



Select Committee on Economic Affairs

Finance Bill Sub-Committee

Corrected oral evidence: Draft Finance Bill 2017

Wednesday 8 February 2017

3.45 pm

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Members present: Lord Wakeham (The Chairman); Lord Bilimoria; Baroness Bowles of Berkhamsted; Lord Flight; Lord Leigh of Hurley; Lord Tugendhat; Lord Turnbull.

Evidence Session No. 2

Heard in Public

Questions 19 - 34

Witnesses

I: Ms Tina Riches, National Tax Partner, Smith & Williamson and deputy chair of CIOT's Digital and Agent Strategy Working Group; Mr Michael Steed, Co-chair of ATT's Technical Steering Group, Kaplan Leadership and Professional Development; Ms Rebecca Benneyworth, Council member, Institute of Chartered Accountants in England and Wales and chair of the HMRC Digital Advisory Group.

II: Mr David Lyford-Smith, Technical Manager, Institute of Chartered Accountants in England and Wales.

Examination of witnesses

Ms Tina Riches, Mr Michael Steed and Ms Rebecca Benneyworth.

Q19 **The Chairman:** You are very welcome. I should declare that I am a chartered accountant. I suspect I am not the only chartered accountant around this table. I also have to say that I am a client of Smith & Williamson, but we have never met before. In my day, we used to ask the witnesses to say in a sentence who they are so that it is on the tape as well as on the record. If you would each like to say in a sentence who you are and where you come from, that would get us going.

Ms Tina Riches: I am Tina Riches. I am the national tax partner at Smith & Williamson. I am also deputy chair of CIOT's digital and agent strategy working group.

Mr Michael Steed: My name is Michael Steed. I am a former president of the ATT. I co-chair its technical committee but I also stand as an adviser for the very businesses that are in the crosshairs of this process.

Ms Rebecca Benneyworth: My name is Rebecca Benneyworth. I am a chartered accountant. I have a small practice in rural Gloucestershire with very small business clients, probably those at the bottom range of this type of legislation. My main occupation is lecturing to other accountants and tax specialists on the latest tax developments. For that reason I am also chair of the Digital Advisory Group, which is trying to help HMRC come up with some of the right answers.

Q20 **The Chairman:** Thank you very much. We all knew that, because you are all distinguished people. We are delighted that you are here. I will ask the first question and then we will go round the table—the usual routine. Could you give us your view of the plausibility of the Government's assertion that mandatory digital record-keeping will lead to a substantial reduction in the tax gap? You all know the arguments they use about improving bookkeeping. Could you tell us what you think about that?

Mr Michael Steed: Do you want us all to comment?

The Chairman: Whoever wants to start, but please do not all say the same thing. If you agree with what has been said, there is no need to repeat it all. We have a lot to get through.

Ms Tina Riches: I am certainly very sceptical about the figures that HMRC uses in its assertions. I have had over 30 years' experience in tax and accountancy, from very small businesses through to large multimillion international businesses. With the smaller businesses, which the measure is particularly targeted at, I find that when there are errors they go both ways. If anything, small business people tend to know what their income is. If they have had cash takings they count them up, and they know what they took. On the expenses side, they do not necessarily tot it all up. They pay for something, get a receipt and put it in their pocket, and some of those receipts may go astray. If anything, we tend to find that the errors are in HMRC's favour. That means that the

businesses are often slightly less worried, because they feel that they may have given HMRC the benefit of the doubt.

HMRC itself seems to find that to be the case. It ran a business record check programme a few years ago. It has still not issued the final report, which is rather telling because it was going to lead to a regular programme of business records checks. HMRC appeared to find little that was substantially wrong. I would like to press HMRC to issue that final report, because it would be interesting to know exactly what it produced.

Mr Michael Steed: The question is whether it will lead to a substantial reduction, which invites the counterquestion: what do you mean by "substantial"? There are two numbers in the mighty beast called the tax gap. The tax gap is the difference between what the Government think they should collect and what they actually collect; it is a big number—£36 billion. It is made up of a number of things and you can analyse the number in a number of different ways. The critical thing is that two bits of it are relevant to this question; one is the concept of error and the other is the concept of failing to take reasonable care. If the question is whether it will lead to a substantial reduction in the tax gap, which is made up of a number of items, the short answer is that that is probably a bit optimistic. There probably would be a reduction. That would be a reasonable conclusion. Whether it would be substantial, I do not know. Interestingly, the number for error is £3.2 billion on the last numbers, which were issued in October 2016. They reckon they are only going to get 10% of that, which is £320 million, albeit on one element of that big beast, the tax gap.

Ms Rebecca Benneyworth: On the issue of error and failure to take reasonable care, what HMRC is not focusing on in closing the tax gap is deliberate misstatement. Is it fair to say that better records, if making tax digital produces better records, are likely to improve the outcomes for HMRC? I take Tina's comments on that. My experience shows that, if I take on a very small business where people have been doing their own accounts, they tend to have lost receipts and therefore not claimed for them. If we look at the other side of the coin, as it were—the underdeclaration of income—I and colleagues in my profession would probably view that as not accidental. The concept that underdeclared income might come back is unlikely. Just because you are using some software to record, does it mean you are going to say to yourself, "I'd better not leave out some of my sales"? I just do not think that is plausible. I doubt, for the very smallest businesses, whether using digital tools will actually give them more accurate books, unless someone like Tina or me goes through to pick out all the gubbins that has gone wrong somewhere along the way.

Q21 **Baroness Bowles of Berkhamsted:** Ms Benneyworth, at the Treasury Select Committee hearing last October you described the difficulties in going digital for some small businesses, and commented that they had been underestimated by HMRC. Could you expand on the reasons for that view? Will mandating digital records put a lot of pressure on to small

practitioners? Have you any thoughts as to which types might be worse off?

Ms Rebecca Benneyworth: There is no doubt that this is probably the biggest IT project ever undertaken. In such a massive project, it is understandable that those at the top of the tree who are charged with landing such a project need to keep on the surface of the big picture rather than looking at the detail. The Digital Advisory Group was set up to give HMRC some idea of the granularity, the detail of small businesses, and the understanding that very small businesses come in a million different shapes and sizes. There might be a taxi driver who has one of those machines in his cab and thinks it is wonderful, but where I come from they take good hard cash and nothing else. If we think about how that taxi driver will create digital records, it might be at the end of the day, but the end of his day might be 2 am. How will that turn into something reliable that he can use to submit to HMRC on a quarterly basis? We have to remember that quite a lot of taxi drivers do not have accountants. They do not make enough money to pay for an accountant. There is a failure to appreciate the needs of very small businesses. There are tiny little pubs making barely enough money to get by, where people are doing very long hours and have neither the interest nor the aptitude to use digital bookkeeping tools to report to HMRC.

That was my concern. On the way to the Treasury Select Committee, I took a cab and, as you do, chatted to the driver. He was absolutely horrified at hearing about making tax digital and said he would not be able to do it. He hoped his wife might be able to work it out, because he would not have a clue. I worry about very small businesses. I worry about them because, although HMRC has fairly said that nobody who genuinely cannot do it will be forced to do it, HMRC has a definition of the digitally excluded. The clients and businesses that I am thinking about will not meet that definition of digitally excluded, because they would need to have disabilities or they would need to be off grid, as it were. Lots of people use Facebook but they could not in a million years use accounting software.

I went for a meal on Friday night at one of the pubs local to me. The publican had horrendous trouble because her till had gone wrong. She only has one member of staff who knows how to reset the till, and that person was not around that night, so she was coping with bits of paper. For me, that completely encapsulates the problem. She can run a pub but she is not computer literate. She just would not be able to do it, and she does not make enough money to pay someone like me to spend hours and hours sorting it out for her.

That is really where my concerns are. The programme will put huge pressure and huge worry on small businesses. There has been quite a bit of talk about driving them underground. That is not my view. Most of the people I come across are honest and they want to get their tax right. That is why they get frightened. I do not think they will be driven into the informal economy. They will just get very worried, and ultimately the economy could suffer.

Mr Michael Steed: The last bit of that was about whether mandating digital records is going to put a lot of pressure on small practitioners. In my experience, that is a yes. They are simply going to throw it into my lap and the laps of people like me. They are going to say, "Sorry, I'm farming and I understand that, but I do not get this, so please take up the burden on my behalf". That means we have to factor in whether we can recover those costs. There are all sorts of figures going around, depending upon the size of your practice charge-out rates and so forth. The issue is whether that will put pressure on us. You bet.

Ms Tina Riches: There will be issues across the board, although digital is the way to go for an awful lot of people. There can be a lot of efficiencies and a lot of improvements, but it takes time and it is not necessarily suitable for everyone. When I was dealing with smaller businesses, we used to encourage as many as possible to convert from paper records or spreadsheets on to proper accounting software or to spreadsheets away from paper. They needed a lot of help at the outset. They needed a lot of hand holding during the first couple of years, through the first complete cycle, and then intermittently after that. If they had that assistance and help, a lot were successful. They found that their digital accounting package could give them more information that helped them run their business better. I think it is the way to go, but the pace at which HMRC is bringing this in, and the speed at which it will make it mandatory, is a recipe for all sorts of problems for small practitioners, large practitioners and their clients.

Lord Tugendhat: I have a great deal of sympathy for the answer you have given. I can imagine the predicament that people might find themselves in. That said, obviously in the long run we are moving towards an increasingly digitalised age. It is incumbent upon all of us, whether old or young, to seek to adapt ourselves to that change. Do you feel that there is anything, a long way short of the proposal, that could be done to start nudging small businesses down the digital route? Are we talking about something that is all or nothing, or can one begin to coax people, rather as the banks have coaxed people so that people who never thought they would do internet banking now take it as a matter of course?

Ms Tina Riches: Definitely. My colleagues and I have managed to persuade quite a wide cross-section of people gradually to go digital. The problem in this case is that we do not yet know which software people will be able to use. There is not actually any making tax digital compliant software on the market yet, because those attributes have not been set out by HMRC. At the moment, everybody is waiting to see what is going to happen, what the final rules will be and what the software will be before they start making the leap. At HMRC, they are managing to prepare themselves and get ready for this, and do all the software behind the scenes. HMRC is spending millions on that, which is great, but on the other side of the fence there is a limit to what we can do at the moment to prepare people. It will take some time. The timescale that HMRC has set out does not build in sufficient time to do it in a proper way.

The Chairman: The answer is that you expect HMRC to come out much more clearly as to what people should do.

Ms Tina Riches: Precisely, yes; the rules could be set out. We have some draft legislation. I think one of your later questions is about the legislation. We only have primary legislation, not all the detail that will be coming in other legislation.

Baroness Bowles of Berkhamsted: While we are on the business of apps and nudging, I accept that there is not a fully compliant app yet. I have been playing with one of the apps on the HMRC website, and was quite surprised to discover that the free version only allows me to do 10 scans a month. Of course, if I am a long hours, exhausted small business person—or even just the person I am—I tend to want to collect things and sit down when I have half a day or a day and do it all at once. I would be trying to do that to meet the three-month deadline. If the apps are going to come out in a way that rations you, it will nudge your behaviour not only towards digital but into a kind of ordered lifestyle. I quite like my ability to be disordered in some ways. If you are exhausted at 2 am after you have been cabbaging around, you just do not want to be doing that. Do you have any input from the Government?

Ms Rebecca Benneyworth: Certainly HMRC has promised, and work is ongoing, that there will be free software that is not restricted to 10 photographs a month or something like that. HMRC is talking about eligible businesses being those that have no employees—people like taxi drivers. It will not be what the free stuff restricts you to at the moment. The software will be available.

If I can come back to a point that Tina made, almost every accountant will be in a happier place when all their clients are using digital records to the extent of their capabilities. There is a lot of waiting around in January for bits of paper; people rock up with a carrier bag on 28 January and things like that. That will go, because those records will be made contemporaneously as they go along, either weekly or monthly, so we will be right on top of it. We can give our clients a better service, and a different service that helps them manage their profitability. I have no doubt that digital is the way to go. What we have to do, and where I have to work with clients, is to identify what my client can manage to do over a period of time, and what she cannot manage to do and thus what we need to provide help with or take on board ourselves. I have no doubt at all about the end goal. HMRC is absolutely doing the right thing. I am quite proud that our tax authority is doing this, but we need a lot longer to do it.

Q22 **Lord Bilimoria:** I declare my interest as a chartered accountant and as a Fellow of the Institute of Chartered Accounts in England and Wales. I am going to speak at an event at Smith & Williamson soon.

The Government have estimated that the average cost to business will be £280 in the year of transition. Do you believe, from your experience, that that will be a reasonable estimate of the compliance costs to be borne by

businesses moving to the new system? How realistic are the assumptions they are making to arrive at a net cost to business of £1 billion over the first three years? Could you take into account the fact that businesses are now going to be asked to report on a quarterly basis?

I should declare that I was misquoted by the press after our last Committee meeting. I said very strongly that I felt it was a burden on business to report four times a year, and they misquoted me on that, so I would like to correct the record.

Mr Michael Steed: The first part of the question is the estimate that the average cost to business will be £280 in the year of transition. I think most people feel that that is quite optimistic, and often wildly optimistic. If you look at the charge-out rates, of course it will depend upon the size of your practice. I have done some rough calculations and I think it is about seven hours' work for one of my average clients, who is in the same sort of range as Rebecca's. By the time you have met them, taken them through it, you have read up on it, they have read up on it, and they have come back and so on, I reckon that is about seven hours. Multiply that by your charge-out rate and it will give you an average just to get going cost.

The Chairman: What would that be, roughly? Is it double the £280?

Mr Michael Steed: Between two and three times that, on my practice charge-out rate. There have been some surveys conducted.

The Chairman: That coincides with what others have said to us, to some degree.

Lord Bilimoria: Are you saying that maybe the estimate of £1 billion should be £3 billion?

Mr Michael Steed: I am less sure about that. Tina has done some work on the second part of it.

Ms Tina Riches: Yes. We have had a look at it in our firm just for the extra tasks our people would have to carry out to liaise with a client four times a year. We have not factored in the fact that you have to pick the file up or open the electronic file four times and do four lots of inputting, because the same amount of inputting would need to be done, potentially. It is just the sheer extra interaction with clients. Granted that our charge-out rates may be a little higher than some of the smaller practices, we estimated that the additional cost could be in the region of £2,000 plus VAT per client a year.

Lord Turnbull: Per year?

Ms Tina Riches: Per year.

Lord Turnbull: Not just in the first year?

Ms Tina Riches: No, each year.

Lord Turnbull: How much extra in the first year?

Ms Tina Riches: On top of that, it will depend very much on whether the clients need training. If the clients need training in using the software, it will depend on their capabilities and the number of businesses they have. We have clients who have rental income, so they will have to keep records for that. They may have a trust with a business or rental income. They can have quite complex affairs, so the extra cost of dealing with all those could be very expensive for some clients and it could distort the averages. That is on the basis of the extra interaction we would need with every client.

The Chairman: What a figure. That is going to put us even further into difficulty.

Ms Rebecca Benneyworth: I am not going to go higher. I am probably going to go lower than my colleagues, but I know a little bit about how that £280 was arrived at, because I am also a member of something called the Administrative Burdens Advisory Board, which is led by Teresa Graham. We describe ourselves as a critical friend, and we work with HMRC and challenge HMRC on burdens on business and costs.

I attended a meeting yesterday afternoon at which people from HMRC explained how they had gone about identifying these costs. What we have done with the Administrative Burdens Advisory Board is put together a group of experienced businesspeople in small business with HMRC to go through the individual underlying assumptions. Some of the assumptions on that £280 would be things like how many businesses are unlikely to have any sort of computer equipment at all, and, if they had to go out and buy it, roughly what they would have to spend. That averages out of course, because quite a lot of businesses have mobile phones, tablets and so on. It feels a bit low, but about half of the actual transitional costs—the main cost element identified by HMRC—is time spent familiarising and understanding what their obligations are going to be. That is how the transitional figure was arrived at.

I still regard some of the cost stuff as work in progress. The admin burdens board agreed yesterday with HMRC two more meetings with real businesspeople to get into some of the more detailed elements. The difficulty is granularity—a point I made earlier. One business will do one thing, and 50,000 other businesses will probably do something completely different because of their particular business needs. An average is always a bit on the wobbly side.

Lord Turnbull: The world you are painting is that there is a spectrum of businesses. Some are more M than S and they are probably pretty well set up already. The marginal cost to them might be quite small. It seems to me that the people who will have the biggest gap and the largest amount of ground to cover are the smallest people. Not only will the sum be larger for them, but it will be larger still as a proportion of their turnover and profit.

Ms Rebecca Benneyworth: Yes, disproportionately large.

Lord Turnbull: This is an extremely regressive measure.

Ms Rebecca Benneyworth: It is for them. I am talking to HMRC and trying to understand why the smallest businesses must be brought in, because like an awful lot of people I, too, feel that the VAT threshold would be a good starting point, even if we say, "Actually lots of smaller businesses will come in later". One of the things I have tried to understand is why HMRC has such reservations about saying, "Let's start at £83,000". It goes back to the tax gap figure. I am told that the money that is missing is below £83,000, so if they are the people where we are led to believe the tax gap is, they are also the people who will have to spend a disproportionate sum in joining the new regime, to correct that tax gap.

Lord Bilimoria: There were two parts to the question I asked. One was the £280. The other one is the assumption that there may be a net cost to business of £1 billion over the first three years. That is also linked to the estimate of the reduction of the tax gap to almost £1 billion—£945 million—by 2020-21 that HMRC projects this will bring about.

Ms Rebecca Benneyworth: Part of me says, "Just ask them for the money and let's not do it", but I suppose that is a bit cynical. I agree that digital is the way to go, but on the net cost to businesses, to be frank, the £280 came second. The £1 billion came first, and then we divide by however many businesses we are thinking about to come out at £280. I think that is how that was actually arrived at.

Ms Tina Riches: Some of the figures seem to be based on HMRC's standard costing system, which is a government admin burdens method of costing devised many years ago. The methodology does not seem to have been updated. It certainly has very little in it in respect of tax agents. It seems to assume that everybody is an expert in accounting and tax, even a plasterer. It is potentially misleading to call it the cost, because it does not necessarily cover all the costs that a business will face.

Lord Flight: What you are saying is that the tax gap capable of being realised is nothing like the £3 billion estimated, and it may be zero. Secondly, you are saying that the extra cost to companies will be miles more than the £280 suggested. On both those counts the whole rationale for the change disappears. The only rationale left is that it is probably coming long term, because it is a new and more efficient technology. Is not the conclusion that one draws from that actually to advance on a voluntary basis?

Ms Tina Riches: I totally agree with that.

Lord Flight: There may be a number of people still running their businesses at 70 who will never want to get up to speed with the new technology. Well, fine, they can go on as they are until they drop, but to

force people seems to me to be almost undemocratic.

Mr Michael Steed: Part of the answer is what Lord Tugendhat referred to. You could extend the timeframe in which you want this to happen, and have an opt-in process for maybe a year or two years—a bit like the new system for recording benefits in kind, and in year one there would be an optional system. If you want to go for something like that, spread the whole system out by another two years: opt-in, with perhaps some incentives. I am thinking on my feet. That would allow people to come to it, because their mates down the pub said, “Oh yeah, I’ve done that. It’s easy. Look, try this one.” They get their phones out and away they go. We need that kind of cultural hinterland to develop to do something as big as this. With Rebecca’s pub clients, what she did not tell you is that at 2 am after a long session they have to go upstairs and put all the pay records in online because that is what real time requires. We have not said that, but that is just an extra.

Lord Turnbull: Real time is introduced from the top down, is it not?

Mr Michael Steed: That is a very significant point, but all the villains here, the numbers, are at the bottom.

Q23 **Lord Tugendhat:** You have given a very interesting reply. I wonder if something else that might be considered is a small element of incentivisation. That could be very helpful. The question I was going to ask you is this. The Government’s response to the consultation includes a number of concessions on the detailed design of the MTD proposals, such as the use of spreadsheets. I think I know what your response will be, but do you think the concessions go far enough?

Ms Tina Riches: No. The CIOT digital group had a meeting with HMRC to try to find out what it meant in the response by spreadsheets that linked to software. What HMRC actually plans to put into the regulations or directions is that anybody who is using spreadsheets or has some other way of doing their records will have to be able to export that from the spreadsheet into the other package.

I tried out one of the packages with a family friend who is in business. It will import spreadsheets, but it is quite a tortuous route to go and the spreadsheet has to be in a very strict format. It is technically possible, but it is quite tricky. The guy I spoke to at HMRC had never actually tried to do it himself. The thought of someone in a small business—a builder, baker or pub owner, who is perhaps not quite capable of using the software itself—being able to cope with the transfer through the particular spreadsheet templates that they would have to use to get it imported into the software beggars belief. We have suggested that if you are happy for people to use spreadsheets, which can be a lot more accurate than having nothing at all, it should be possible to copy and type the total figures into a tax package that can be sent off, rather than having to go through that tortuous electronic route, which, from our experience, can lead to even more errors.

Mr Michael Steed: The biggest issue is the initial exemption threshold. I know HMRC has made concessions, but the biggest issue is at what level it should be set such that you are under the radar and do not need to conform.

The Chairman: And the existing VAT level is the figure we seem to be hearing.

Mr Michael Steed: That is the figure we would probably stick on for the purposes of this discussion.

Ms Rebecca Benneyworth: That is quite widely agreed. There are two elements to do with commencement that we do not know yet, because Government are taking a view. One is the exemption threshold below which you will not have to keep digital records, nor will you have to update HMRC quarterly. The other is a threshold below which you will have extra time to prepare, to give you a bit more time to get yourself up to speed with digital tools. Both of those are very important.

There are some other, quite important, concessions in the response, particularly for accountants. There is the requirement that you finalise the year within nine months of the end of the client's accounting period. Something like 80% of businesses have March year ends, so it would give them a miserable Christmas. HMRC has heard that and extended the period by a month. That is very welcome. There are some good and important concessions, but I am still very eager to hear what the Government decide to do about the commencement dates.

Mr Michael Steed: Any threshold will have a cliff-edge effect. There will be people shooting to try to avoid it in some way or another, just like the VAT registration threshold. They will do everything they can to avoid getting into that.

Q24 **Lord Leigh of Hurley:** I declare my interest as a chartered accountant, chair of the Corporate Finance Faculty—your sister faculty—and an associate of the Chartered Institute of Taxation. Although not a client, my firm has a joint venture with Smith & Williamson in corporate finance.

Drawing on your experience of dealing with clients, how prepared do you think they are for April 2018? Having disclosed your interests as professional advisers—tempering that—what help and assistance do you think they will need?

Ms Tina Riches: There is a huge range of capabilities and readiness. In our firm, it will probably be more of an inconvenience for the majority of corporate clients. They already have teams of people who work for them dealing with accountancy and producing monthly management accounts. This will be a bit more red tape. A lot of those we have spoken to already said that they would like us to look over the figures before they go in, so they will bear the cost or we will bear the cost of that happening. It is all doable, as long as the software produces what is required.

If we go through the income scale, we come to smaller businesses that have some accounting software but are operating it themselves. This will be an extra and more significant burden for them, because generally they will need more interaction with us during the year rather than us dealing with all the adjustments at the end of the year and picking up all the loose ends. We then come down to those who are not using any accounting software. We are considering offering them a different range of products depending on their particular needs and how much time they want to spend on it themselves. A number of clients have said to us that they value their time more, and they do not want to spend more time having to do this. They will inevitably want to pay somebody else to do it.

Mr Michael Steed: We operate in a different part of the spectrum from Tina. Rebecca and I are in similar OMB territory. There is a whole range of responses from, "That will be okay", to, "You must be joking. I don't even do computers". Some of my farmers just do not do computers; they do farming.

Lord Leigh of Hurley: I want to come back to something that Ms Benneyworth said in respect of the tax gap. You said that there is underdeclaration, and that will not change digitally. Do you think that if people go digital, the purpose of which is to get more accurate records, there will be an increase in the tax gap as people record more expenses that they would otherwise have missed with bits of paper flying around?

Ms Rebecca Benneyworth: There is certainly a possibility of that. It is a fairly widespread view among members of my professional body. Clients lose receipts when they pay by cash, so they have no record. I find that myself. Contactless is wonderful, because now I do not lose taxi receipts, train tickets and things like that. Everything goes through my bank account, so it is all there. There is an element of that. HMRC really needs to be aware that, in the early years, errors by people doing their own books may throw into government figures for income that transpire not to be right by the end of the year. I will give a very small example, if I may.

One of my delegates explained to me that his client had bought a proprietary package because he had seen it advertised. He had not discussed it with his accountant. He had run two VAT returns on it and in about month eight rang the accountant and said, "You need to come in, because I am dreadfully worried". He had actually double-counted his sales by putting through the sales invoices and the money he had received from his customers, and had doubled his VAT. Those figures going into government might give a picture about what tax would be payable during that year that would be a very long way from the right figure.

Yes, on the detail, there is a possibility that more expenses will be recognised. I do not dispute the theory that more contemporaneous records are likely to be more correct. I question whether that necessarily means that people will declare more net income at the end of it. For a couple of years, the in-year stuff will be very flaky.

Lord Flight: I forgot to declare that I have been a client of Smith & Williamson for 25 years.

The Chairman: They are doing rather well today.

Lord Turnbull: I want to explore quarterly accounting. You can be not just digital, but digital quarterly. What is the point of it? Is it an essential part of MTD, at least in its first five years of existence?

Ms Rebecca Benneyworth: I think it is, my Lord. My experience with my clients is that, when they are VAT registered and they have to do a quarterly VAT return, their records are better through the discipline of having had to do that quarterly return. There is the availability of an annual VAT return. I am afraid I am somewhat remiss in not mentioning that to my clients because I am concerned they will let their records get into a mess after leaving them for a year. Quarterly reporting is part of the accuracy and timeliness of record-keeping. Part of the design of the system is also to give people feedback on what their tax is likely to be later in the year. Certainly research by the OTS indicates that businesses find that quite an important thing. It is a service that I would love to offer my clients, if only they would turn up with their books.

The Chairman: We are getting a lot of fascinating answers, but we are also running out of time.

Lord Bilimoria: I have run businesses myself and at the moment I am building businesses. We can understand VAT quarterly. It just comes out as automatic, and we can understand it from the Government's point of view—cash flow, getting the money every quarter. Having quarterly tax returns is a huge burden. Having to calculate tax once a year is burden enough, let alone having to do it every quarter. It is just impractical.

Ms Rebecca Benneyworth: There is quite a bit of misunderstanding about what quarterly reporting will be. The essence of it is that you enter your transactions. You do nothing else. There are no penalties for misdeclaration on quarterly reports. You enter your transactions and press a button to send that information to HMRC. That is why I said it is likely to be quite flaky. It is not a set of accounts. It does not need accruals and prepayments. It is just data.

Lord Flight: Sending a load of wrong data.

Ms Rebecca Benneyworth: Quite likely.

Lord Bilimoria: There are no cash flow implications.

Ms Rebecca Benneyworth: No.

Baroness Bowles of Berkhamsted: Then at the year-end you have to correct—

Ms Rebecca Benneyworth: You have nine months to put through adjustments and clean up the data.

Lord Turnbull: Are we talking about four returns, and then a fifth for reconciliation, and four VAT returns?

Ms Rebecca Benneyworth: Yes.

Lord Turnbull: Are the VAT returns in the same months as the other returns?

Ms Rebecca Benneyworth: If you choose to align your accounting period with your VAT quarters, yes.

Lord Turnbull: You could be making nine returns a year to the same organisation.

Ms Rebecca Benneyworth: Yes. The ambition is for the quarterly submission to do the VAT and the updating on the income tax side in one go.

Ms Tina Riches: Personally, I would pilot it with far less frequent reporting. It is an unnecessary burden. I totally agree with Lord Bilimoria. VAT is one thing, but reporting income and expenses is completely different. The number of reports may be even more. When you need to do the reporting depends on your year end. The final catch-up on the accounts may have to be before the date when all your tax information has to be submitted. There could be six or, if you are also VAT registered, 10 reports that have to be made.

Q25 **The Chairman:** There are a couple more questions that we have not asked. One is about the extension of cash basis to property businesses being presented as a further simplification for small businesses. The draft legislation suggests that property businesses will have to opt out of the cash basis while trading businesses will have to opt in, depending on their circumstances. Is that tax simplification?

Ms Tina Riches: No. The opt-in/opt-out should be the same for both, otherwise it will cause confusion. Giving the cash basis to property businesses is good. A lot of people are actually doing it that way, not knowing that it is wrong at the moment. It will make it legal.

Mr Michael Steed: There is a transitional implication on that too, and that is quite strong. On the surface, I agree that it looks bonkers. Why should one be an opt-in and one an opt-out process?

The Chairman: We have several questions on similar areas as to whether or not the simplification is enough. I get the impression that your answers will almost certainly be that it is not; it is too complicated.

Ms Rebecca Benneyworth: The difficulty is that HMRC has embarked on this all in one go. The simplification to enable making tax digital will be happening as we go. We would have called for more simplification, but doing it at the same time as introducing the new regime makes too much change. Yes, more simplification, but doing that first and then moving on to making tax digital would have been the sensible way to approach it.

Q26 The Chairman: I do not know if I dare ask this question, because you have given so much advice between you, but how effective do you think professional advisers have been in advising HMRC in all this process? Do the people at HMRC listen and have they taken much notice?

Ms Tina Riches: The consultation has not been anywhere near as good as some of the previous ones on digital transformation. I was involved in the SA, the iXBRL and the RTI consultations. They all had problems. There were problems bringing in the new systems, but the actual consultation process and the improvement to the plans that went on during the consultation was far greater than in this one. For RTI, in a room about this size, once a month they got in software people, practitioners of all sizes, professional bodies, academics and people from universities dealing with complex payrolls and charities, et cetera, to make sure it worked as well as it possibly could for everyone. That has not happened with this programme.

The Chairman: That is clear. Do you both agree with that, or do you think that is wrong? If you agree, you do not have to say very much.

Ms Rebecca Benneyworth: HMRC has tried very hard to get out of 100 Parliament Street to meet people, both businesses and professional bodies. As to whether the advice has been listened to, the strongest message that the professional bodies have given is about thresholds and exemptions. We do not know the answer to that yet.

Mr Michael Steed: And timelines.

Q27 The Chairman: We are getting near the end. For the last question I like to ask whether you have things you wanted to say and which somehow you have not been allowed to say because the questions have not been right. Please do not go away with any information that you want us to have and that you have not had a chance to give. You have done brilliantly up to now.

Ms Tina Riches: I have a few asterisks against a couple of points.

The Chairman: Fire away quickly then.

Ms Tina Riches: One is VAT. VAT is due to come into this system in 2019, which is the year I believe we may be Brexiting. There could be a number of problems—things that may or may not come in, depending on whether we are in Europe. It is probably the worst year that VAT could come in to a new system. A number of our VAT experts have suggested that bringing VAT into it should perhaps be delayed, because there is not much software aimed at VAT.

You asked about consultation. The Institute for Government, combined with the Institute for Fiscal Studies and the Chartered Institute of Taxation, recently brought out a report on better consultation. One of the key things they mentioned was that often consultation starts too late in the process. That is one of the real problems in this case. A lot of the

decisions were taken, such as quarterly reporting, before the consultation started.

The Chairman: We have those two points. Anyone else?

Mr Michael Steed: It felt preordained. It was the tax gap driving the whip across HMRC's shoulders. They knew what they wanted to do. There was consultation, yes, but arguably it was not much use.

Ms Rebecca Benneyworth: I would like to reinforce the point that the entire profession—certainly my professional body—is in support of digital, but at the right pace.

The Chairman: Thank you very much. You have been excellent witnesses. We have enjoyed it, and learned a lot from you. Thank you very much for coming. It has been very helpful to us.

Examination of witness

Mr David Lyford-Smith.

Q28 **The Chairman:** Welcome. Could you say in a sentence, so that it is on the tape, who you are and what you represent here? Then we will start asking questions.

Mr David Lyford-Smith: My name is David Lyford-Smith. I am a technical manager in the IT faculty of the ICAEW. I look over a few different areas. I am a spreadsheet expert. I wrote a paper last year about the digitalisation of tax in different countries, trying to draw some holistic lessons from the process of digitalisation as it has been done in different places.

The Chairman: Thank you very much. You will find there are chartered accounts littered all around the room, including me. Would you tell us about your experiences of a number of countries in moving from paper-based to digital systems of reporting income and relevant expenses to their tax authorities? What are the main lessons that should be learned by the UK tax authority from overseas experience?

Mr David Lyford-Smith: There are a few different issues that we drew out of our report, principally focusing on two areas: businesses and individuals. For individuals, one of the key areas that we saw as most advantageous was the pre-population of tax returns with information that government already hold through various things, such as RTI, which we were discussing just a moment ago, and employment income. That is something we are very heartened to see mentioned throughout the consultation documents. They are aiming towards more and more of that work being done automatically on HMRC's side rather than the taxpayer having to spend time giving the Government numbers they already have, and telling HMRC things it should already have access to.

On the flip-side of things, digital exclusion is another issue for companies. We also talk about rollouts. I will take each of those points. On rollouts, pilot studies and all the change management side of things, our studies

showed that, if you changed rapidly, you would incur more costs for businesses, and if you ran pilot studies and practice runs for things it would go more smoothly. That was fairly consistent across what we saw.

Digital exclusion was never not considered at all, but it was sometimes underestimated. It had to be taken pretty seriously as an issue. It is more complex than just people who perhaps have a disability or a lack of internet where they live. Issues that might come up suddenly, such as flooding or some sort of natural disaster, could drop people out of access; or illness could mean somebody was temporarily unable to do it. It is a very complex issue that required quite a lot of effort. The last key point I made in the paper was about simplicity and tax simplification, which you might have a question about in its own regard.

The Chairman: Which countries do you think we ought to be learning most from in this exercise?

Mr David Lyford-Smith: The closest thing to an exemplar country in my study was Estonia. Estonia is a fellow member of the Digital 5 and has spent a lot of effort on digital. Whenever I was reviewing anything to do with digital government or digital taxation, eventually the country would come up.

The Estonians have had a head start on many people, I suppose. It seems that their strategy in exiting the Soviet Union was to say almost from the beginning, "Right, how are we going to distinguish ourselves and how are we going to make things work for ourselves in this new world out on our own?" They went in for digital government and digital computer training right from the beginning, and that has paid longer-term benefits.

The Chairman: Do you think HMRC has really studied all those overseas examples?

Mr David Lyford-Smith: I think so. There are certainly indications that HMRC has looked into research elsewhere. It is worth mentioning that other Governments are looking at HMRC, for example. One of the other case studies in my paper is Australia. A lot of the mentions there are of the ATO—the equivalent of HMRC in Australia; the Australian Tax Office—looking to HMRC as an example of good practice and looking to the UK Government as a particularly digital one.

It is worth mentioning that making tax digital is almost a second wave of digitalisation. We already have online self-assessment and online VAT returns. We already have a lot of digital tax administration compared with many places. Making tax digital is an expansion of that into mandatory quarterly reporting and is building on the bedrock of something that is already quite advanced.

Lord Bilimoria: Estonia has a population of 1.3 million and a GDP of \$40 billion, compared with us at 65 million.

Mr David Lyford-Smith: It is certainly true that it is not a comparable problem to solve. The solution the Estonians have reached is very impressive. They have an interconnected issue. There are fewer examples. We are in a difficult position for finding comparatives that can really be of the same size and that we can point to. A few of the other larger European economies mentioned in the paper have had more middling success. Russia and Australia are both case studies of larger economies. There is Brazil as well. They have had successes in particular areas. I suppose Estonia had a simpler time of things, but has also had an especially successful total look. It depends on what you are looking at.

The Chairman: Is not the very success of Estonia making Lord Bilimoria's point? It was because it was small and people had to start more or less from scratch that they managed to make it a success in the time they did?

Mr David Lyford-Smith: That is a reasonable way of looking at it. Different taxation things are always going to be difficult. The difficulty with writing a paper like this is that it is very easy to say for any two countries, "Well, they are not the same and there is nothing to be said". There is some attempt at some core lessons that we can try to draw out. Even in Estonia, which has the fastest rate of broadband in Europe and lots of digital investment, there are still rural areas, and more elderly citizens who have not had experience with computers. They still have problems with digital exclusion, even in a small and very digital-positive nation.

Q29 **Baroness Bowles of Berkhamsted:** Could you explore the mandatory aspect a little? Denmark has made digital record-keeping mandatory, and Finland is going to follow this year, but that is the end of the story. Why do you think that other countries that have gone down that track ahead of us have not mandated more?

Mr David Lyford-Smith: There are other case studies where at least the reporting is mandatorily digital and there is interaction with the tax office. Italy, for example, has had mandatory reporting for about 10 years. As regards keeping digital records, it is a matter of wanting to extend the amount of information that can be reviewed automatically and the ability to review data in that way.

The OECD recommended that, in order to get taxpayers to move to the new channels, you should look to some combination of making things mandatory and leveraging tax agents as a way of helping clients to transition. Italy is one of the roughly 50% of countries that has mandatory tax returns for all citizens, regardless of their employment or otherwise. They already have a pretty advanced network of commercial agents that help people to do their taxes. The fact that lots of the citizenry might not be able to do digital reporting is not necessarily an issue, because a lot of them already have to use someone else to do their taxes, and those agents will have it. It is the same thing in Australia. There are mandatory tax returns for everybody, and lots and lots of high

street agents that were helping people already. There is a simpler time to make things mandatory.

The reason why lots of other places have not looked for records as such is precisely that there are problems of exclusion and making a fair chop at it, making something that can work everywhere. Like ourselves, many of those places already have well over 90% of business reporting done online; 94% to 99% of VAT and corporation tax, and self-assessment returns are in the high 80 per cents. Those are already high numbers, and most of them are not mandatory. Really it is only a small number that you are forcing over by making something mandatory, versus those who would come over if it was optional.

Baroness Bowles of Berkhamsted: It is all at the small business end and the sole retailer probably.

Mr David Lyford-Smith: Yes.

Baroness Bowles of Berkhamsted: Of the countries that are mandatory or quasi-mandatory, is it on such a regular basis as quarterly?

Mr David Lyford-Smith: No. The quarterly reporting aspect is relatively unusual. There are some countries that require more information, or require it more frequently. For example, Brazil has a set chart of accounts that everybody has to use, and they require full nominal ledgers to be supplied using that prescribed format. Even then, I believe that is on an annual basis so I do not think it is as frequent. There are some cases where there are more frequent requirements. I almost do not see quarterly reporting as part of making tax digital as such. It is a part of that initiative, but it is not necessarily a digitalisation thing so much as a policy change elsewhere.

Baroness Bowles of Berkhamsted: It is quite a big behavioural thing, because it is forcing you to keep your records up to date, which may have some advantages. Is there research in any other country on the behavioural responses once things go digital? Do people avoid it? Is it just the same?

Mr David Lyford-Smith: I do not know the answer to that off the top of my head. It is not something that was particularly a focus of the paper, so I am afraid I could not answer at this time.

Lord Turnbull: It seems to me that there are four variables. It is something mandatory. It is quarterly. There is a threshold and there is the speed with which it is done. What is special about the UK is that it is right over on one side in all four of those variables. You could play all sorts of tunes on this. Bigger people could be mandatory early. They could have longer to do it and you could come to the smaller people later. There could be a transition to quarterly. It is the absolutism of the proposals, despite the consultation, that seems to me to be outside the experience of other countries.

Mr David Lyford-Smith: I agree. We are on a fairly aggressive timetable compared with many others, along with the other factors you mention. One of the points we made in the paper and in the consultation is that, for example, the order of the rollout as currently proposed, regardless of the speed, would be to sole traders and personal income first, then to VAT and then corporation tax. It is working from the small end upwards. That makes sense in the context of what HMRC is looking to achieve, which is to target those it believes are making the most errors and where it can close the tax gap more. That is presumably the rationale for why it is that way, but in terms of who is most able to bear the costs of rapid change and the acquiring of new technology it is the reverse order. It is starting with those who are least prepared and working up. There are a few different things.

Q30 **Lord Leigh of Hurley:** Are there any examples of other countries doing this MTD rollout or initiative on a locality basis or the trial basis that the Government use in other projects?

Mr David Lyford-Smith: There are. Russia, for example, which was one of the case studies in the paper, started with trialling things in one particular area before rolling it out. Some other places have done rollouts in other ways, such as by industry. In Brazil, they started with the oil and gas and natural resources industries and rolled it out by sector. Rollouts have been done in a variety of ways. At the moment, it is proposed that our rollout is by order of different taxes, but different rollouts have been done in different ways.

A rollout is simultaneously a pilot study. It gives an opportunity to try something in a particular area and see what comes up. There will always be unexpected problems with the system—things that could not have been anticipated. One tries to catch them and fix them to the best of one's ability before taking it wider. The pilot study that HMRC is proposing starts in two months, but by the nature of its timeline the full making tax digital will start before that could possibly be finished, because it will be only a year later, so of course we will not have had the full time to run it through the process. There will be no year-end reporting specifically. Some quarterly updates will have happened, and people will have had a chance to use the software to try out quarterly reporting, for those who were involved in that pilot, but the year-end update, whatever the term is going to be, will not have happened by the time the real thing starts going live. It is all very condensed.

Lord Bilimoria: Lord Turnbull mentioned four variables: mandatory, speed of implementation, threshold and quarterly. In addition, there is the cost to business of implementation and the burden on business of time. Your work suggests that when properly implemented the greater use of digital systems produces substantial cost savings for tax administrations, but HMRC seems to make little of those potential savings and to focus on the tax gap effects in making the case for MTD. Is that because the digitalisation of tax administration is already so advanced in the UK that any HMRC savings are likely to be marginal?

Mr David Lyford-Smith: That is a reasonable explanation. The savings mentioned specifically in my work are discussing the costs of providing the service online as opposed to over the phone, in person or by post. It is certainly considerably the cheapest of those four options. Given that 86% of self-assessment returns, for example, are already done online, there is perhaps less room there. There are already cost savings going on in HMRC by closing offices and reducing staff in those areas.

What is more interesting from my reading is that the tax gap is by majority made up of fraud rather than error. The larger part of it is tax evasion and avoidance behaviour rather than error and lack of sufficient care. There is perhaps more room to talk about the ability of detailed digital information to detect some of the compliance behaviour that can be targeted through analytical devices—data analytics and big data—that might be able to close some of that. As to how well HMRC feels that the information it will request might help with that, I could not say. It may well be that we have already reduced a lot of costs with our existing digital platform.

Lord Bilimoria: What is the cost to businesses?

Mr David Lyford-Smith: That is more interesting and more complicated. One of the points that is made, and we were trying to make in consultation responses, is that it does not benefit UK plc to reduce costs and close the tax gap by government putting extra costs on business. It does not really advantage the economy as a whole. On the cost to business, 99% of VAT returns are online already. That is at the VAT threshold. The costs to business are very much focused on businesses between the proposed threshold for making tax digital, originally at £10,000—we do not know where it will end up—and the VAT registration threshold. That is where the issues will come and where the costs will be. We had some excellent analysis earlier of exactly what that cost might look like and how it might break down. I do not know that I can add to that. There is certainly some potential for issues.

Q31 **Lord Tugendhat:** What does the experience of other tax administrations have to tell us about the best way to support taxpayers who are not familiar with digital tools?

Mr David Lyford-Smith: As I alluded to earlier, one of the important things is that many taxpayers will be looking to their tax agents and accountants to help them with the transition, to explain what they need to do now under the new system and to help them to identify what kind of software to use and things like that. In the Australian case study that we did, I spoke to quite a lot of Australian tax agents who found that as well as being tax advisers suddenly they were part-time IT advisers—not something they necessarily welcomed. They had a lot of ability to work with their clients and help them find what was right for them.

One of the lessons is that building an agent strategy into the heart of the system is quite important. The gentleman from IRIS who spoke here on Monday afternoon mentioned that they may not have their agent side

programme ready until the autumn. That might be a difficulty. I do not think that is the fault of IRIS, but these things take time to develop. Having something that will help agents to access and support their clients is quite important.

Even regardless of the fact that the quarterly updates might not have to be as accurate, as we said, a lot of small businesses will not be comfortable sending numbers to HMRC that have not been looked at and which they do not have confidence in. They will look to their agents for that. Public education is always an answer. There is always more to be done in educating and providing training. HMRC is discussing that; it wants to provide over-19s who do not already have a digital qualification with an amount of free training, but the specifics of that and what it might look like are difficult to say.

We have seen in some other countries tax incentives for the cost of compliance. Making tax deductible anything that you have to purchase to comply with the new legislation would be fairly straightforward. The most rapid transition in the seven countries that we used in more detailed case studies was Russia. The Russians brought in things over a period of only a few years. That showed that taxpayers were footing the costs. They looked at larger organisations, but the organisations still had to pick up extra software—in some cases multiple pieces of software, because of its not being especially joined up. They had to use different things to speak to different parts of government. Yes, a quick transition will mean costs for taxpayers. What other administrations have shown us is that education, tax incentives and the use of agents as guides or assistants to help people are important. Involving them in the decisions is important.

Q32 Lord Tugendhat: More than once we have found Finland, Denmark and Russia bracketed together. Finland and Denmark are two very small, very transparent and very non-corrupt countries, and Russia is a very large and very corrupt country. I find it rather surprising that they should be bracketed, and all three are of course very different from the United Kingdom in different ways.

Mr David Lyford-Smith: That is very true. The Nordic countries as a group have done an awful lot on tax digitalisation. I think a lot of that comes from the fact that they have higher levels of taxation and high tax morale. There is a lot of support for state activity and a willingness to be involved in paying taxes and so on, and low corruption. Russia is obviously a bit different, as you rightly say.

My impression, from speaking to interviewees for the Russian thing, is that it was very much driven by a strong government focus. The head of the Russian Federal Tax Service, Mikhail Mishustin, is also on the OECD group on the forum of tax administration focusing on digital. I think he is the vice-chair, so the focus is very much driven from the top in trying to get it done quickly, presumably with the same incentives and objectives as any other country looking to collect more tax and reduce gaps in the system. It is an unusual example, I agree, but it seems that it is being done through a strong government.

The Chairman: We have a bit more time, but not much. We have two more questions.

Q33 **Lord Leigh of Hurley:** I do not think one of them is appropriate, given that you are not a tax expert, so I will ask you about HMRC not issuing any free software or apps. Did that situation arise in other countries? Is the software industry going to respond to that?

Mr David Lyford-Smith: It is not that uncommon. It is probably true that in the majority of the case studies we looked at there was at least some provision from the tax authority—an application or something. HMRC’s strategy is based a lot more on developing APIs that the software industry can use to build services. I do not see that that is necessarily an issue.

Running through the consultations, HMRC is very clear that it expects free software to be available to many of the people who will fall under the remit of making tax digital. Having been to a few meetings at BASDA and a few other places, it is unclear exactly what the incentive is for companies to produce that. The most likely cost model is the freemium model that was discussed earlier when we were talking about apps. Something might be free up to a point, but once somebody passes some level of activity, it might need a cost. The other thing we have seen, even for the existing ones, is that the model is free for the companies, but they charge the agents who collect the data and use the agent-side version, which in turn, because of the pricing model, incentivises agents to try to get all their clients on to the same one, and it drives a lot of competition in that market.

In many respects, it does not make a great deal of difference as long as there are lots of clear standards and regulation around, for example, ability to transition out, so that somebody does not just get locked into whichever software they first purchase because they have difficulty moving their records elsewhere. There is some mention in the consultation documents already about ensuring that people can easily transition to another software provider if, for whatever reason, they do not like the one they first go to. That is an important aspect of the market.

The Chairman: Does anybody have a question they want to ask that they have not asked?

Lord Turnbull: In relation to the free app provided by the Revenue, is it not a bit like NHS frames, with kids going to school in horrible frames? Everyone will think that the one the Revenue has chosen will be a utility model.

Mr David Lyford-Smith: It could be. At the same time, it could be considerably more. The Australian example was thought to be very good. The software that they were providing was pretty solid. Of course, in the past HMRC has had an amount of software available. Until last year—

Lord Turnbull: But HMRC has to pay the company providing it, so it is

not going to want a top of the range thing.

Q34 **Lord Bilimoria:** You have done comparisons with all those countries. We have one of the most complex tax systems in the world. Does your research show that? It is going to be more difficult for us to implement some of these things compared with other countries who, in extreme cases, have flat rates of tax?

Mr David Lyford-Smith: Yes, that will make it difficult. It will not necessarily make it more complicated to collect data but it makes it more difficult for HMRC to use the data in a meaningful way. It is harder to build computer rules and automatic analysis that can help do the statistical work and the data analytics that would help HMRC to identify errors, fraud and so forth, because there are so many exceptions, changes of rules, options and all those kinds of things. Simplification is always a popular thing to mention in Budgets and so on, but it is a very difficult thing to carry out in reality. In order to get the most out of the process, rules that are more straightforward and more amenable to computer analysis are necessary.

The Chairman: First of all, thank you very much. Is there anything you came here to say that you have not managed to say despite all the questions?

Mr David Lyford-Smith: That is a very good question. I am just looking at my notes. I think we have managed to cover pretty much everything.

The Chairman: Thank you very much indeed. It has been very helpful to us and we are very grateful to you for coming along.