went there this week. As I say, our big push is how we work with those who directly engage with the customers—the banks and the building societies—to explain in some detail, through what is about a three-page information sheet, what it will mean not to have tax deducted in the future and what allowances individuals will now benefit from and therefore what declarations they have to make to HMRC. We would want to follow that up not too long after April, to understand what customer understanding is in this area.

You will be aware from other commentators to this Committee that research undertaken a couple of years ago pointed to a very low level of understanding among those with interest-bearing accounts as to the taxation position. We are trying to simplify that. Part of the challenge is to get that simplification measure over. If we have to do more with the banks and the building societies later in the year, we will step up to that mark. If we find that we are getting quite a lot of confusion and that manifests itself through contacts to HMRC's telephone lines or through correspondence, we will look to respond. I do not think that we have finished and that is the end of it. We now need to understand whether the messages that we have put out are understood and whether there is more that we have to do.

Q82 Baroness Drake: Staying with that point, the efficiency of your communication plan to taxpayers will depend heavily for large numbers of them on the efficiency of the banks and the building societies in communicating the information. When we talked to some representatives of those financial institutions, they talked about being in ongoing discussions but could not give us any certainty as to whether those discussions would be robustly finished in time for the implementation. So how can we be confident that your discussions with them and their readiness for this will deliver their contribution to the efficiency of your comms plan?

Brian Redford: We have finished the discussions in so far as this is an agreed text that has been proofed by a number of our stakeholders, including John Whiting from the OTS, those from the Low Incomes Tax Reform Group and other commentators, who say that it conveys the message that we want to convey in language that we think most customers will understand. So only as of last week did we mail that final proof to all the banks and building societies. I fully expect it to start appearing now in branches in static stands or to be given away when people come in and ask about products for next year and what they should do this year. I believe that some banks and building societies are thinking about mailing it out to their customers as part of their end-of-year financial summary. We do not have a locus where we can insist that they do any of those things, but the commentary that we are getting from the banks and building societies is very positive that they are taking that up and briefing all their contact centre staff so that they will be able to provide advice and support to their customers. But I would be very interested, as we move beyond April, to understand how well that message is landing and whether we need to do more. As I say, if we start to receive many calls and contacts from people who are confused, it is absolutely right for the department to put more effort and energy into conveying that message more strongly.

Baroness Noakes: You talk about banks and building societies and the savings allowance. Are you having equivalent discussions with dividend-paying organisations? Banks and building societies have a genuine desire to help their customers. I do not think that companies are in the same relationship with their shareholder base, which is very diverse; we do not have the same relationship with them. What are you planning to do for that group, because there will be a large number of people with small holdings as well as the ones further up the scale?

Brian Redford: The legislation that was most recently enacted removed the requirement for companies that pay dividends to create a voucher that shows the tax credit: that has gone. They are still under a requirement to produce a dividend voucher when they pay a dividend to an individual and mail that out so that the individual is aware of the dividend that they have received and the price per share that they are getting.

Baroness Noakes: But is anybody telling the recipient what the new rules mean—including the higher rates?

Brian Redford: As you say, it is incredibly diverse, from the very large blue-chip companies that will mail millions of these vouchers right through to individual company-owner concerns, so we do not have the same ability to say, “Would you do this with all your customers?” To that extent, we have not engaged with them to ask them to communicate; our messaging has been via the government website and will be reflected in our self-assessment products, which will show the different allowances.

Baroness Noakes: And does HMRC think that putting messages on the government website is a good way of communicating with the large number of taxpayers who will be affected?

Brian Redford: Generally, yes. We get very high traffic through GOV.UK and the tax-related pages on that. We know that social media is becoming more and more used, so as a method of communication that ensures that up-to-date information is provided for the widest possible audience, it is a very good way of communicating.

Q83 Baroness Drake: I would like to see the demographic breakdown of that comment—but anyway. One of the purposes of the changes to dividend taxation was to address the situation where private companies pay less tax and national insurance contributions by structuring payments as dividends rather than salary. Could you comment on why the proposed changes to the taxation of dividends were considered a more effective way of addressing this issue than the approaches that the OTS had recommended?

Cerys MacDonald: Yes, of course. As I said when I responded to Baroness Wheatcroft earlier, the UK tax system treats the employee, the self-employed and the incorporated differently. That is a long-standing feature of the tax system. But in wanting to go further and reduce corporate tax rates, the Chancellor was very clear that he could go further on headline rates only if the rates of taxation on dividends were addressed, both to reduce the incentive for tax-motivated incorporation and to limit the fiscal cost of reducing the headline rates, particularly for smaller, privately-owned companies. I am not aware of whether the OTS has made any specific recommendations on the reform of the taxation of private companies, but the Chancellor did indeed at the start of this Parliament ask the OTS to undertake a wide-ranging review of the taxation of small companies. We are expecting that report ahead of the Budget and I expect the OTS to make some far-reaching recommendations in that area which we will need to consider.

Baroness Drake: I might be wrong, but I thought that the OTS had recommended that one of the ways to address this problem was closer integration of tax and national insurance contribution regimes.

Cerys MacDonald: The OTS is also undertaking a second wide-ranging review, which is into the closer integration of income tax and national insurance, although of course that undertaking in itself would go far wider than just looking at the tax treatment of personal service companies. I do not think it is possible to look at any one aspect of the regime in isolation. What is particularly welcome, going back to our earlier conversation about the role of the OTS, is the fact that it is carrying out these reports in a public way so that some of the trade-offs between things that could be achieved for simplification purposes and things that may be achieved for reducing distortions in the tax system can be debated publicly.

Baroness Drake: And was any assessment made of the impact on the compliance costs for small businesses of these changes?

Cerys MacDonald: Of the increases in dividend tax? Yes, alongside the draft legislation, the Government published a Tax Information Impact Note that would have set out what we consider to be the administrative costs of the changes. I am afraid that I do not have a copy in front of me, but I can make one available to the Committee. It is routinely done as part of the policy-making process.

Baroness Drake: I have a follow-on question. Others have speculated that there could be wider consequences from the dividend changes, and in particular that some private landlords may use incorporated structures in future to get round some of the buy-to-let charges. Has the Treasury thought of that possible consequence, and how would it respond?

Cerys MacDonald: We think about the knock-on consequences of pulling a lever and what behavioural shift that may cause elsewhere. I am not an expert on incorporation, but as I understand it a number of different tax charges may well be triggered were a landlord to incorporate. For example, stamp duty and capital gains tax would need to be taken into account, so I do not think incorporation is that straightforward a loophole in order to side-step the tightening up of mortgage interest relief. There are a number of factors that an individual landlord would need to take into account. In some cases it may well be in their interests to incorporate, but in many it may not be.

Q84 The Chairman: We have heard from a number of witnesses, particularly those representing small businesses, that this will create a significant additional burden and that the quarterly accounts will also impose additional work on small companies whose incomes fluctuate and do not do tax accounting on a quarterly basis; they do it annually. How are those companies going to cope with the increased requirements?

Emma Churchill: Do you want me to say something about the quarterly updates, because I think there has been a bit of a misunderstanding about the announcement that was made in the Autumn Statement and then again in the Making Tax Digital road map that we published in December. HMRC has put out some hopefully helpful myth-busting paperwork which we will make available to the Committee if you have not already seen it. It is certainly not our intention to introduce four tax returns a year. We are going to consult on the information that businesses will be required to keep digitally, and the information that they will be required to send us via a quarterly update, but that does not equate to four tax returns a year. The announcement was focused on the way in which businesses will be required to keep their records in the future. Obviously requirements are already in place for businesses to keep the information required to complete the tax return at the end of the year. What we have announced that we will require businesses to keep that information digitally within software or applications that are then linked directly into our systems. We have an API strategy which the Committee may be aware of where we will make APIs available to software companies so that they may make software and apps that integrate directly into the back-end systems of HMRC. The point about digital record-keeping is that it will reduce very significantly the amount of errors that are made. We lose approximately £6.5 billion in revenue from simple mistakes and errors that are made in the system. The Committee will know that £920 million of revenue was put on to the scorecard at the Autumn Statement as a result of this measure. That is not as a result of requiring quarterly tax returns; it is simply the result of the much better record-keeping that businesses will be doing in the future. This will be done in a timely way because we will ask them to update our systems on a quarterly basis with the information that they will be recording digitally in their software or their applications.

Baroness Wheatcroft: How can we be confident that the errors that occur at the moment are so heavily balanced against the Government, and that you are confident that when the digital transactions begin and thus businesses are monitored quarterly, the accuracies will make such a big positive difference for the Government rather than the other way around?

Emma Churchill: There is quite a lot of evidence about the type of mistakes that we commonly see made in those returns. The evidence that we submitted to the OBR, which had to scrutinise it very closely as you can imagine, showed quite strongly that the mistakes were significantly in that direction, if I can say that, with the tax gap. We were heavily scrutinised by the OBR, but I do not know if the Committee has seen a copy of the costing note that the OBR published at the time of the Autumn Statement. Again, I am happy to make it available to the Committee. The benefits to HMRC are very substantially in that revenue, but there are also benefits for businesses themselves. The implication in the question earlier was quite right for many businesses, particularly large ones. They will not be able to see, having submitted information on a quarterly basis, what the final tax bill for the year will be, but around 3 million small businesses have incomes below the VAT registration threshold and are therefore working on a cash accounting basis. Of course, when they send us the quarterly information update and it appears in their personal tax account or business tax account, they will be able to see the amount of tax that will become due. We think that will enable them to plan their business much better because they have greater certainty about what tax we will ask them for. We think there are benefits both for us as the Exchequer but also for small businesses themselves.

The other point I would make in respect of administrative burdens is that we know that many small businesses will need support during the transition phase. We have said that free software will be available and we will work closely with the software companies to make sure that it is, although many businesses may choose to use commercially available software that has additional functionality if it supports them in running their business. Once businesses have made the transition to the new system and have become accustomed to it, there is absolutely no doubt that the button they will need to press in order to push the information into our systems will be significantly less burdensome than the current arrangements for tax returns. Indeed, we think this is going to take HMRC a long way towards the new target we have been given to reduce the burdens of administration for small businesses by £400 million.

The Chairman: Will this quarterly update, as you call it, lead to a quarterly tax demand?

Emma Churchill: We published alongside the road map a discussion document on payments, which I am sure the Committee will be aware of. We wanted to start a discussion with stakeholders about whether some alignment of payments dates would benefit them.

The Chairman: When you say stakeholders, do you mean taxpayers?

Emma Churchill: And their representative bodies.

The Chairman: Many of whom aren't represented.

Emma Churchill: Of course, we are talking to representative bodies in the consultations we are running at the moment, but we are also talking directly to businesses themselves, particularly small businesses, because it is generally small businesses that tell us that they would rather have a system whereby they can make more regular payments, because again that enables them plan better and manage their cash flow. No decisions have been taken about where the future might lie on payments, but there is the discussion document that we published and the consultation is going on at the moment.

Q85 Baroness Drake: Perhaps I may continue on that point. Obviously these changes will facilitate quarterly tax payments if that is the direction of travel decided upon, but I want to look further into the balance of benefits for the assessor and those for small businesses. The Treasury submission to the Lords Economic Affairs Committee states in paragraph 8 of the introduction that, "HMRC will collect and process information affecting tax in as close to real time as possible, stopping tax due or repayments owed from building up. For businesses, that means submitting details of income and expenditure quarterly using software or applications." I would assume that small businesses reading that as the drive behind HMRC's change will be quite anxious before they press the Send button. There will be a consequence from that data being captured and there might be a move towards quarterly tax payments. I know that the Economic Secretary is saying that this is all meant to be helpful, but individuals may well be anxious if they need to commit a lot more time on a quarterly basis and need additional accountancy help in order to deal with it. How is the balance of that behavioural reaction being struck? The Treasury or HMRC might be saying that this is highly rational and from a detached point of view it is beneficial to both parties, but a very small business might become quite anxious and see the compliance response as much greater than your more detached and rational analysis of this change.

Emma Churchill: I completely accept that this is a rational explanation of the change. In the first instance, when small businesses push the button that sends the information to us, they will see that immediately in their business tax account and therefore see the information that they have given us and what will mean, or indeed not mean, for their tax bill. They will have greater certainty about what that might be going forward. This is particularly the case for small businesses, as I said, that are operating on a cash accounting basis. This is why we want to consult small businesses directly as well as their representative bodies on a number of points about how we will implement this. We will include in the consultation exactly what kind of information we will require businesses to keep digitally. We will also consult on which information is pushed through the system into ours in order to play it back to them through the digital account. We will consult on both those things. So I hope that through the consultation period we will have a chance to reassure small businesses in particular about compliance activity, which you raised. The Minister in the Westminster debate the other day gave very clear reassurance that we do not intend the quarterly updates to increase the level of interventions by HMRC. That is not our intention.

The road map makes clear that we will publish a number of consultations throughout 2016, which will of course culminate in clauses for the Finance Bill 2017, on which there will then be further consultation. One of the reasons why we are looking to make 2016 such an intensive year of consultation is that we want to make sure that businesses have a chance to express concerns and ask questions and that we are absolutely clear not just about the information that we are asking for but about what we will do with it when we have it.

Brian Redford: I have a couple of things to add. We have many businesses that are used to more regular engagement with HMRC through the VAT returns system, so they are used to providing electronic information on a more real-time basis and settling bills or claiming a repayment. One of the overriding things that businesses say to us in trying to frame a fair and efficient tax system is that they want certainty, and when they are met with a tax bill that they had not expected some months after the end of the year and they have to go to the banks to borrow to cover it or to change an investment that they might have made in the business, it is really important to them to have that certainty as early as they can. Irrespective of a move to equate earlier knowledge of a bill with whether it is paid or not, which we will consult on over the summer, the businesses have been very clear that they want to know where they stand as they go, because it helps them to run a better business.

Baroness Noakes: You have talked a lot about the consultation. We heard last week from witnesses representing small businesses. A point was made that they understood that there was no intention to produce an impact assessment for your proposals for the extra information that will be required quarterly from companies. There was quite a strong feeling that this would place a significant burden on small businesses through the additional professional fees that they would incur in compliance. You quoted a figure for your contribution to remove administrative burdens, but I would guess, given the sheer number of small businesses and the change in record-keeping that you contemplate for them, which they would have to discharge with professional help, that the burden would be significantly more than the figure you quoted earlier for the administrative savings that you calculate. Is the intention to produce something that shows both the benefits to the Exchequer and the burdens on business, because I do not think they are insignificant; certainly that was the evidence that we received.

Emma Churchill: That is certainly our intention. Initial information on the impact will be published alongside the consultation, when that comes out in the spring. Then, of course, there will be a full set of information on impacts when legislation is published in December. It is absolutely our intention to do that.

Baroness Noakes: Before I move on to my question, I have a question about personal service companies. I should say that I chaired the House of Lords Select Committee on Personal Service Companies a couple of years ago. One of the things we heard at that stage about keeping IR35 was the risk to the Exchequer, which I recall was £400 million to £500 million. The dividend changes would reduce that impact. Have the Treasury or HMRC calculated what risk to the Exchequer they consider would remain post the dividend changes?

Cerys MacDonald: Yes. Alongside the summer Budget when we announced the corporate tax rates and associated dividend tax changes, we were clear that the Revenue gain from the dividend tax increases was in the region of £2.5 billion, £500 million of which came from the savings from reducing the incentive to incorporate. However, we also set out in the Red Book at the time that the associated costs of IR35 continue to be in the region of £500 million. That is £500 million that we are losing, and it is no coincidence that the number has stayed static and we have done something else. The methodology in the OBR's forecasts has changed, but we are still at risk, and the Chancellor has indicated that HMRC is reviewing IR35 at present.

Q86 Baroness Noakes: Thank you. We have talked quite a bit about the work that has been done by the banks and building societies to make people aware of the personal savings allowances. We had evidence earlier in our sessions from those who said that because of the lack of awareness of individuals about this, there would be an Exchequer risk from changes not being properly understood: from people not understanding what their obligations would be to return income because of a combination of the complexity of them, especially when you go over the thresholds, and the lack of information that was being put out. To what extent do you consider there to be an Exchequer risk from a lack of taxpayer understanding of the changes that are being brought in?

Brian Redford: Perhaps I can talk about our plans to support customers, and I will ask Emma to cover the impact on the personal tax account. As I say, the original policy intent was essentially to remove both the worry and the taxation for the largest number of people. Beyond that there will be individuals who have income from interest that is beyond the allowance and who therefore need to pay the tax that is due both at the basic rate and as they move up into the higher rates. As far as we are able, we will do that for them through their Pay As You Earn coding, so we will receive details of the interest that is being paid on deposit by banks and building societies. We will then undertake to amend the Pay As You Earn coding, at the level of granularity that Emma laid out, to ensure that the customer knows what the liability is. Do you want to fill in the detail, Emma?

Emma Churchill: Only in the sense that it is important to say that there was already a potential tax gap risk in this area, because although the tax on interest is deducted at the basic rate, there is currently a significant number of higher-rate taxpayers who of course ought to be informing HMRC of that and paying tax on their savings interest but who, as we know from research that we have undertaken, are not aware of that. Actually, through our proposals for coding out for the vast majority of taxpayers who will still owe tax under the new system—and as Brian points out that will take a lot of people out of the tax altogether—for those who still owe us tax we will be able to collect it through the coding out of PAYE and to do it at the correct rate, whether that is the basic rate or the higher rate. So by doing that we will have closed an element of the tax gap.

There will be a very small number—our current estimate is that it will be in the low thousands—for whom we will not be able to code out the tax that they owe, and we will need to inform them of that. For the year 2016-17 we will do that in the summer or autumn of 2017, because we will know that those individuals owe tax on their savings interest, which we have not been able to code out. We will either write to them or, if they are in a personal tax account, indicate to them through their personal tax account that an amount of tax is owing. Of course, they all have a wide variety of options for payment of that tax.

Baroness Noakes: How effective is coding out for dealing with taxpayers who hit one of the cliff-edges and go into the higher rate and additional rate bands?

Emma Churchill: We will code out on the basis of an estimate of whether that person is a basic-rate taxpayer or a higher-rate taxpayer based on what has happened in the previous year. You are right to say that there will be some cases where we will need to reconcile at the end of the year if the assumption has turned out to be wrong. If someone had been a basic-rate taxpayer the year before but has now moved into being a higher-rate taxpayer, we will have coded out on the basis of them being a basic-rate taxpayer the year before, so at the end of the year there will be some additional tax to be paid.

Baroness Noakes: Or vice versa.

Emma Churchill: Yes indeed.

Baroness Noakes: So if it is the other way around, does HMRC have an obligation proactively to search out those areas where they have over coded?

Emma Churchill: Yes, absolutely. It would be equally clear to us in our systems if we had assumed the higher rate figure and in fact someone turned out to be basic rate for that year. We could put that into the end of year reconciliation and code it out. We are able to deal with that.

Brian Redford: Can I just add to that as regards mistakes? A very significant proportion of those individuals will also be within the self-assessment system in any event, so their annual reconciliation, even though they will have had a figure deducted through coding in Pay As You Earn, will be reflected in the self-assessment process. If a repayment is due, it would be generated as a result of that.

Baroness Noakes: Does that mean that the population of self-assessment payers will not change?

Brian Redford: We are making a number of changes to remove as many people as we can when we decide that they are low risk and no longer need an SA return, but for this particular measure I do not believe that it will result in a significant reduction in the number of those within self-assessment.

The Chairman: First, the new regime will require a much greater amount of third party-generated information. We have been told that many third parties simply do not have the taxpayer identification. How will you resolve that issue? Secondly, will the taxpayer receive a simplified form which explains where the money has come from and how it has been calculated so that they can actually compare that with their own experience in their bank details?

Emma Churchill: Of course you are right that matching the data is going to be incredibly important, as will be doing that as accurately as possible. Indeed, it is something that will be very important during the coming year when it comes to matching the BBSI income so that we can correctly code out. In terms of the level of confidence we have about the information that is already coming to us from the banks and building societies, as you would expect, we have been doing a series of test matches in our data systems. At the moment the level of accuracy is high, in the mid 90 percentage points. Of course that is not 100%, and we will be talking to the banks and building societies about whether there is anything we can do to increase it right up to 100% matching.

The question you asked is about the future road map. You are right that we have said that in order to end the tax return, what we need to look for is a greater range of data from third parties. Before we get to that point, I should say that there is a very significant amount of information that HMRC already collects but which we do not utilise in a way that is helpful to our customers. If we go on to talk about simple assessments, we will come to some examples of that. What we have said is that where we think that better and more data feeds from third parties will reduce the reporting burden on individuals, that is a conversation and discussion we want to open up with those third parties. We have said that we will publish a consultation document later in the year which will look at those potential sources of data and how that might work. In the run-up to developing the proposals, we will of course be talking to a range of stakeholders and those from whom we might potentially be getting this information. What we need to be able to do within our own systems is take the information that we are given and match it accurately to the customer to whom that data pertains. We are doing a very significant amount of work in HMRC at the moment looking at our current systems and trying to move towards a position where we will have what we call a golden customer record. Of course we have a large number of legacy systems. At the moment it is not the case, whether you are an individual or an organisation, that we have a single golden customer record where we have with a high level of confidence associated all the different records about you. As I say, a significant amount of work is going on in HMRC to create that golden customer record. The issue about matching is not just about the quality of data we get from other organisations, it is also our own ability within HMRC to be clear that this is the customer who we need to match the data to. We are not at all complacent about the amount of work that needs to be done in order to achieve that. We are getting on with the work, as you would expect, as we discuss with those potential third party data suppliers what the consultation proposals might look like. They will include the kind of data attributes, if you like, that we would need in order to match with a high level of accuracy within our own systems before we present the information to the customer.

The Chairman: Will the taxpayer receive a summary statement of all of the inputs that you have to collect?

Emma Churchill: There may well be a summary at the end, but it is important that it is not only a summary that they receive. This goes back to the conversation we had earlier about the importance of disaggregating for customers all the data sources. It is no good showing someone something and saying that the answer is 152. How would I as a customer know whether that was the right number or not? It is very important, whether our communication with the customer is through the post, the traditional way, or whether it is as it increasingly will be through the personal tax account, that we set out clearly exactly what information we have, from what source, and how those pieces of information have been used to prepopulate and come up with the tax calculation.

Baroness Wheatcroft: Getting these systems up and running is clearly a massive undertaking. Do you have the resources within HMRC to do that or are you having to bring in resource from outside to get all this ready in what is really quite a short space of time?

Emma Churchill: Of course, this is a five-year programme. We have not even got to the point yet where we are ready to consult people what that new third-party data might be. So we are not quite there yet, but the Chancellor's announcement in the spending review of £1.3 billion of investment in HMRC over the period specifically for the work that we need to do to make a reality of the vision that we have set out in the Making Tax Digital road map. We therefore have £1.3 of investment to make the changes to the underlying systems that we need.

Baroness Wheatcroft: And is that going on bringing in HMRC staff, or outside consultants and so on?

Emma Churchill: The programmes will need to do a range of things to deliver. Once we have consulted and had the new legislation, we will have programmes that are designed within

HMRC to deliver, and the investment will go on a wide range of things, including the systems changes that we need to make to the underpinning systems—the plumbing, if you like—in HMRC, and the development of our digital accounts, which our customers will see increasingly in the future. It will also go on the integration layers within our IT that we will need in order to make the back-end systems translate for our customers what they need to see. That investment will be made to develop all those systems.

It is also important to say that we also have in our spending plans for HMRC the support that customers will need to make the transition to digital. We have not forgotten that there will be customers right through this period who will need a range of support, including by phone. The Committee will know that customer service on our phones has not been good enough in the past. We have seen investment in that, which has led to significant improvements. Over the self-assessment peak, 90% of calls were answered in five minutes. We know that not all customers will find the transition to digital easy, and that we will need to continue to invest in multichannel support, whether by phone or through our Needs Extra Support service. So there will also be spending and investment in supporting to make the transition to digital.

Q87 Lord Kerr of Kinlochard: You are going to introduce so-called simple assessments, which will go out in summer 2017. Your evidence to us says that you plan to send them to about 750,000 taxpayers, principally those who do their own tax returns—pensioners, those on a low income. Are you sure that you have available for them the support that they will need as they take on this task of checking your assessments? What sort of support will they get?

Emma Churchill: The full range of support will be available to them. I should say that we are starting with that customer segment because HMRC is not reliant at all on getting new information from them into our systems in order to give them tax bills. These are customers for whom we already have the information in HMRC. Nearly 750,000 of those customers will have underpaid on their PAYE the previous year but for whom we cannot code out. At the moment, that is information that we send to those customers. We say, "In order for us to enforce this tax bill, we need you to fill in a self-assessment return", and we send them a notice to file. You will not be surprised to hear that our advisers take a good many calls from people saying, "You have sent me all this information". We say, "Are you happy that it is correct?", and they say, "Absolutely". We then say, "We would now like you to key all that information into a self-assessment return", and they say, "Why? You're the people who have sent us this information". For 2016-17, and the letters that we will send out in 2017, we are trying to avoid telling customers simply that we know this information to be true, either because we have had the data from an employer or, in the case of a much smaller number of pensioners who receive a state pension that puts them over the personal allowance, because they agree with us that it is right but we still have to ask them to fill in a self-assessment return, because otherwise we have no means of enforcing that payment. This is designed to be a significant reduction in the burden for those customers, but of course we will need to make sure that the notifications that they receive are crystal clear about the information that we already have in our systems and why we therefore believe that the tax due is what we say it is. It is to avoid the very unsatisfactory situation where, even though we have absolutely all the information that we need in HMRC, we still ask people to fill in a self-assessment.

Should they believe that the information is wrong, there is a full range of channels through which they can get support. They can phone us, as I said. But we appreciate that it has not been adequate in the past.

Lord Kerr of Kinlochard: That is where I start to worry. I start to worry anyway when you say that you have the information and that you know. If the replacement for tax deduction at source and for dividend vouchers and so on has gone swimmingly, the information that you have will be correct, but I do not know that you can really assert that you have all this information, because quite a lot of those 750,000 people will have some sort of income in addition to their pension or their wages. You say that they may telephone. I have never got through in less than 50 minutes. You say that it will all be online, but your own documents show that 7 million people are digitally excluded. I am uneasy. I see what could be a train crash coming down the line. I have been struck, as we go through this session, by the way you reply to questions about informing the taxpayer. In answer to the question about the abolition of tax deduction at source on interest, your reply several times was that you are talking to the banks and the building societies. When the question was about the end of the dividend voucher, you said that you are talking to stakeholders and companies. You tell us that all the information that the taxpayer needs will be available on the government website. I think the taxpayer likes to think that he has a relationship with his tax inspector and would expect to hear directly from HMRC about changes, not necessarily a communication specific to him and not necessarily telling him about the changes in the numbers for him, but a communication telling him about the changes in the regime and the changes in the administration of the regime. I have heard nothing yet about that direct communication to the taxpayer. That is really quite important.

Emma Churchill: It is worth taking a couple of steps back to the beginning of your remarks. I just want to be clear that the simple assessments that we will send out in 2017 will not include the dividend, so they will not include people who have dividend income because we will not have put a system in place whereby we receive that information from third parties. The simple assessments that we will send out in 2017 are really only, to start with, for customers who have only the underpayment from PAYE the previous year, because we have that information through the RTI system from employers and for the very small group of pensioners I referred to where we have the information from DWP. So it is only those groups of taxpayers who we will send a simple assessment tax bill for the year 2016-17.

Lord Kerr of Kinlochard: Thank you. I had not grasped that. That is very clear. I am not sure when to date my train crash now. The train may stay on the tracks till 2018.

Emma Churchill: It certainly leaves us with more time for consultation in order to deal with some of the issues you have raised. Perhaps I can come back to your point about direct communication with our customers, because of course we think that that is very important. For customers who have been completely unnecessarily in self-assessment in previous years for the reasons we have articulated, we want to say, "You do not have to do a self-assessment any more. We will be moving you into this much simpler system". That absolutely will be a direct communication from HMRC because we know exactly who those individuals will be. Whereas they would previously have received a direct communication from us stating, "Here is a notice to file. Please fill in the self-assessment form", they will receive a direct communication from us which explains that no longer do they have to be in self-assessment and that we are instead sending them a much simpler tax bill. I should say that if the circumstances of those individuals have radically changed, while of course we will have selected them on the basis of what has happened in previous years, so that they now have other sources of income of which we are not aware, they will need to tell us that. We will be very clear about it because it will not be reflected in the bill we send them. That bill will reflect the information that we already have. Again, we will be very clear about that and it absolutely will be a direct communication from HMRC to our customers.

Lord Kerr of Kinlochard: If you under-record, the temptation of Lord Forsyth's aunt—you are lucky to have been spared Lord Forsyth's aunt because he is caught up in Scotland—who has difficulty with tax matters so he advises her. If you under report on the simple assessment form, I think that quite a lot of people out there will think, "Well, they must know that it is less than I thought it would be, but okay, they know". If on the other hand you over-report, people will panic and start trying to ring you up, at which point the 30-day appeal rule comes in. Are you sure that 30 days is not going to be a little short for people who for the first time are going to have to do things which in some cases, particularly pensioners and the people you are starting with, the lower income groups, are going to be quite difficult and worrying? Are you sure that a 30-day appeal period is right?

Emma Churchill: The 30-day period is for people to check whether the information is correct. Of course this is something that we have put out for consultation. The legislation is out for consultation and this is an area in which we have received a lot of responses, which of course we will take into consideration.

Baroness Wheatcroft: You are talking to stakeholders about how you will get the sort of information that you are going to need. Could you be specific on the issue of dividends? Are companies going to be obliged to tell you about the dividends that they currently pay? At the moment you get the information through tax credits. Are they going to have to make a new and separate filing to HMRC about all their dividend payments?

Emma Churchill: No. For 2016-17 no changes are being made to what people are required to do in respect of dividends. As Brian mentioned earlier, the requirements to send out dividend vouchers are unchanged, it is simply that they will be without the tax credits. We are not asking people to do anything different at this stage. When it comes to further consultation, of course this is one of the areas that we might look at, but we are absolutely not asking anybody to do any more for 2016-17.

Baroness Wheatcroft: How for the purposes of simple assessment will you have the information?

Emma Churchill: I am sorry, I intended to make that clear in my previous response. The information about dividends will not appear for those who are getting simple assessments. The simple assessments for 2015 to 2017 are only for two very narrow sets of customers. The first set is where we know that there is underpaid PAYE from the previous year and the second set is the very small group of pensioners where we know that the state pension they receive takes them over the personal allowance. I think that there has been an unhelpful bringing together of two different areas. As I say, the simple assessments for 2017 are focused on those particular groups. There will not be any information about dividends in the simple assessments because they relate only to information that we are currently holding within HMRC.

Baroness Wheatcroft: What proportion of the people that you think will get simple assessments will then have to use them simply as a starting point?

Emma Churchill: For the vast majority they will not because their circumstances will be unchanged. If there are people in 2016-17 and 2017-18 who have seen a very significant change in circumstances, they will need to inform us of those changes in the way they normally would.

Brian Redford: I think I might be able to pass over some figures which we can check with the Committee Clerk afterwards. Our current estimate is that something like 5.2 million people in the UK receive dividends. The vast majority of them will now no longer have any form of liability because they will be under the £5,000 annually 0% band. We believe that there will be around 8,500 people who will have dividend income of between £5,000 and £10,000. The reason that that is relevant is that those with a dividend level of more than £10,000 will already be returning their income through self-assessment. That is where we will get the information from. So we have a group that is very small in comparison with the 5.2 million group who we will have to work with in order for them to declare the dividends that they now receive. Of course this is one of the areas where the policy means that they will now have a liability where previously as basic-rate taxpayers they would have had a tax credit to offset it. I hope that that is helpful on the numbers, but we will confirm them.

Baroness Wheatcroft: 8,500 is not a huge number by any means.

Brian Redford: No, it is not, but we still need to look after them.

Q88 Lord Turnbull: It states in paragraph 27 of the memorandum you sent us that, "Nine-five percent of all taxpayers—and more than three quarters of all those who receive dividend income—will either pay less tax … or be unaffected", and then you mentioned the very small number. However, in paragraph 30 it states that, "Around 2 million individuals are expected to have some tax to pay on their dividend income after April 2016, compared to 1.8 million if these reforms had not been put in place". In other words, these reforms will bring 200,000 people into paying some level of tax on dividends which they did not before. Can you tell us the profile of those people?

Brian Redford: Under the old system they would have been people who were basic-rate taxpayers, so the dividend credit would have met their liability for those dividends. But in the future they will have a dividend profile greater than £5,000 with no tax credit attaching any longer. They will therefore have to pay tax on the bit over £5,000. So there are extra liabilities within this policy. It is the Government's decision where they choose to tax individuals.

Cerys MacDonald: I do not have the exact breakdown, but in terms of providing a little colour to the profile, a large proportion of them are likely to be owner-manager businesses who are drawing down dividends from the company, but they do not take those individuals into higher rate tax.

Lord Turnbull: You have not mentioned capital gains tax, which produces liabilities that can be highly variable from year to year and for which there is an allowance of something like £11,000 a year. If you have more than £11,000, does that mean that you have to be in the self-assessment system? I cannot see how else this can be dealt with in the simplified arrangements.

Brian Redford: I shall touch on this. You are absolutely right, Lord Turnbull, that this can be a highly volatile area. Individuals will make gains in one year but may not do so for another couple of years. Equally there are concerns if there is a consistent level of gains every year that are returnable. In the past we have used the self-assessment vehicle to deal with those individuals. For people who make a one-off gain, perhaps through inheriting a property which they have let out and then finally sold, it is quite an expensive way of managing an administrative process for one particular gain. One of the things we would like to look at as we move towards simple assessment and the way information is provided is whether there is a way of dealing with one-off and fairly simple capital gains that does not have to have the paraphernalia of self-assessment wrapped around it. We need to look at this. As I say, there are those who are very regular capital gains individuals for whom the self-assessment process is absolutely right, but there is a group for whom we ought to be able to make it simpler. We would like to use the vehicles that we are now constructing to see whether that is possible.

Lord Turnbull: I should like to cover another category of people: those who are digitally excluded. I do not know how many people that would cover, but I would imagine that it is a relatively common occurrence. Let us take a couple, and let us say that the husband has always looked after their financial affairs. He may do that digitally and have a good relationship with it. He dies and the widow is left not only with her own tax affairs, which were probably not complicated, but with the whole paraphernalia of tax, never having done it before. She is possibly in her 80s. How will you deal with that kind of case? There may not be that many of them, but equally they are not going to be that uncommon.

Brian Redford: I agree, and they do exist. It is not an easy position, especially if the spouse has just lost her husband and is left managing financial complexity that she had not previously been aware of. We use our Needs Enhanced Support team to fill the gap. When we are advised of a bereavement and someone needs extra support to put them into a position where they can do the right thing, we will deploy our resources to give them that support. Very often it is linked to bereavement and a declaration for inheritance tax purposes. What we try to do is provide a complete service which makes it as easy as possible.

Lord Turnbull: How will the widow know that this service exists?

Emma Churchill: We have trained our customer service advisers to recognise early on that where they think a customer will need the extra support service, they can be proactive in making sure that the customer gets the support they need. It might be just additional support over the phone or it might require a face-to-face appointment, which our advisers can organise. We have been proactive in training our advisers to make sure that when people come into the system, they can be identified so that the support they need is there for them.

Brian Redford: We get referrals through working with the bodies associated with Low Income Tax Reform and with TaxAid. They will make referrals if they think it is appropriate to do so.

Q89 The Chairman: Can we finish with two specific questions, among many that have been raised by other witnesses, which are really addressed to the Treasury? The first is that the Chartered Institute of Taxation believes that Clause 12A(1) is very confusingly drafted, and in particular does not make it clear that an individual who has savings income below £5,000 is entitled to the nil savings rate. Will that drafting be changed as part of the consultation process?

Brian Redford: Yes.

Q90 The Chairman: The second question is this. Crunch accounting, which looks after 45,000 microbusinesses, has made a range of representations about the impact on small businesses, stating that the burden is greater on small businesses and those that are reasonably new. It regards that as unfortunate and cites a particular example: the director of a limited company paying themselves primarily through dividends will be paying £1,528 more tax a year on pre-tax profits of £48,000, whereas a director with a pre-tax profit of £78,000 will be paying only £1,343 more. Is that what the Treasury intended?

Brian Redford: I will take the first one, because it is easier to respond to. Clause 12A is drafted to give effect to something that we have been discussing: the nil rate band for savings and the personal savings allowance. We are grateful to the Chartered Institute of Taxation and the Association of Accounting Technicians for making those comments. As the Committee knows, the consultation on the draft legislation has just finished. We will fold their comments into that and see if we can make it easier.

The Chairman: What about the regressive nature of the tax on the poor company director?

Cerys MacDonald: I think it is possible to do calculations that can give all sorts of different results on people's tax liability. It depends on how individuals remunerate themselves and whether they are drawing a minimum salary below the personal allowance, what practices they may have for income shifting between themselves and their partner if, as in many cases, they and their spouse are involved in the business, and the strategies they are employing on earnings that they retain in the business for future use. I do not think it is possible to validate the figures quoted without having the specific assumptions that were made in those calculations. I can assure the Committee that we recognise that the dividend tax changes will mean that a lot of people in owner-managed businesses are now paying a higher level of tax than previously, despite the benefit that they will see in the reduction of the corporate tax rate. But they are still paying less tax than they would be if they were operating as a sole trader and not incorporated.

The Chairman: I think the question was whether it was intentional or accidental that this is regressive.

Cerys MacDonald: I do not think I can confirm that it is regressive. It would very much reflect the specifics of the case.

The Chairman: I recommend the statement of Crunch accountants to you. Thank you very much. You have combated the noise of the wind on the windows rather well.