HOUSE OF LORDS

Economic Affairs Committee

Finance Bill Sub-Committee

Corrected oral evidence: Finance Bill 2018

Monday 22 October 2018

4.05 pm

Watch the meeting

Members present: Lord Forsyth of Drumlean (Chairman); Baroness Drake; Viscount Hanworth; Lord Hollick; Baroness Kramer; Lord Lee of Trafford; Lord Leigh of Hurley; Baroness Noakes; Lord Turnbull.

Evidence Session No. 4	Heard in Public	Questions 43 - 57

Witnesses

I: Ruth Stanier OBE, Director-General, Customer Strategy and Tax Design, HMRC; Theresa Middleton, Director, Making Tax Digital (Business), HMRC; Lindsey Whyte, Director, Personal Tax, Welfare and Pensions, HM Treasury.

Examination of witnesses

Ruth Stanier, Theresa Middleton and Lindsey Whyte.

Q43 **The Chairman:** I welcome Ms Stanier, Ms Whyte and Ms Middleton to the Economic Affairs Finance Bill Sub-Committee. I am sorry that we have kept you waiting. As you probably realised, there was a Division in the House and we had to suspend the Committee. There might be another in an hour or so, in which case we will have to break for 10 minutes.

I will get on with the first question, which is to you, Ms Stanier. You wrote to me—on my birthday, actually—to state that businesses with more complex requirements such as government departments, NHS trusts and local authorities would be given an extra six months to implement Making Tax Digital. Why have these organisations been allowed a deferral but not the small businesses that have repeatedly asked for one?

Ruth Stanier: Had I known it was your birthday I would certainly have congratulated you. My apologies that I was not aware.

The Chairman: I thought you were going to say that you would have extended the exemption—

Ruth Stanier: Not exactly. This is clearly a very important milestone for the programme, having moved into the public beta stage of the pilot. This now opens up the service to around half a million taxpayers. We have obviously reflected carefully on the feedback that we have had on business readiness, and we have done some comprehensive analysis of businesses with the most complex requirements.

We also looked in our analysis at the amount of yield we were expecting to receive from the different segmented groups. That led to our decision to identify, for the functionality that we need to deliver, a very small group of those with the most complex requirements and those with the smallest amount of yield at stake. We identified that group for a six-month delay in mandation.

We think that is a sensible decision, which reflects where we are in the delivery of the programme. We have made a great deal of progress over the last six to 12 months, but we needed to recognise that for those with the most complex needs, as I say, some more time will be needed to allow for testing. We will have the functionality by next April, but it is about giving them enough time for testing.

The Chairman: On the yield point, are you saying that those who will pay the most tax, and therefore who might have difficulty, have been singled out, or is it those with the least yield?

Ruth Stanier: This is not about yield in the amount of VAT. It is about the additional yield that we expect to receive as a result of implementing mandation.

The Chairman: So the public sector bodies make more mistakes because they are not digitised.

Ruth Stanier: In the groups identified, we looked to minimise the amount of yield that we would lose.

The Chairman: Why do you think that would be the case? The argument that you put for doing this is that it will make businesses more efficient, which will mean fewer mistakes. If you are saying that you have singled out NHS trusts and local authorities because you think that you will get most yield, does it not follow that you think they make more mistakes?

Ruth Stanier: As I said, we looked carefully at two criteria. We looked at the complexity of the functionality that we still needed to deliver, and for each group that we had segmented we looked at the amount of the yield we expected to get. We looked to de-risk the programme by removing complexity and to minimise the overall yield that we would lose.

The Chairman: So how much extra yield do you expect to get as a result of this exemption?

Ruth Stanier: We have assessed that the impact of the six-month mandation will be negligible. But Theresa may wish to set out more detail on this.

The Chairman: Hang on. When you say that you did this because you had done a careful analysis of the yield that you expect to achieve, you must have had a number in mind. What was the number?

Ruth Stanier: As I said, we assess that the impact on yield of the six-month delay will be negligible.

Theresa Middleton: Perhaps I could add a few bits of information that might help the Committee. You indicated in your question that you felt that we were letting out larger businesses and keeping smaller ones in the earlier part of the pilot. It is actually a more complex picture than that. The groups given more time include some smaller ones and some bigger ones. I think that is important.

The Chairman: It is only 3%, is it not?

Theresa Middleton: It is only a tiny number, but it is not about big businesses and public corporations getting more time and small businesses not. It is important to note that.

The Chairman: That is not what you said in the letter.

Theresa Middleton: The letter sets out the type of entities that are allowed six months before they are mandated.

The Chairman: Yes, and they were NHS trusts and local authorities. I am sorry to keep interrupting you.

Theresa Middleton: It is a longer list than that. Not-for-profit organisations such as community amateur sports clubs, for example, would be included. We can obviously let you have the list if that would be helpful. That is important. It is not about size but about complexity. The second thing, as Ruth said, is that we were mindful that one of the key reasons for introducing the Making Tax Digital reforms is to close the tax gap due to errors with people making their VAT returns.

In general terms, error is mainly among the smaller business population. This is not to say that larger ones and the sorts of entities that you have mentioned do not make mistakes, but typically those mistakes are not the types of mistakes that are addressed by measures such as digital record keeping. That is why there is negligible difference in the yield that the measure will produce in giving those groups a little more time before they are mandated.

The Chairman: Have you had a chance to look at the evidence that has come to the Committee, which is published on our website? We have also had some evidence in private. Pretty well overwhelmingly, the message that we have had from small business and from practitioners is that those businesses are not really aware of what is required of them.

On making mistakes, it is suggested that the business of moving from their spreadsheet or shoebox method, or whatever, to inputting in the normal way on the gateway will result in more mistakes and that people are not prepared for this.

Theresa Middleton: Shall I address the issue of awareness and then we can come on to the tax gap and how we have calculated what the benefits will be?

The Chairman: Just on the point about making mistakes, if you are moving from a manual system, that will result in more mistakes not fewer mistakes.

Theresa Middleton: I think it is fair to say that there is some concern among professional bodies and businesses themselves about how this will work in practice. We absolutely acknowledge that people are keen to make sure they get it right and that on the whole they are nervous about the change.

As we all know, if you are familiar with one way of doing something, when things change it can make you feel concerned. Our approach to this has been to work with the software industry to make sure that there is a range of products available at different price points and with different types of complexity, which can be used by businesses with different processes, such as on a desktop, a tablet or a phone.

The challenge for the business is transitioning from its current way of keeping its records and making its VAT return to a new way of doing it. We know that some scepticism has been expressed by some bodies as to how our tax gap figures add up; we can come on to that if you would like us to do so. We have persuaded the Office for Budget Responsibility of our figures, and I can assure you it was not a pushover persuading the OBR that our measures do address these types of error.

Of course there is a risk as people move from one system to another and have to learn a new system. That risk is largely accounted for in our admin burden calculations. The risk is that there is an additional cost for the business to transition rather than there being any tax loss as a result of that change.

Once the business has moved to using software, the software will add up the expenses and income more accurately than some businesses are able to do. It will produce the nine boxes of data for the business to send to HMRC without having to take that data out of one system and put it into another. Seamlessly, from the software, the data will come through to HMRC. At a stroke, certain types of error—arithmetical errors and transposition errors—are removed from the process.

The Chairman: We have evidence that computers can certainly add up, but the invoices might be more complex. One example given to us is what would happen if you bought some petrol and a Mars bar, and another concerns varying rates of VAT—you cannot just digitise.

It is very difficult to understand why your view is so out of line with what we are hearing from the businesses and their advisers, who are responsible for responding to this.

Theresa Middleton: To use your example of the receipt that has different things on it that are used for different purposes, that is a good example—a Mars bar is obviously a small, trivial example, but it illustrates the point—of the type of thing that businesses get wrong now. That is not because they are deliberately trying to claim the Mars bar on their expenses, but because by the time they come to fill in their VAT return and to assemble the pieces of paper that they need to add up and adjust in order to create the information that goes into the nine boxes, they may not notice what is on the receipt. The receipt may have faded because it has been sitting in their car in the sun for months or it might have vanished altogether.

There are lots of reasons why a digital approach, which requires a more disciplined and timely approach to keeping the records, reduces the risk. Of course it does not eliminate the risk altogether, but it reduces the risk. Therefore, it starts to eat away into some of the errors that small businesses make.

Ruth Stanier: The other point I would make, if I may, is that our estimates of yield have been crawled over by the independent Office for Budget Responsibility, which has scrutinised them and continues to scrutinise them at each fiscal event. These are not estimates that we have only worked through internally. They have been externally scrutinised as well.

The Chairman: I must not hog this, but, finally, on that point about the OBR, did it also look at your estimates about the costs to small businesses of implementing this?

Ruth Stanier: It is specifically the estimates of yield that the OBR looks at in detail.

Q44 **Baroness Noakes:** Can I just explore this? You have an invoice with a mix of things on and the source of error is that the VAT payer forgets that it needs to be adjusted. I do not understand how making it digital will affect that at all. At the moment, there is still no requirement to have a completely digitised software system or a requirement to enter on a timely basis, other than in connection with the quarterly VAT return.

It has been put to us that you have just required people to put things on a particular kind of spreadsheet, which is what they do at the moment, broadly, and then they transpose it over to the nine boxes. Nothing in what you are doing will change what they will do in their businesses, so I cannot get to where you are going to achieve any difference in yield because you have mandated that somehow spreadsheets have to be linked by an API.

Theresa Middleton: The underlying evidence for the reduction in error—we should bear in mind that this will not eliminate all error from the VAT system; some types of error will remain, because these changes do not attack all aspects of error—is that the aspects of error that this tackles are arithmetical error and transposition error. When we inquire into a VAT return, at the end of the inquiry we may adjust what the business has returned because there is something wrong with it. That is how we know the type of thing that leads to mistakes.

There is adding things up wrongly, which sounds quite simple but it happens. There is also transposing your data out of your spreadsheet or your paper record-keeping system into our HMRC online VAT portal. In that process, things go wrong—transposition is a well-known common cause of error. On your spreadsheet example, Baroness Noakes, having a piece of bridging software that sucks the data out of your spreadsheet and then sends it to HMRC simply removes a step in which we find, in our evidence in the inquiries that we do into VAT, that things can sometimes go wrong.

Baroness Noakes: That does not address the point that Lord Forsyth raised with you about an invoice with a mixed supply.

Theresa Middleton: No, it does not. The more rigorous approach that these changes bring in, because the business needs to enter into its software its receipts—

Baroness Noakes: But will there be any spreadsheets? We are talking about very small businesses, which will use spreadsheets once a quarter. They are not going to be doing it every day.

Theresa Middleton: Quite a lot use spreadsheets, but you are right that a lot use paper at the moment. Our expectation is that lots of the ones that use paper will move not on to a spreadsheet but on to software. HMRC's advice is that you should move to software rather than go via a spreadsheet, because software provides more opportunities for greater value for the business and removes some errors that can occur in coding a spreadsheet.

In Lord Forsyth's example of the Mars bar and the petrol, if the person is entering the details of their receipt into their software pretty close to having got the receipt, the chances are that they will remember. If they put the receipt into a carrier bag and either they or their accountant look at it three or four months later, the chances of remembering or noticing are much reduced.

Baroness Noakes: But our evidence is that that is what they will do. There is no desire, if you are a very small business, to acquire software to run your business. You will probably ask your accountant to do it if you cannot manage it yourself. We were told that there was not a high degree of competence in some businesses on how to use spreadsheets, although they might do it themselves. However, there is no sense in which there is a desire to acquire software packages for the purpose of running their business.

Theresa Middleton: It is fair to say that there has been mixed enthusiasm among the accountants who represent small businesses for encouraging their clients who use spreadsheets to think about moving to software. There has also been the sense on the part of some firms that they are reluctant to encourage their members to move down that road at all.

Within the professional membership body of all different sizes and shapes, the people who have appeared before you recently have to represent all their members and within their membership there are people who feel the things that you have described. As you would expect, HMRC is in very regular contact with a wide range of members of those bodies and it is definitely not the case that everybody feels the same as the representations that have been made to you.

Within that group—I apologise that this may feel slightly anecdotal, but we are within the territory of anecdote here—there are people who have already started moving their clients on to software and have been surprised at how well that has gone. There are people who have assessed the capability of their clients and have concluded that this will be fine for most of them, but they are worried about a few of them and are not sure how they will get them on to the new system. There are some who will stick to spreadsheets because that is what they know and love and there are others who say, "Thank goodness there's now a reason to nudge my clients into the type of software that I've wanted them to use for years".

There is a very mixed approach. Obviously, you have heard one side of that story from some of the people who have given evidence, but there are other views within that representative body.

Q45 **Lord Turnbull:** You say that you have had extensive dialogue with the OBR. Has the OBR had any dialogue with the people to whom we have been talking and the people to whom you have been talking? In other words, is it only getting its story from you, in which case why should that represent the truth of the matter as opposed to just incorporating the views that you have put to them?

Ruth Stanier: I suppose that you would need to ask the OBR about its exact approach to its work. As you know, the OBR looks primarily at the analysis that we put forward, but it certainly scrutinises it.

Lord Turnbull: It scrutinises your work, but I very much doubt that it does research into what people other than HMRC are telling them. If it does not do that work, I do not see how it can come to a properly informed judgment about whether your figures are good or not. There is a natural bias if it is getting the information mainly from you.

I have one other question. There is a view that errors will end up producing more tax, yet, Ms Middleton, you talked about things disappearing altogether. That rather implies that there is an invoice that the guy throws on to the dashboard of his van; if it disappears altogether, it is quite likely that it may be an invoice about some stuff that he bought from the local hardware merchant. In other words, it is just as likely that he will find too little information about his inputs as opposed to his outputs, yet there is this universal view that errors will always end up producing net more revenue. People are very unconvinced about that.

Theresa Middleton: Lord Turnbull, you are absolutely right that there are people who have claims for expenses that they do not make because they lose the piece of paper—it flies out of the door of their car or, by the time they come to look at it, it has faded. They cannot remember what it said and they would rather not take the chance of claiming for something that they are not entitled to. That definitely happens.

The figures that the OBR has certified are net figures that take account of that. It is not the case that we only ever assume that every time a taxpayer’s VAT return is incorrect for reasons of error, it is always that they have not paid enough money to the Exchequer. It is a net figure. There are people whose circumstances mean that they will pay less tax than they otherwise would have done.

Lord Turnbull: The OBR is certifying the figure that you gave it. I do not believe that it is doing its own examination.

Theresa Middleton: As Ruth said, you would have to ask the OBR precisely what its method is, but it scrutinised us quite rigorously on this. It looked at the evidence that we presented—a lot of it from our inquiry work. There are different reasons for people making incorrect VAT returns. If it is error, we ask what mistake led to the error and whether it is a mistake that would be completely wiped out or partially addressed by the use of software. Then everything is discounted some more to make sure that it is a mid-range estimate. So the OBR was persuaded.

One reason why we were able to persuade the OBR is that, again, using our evidence from actual inquiry work and looking at underlying errors, if somebody loses 10% of the pieces of paper in their carrier bag or shoe box or from their car, they will tend to lose things that relate to sales as well as to expenses. Sales are typically of more value than expenses, so typically, although not in all cases, they tend to declare less VAT that they should.

The Chairman: I am going to move on to Baroness Kramer, but just before I do that, I am a bit puzzled as to why you rely on theory when you have had these pilots operating. What do the pilots show the error rate as being?

Theresa Middleton: It is too early to say. You are quite right to say that we should have a way of measuring it, and we are now in the process of designing a study that will do precisely that.

The Chairman: But is that not the whole point of having pilots?

Theresa Middleton: No, the pilot was really to test whether the system was working on the customer experience side rather than to test the effect on tax revenues.

Ruth Stanier: I want to make a brief point, as I think my mind was working on similar lines to yours. As we move into April and mandation, I feel that we are struggling to convince you of our position. However, once we are into mandation, we will absolutely monitor whether the yield is coming through, and we will be scrutinised on that. So, as we move into next year, we shall see—we shall have evidence.

The Chairman: Perhaps naively, I thought that the whole point of having a pilot was to work out how the system should work, not to start the system and then—

Ruth Stanier: It is to ensure that it functions effectively.

The Chairman: We will suspend the sitting for 10 minutes because there is a Division in the House.

The Committee suspended for a Division in the House.

The Chairman: We have lost a bit of time so we will make a start.

Q46 **Baroness Kramer:** Perhaps we could talk in more detail about the software issue. As you will know from having looked at the evidence that has come to us and from the comments on your website, it appears that one conversation is taking place between HMRC and the software companies, for which this is all their Christmases come together, and, on the other side, a conversation between HMRC and those who work regularly with small businesses. There is a great deal of concern for businesses that are not represented by anybody but will have to be able to use this kind of software.

If I understand the pilot correctly, so far all that has been piloted has been the simplest of arrangements. There is a great deal of complexity, particularly from the software perspective, that has not been piloted, yet you expect very small businesses to be able to manage this in a matter of six months. Can you help me through that process?

Theresa Middleton: It is true that the businesses that can join the pilot now are about half the businesses that will need to use Making Tax Digital.

Baroness Kramer: This is the original pilot—the pilot that started last week. Am I right?

Theresa Middleton: The pilot that started last week is not a new pilot; it is the enlargement of the existing pilot, where we started off with a small number of specially invited businesses in order to test that the service was working. We call it the Agile process, and it is the process that government departments and many businesses use to design and develop their IT. You start with smaller, more straightforward types of functionality, then you gradually build on that. We did not want to invite more businesses into the pilot until we were confident that it was working.

You are quite right: the half million or so who can join now are those with the most straightforward affairs and are up to date. By up to date, I mean that they do not have an outstanding VAT return and they do not owe us any VAT. So if you are broadly up to date and your affairs are straightforward, you can join now.

Over the coming months, we will be adding additional functionality, and I will give you one example. By the end of the month, we expect to have rolled out the functionality to allow 100,000 more businesses that have been in receipt of a late payment penalty to join. They cannot join at the moment but they will be able to join at the end of the month, and then we will roll out more from there. So those that can join now are those with the most straightforward affairs.

We have tested 23 software products fully. First, we test in what we call our sandbox environment—a sort of technical testing process. Once the product seems to be working, we then need to make sure that we test it with an actual business, so that we can check that it works not just in theory in that environment but when a business goes through it. By "work", I mean that the business can sign up, register its software with HMRC and use it to keep its records, generate the data and send us the data. We receive what it has sent and can play back to the business what it has sent us through its digital tax account or software.

In that end-to-end process, 23 products are working. There are another 20 or so products where everything is right, but we have not had a customer test the service because not all software firms have the right type of customer who can join at the moment. We expect that those numbers will start to go up as more businesses are able to join and more customers go through the service. We expect many tens more products to be available by April when businesses are mandated to start using the service, and that is one thing that gives us confidence that there will be a variety of products with different price brackets that do more or fewer things for individual businesses.

Baroness Kramer: Have you any awareness of how difficult it is for a small company with no expertise to work its way through 23 different offers at different price points with different packages, never mind another 10 coming on to the system?

People find it difficult enough to switch electricity companies; to be able to measure and choose between this complexity of packages is extraordinary. I cannot see how you can put in place training or support to help companies get through that period, or even consider it a way of embedding that strategy.

Are you expecting that 1 million companies will work their way through that degree of complexity and then be up and running?

Theresa Middleton: You have put your finger on an important challenge. Most of the businesses will be using software already or will have an accountant to whom they will look for advice. That is very much our experience. We do not want businesses to go out and start rummaging around our website themselves to choose software. If you have an accountant, ask your accountant for advice.

Baroness Kramer: I am sorry, but you will have seen our evidence from accountants. There is a very large number of unrepresented companies, particularly the smaller ones, which are still over the £85,000 benchmark. Accountants have pointed us to software packages that have been well promoted and have identified how they are often virtually incomprehensible.

Terminology that is fine for someone with an accounting background is pretty impenetrable to somebody who is basically coming off the street. Is it your intention to drive all small businesses into seeking professional support? Have you costed the process of driving them into that degree of intense professional support?

I have one last question—and then I will stop and pass on to others—which is on the actual cost of the software.

Theresa Middleton: It is absolutely not our intention to drive small businesses into professional support. That is very much a choice that a business will make for itself. My point about people asking their accountant or software adviser for advice is really to illustrate that not all

1 million businesses will need to work out for themselves the right product for them; it is a much smaller number, but you make a very fair point.

One of the challenges that we have been addressing and which we are doing more work on—we are not there yet—is that obviously, as a government department, we cannot endorse any of the software packages. We need to make sure they work, but we cannot say, "Use this one", or "Use that one". That would not be an appropriate thing for the Government to do.

Baroness Kramer: But the Government could offer their own software package.

Theresa Middleton: That is a different question, but at the moment there is no plan for HMRC to offer its own software.

The Chairman: That is what you do at the moment; the gateway does that, does it not?

Theresa Middleton: That is right, but we have found—and the decision has already been made in this territory—that the software industry is much better at this than HMRC. Therefore the decision has been made to allow them to produce the richer, more up-to-date products that they can produce and allow us to get on with being a tax authority.

On your question of how a business can choose the right package for them, one challenge we have set ourselves is to find a way that does not breach any kind of protocol, and which will allow us to show which sorts of products do which things for what type of small business. For example, there are some providers who specialise in products for certain types of trades. You would not want someone who has never used software to have to find that out by accident. You would want to highlight the fact that, if you are a hairdresser or a childminder, for example, there are products designed especially for businesses like yours.

On the other hand, somebody might want a package that does a lot more than just add up their invoices and produce their VAT return, for which they will pay more. You do not want them to buy something that is inadequate for their needs and then find out about it later.

I agree with you that one of our tasks is to try to help businesses navigate their way through that list in a way that allows them to say, "OK, for a business like me, these look like the likely products".

Q47 **Baroness Kramer:** What work have you done on the actual costs? The quotations that we have seen submitted from the software companies are completely out of line with what we hear from both the accountants and, through them, their experience in talking to businesses that are getting quotations.

We are looking at two entirely different pictures. We understand: that the ability to make a one-time purchase has effectively disappeared—you now have to be on contract; that price guarantees are very limited for the time period of the contract; that you might have purchased software recently, which becomes redundant; that you have to replace not just the one item but a total package of extensive software.

Characteristic after characteristic suggests these numbers are way off the mark. I wonder how you have interacted with small companies to verify the numbers that you have provided and which are the basis of your argument that it leads, if anything, to a reduction in costs for small businesses. Everything we hear is that actually it is a crushing increase in costs, especially when you add on the need for training and professional support to work your way through them.

Theresa Middleton: As you would expect, we have done a huge amount of work in this space. I think it was one of the areas in which, when we were here last time, the Committee encouraged us to take a more granular approach. We have done that. Rather than having a more general approach, we have looked at five different sorts of scenarios, or journeys, of businesses—for example, a business that is using paper and then moves to software, or a business using a spreadsheet that moves to software. Then there is spreadsheet to bridging software, or an existing software user, or someone who uses an agent for all their affairs.

We have looked at the obligations for each of those scenarios and what would be different, and then we have done work on what the cost of those differences will be. You may, Baroness Kramer, be recalling the original figures that said there would be a saving to businesses once they have transitioned. Our figures have now changed, and they show that, because of the much-reduced scope of businesses that are mandated to use the service, the transitional costs have fallen. They have fallen because there are fewer businesses and the businesses in scope are now bigger and are often using software already. Equally, the savings from the original measure—

Baroness Kramer: I am sorry, but are you suggesting that businesses with over £85,000 in revenue are using software already?

Theresa Middleton: Many of them are using the software already. They may have bought a one-off package five years ago of the kind you described, and may still be using that. Many are already using software, although by no means all. Because of the reduced scope, the transitional costs of moving from the old to the new system are less. Fewer businesses are in scope and they are generally more digitally sophisticated. Some of them are using software or spreadsheets already.

The second thing that has changed is that whereas previously we were showing an ongoing saving to business, which the Committee challenged us quite hard over, it is now showing a small ongoing cost to business. Again, the reason for that—please feel free to challenge and test us on this—is that most of the savings, once a business had transitioned to the new arrangements, accrue to businesses that are using paper and are small. As those groups have been carved out of the mandation, the benefits to the businesses that remain are less.

The costs that businesses incur in acquiring hardware or software, or upgrading their existing hardware or software, are all fully deductible against tax. The ongoing costs do not reflect that, because the methodology that we use does not account for it. If a business has to spend some additional money upgrading its software package, perhaps because it has not kept up to date, those costs are fully deductible against its tax. They are not a pure additional cost, but in methodological terms they are a cost.

Baroness Kramer: But tax is not 100% offset, I would point out.

Q48 **Lord Lee of Trafford:** I would like to come back to what I regard as almost the macro point of the start date and preparedness.

Ms Middleton, I think that you acknowledged that there was "some concern" out there about the lack of preparedness and awareness. I have to say to you that we have had absolutely overwhelming evidence that there is a huge lack of awareness and preparedness out there. The firm impression that we have at the moment is that we are heading for a giant car crash.

Can you point us to any witnesses or independent evidence to support your rather more optimistic position that there is only some concern out there and that everything, or most things, will be all right on the night?

Theresa Middleton: What gives us confidence that we are better placed than perhaps some of your other witnesses might have indicated is the fact that we started our communications campaign literally last week. Let me explain that a little. Various audiences are affected by the changes, and one is obviously the software industry. If the software industry is not ready, we cannot start the service. We have made a lot of effort to work with that industry to make sure that a range of products is ready at a range of price points and with different providers. So far, that has worked well and there will be more.

The second group that needs to be ready—this is a group that you have heard from, but you have perhaps seen only the partial picture from it—is the accountancy profession and other forms of tax advisers who support small businesses. Generally, small businesses turn to them first for advice rather than go to HMRC. We have agreed with those professional bodies that it is right to take what we have called the "partnership" approach with them—that is, we do not tell their clients what they should be doing; we want their clients to hear from them when they want them to start making the required changes and what type of software they recommend, rather than their clients rushing ahead and perhaps buying a package that does not sync with what their accountant uses. Again, there are very high levels of awareness among the accountancy profession.

The third group, which Baroness Kramer in particular talked about, is unrepresented small businesses and the business population that is generally in scope. Here, we have literally just started our campaign. There was a press release last week inviting people to join. We have started to see a bit of publicity about it in the media. Some of the software companies have started their advertising campaign, some of it in prime-time TV spots, so they are obviously spending quite a bit of money on it. We will be writing to every single business affected by Making Tax Digital, including the ones that have more time, so that they have the certainty that they do not have to be ready by 1 April but have a bit more time.

So although, as you say, awareness levels are not massively high among the business population, they are where we expected them to be. Our judgment was that when you start to raise awareness, people get in touch and ask "What do I do?". What we want them to do is join the pilot, but until the pilot was ready to allow more people in we judged that it was not sensible to get people excited or anxious or to start investing in software before they could start to test it with HMRC.

Lord Lee of Trafford: I think we all support the principle of the communication exercise, but we are only six months away, or perhaps slightly less, from the start date. We are now beginning to move into the Christmas period. Surely, privately you wish that the start date was 2020 rather than 2019.

Theresa Middleton: The key thing is whether we think that we and the software, as well as the business population and the people who represent them, will be ready. Our judgment at the moment is that we will be, but as Ruth has already indicated—

Lord Lee of Trafford: But will they be?

Theresa Middleton: Yes. Our judgment is that all those groups will be ready. As Ruth has indicated, in terms of the additional tax attributed to the measure, as we go forward we will see more evidence. For example, we expect to see more people joining the pilot and more software products being available, and we will remove some of the restrictions that prevent certain types of businesses being able to join at the moment. So this Committee hearing is happening right at the moment when things will change on the communications front.

Ruth Stanier: It is also important to be clear that in July we set out, through a VAT notice, a lot of detail on GOV.UK about how this will work. As Theresa has said, we will absolutely follow up directly with businesses in line with the research that we do. Once we have a clear call to action, we will do that. At the same time, we have set out our partnership pack, which the accountancy profession has, and all the feedback that we have had on the products has been good.

Q49 **Lord Hollick:** I was going to put that in a slightly different way. I think it was a New York Yankees coach called Casey Stengel, who had a bit of a way with words, who said, when he heard the same excuses yet again, "This is déjà vu all over again", and those of us who sat through last year's Committee sessions have the same feeling. We heard very much the same points last year. So, to follow up on Lord Lee's question about business readiness, roughly the same percentage of businesses are as ignorant this year as they were last year. What has happened in the last year?

Regarding your response that if you tell people too soon, they might phone up and try to find out what it is about, I think that anybody working in the commercial sector would say "Yippee". So your comment that you do not want people phoning up seems to me rather odd and rather at odds with the objective of informing taxpayers of a very important change in their lives, and indeed the responsibility to do so.

From the evidence that we have taken, this is going to cause a vast amount of personal distress and some financial distress. I really do feel that the comments made last year—that you were going to go out and tell people what this was all about—are even more important as we are only six months away.

Another issue that we discussed last year—there were many—was the question of a pilot. A pilot is an extremely good idea in that you can test something. You have narrowed down the definition of a pilot to, "Is the software working?" The impression that we gained last year—if you read our report, you will see that we made this point—is that the pilot will give you an opportunity to find out how businesses and customers are going to react. That is something that in every other walk of life would be regarded as an extremely valuable input.

It seems to me—I shall be grateful if you can show me that I am wrong—that precious little progress has been made on either of those fronts over the last year. First, why is that, and what are you going to do in the next six months to inform 42% of the business population, which is half a million businesses? Secondly, how are you going to find out what the user experience and the issues are? As you said, there are mixed messages out there. The mix that we had this year and last year are exactly the same: highly critical, highly anxious, highly concerned. I am not sure who is telling you that it is all okay out there, cos it ain't.

Theresa Middleton: On your question about what is different from the last time I appeared here, the main thing that has changed is that when I was last before you we had a different scope and a different timetable. The questions that we discussed were about the income tax pilot and the income tax service, and how quickly we would contact people to tell them about it and invite them to join.

As a result of a lot of feedback, including from this Committee and other stakeholders, the Government decided that the pace of the Making Tax Digital reforms should slow down a bit and that the size of business that would be within the scope of mandation should be changed in order that only businesses above the VAT threshold should be mandated, and then only for their VAT.

I hesitate to say that the income tax pilot stopped dead in its tracks, but it meant that enthusiasm for and interest in the pilot declined somewhat, particularly on the part of the software industry, and interest in VAT went up quite a bit. The VAT pilot has run to the timetable that was originally planned for it, because VAT always ran slightly behind income tax. That is the honest reason why some of the things that we discussed when I was here last time did not come to pass in the way that we expected. The scope and the timetable for income tax changed and the Financial Secretary to the Treasury had said that income tax was not to be mandated before 2020 at the earliest. Therefore, all hands were put to the VAT pump instead. That is the main thing that has changed.

On your remarks about what a pilot is for, I completely agree. A pilot is intended not only to test the software, and I am sorry if I gave the impression that that was the only thing we were doing. The other things that we want to test relate very much to the customer support model. For example, we have some YouTube videos, webinars and other types of online guidance, and we are working out whether these things collectively are good enough for what customers need and good enough to support the third parties that I have mentioned—the software providers and accountancy bodies and individual firms of accountants.

We are looking at how to ensure that they have what they need to support their clients to join the service and to remain in the service successfully. So we have been testing all those things, but we now need to test them at much greater volume, and we can do that now that we have opened up the service.

Lord Hollick: Will you be contacting the 42%, or rather the 100% because you do not know who the 42% are, so that all companies and VAT players are aware in good time that they will have to make some changes?

Theresa Middleton: Yes, we will.

Lord Hollick: In writing?

Theresa Middleton: In writing, absolutely. We will send individual letters to everybody.

Ruth Stanier: Just to be clear, in the programme we absolutely recognise your point that external readiness needs to be a top priority, and we will accelerate work on that in the weeks ahead. We are also very carefully tracking levels of awareness to make sure that we can take further action if we need to.

Q50 **Lord Turnbull:** I, too, was struck by the repetition—Groundhog Day was what came to mind. The evidence we have had is almost identical to what we had before: that players will be ready, the consultation has taken place, people are being briefed, the software has been developed, and the costs and benefits have been established.

At the time, no one believed you—taxpayers or their agents and trade bodies. The Commons did not believe you, the Lords did not believe you, and eventually Ministers did not believe you. Looking at the situation now, what we are hearing is a re-run. It is an easier proposition, as only about a third of businesses are involved and the really small businesses are not being brought in. In fact, they would not be able to do it. You say, “We’re confident, because we introduced such a pilot a week ago”, but surely you would have more confidence if you had started it six months ago. I have a feeling that we might be in exactly the same position that we were in before.

If you have a pilot, it is relevant to the next phase. When you get to income tax and sole traders, you do not just want to get to April 2020 and then say, “Well, we’ve had a year of VAT”, because you will not have completed the full year, with the wind-up of that year, and have analysed the experience. That tells me that it would be a mistake to go straight from the completion of the VAT’s first year into the next phase, because you will not have had time fully to analyse all the things that happened in the first year of VAT.

Theresa Middleton: We did indeed start the pilot much earlier, but last week we reached the point where we can invite people to join without them having to be on what we call a white list: that is, receiving a special invitation. For a long time we had to go with that process, because businesses had to satisfy certain eligibility criteria to be able to join, and they had to have access to software that we had checked would work with the new system. Therefore, you make a very fair point about the pilot, but it did start in April, so it will have run for the best part of a year by the time we get to April next year.

Lord Turnbull: You know that they have had an invitation, but you do not know the response rate or what people think of it. Mandation is now five months away, and it is pretty late to invite people to join a pilot and give yourself time to analyse it.

Theresa Middleton: One thing that helps here is that VAT on the whole is a quarterly tax. If you were talking about opening up an income tax service at that stage in the year, I would agree with you more strongly that people had missed the boat. If their accounting period started in April, are they going to join half way through the year? The beauty of VAT is that some people do it monthly and some do it quarterly, and there are a few other ways of doing it. It means that you can join the pilot during the year, and that is what we would like people to do: join the pilot if you fit the eligibility criteria and have a go before you are required to do it later.

All our projections for how many businesses are likely to join the pilot assume that as we get nearer to April more businesses will join because they will want to have a go in the voluntary service before they are mandated to join.

Lord Turnbull: So you are still planning to tell everyone to join the scheme by April next year without knowing how many people took part in the pilot.

Theresa Middleton: But we will know. As Ruth has said, we are tracking it very carefully, and we will be tracking not just the numbers but feedback and usability. As we add more software providers to the page, we will make sure that people have more choice, and, looking at Baroness Kramer's point, we will see whether there are things that we can do as a government department to allow people to sort the providers in a way that helps them to identify what is good for their business.

The Chairman: Does that mean that you might delay the implementation of the scheme, given that VAT is done on a quarterly basis?

Ruth Stanier: We have no plans to delay the mandation date, but the way that this works—

The Chairman: That is what Ministers always say when they are going to do it.

Ruth Stanier: Oh dear. In that case, I shall definitely rephrase that. In terms of how this manifests itself from a business's perspective, the requirement is that a business will submit the first quarterly return that is due after 1 April; it does not need be by 1 April.

The Chairman: My question, which was slightly mischievous, followed up from Lord Turnbull's point: that you do not really have enough time to assess this. You made the point that it was easier with VAT because the returns are quarterly or monthly. Does that mean that you might, for example, decide to defer the implementation until later in the year?

Theresa Middleton: There are no plans to do so.

The Chairman: Is that because Ministers are telling you that? Have you told Ministers about the concerns that have been expressed?

Theresa Middleton: Our Minister has taken a really close interest in this. He has received representations from this Committee and many other stakeholders, as a result of which the overall scope of the Making Tax Digital reforms has been scaled back. We are starting with VAT and with businesses that are above the threshold. They are a digitally more capable group. A lot of them, although not all of them, already use software and they already send in their returns quarterly, which was one of the areas of contention with the arrangements for income tax.

The Chairman: So you have made your Minister aware of the evidence that we have had of the distress that is being reported in certain areas.

Theresa Middleton: He is aware of the feedback about the full range of software, the costs and the tax gap. Yes, he is aware of that.

Lord Turnbull: Last time, there was a lot of discussion about your estimate of the costs, which people quite frankly laughed at. I do not think that it is very much better now. We had an estimate that the transition costs would be about £130 million for 1.3 million customers. It worked out at about £110 a head. You cannot buy anything for £110 a head. You go to a seminar, you get advice from a professional adviser, you buy some software and you get a licence or whatever. Where on earth does this figure come from, and how can it possibly be plausible?

Theresa Middleton: Of course, the figure that you have come up with is an average by dividing the costs. Some businesses will spend less than that on transitioning to the new arrangements and some will spend more. It really depends on how the business is currently keeping its records and what choices it will make on how to do it in the future.

A typical software cost is around £10 per month—£10 to £20 a month is also typical. If you are a business that is currently using a paper system and you move on to a system like that, as well as the additional costs of paying for the software you will have the cost of learning to use it—an opportunity cost while you make the transition into a new service.

The transitional costs cover all your learning on the system as well as any hardware and software one-off costs. The ongoing costs that I referred to earlier—where we were very clear that there is not an ongoing saving on average, there is an ongoing small cost on average—are linked to those sorts of things.

Lord Turnbull: That it is an average tells me that if you are highly competent, you are already there; it will not cost too much, because you can basically do it. The novices will pay a lot more than this, because they are starting from scratch.

Theresa Middleton: I do not know how many software advisers you took evidence from; I know you spoke to one. I think the market will be quite competitive, particularly for people who are not existing software users. If you are a software user, you need to speak to your provider about when they will become compatible and then there will be questions about upgrades.

Some providers have told us that they do not expect to charge businesses for upgrades because they will be doing upgrades anyway. On some evidence that we have heard, some clearly will charge. There is a very mixed picture. But for the novices you have described, there are genuinely some quite competitive options out there which new small businesses that have not used software before can go after. They can choose whether they want to do it on their desktop, their phone, in the cloud or not in the cloud. There is a whole series of choices, some of which we want to be able to draw out for businesses.

The number of providers in the space and the desire on the part of all of them to pick up more customers will drive costs down in the market, but of course it will not get rid of them.

The Chairman: I am conscious that the Committee wants to get on to talk about powers, but Baroness Kramer has a quick question first.

Baroness Kramer: I was one of those people who was slightly offended to see an average number that is clearly financially illiterate when it comes to giving us any information on this. Presumably you have a mean, you have a curve. Is it possible for us to see what you have actually costed out for small businesses, presumably against both their revenues and their profitability, to help us to see what the impact will be on those businesses? That is incredibly basic. You are making a lot of assertions about what cost will be. I would like to understand what sits behind that, what the analysis is that leads you to high confidence of such de minimis cost.

The Chairman: If you could provide a note on that, it would be very helpful.

Theresa Middleton: I will do so.

Lord Leigh of Hurley I would like to clarify one comment made to the Chairman. In your letter of 16 October, Ms Stanier, you say: "the deferral will apply to customers with the most complex VAT affairs". The people with the most complex VAT affairs will all have tax accountants who they employ, who will engage with you. Can you clarify whether that is because they shouted the loudest and HMRC is always bending over backwards to help large companies? Will you offer the same ability to defer to SMEs that request it?

Ruth Stanier: When we looked at complexity, we looked at the complexity involved in making sure that the necessary IT functionality is in place. It is important to note that the group of businesses for which we have put a six-month deferral in place is a wide spectrum of different types, including charities, many of which are very small organisations. The decision was driven by an assessment of the complexity and functionality.

Lord Leigh of Hurley: Okay, so the answer is no, you will not give SMEs the same deferral opportunity.

Ruth Stanier: That is not the plan.

Q51 **Lord Leigh of Hurley:** That takes us neatly to penalties. Although the new system is generally recognised as better, HMRC said that it is to be introduced from 2020, a year after mandatory reporting. So is the new system really simpler? You also say that you will not pursue filing or recordkeeping penalties in 2019-20 where businesses are doing their best to comply. Can you amplify what that means?

Ruth Stanier: We absolutely recognise that businesses will take some time to become familiar with the new arrangements, so, as you say, we envisage a light-touch approach during 2019-20. We do not intend to come down hard in cases where digital recordkeeping has not yet fully started, where there are delays due for example to software problems, or where there has been genuine misunderstanding about the requirements. But it will remain the case during 2019-20 that penalties could be payable in the case of deliberate evasion to protect the revenue.

In respect of the reformed penalty regime, we set out in the government response document that this will be introduced from April 2020 at the earliest. However, we have also set out that the Government will make a further announcement about the penalty amounts and the proposed implementation timetable. Those decisions are still to be made and an announcement has not yet been made on that.

Lord Leigh of Hurley: Okay. On the point that has already been made, should HMRC not be subject to the same commercial discipline as taxpayers with regard to responses and repayment times? Should HMRC not be paying repayment supplements in the same way as it would seek them from taxpayers?

Ruth Stanier: We set out in the government response document the harmonised interest approach that we intend to take. I checked with the team before coming to give evidence today on what responses we had had to the current consultation on the draft legislation. My understanding is that at this stage there are no concerns about the approach that we have set out in the draft legislation on that point.

Q52 **Baroness Noakes:** We turn now to powers, culture and oversight. We have been quite shocked about some of the evidence that we received on the level of aggression that taxpayers perceive to be coming from HMRC and an increasing level of aggression in the way in which it deals with taxpayers, such as aggression in its use of powers, failing to give adequate information to unrepresented taxpayers in particular and failing to explain their rights. This is clearly not in accordance with your taxpayers' charter. Are you aware of the concerns, and, if so, what are you doing about them?

Ruth Stanier: I watched those evidence sessions myself.

Baroness Noakes: We also had private ones.

Ruth Stanier: I have not had access to those, obviously, but with the televised one that I was able to watch, I was certainly surprised and listened to the feedback given.

Baroness Noakes: Have you never had an inkling that this might be a view of HMRC?

Ruth Stanier: It is absolutely the case in the numerous fora that we have with external stakeholders, we do hear from time to time about individual cases that have not been handled in the way we would ideally have wanted. Certainly in the evidence session that I watched, the evidence was all in that direction.

But our approach is to use our powers in the interest of the vast majority of taxpayers. We work to the principles of even-handedness and proportionality as set out in our strategy. We want to help taxpayers to get tax right and we want to apply the law fairly. That is the approach that we take.

On our enforcement culture, our aim is to settle all disputes in accordance with our published litigation and settlement strategy. There has been no change in approach there. Our compliance handbook is publicly available, and we are always striving to improve our performance against the standards that we set.

It might be worth setting out our internal assurance approach. We work to the three lines of defence model, which is also used by a number of other public sector and private organisations.

The first line of defence is high standards being set and managers conducting risk-based assurance. The second line of defence is through the tax settlement assurance programme, which we have radically changed in the past year. In undertaking that assurance work we now focus on cases that were closed in the last quarter rather than looking right back to the previous year. We are taking a more customer-focused approach in cases where there has been significant impact; we have put measures in place.

On cases where there is vulnerability, we in HMRC absolutely do have a range of procedures to make sure that people working directly with customers are able, at the signs of distress or anxiety, to handle those appropriately.

Where there are concerns, we have a needs-enhanced support service. Last year, it undertook 19,000 face-to-face meetings with our most vulnerable customers. It also handled 97,000 issues by telephone. I met people in Manchester last week who work in that service. I was struck by their professionalism in supporting people through what can often be a difficult time, while at the same time very much looking to collect the tax that is due wherever possible.

Baroness Noakes: We heard about letters to taxpayers presenting non-statutory requests for information as if they had statutory backing. Clearly that is not the right way for people to go about things. We heard of HMRC badging compliance failures as "deliberate" or "careless" without any proof—in these cases, not giving the taxpayer the benefit of the doubt on their innocence.

We have seen a number of examples of HMRC communicating with taxpayers in an inappropriate way. In any large organisation, individual employees potentially will not act well for customers or taxpayers. What do you do to find out whether this kind of activity goes on, and what would you do about it if you found it?

Ruth Stanier: Our complaints processes are at the heart of this—making sure that that we respond appropriately to complaints when they come in. We investigate them thoroughly and take action when that is required.

We received over 77,000 complaints last year, which is obviously higher than we would ideally want, although the number is fairly stable compared to the previous year. Of those complaints, 54% were upheld in full or in part. In some ways, this is a positive indication that where concerns are raised with us we do not push them away; we absolutely look into them and look to put things right.

Only 6% of these complaints went on to the second tier of the complaints process. Fewer than 1,000 went all the way to the adjudicator, which is a 15% decrease on the previous year. At that stage, 39% were upheld; that is still higher than we would like, but it is significantly lower than the level we saw four or five years ago.

People have a final course of redress to the Parliamentary and Health Service Ombudsman. In the last year for which figures are available, there were 90 investigations, but at that stage none were fully upheld and only three were partially upheld.

That evidence suggests to me that we have processes for working through complaints internally and taking action.

Baroness Noakes: Any good organisation has a good way of responding to complaints. The levels of those being upheld would frighten any commercial organisation. I was asking what you did to find out about bad practice. What kinds of assurance mechanisms do you have in place within HMRC to detect these problems and deal with them before they turn into a measurable level of complaint?

Ruth Stanier: There I would very much turn back to the three lines of defence model, which I outlined. This is very much about having clear standards, ensuring that we have appropriate management governance and making sure that those standards are being adhered to. Then, through the tax settlement assurance programme, it is about being able to look in a more independent way at what is happening.

It is a very important part of how HMRC operates that the Tax Assurance Commissioner sits outside the management chain and thus can provide some independent oversight of the resolution of disputes.

Baroness Noakes: It seems that the perception outside is that those processes are not working for all taxpayers. Our consistent evidence, as I described earlier, was that there is a level of aggression and poor treatment of taxpayers.

What do you think your responsibilities are towards unrepresented taxpayers—not necessarily vulnerable taxpayers, who may be a subset of unrepresented taxpayers, but unrepresented taxpayers more generally?

Ruth Stanier: Our customer-handling staff absolutely do have training on the importance of making sure that unrepresented customers are appropriately supported, including in cases that we end up taking to tribunal. We ensure that we are clear when someone is not represented and we will in some cases support them to make sure that they are ready to present their own position at tribunal.

Baroness Noakes: My question is probably directed more at whether or not you gear your communications towards them on a day-to-day basis, not necessarily only when something has gone wrong. This is about everyday behaviour, not dealing with things only when they get to the point where they need to make a complaint or take something to a tribunal.

What do you do to make sure that you are communicating appropriately, such as not misrepresenting a request for information as having statutory backing when the backing does not exist to that extent?

Ruth Stanier: I have not seen the specific example that you mention, but it sounds like an example of where something has clearly gone wrong. We would want to look into that and look to put it right.

Baroness Noakes: If they had not put a complaint in, your processes would not find it.

Ruth Stanier: That is not necessarily the case. Through our quality assurance and management approaches we would absolutely hope to find it, ideally without a complaint, but I recognise that that does not always happen.

The other point to make is that the vast majority of customers we deal with are not represented. As an organisation, we deal with individuals all the time. It is a minority of our customers who are represented.

Baroness Kramer: That is the opposite of what you said earlier. You were implying that most people would be able to adapt to this because they are already represented.

Baroness Noakes: That was in respect of VAT.

Ruth Stanier: It was in respect of the VAT-mandated population. I was responding about all our individual customers.

The Chairman: Lord Lee, you wanted to make a point.

Q53 **Lord Lee of Trafford:** On the question of resources, I think you said that there were something like 77,000 complaints last year. On the basis of a five-day working week, that seems broadly to work out at about 300 complaints per day. How do you assess your internal capacity to deal with that number?

In other words, if you imagine an organisation operating at around 100% efficiency with staffing levels up to an ideal 100%, where, in very broad terms, would you say your department is now? Would you say that you are two-thirds ideally staffed, half, or less than half?

Ruth Stanier: As at March this year, we had over 59,000 full-time equivalent staff in post, so clearly we are a very large organisation. We have ongoing discussions with Treasury colleagues about the appropriate level of funding. Obviously, as new measures are announced and we take on new initiatives, we will work together closely to make sure that those initiatives are adequately costed.

Before I came today I looked at some figures. Since 2010, something of the order of £2 billion-worth of additional new initiatives have been put in place. Also, as an organisation, at the moment we are recruiting large numbers, partly in anticipation of EU exit work.

Lord Lee of Trafford: With respect, you are not really answering my question. I am trying to get a broad feel of your capacity as compared with what you might term the ideal capacity. You are not really being specific; you are talking in very general terms, which I understand, but I would like to try to get a feel of the shortfall or the pressure you are under.

Ruth Stanier: It is very difficult for me to give you a specific percentage. On the one hand, our staffing level is significantly higher than it would have been according to the forecast at the last spending review settlement with the Treasury. We are operating above that. We are careful to ensure that we get the resourcing for the work that we need. We also need to drive efficiency, as does any other public sector organisation. Do we feel stretched? We do; we have a lot to do.

The Chairman: But in practical terms we are getting evidence that you will send someone a letter saying that they have to reply within 30 days and asking a series of very complicated questions, and you then take months to respond. Or people ring up on the telephone, hang on for ages and then get someone reading from a script. These are the sorts of things that we are hearing.

Ruth Stanier: I recognise that there is room for improvement. Watching some of the evidence sessions, I was also struck that some agents have experience from a particular perspective. We are very focused on working as effectively as we can to collect the tax that is due.

The Chairman: So getting in the money is the most important thing.

Ruth Stanier: It is the core purpose of our organisation. Our principle is absolutely to focus on customers in doing that and to be even-handed and proportionate.

The Chairman: Listening to what you say, I find it quite difficult to understand in what way you are fair to what you call the customers—the taxpayers. For example, if they challenge you on general anti-avoidance or follower notices and they go to the court, if they lose, why is it necessary for you then to impose a 50% or 60% penalty on them? Why should they pay a penalty if they seek to go to the courts to establish what the law is?

Ruth Stanier: There is quite a lot that we could say about accelerated payment notices and follower notices.

The Chairman: I am just asking you why you levy a penalty on people who challenge your view in the courts and then, if they lose, they have to pay what you say. That does not seem to me to be consistent with what you have been saying about treating taxpayers fairly.

Ruth Stanier: Let me set out how the safeguard in the case of follower notices works. When we issue a follower notice, at that point the taxpayer can choose whether or not to settle. That is a safeguard that we put in following consultation. Indeed, at the time, a number of commentators felt that the Government had gone too far in offering that position. Where somebody decides not to settle and they win, there is no penalty.

The Chairman: That is fantastic. You are very generous.

Baroness Noakes: Very generous.

Ruth Stanier: That is the safeguard, and that is the position.

The Chairman: If I genuinely believe that you have got it wrong, I test it in the courts and you slap a 60% penalty on me on top of what I owe if I lose. That is putting a price on seeking access to justice, is it not?

Ruth Stanier: A follower notice—this goes through senior level governance within HMRC—is issued only in cases where we are clearly of the view that a similar scheme has already been struck down. A follower notice is a very specific set of circumstances.

The Chairman: I understand that.

Baroness Drake: I was quite taken aback by your phrase "room for improvement". The department has described to us in writing and verbally your internal governance, assurance and complaints process, but the evidence we are getting consistently shows that the Revenue applies its policies inconsistently. It has differential treatment, particularly towards the unrepresented taxpayer. It does not meet the legitimate expectations of the taxpayer, and, taking their evidence, that goes beyond the simple description "room for improvement".

You do not seem to be coming up with solid evidence to assert that these people are wrong in their view. You just keep coming back with, "These are our processes", but the evidence we are getting shows that a section of the taxpayer community is not being well treated. That has nothing to do with them avoiding tax or the legitimacy of collecting the revenue. The quality of the treatment of people is now being prejudiced.

Ruth Stanier: I have not had the opportunity to go through all the written evidence that you have before you, and I would be extremely interested in seeing it set out in your report when you issue it. From the session that I saw with the adviser representatives, I certainly heard of a number of specific cases and anecdotes that gave rise to some concern. I did not hear numerical evidence in that session, so I would be interested in understanding more.

Baroness Drake: There were some clear assertions about what is driving the policy. I do not feel that you—HMRC—are coming up with anything that says, "Here is some pretty overwhelming evidence to show that that is not correct". You keep describing the processes, but people's experience of those processes is not favourable. The Revenue keeps saying, "These are the processes". If 54% of complaints are upheld, then gosh, that is a very high number, and those are people who are confident enough to pursue a complaint. It is a pretty high level of complaints to be upheld. The evidence that you gave made me think, "Gosh, that's a large number of complaints upheld for those who feel confident to get through".

Ruth Stanier: I suppose I was also reflecting on some of the evidence that I have from discussions about concerns about HMRC being in a position where we "mark our own homework". Looking at the evidence before coming here, it seems to me that there is a lot of evidence to show that, as we work through issues when they are raised with us, we do put things right.

Q54 **Baroness Drake:** Many of those affected by the 2019 loan charge are aggrieved that the Revenue did not make its position clear to them earlier when they disclosed their use of the relevant schemes and that the Revenue has not engaged with their efforts to settle their affairs, with the result that they now face very large tax bills. Why the inordinate delay in dealing with these schemes?

Ruth Stanier: Clearly this issue is causing concern at the moment, and we are having a lot of representations about it because of the stage that we are now at, ahead of implementation of the loan charge from next April. These schemes are clear examples of avoidance, where income is disguised as a loan, for example, often through an offshore trust, seeking a tax advantage that Parliament never intended. It is not normal or reasonable to be paid in loans that are not repaid in practice.

I again saw the evidence given where concerns were raised about what has happened in the past. Of course, legislation was brought forward in 2011 to seek to bear down on these schemes. Following that, the promoters of the schemes slightly changed the way they worked. It is also the case that, before the announcement about the loan charge was made in 2016, we made the opportunity to settle available to people. Following the 2016 announcement, the legislation was passed with cross-party support.

Our position is that these schemes have never worked. Concerns have been raised about avoidance over many years now. We have absolutely taken action to seek to address and close down those schemes. The position we found in taking forward that work is that it takes a lot of time to pursue individual schemes. It could take many years to litigate through the courts. As we do so the schemes keep changing.

Baroness Drake: Another issue is that we have been told that the instalment arrangements under time to pay would be limited to five years. Is that true?

Ruth Stanier: The commissioners have made it clear that, for people earning less than £50,000 a year who have now stopped using avoidance schemes, we have put a simplified process in place to agree settlement arrangements over a five-year period. However, we have also been clear that we will look at every case on its merits. There is no maximum or minimum period within which an overall settlement period can be agreed.

Baroness Drake: So you retain discretion on an individual basis to extend.

Ruth Stanier: Absolutely.

Baroness Drake: How many times has the extension beyond five years been given?

Ruth Stanier: At the moment, 5,000 people have agreed settlement terms, and at this stage we have 24,000 people registered to settle. I do not have information on those terms.

The Chairman: Perhaps you could let the Committee know that in writing.

Baroness Drake: The impact assessment stated that taxpayers might be bankrupted by some of the tax bills they would receive. There are two parts to the question. First, why would you bankrupt someone if they could stay earning and accrue the funds to pay the tax? Would it be in people's interests to push to bankruptcy? Secondly, how is HMRC accountable, and to whom will it be answerable if its decision results in someone becoming bankrupt?

Ruth Stanier: These cases will be taken through our debt management service in the normal way, where appropriate. I agree with you: we do not want to make anyone bankrupt. Making people bankrupt does not help us to collect the revenue. It absolutely is a last resort. Less than 0.01% of our debt management cases end up in insolvency due to an HMRC petition, it is absolutely not our approach of first resort at all. I can give an absolute assurance on that.

Baroness Drake: How much revenue has HMRC recouped from these schemes to date? How much do you expect to recoup from the loan charge legislation overall?

Ruth Stanier: From the 5,000 people for whom settlement has been agreed, we have raised more than £500 million to date. I do not have figures to hand, but the yield we expect to receive from this measure overall is a matter of public record.

The Chairman: Is it the richest people who can pay first? I think the answer is yes. Presumably the people from whom you recruited this huge sum of money are the wealthiest.

Ruth Stanier: I have no information about that. It is really important, though, that I share with the Committee that we estimate that around 50,000 people will be caught by the loan charge. On average, these people receive twice as much income as average UK taxpayers: 65%

work in the business services sector, typically as management or IT consultants.

The Chairman: I know you are fond of averages, but it would be quite useful to have the actual data if you could let the Committee have it.

Ruth Stanier: We can look at providing a more detailed breakdown.

Q55 **Lord Hollick:** You are proposing to reach back as far as 1999 to address this issue. You say that over the past 18 years you have raised concerns about this, yet throughout that period many major public sector organisations—the NHS, local authorities, the BBC—have not only encouraged people to come and work on that basis, but said, "We can't have you on our staff any more, but you can go and work for an agency or whatever and we'll pay you". We have evidence of this. It would seem that the very large public sector organisations, perhaps including HMRC itself, are contracting self-employed people who have been using this over the past 18 years.

Do you not think it is incumbent on you to inform people at an early stage? If you say that it has taken you a long time to work out that it is a problem, why should they not be treated in the same way as, for instance, Goldman Sachs was, with which one of your predecessors, Dave Hartnett, was able to cut a deal where it substantially reduced its tax liability because there had been uncertainty about it for some years. Is this not a case where there has been a great deal of uncertainty, and by taking the approach that you are taking you are going to drive people into bankruptcy?

Ruth Stanier: We certainly do not cut deals. That is the first thing I would say. To be clear, the loan charge itself is not a retrospective measure. It is not a power that we have been given. It is a charge that—

Lord Hollick: It relates to earnings since 1999.

Ruth Stanier: I will come on to address that point. As I set out, these are schemes where income is being paid as a loan—

Lord Hollick: I am not quarrelling with your judgment at the moment, I am saying that it could have been made in 2002, 2005 or 2010. Local authorities, the NHS and the BBC could have been informed. Do you have independent contractors working for HMRC?

Ruth Stanier: We do on occasion.

Lord Hollick: And did you inform them that this sort of arrangement was not permitted?

Ruth Stanier: The question I am raising is whether it is normal for income to be received as a loan. This measure impacts some 50,000 people. That is a very small proportion of the overall, much larger number of people in the UK who pay tax in the normal way. There is an issue of fairness.

Lord Hollick: I am entirely with you, and I am sure that everybody is—it is certainly an unusual practice—but would it not be incumbent on HMRC to say to people, après fact, that they should not do this, including people who presumably are contracted by HMRC itself?

Ruth Stanier: As I set out in an earlier response, we have been pursuing similar cases over many years, including the Rangers litigation, which is very well known. Our clear view is that these schemes have never worked. I do not think there is much more that I can add to that.

On the point you raise about the NHS, it is also our clear view that this measure will not have a significant impact on the NHS.

The Chairman: I do not really understand that answer. Lord Hollick's point in part is that, if you thought that the schemes were wrong, why did you not tell the taxpayer? Here we are dealing with people whose tax affairs have been closed; the book has been closed. Then subsequently you say, "We've won this legal case, so you now owe us X pounds".

That seems, first, to be a breach of the principle that once matters are closed they are closed unless there is evidence of fraud. Secondly, it seems extremely unfair to the taxpayer. We had evidence of someone who was employed as a social worker, who was retired. He was invited by the local authority to come into one of these loan schemes. Then, years down the line, he is faced with a huge tax demand. Do you think that is just?

Ruth Stanier: I heard the evidence about the social worker case. In any cases where people are concerned about settling or paying the loan charge, we strongly encourage them to get in touch with us as quickly as they can. We will deal with cases appropriately and sympathetically.

The Chairman: We are talking about the principle here. What you have done is quite clever; you have not reopened it, but you are able to go back retrospectively because of a change. The people concerned, who receive very substantial tax demands, are not able to pay because they have already spent the money. As Lord Hollick has suggested, they entered into these schemes without the Revenue having indicated that there might be a liability. Why was that?

Ruth Stanier: I will seek to address those points. With respect to promoting awareness, we have set out over a number of years, such as through our *Spotlight* publications, advice to taxpayers about not believing schemes that are too good to be true.

We have also submitted complaints to the Advertising Standards Authority to stop advertising that is clearly misleading. We absolutely have taken, and do take, steps to promote awareness. It is important to come back to the point that the loan charge was passed through the House with cross-party support. Our role is to collect the tax that is due under the law.

The Chairman: Right. So this is a problem for Ministers.

Q56 **Viscount Hanworth:** We have dealt with the question of the 60% penalties, so I would like to move to offshore measures. The draft Finance Bill contains provisions to extend the time limits for dealing with offshore matters to 12 years for compliant and non-compliant taxpayers alike.

We have heard strong opposition to this proposal. In particular, it is observed that compliant and non-compliant taxpayers are being treated in the manner in which you would treat a non-compliant and evasive taxpayer. Is this fair? Is it necessary to extend this period to 12 years?

Ruth Stanier: This provision was put forward based on operational experience that it takes us significantly longer to investigate offshore cases of this type. Typically, when we start to investigate, we need to ask for information from other jurisdictions. We then analyse that information.

Often these arrangements are very complex, and we then need to approach other jurisdictions for further supporting evidence. Our operational experience is that the four and six-year time limits do not give us the time to do that. That is the rationale for this measure.

The other issue is in cases of voluntary disclosure. Obviously I am not allowed to share specific cases with you, but it may help if I share an anonymised case study. To take an example of a UK resident non-domiciled taxpayer, such a person has disclosed underpaid tax going back several years. That is a case of voluntary disclosure.

In a case like this, the taxpayer may have used advisers and not been personally involved in decisions made by trustees of offshore structures. In this case, the taxpayer agreed with that reasonable care had not been taken.

Under current law, we can only assess back six years, even though the voluntary disclosure in this case study was significantly more. There was £200,000 that we could not assess.

That gives you some operational background as to why we felt that this measure was justified.

Viscount Hanworth: There was a suggestion that if you had better resources and applied them in this area, you could cut down this period by a considerable factor. Would you accept that, or would you say you are doing all you that can?

Ruth Stanier: I suppose standard project management is the triangle with resources on one side. I cannot deny that there is some truth in what you say. However, as I say, this is about cases that are very complex, which involve going from one jurisdiction to another and potentially then to more before bringing everything together. All our operational experience suggests that we do not have enough time.

Viscount Hanworth: You have been asked about the extension that you require, which there may have been representations about.

Ruth Stanier: There have been representations. From memory, we have had something like 20 responses to our consultation.

Q57 **Lord Turnbull:** We have had a certain amount of evidence from people who are concerned at recent restrictions on the ability to go to a tribunal, as a result of which people have to go straight to judicial review. That is a more cumbersome and expensive process. Do you think that these restrictions are justified, or would a better balance be achieved by returning some of these rights to use a tribunal?

Ruth Stanier: Do you have particular restrictions or incidents in mind?

Lord Turnbull: One case given to us was about where you want to seek third-party information and someone wants to challenge that with you. That used to be taken to a tribunal but that cannot be done any more, so they have to use judicial review.

Ruth Stanier: Thank you very much for that clarification. I was just wondering whether you were asking me about the access to justice issues in the round. They are linked, are they not?

Lord Turnbull: Are there other cases? Is it your policy, to try to speed things up and strengthen your position vis-à-vis the taxpayer, to curtail access to tribunals?

Ruth Stanier: The civil information power consultation was a very specific issue. This absolutely is not part of a wide approach or policy. We consulted over the summer in response to OECD criticism of our performance in responding to information requests on a proposal, as you say, to remove the need for a tribunal to sign off third-party notices.

In the consultation document, we set out that we had looked at 19 other members of the G20. In all those cases, judicial approval was not required before seeking such information, which is why we are falling behind the international level of performance expected.

Lord Turnbull: Falling behind in the severity of your treatment of taxpayers might be a good thing.

Ruth Stanier: In this case, there are more protections at present than in those 19 other cases.

Lord Turnbull: You have withdrawn some of the protections that there were previously.

Ruth Stanier: To be clear, in the case of the civil information powers consultation we have not yet taken final decisions or published a government response document. These are just proposals at this stage and we have had representations that we are currently considering.

Baroness Kramer: Quickly, to conclude this, you have heard a wide range of issues about the expansion powers and the way they are exercised. There has not really been a review of powers since 2012. Are we at the point where we simply need a new powers review to assess exactly where HMRC stands and whether it is an appropriate place?

Ruth Stanier: We keep our powers and our overall approach to tax policy under constant review. The powers review took seven years from end to end and was a very significant investment of resource. Careful consideration would need to be given to the case for such a review, how much it would cost and the potential benefit. Lindsey may well want to comment.

The Chairman: Your colleague is about to set a record as coming to the Committee and not saying a word.

Baroness Kramer: We are about to give you an opportunity to say. There has been a real argument that, in the expansion of powers, taxpayer protection has essentially been a victim of all this and that the balance is now inappropriate. Do you feel that there has been a big shift between powers and protections?

Lindsey Whyte: Taxpayer protection and confidentiality remains a real priority for the Government throughout this. The suite of powers has of course been amended over the past several years in response not only to the review of powers conducted but to several other hearings and representations to try to make sure that, overall, HMRC has a balanced set of powers at every part of the spectrum in supporting taxpayers to pay the right amount of tax at the right time. There are, of course, different degrees of power for different types of taxpayer.

In ministerial terms, the Financial Secretary is responsible for the passage of the Finance Bill. The powers that we have at the moment have been legislated through successive Finance Bills. We believe that they are a balanced set of powers. Ruth has already talked about the structures and assurance processes put in place internally in HMRC to govern those powers.

From the Treasury’s perspective, it is inappropriate for Ministers to have sight of individual taxpayers’ tax affairs, but they have an oversight role in the overarching approach of HMRC. We take those representations. I believe that the Financial Secretary has got in touch today via our offices to say that, should the Committee choose to make a recommendation, he would consider it, assess the issues that Ruth set out and respond in due course.

The Chairman: Actually, we have offered the Financial Secretary three dates and he has not been able to come to the Committee, but we are about to send him a letter indicating that we feel that he needs to come to us to address the points that you quite rightly have avoided, which are for Ministers.

On that note, I thank all three of you. I am sorry that it has gone on a bit; we have had two Divisions. I am sorry that the questioning has been quite forensic, particularly to Ms Middleton, but that is because of the weight of evidence we have had.

Ms Stanier, you said that you had not had a chance to see all the evidence. It is on our website and it would be marvellous if you had the time to read the evidence and felt able to respond to some of the points, which are very concerning. You made the point about legislation being passed on an all-party basis. This Committee is an all-party committee, and I think that there is pretty universal concern about the evidence we have had.

On that note I thank you and thank colleagues for attending this session of the Committee.

Lord Hollick: Can I just say that I misattributed the statement about it being déjà vu all over again. It was Yogi Berra, not Casey Stengel, but it still sums up what I felt.