



ICAEW REPRESENTATION 175/16

TAX REPRESENTATION

MAKING TAX DIGITAL: TAX ADMINISTRATION

ICAEW welcomes the opportunity to comment on the consultation paper [*Making Tax Digital: Tax administration*](#) published by HMRC on 15 August 2016.

This response of 7 November 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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MAJOR POINTS

Key point summary

1. We welcome the fact that HMRC is intending to retain the current familiar compliance framework during the introduction of Making Tax Digital. A further consultation on the tax administration framework and legislation would be appropriate once MTD is well established.
2. It is not clear why the right of the taxpayer to amend returns is not also being replicated but is instead to be subject to a separate consultation.
3. There are some important aspects of tax administration (such as notification deadlines and the general time limit for claims and returns) which are not covered in this consultation document and need to be addressed.
4. We are in agreement with the principles that are to underpin penalties, as outlined in the consultation document, but it is not clear that the proposals for late submission penalties fully reflect these principles. The proposal is likely to result in disputes about very old penalty points, fixed penalties may not be proportionate in all cases (the levels of these will need to be set carefully) and the detailed rules will need to reflect the fact that some taxpayers have more frequent filing obligations than others. The 12 month familiarisation period proposed is too short and should be extended to 24 months after MTD has been fully introduced. Penalty points will need to be clearly communicated to taxpayers and their agents.
5. We recommend that HMRC gives further consideration to the reasons for persistent late or non-filing (including research into the causes) and considers other approaches including the role of education and tailored taxpayer contact.
6. We support the proposal for penalty interest rather than “cliff-edge” late payment penalties but there are two flaws in the design (the 14 day period to make a time to pay arrangement is too short and the design should allow for an incentive to make a time to pay arrangement to remain even after this period).
7. We support the alignment of interest rules across taxes. The alignment of interest and late payment penalties is a prerequisite for voluntary pay as you go.

General comments

8. We welcome the fact that HMRC is intending to retain the current familiar compliance framework during the introduction of MTD. We recommend that the minimum necessary legislative changes be made and for no further changes to be considered until MTD is well established.
9. The current legislation on tax administration contains aspects which predate self assessment and electronic records. We recommend that, once MTD is well established, the government consults on the tax administration framework. In particular, HMRC’s discovery powers need to be reviewed in the light of the additional sources of information now available to HMRC (third party information provided directly and available through Connect). There has, in recent years, been something of a blurring of enquiry and discovery powers and the opportunity should be taken to re-establish a clear distinction.
10. There are some important aspects of tax administration which are not mentioned in this consultation document.
 - There is no mention of the general four year deadline for claims in TMA 1970 s34 or the Finance Act 2016 amendment to confirm a four year deadline for the submission of self assessment tax returns – we assume that these deadlines would be replicated for MTD but would welcome specific confirmation.

- There is no mention in this consultation document of the deadline to notify HMRC of a taxable source of income for income tax purposes (currently six months from the end of the tax year), or late notification penalties. In the *MTD: Bringing Business Tax into the Digital Age* consultation document it is suggested that new businesses would be expected to make their first quarterly report within four months of starting to trade and that the same period would apply to landlords. This is a very significant reduction of the notification period. It can be counterproductive to impose harsh penalties where there is delay in registering with HMRC and the current notification deadline and penalty regime allow time for businesses to register without incurring penalties. We recommend that the appropriate notification period be carefully considered and this consideration should include the interaction of late notification penalties and late submission penalties. It is our view that the notification period (or at least the period before a failure to notify penalty is charged) should not be reduced.
11. We are in agreement with the principles that are to underpin penalties, as outlined in the consultation document, but it is not clear that the proposals for late submission penalties fully reflect these principles. In our view, penalties on their own are not sufficient to promote compliance or an adequate response. It is apparent that the current late filing penalty system is not working as approximately 870,000 2014/15 self assessment returns were not filed by the 31 January 2016 deadline and approximately 400,000 of these remained unfiled by the end of June 2016. We suggest that HMRC commissions research into the reasons for late filing, particularly very delayed filing or failure to file, and uses this research to inform its approach to late filing.
 12. Sanctions for late submission of information and late payment of tax are needed to ensure that information is provided on a timely basis and that when tax is due, it is paid promptly. However, it should not be forgotten that late filing of information/returns and late payment of tax is often symptomatic of underlying issues in a business, be they administrative problems, cash flow difficulties, a failing business or, in the case of a sole trader, personal difficulties. Penalties – of whatever kind – as a first (or worse, sole) response to taxpayer failures of this kind will be less productive than a taxpayer contact programme aimed at finding out why there has been a default and what steps can and should be taken to avoid a recurrence. We recognise the fact that the type of tailored contact we suggest is resource intensive, but there will always be a need for this type of contact and where it is required the earlier this contact is made the better.
 13. Simply imposing penalties will sometimes do nothing more than make a bad situation worse. We recommend that HMRC thinks more imaginatively about how it deals with failures to file information, including the role of education which has so far been dismissed. HMRC has a responsibility to ensure that all taxpayers are aware of their obligations and are supported in complying with them – some of the remarks in the consultation document suggest that HMRC is disengaging from that responsibility.
 14. The consultation document refers to it being necessary for the legislation regarding record keeping to be updated. The precise terms of this legislation will be critical and we would request that a draft be shared at as an early a stage as possible, with ample time allowed for consultation.

RESPONSES TO SPECIFIC QUESTIONS

Question 2.1: Do you agree that compliance legislation should be amended to replicate current enquiry powers into the Self Assessment return to the End of Year declaration?

15. We agree that compliance legislation should be amended to replicate current enquiry powers into the self assessment return to the end of year declaration. We are concerned that sufficient time be given to scrutiny of the amendments to ensure that there are no unintentional changes – especially given the significant amount of legislation likely to be associated with MTD and other calls on the time of parliamentary draftsmen.

Question 2.2: Do you agree that current HMRC and customer safeguards should also be maintained?

16. We agree that current safeguards should also be maintained. The safeguard in respect of determinations is misstated in the consultation document. The time limit to displace a determination is currently the longer of 36 months from the filing date and 12 months from the date of the determination and we assume that there is no intention to reduce this period.

Question 2.3: Are there any other options for preserving HMRC's current enquiry powers in MTD?

17. We have not identified any other options for preserving HMRC enquiry powers under MTD; the nature of the changes is such that they should be made by way of primary legislation.

Question 2.4: Do you agree with the proposed approach to replicate HMRC's compliance powers for determinations, corrections, information powers and discovery assessments

18. We agree with the proposed approach to replicate HMRC's compliance powers for determinations, corrections, information powers and discovery assessments.
19. In the medium term, HMRC's discovery powers need to be reviewed in the light of the additional sources of information now available to HMRC (third party information provided directly and available through Connect). There has, in recent years, been something of a blurring of enquiry and discovery powers and the opportunity should be taken to re-establish a clear distinction.
20. We suggest that the opportunity is taken to change the deadline for displacing a determination to the longer of four years from the end of the tax year or 12 months from the date of the determination. The period of three years from the filing date in the current rules is in most cases approximately two months shorter than four years from the end of the tax year and creates something of an anomaly in that during this two month period HMRC will accept a return if no determination has been made but will not accept a return where a determination has been made.

Question 2.5: Do you have any other comments on how compliance powers need to change to transition to MTD?

21. It is not clear why the right of the taxpayer to amend a return is to be subject to a separate consultation; we see no reason why this safeguard should not be replicated in the same way as other powers and safeguards. The right to amend and Overpayment Relief (including Special Relief) are important safeguards that will still be required with MTD.

Question 3.1: Do you agree that 12 months is an appropriate length of time to allow customers to become familiar with the new obligations before the new penalty regime comes into effect?

22. We do not agree that 12 months is an appropriate length of time to allow taxpayers to become familiar with the new obligations before the new penalty regime comes into effect. A 24 month period would be more appropriate. Penalties for RTI are still risk assessed rather than fully automated and MTD is a much bigger change.
23. There will be a number of different start dates for the new obligations: for example, the different start dates for income tax, VAT and corporation tax and the delay until April 2019 for a tier of non-exempt small businesses. Start dates will also vary depending on the accounting date adopted by the business. We suggest that the penalty regime does not come into effect until 24 months after all businesses have transitioned into the new system.

Question 3.2: Do you agree that the period to wipe the slate clean should be 24 months? If not, what other period would be appropriate?

24. We do not agree with the approach that a 24 month period of full compliance should be required to wipe the slate clean. This could have the effect that a penalty is charged based on

a point incurred many years earlier. For example, if 1 point were incurred every 21 months and a penalty were to be charged when four points had been accumulated the oldest point would be seven years old by the time the penalty was charged. Consideration should be given to each point being dropped after a certain period of time (perhaps two years) to avoid disputes about very old points.

Question 3.3: We invite views on the design principles outlined for the points-based penalty. For example, do you consider there are any further elements to build in to this basic model?

25. We welcome the proposal that taxpayers would not be charged a penalty the first time they are unintentionally late in complying with a submission obligation.
26. We are not clear how the model would work for those who choose to update HMRC more frequently (but perhaps more irregularly) than they are required to.
27. Notification of points through the digital tax account may be insufficient as those who are non-compliant may be the ones who are least likely to be accessing their digital tax account. An email or text advising a change to a digital tax account will be easily overlooked as compared with a paper notification through the post. It will be essential that agents are also notified of penalty points and that information on accumulated penalty points is readily available to any new agent appointed.
28. Our initial comment on inaccuracy penalties is that careful consideration should be given to inaccuracy penalties for information that is pre-populated but incorrect. Taxpayers may expect to be able to rely on HMRC and the third party provider and this type of error may require a different approach as compared with inaccurate information provided directly by the taxpayer.
29. If a dispute over a pre-populated figures arises shortly before a deadline, a taxpayer could have the dilemma of submitting an end of year declaration or self assessment return late or submitting incorrect information, as it could take far too long to get information corrected. This would be solved if taxpayers were able to amend incorrect pre-populated information themselves and not have to refer back to the provider of the information.
30. We recommend that HMRC gives some thought to the suspension of late submission penalties as an alternative. Another option is risk-assessed rather than automatic penalties, as are currently in place for PAYE RTI.

Question 3.4: At what stage for each of these different submission frequencies should points generate a penalty?

31. We agree that the number of points may need to vary depending on the frequency of the reporting obligation. Careful attention needs to be paid to ensuring that the number of points incurred and the number of points which prompt the charging of a penalty reflect the fact that some taxpayers will have much more frequent submission obligations than others.
32. It is arguable that an annual filing obligation alone is infrequent and there should be a different approach where taxpayers have an annual obligation only.
33. In order to determine the best approach to late submission penalties, it would be helpful to have clarity on the size of the group that will be required to complete an end of year declaration and the proportion of these that will also have more frequent obligations.
34. We understand that all businesses and landlords who are required to update HMRC quarterly will complete an end of year declaration which would also cover their other income. We presume that there will be a similar requirement for an end of year declaration from a reduced number of taxpayers who will continue to have income to report annually (self-employment and property income that is exempt from quarterly reporting, dividends, foreign income and information on residence status). We have, as yet, no details about whether an end of year declaration will be required from those taxpayers whose tax account is fully pre-populated. Any such requirement would put a vastly greater number of taxpayers at risk of incurring late submission penalties and we assume that there is no intention to introduce any such requirement.

Question 3.5: We would welcome comments on whether existing penalties are sufficient to support compliance with occasional filing obligations. If not, what more is needed?

35. We agree that there is a need for a different penalty system for occasional filing obligations and that there is no immediate need to review the existing penalties for such obligations.

Question 3.6: Do you agree that, in principle, a single points total that covers all of the customer's submission obligations is the right approach?

36. We agree that, in principle, a single points total that covers all of the taxpayer's submission obligations is the right approach.
37. There is no specific mention of penalties for late submission of returns by a partnership. We propose that late submission penalties for all taxes (including employer's PAYE, VAT and income tax) should remain the responsibility of the partnership (the individual partners remain jointly and severally liable for partnership liabilities under general law). There is often a limited amount that individual partners can do to influence the submission of partnership returns and we consider that the best approach would be for late submission penalties to reflect the behaviour of the partnership as a whole and be payable by the partnership alone.

Question 3.7: Do you agree that the proposal outlined in paragraphs 3.25 to 3.28 is the right way to operate a single points total? If not, what alternative would you suggest that ensures the design of the penalty is kept simple?

38. We agree that the proposal outlined is the right way to operate a single points total. The proposal to effectively treat all submissions due in the same calendar month as being due at the same time and not add a multiplier is sensible.

Question 3.8: We welcome views on whether the escalator model would be a more effective way of aligning with the five principles described in paragraph 3.2?

39. Our view is that the escalator model does not align with the five principles. It is complex and unwieldy and could result in points and penalties accumulating very quickly in a way that would not encourage compliance. Persistent non-compliance requires a different approach – we would refer you to the general points we make in paragraphs 11 to 13.

Question 3.9: Do you agree that a fixed amount penalty is appropriate?

40. We agree that fixed penalties are generally appropriate but the level needs to be set very carefully. Fixed penalties may not always be proportionate, particularly in cases where no tax is due beyond that already deducted under PAYE or withheld under another process.

Question 3.10: Should the amount of fixed penalty reflect the size of a business?

41. We agree that fixed penalties should reflect the size of a business.

Question 3.11: Do you agree that points should only become appealable when they have caused a penalty to be charged?

42. We understand why the proposal is that points should become appealable only when they have caused a penalty to be charged (as otherwise there would be a lot of wasted effort in appeals against points which never result in a penalty) but we think this will give rise to a number of practical difficulties.
43. As explained in our response to question 3.2 there is a risk of there being disputes over points that are very old by the time a penalty is charged. There are two possible solutions to this: a limit to the length of time each penalty point remains on a record and a process for the taxpayer to dispute a point at the time it is incurred which falls short of a formal appeal. This might include a means of recording the reason for the late submission at the time it is made.
44. Some taxpayers will be very anxious about points sitting on their account and will want to deal with any dispute immediately, for peace of mind – the absence of a dispute mechanism could drive contact with HMRC.

Question 4.1: Do you agree that 14 days is an appropriate length of time to allow customers to either pay in full, or make arrangements to do so before penalty interest is charged?

45. We do not agree that 14 days is an appropriate length of time to allow taxpayers to pay or make a time to pay arrangement before penalty interest is charged. It often takes considerably longer than that for a taxpayer to become aware of the debt and to negotiate a time to pay arrangement, let alone arrange any necessary financing. Would HMRC have the resource available to process the number of time to pay arrangements required within 14 days of the deadline for paying income tax (even if there were to be an online process to apply for time to pay)? The current period allowed before penalties for late payment of income tax are incurred is 30 days and we see no good reason to shorten that period.
46. Cases where the deadline to avoid penalty interest is missed need further consideration; it is important to ensure that an incentive to reach a formal time to pay arrangement remains after this deadline. Under the current system for income tax a taxpayer who is charged the first late payment penalty still has an incentive to make a formal time to pay arrangement before the second or third late payment penalty to avoid those charges. We suggest that the making of a time to pay arrangement after the deadline should stop further penalty interest being charged.

Question 4.2: Do you think that charging penalty interest is the right sanction for noncompliance with payment obligations?

47. We think that penalty interest is a better sanction for non-payment than the current penalties for late payment of income tax and Class 4 NI contributions. The proposal would end the cliff edge at 1, 6 and 12 months overdue which are a feature of the current system. The level of penalty would be less than or the same as the current system up to 18 months overdue and late payment penalties would continue to be charged after 18 months which they do not under the current regime.
48. The replacement of VAT default surcharge is particularly welcome as it does not fit the principles that should underpin a penalty regime.

Question 4.3: Are there other commercial models that might be appropriate for us to consider?

49. We have not identified any commercial models that should be considered.

Question 4.4: We invite views on the design principles outlined for penalty interest. For example, do you consider there are any further elements to build into this proposal?

50. See our comments in response to question 4.1.
51. Prompt and clear communication of the imminent risk of penalty interest being incurred would be vital. An email or text alerting the taxpayer to a notification in the digital tax account may not be sufficient and the agent will also need to be notified.

Question 4.5: Does model 1 or model 2 best meet the government's objective of providing a fair and proportionate response to late payment of tax?

52. Of the two models outlined under Proposal B we consider that model 1 better meets the objective of a fair and proportionate response to late payment. The penalty percentages outlined in model 2 would be regarded as punitive rather than proportionate.

Question 4.6: Do you agree that the timing of late payment penalties should change to reflect the frequency of payment due dates?

53. We do not agree that the timing of late payment penalties should change to reflect the frequency of payment due dates. If voluntary pay as you go is to work successfully late payment penalties and interest must be aligned across taxes.

Question 4.7: We invite views on the design principles outlined for late payment sanctions. For example, do you consider there are any further elements to build into these proposals?

54. We have no further comments to make beyond those made above.

Question: 4.8: Which proposal best meets the design principles?

- 55.** We favour Proposal A (Penalty Interest) mainly because the penalty is imposed gradually in proportion to the length of time the tax is outstanding and there is no cliff-edge effect.

Question 5.1: Should the current interest rules for Income Tax and Class 4 National Insurance contributions continue to apply in MTD?

- 56.** We agree that the current interest rules for Income Tax and Class 4 National Insurance contributions should continue to apply when MTD is introduced.

Question 5.2: Do you have any initial comments about aligning interest rules across taxes?

- 57.** In principle we support alignment of interest rules across taxes. Alignment of interest and late payment sanctions is a prerequisite for voluntary pay as you go.
- 58.** We recommend that HMRC gives careful consideration to how the interest rules will operate where HMRC offsets repayments against an amount due for a different tax. We suggest that the rules are designed to avoid a tax debt being created purely because there is a differential in the rates which apply to amounts owed and amounts repayable.

Question 6.1: Please provide details of how the proposed administrative changes will affect you, including details of any one-off and ongoing costs or savings.

- 59.** No comment.

Questions 6.2: Do these administration proposals have a significant or disproportionate impact on groups with legally protected characteristics, as recognised in the Equalities Act 2010?

- 60.** No comment.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).