

## House of Lords Economic Affairs Finance Bill Sub-Committee

### Inquiry into the Draft Finance Bill 2021-22

#### Response by the Chartered Institute of Taxation

## 1 Executive Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 We are concerned that, for those businesses affected, **basis period reform** will exchange largely one-off complexities for ongoing ones and will not provide the desired simplification. There are numerous knock-on effects in the transitional period which also need addressing to prevent unfair outcomes.
- 1.3 Notwithstanding the ongoing engagement between HMRC and interested parties, we do not think that the **requirement for large businesses to notify uncertain tax treatments** will achieve the stated policy aims effectively or proportionately. There remains too much subjectivity in the notification ‘triggers’, and we remain concerned that the expected revenue benefits do not justify the likely compliance costs for businesses (and HMRC).

## 2 About us

- 2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 2.2 The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

- 2.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

### **Proposals for income tax basis period reform**

#### **3 How far does the reform represent a useful simplification?**

- 3.1 We do not think the reform represents much of a simplification, and for some businesses the reform will introduce new obligations and significant complexity.
- 3.2 Whilst there are some complications in opening and closing years, and the change of accounting period end rules, they arise only at those specific points in a business's life and will mainly affect the minority of businesses that do not use the tax year as their accounting period end. Overall, the existing rules are well understood by tax professionals. Further, tax software and HMRC's systems can adequately deal with these rules and calculate and store overlap profits.
- 3.3 We recognise that unrepresented taxpayers may find the rules difficult to understand, although we would expect most unrepresented taxpayers to be using the tax year end (or 31 March) as their accounting period end date – HMRC should be able to provide statistics as to the likely affected population.
- 3.4 The proposed tax year basis will introduce recurring complexities, where none exist at present, in two areas:
- a) It will require businesses with a period of account that does not match the tax year to prepare, report and apportion two sets of accounts or computations in order to complete one year's income tax self-assessment (ITSA) tax return (with all the associated additional administrative burdens and costs).
  - b) Some of those businesses will have to provide estimates in order to comply within the current deadlines – and then correct those estimates at a later date. HMRC estimate that this will affect those businesses with a period ending 30 September or later, but anecdotally we are hearing that businesses with an earlier year end may also be affected.

#### **4 To what extent would the reform deliver a fairer result than the current rules?**

- 4.1 There was a suggestion in the consultation that there is unfairness in the current rules due to the cash flow advantages which larger and more sophisticated businesses may obtain from adopting an accounting date early in the tax year, whereas smaller businesses more commonly use 5 April or 31 March as their year end.
- 4.2 We are not convinced that this argument has really been made out: The choice of accounting period is open to all taxpayers, tax is always calculated based on a 12-month period (save for opening and closing years) so unless the business is increasingly profitable there may be no financial benefit at all. Further, larger businesses will be unable to use the cash basis and must adopt accruals-based accounting standards which may require them to recognise income long before payment is actually received, thus narrowing any potential cash-flow benefit of choosing an earlier year end.

4.3 Indeed, while the consultation states the proposals will ‘help to make the choice of accounting date a purely commercial one’, we think that the proposals do the opposite, and push businesses towards adopting a 5 April or 31 March year end, or face additional complexities if they do not.

**5 Would either of the alternative options mentioned in the consultation document be a better solution? If so, why?**

5.1 We do not think either of the alternative options would be a better solution for the reasons that were outlined in the consultation document itself.

**6 Are the transitional provisions sufficiently robust? If not, how do they need to change?**

6.1 There is the potential for excess profits to be taxed at much higher income tax rates than would be normal, even if the excess profit is spread over 5 years. There could also be numerous knock-on effects such as the loss of the personal allowance, triggering the High Income Child Benefit Charge, and around superannuation/pension contributions, repayment of student loans and so on.

6.2 Consideration should be given to ring-fencing the excess profit and treating it as a one-off receipt (including when the profit is spread) and taxing it at the individual’s marginal tax rate ignoring that excess profit, rather than treating it as additional income.

6.3 HMRC’s proposal to allow overlap relief brought forward to be deducted in full in the transitional year is intended to mitigate this increase in profits, but itself raises the following issues:

- a) It is important that the business (or its agent) can double-check or obtain the overlap figures from HMRC, and we would encourage HMRC to explore whether this can be done through the business’s Digital Tax Account, via APIs into third party software, or prepopulating into tax returns. HMRC would need to put the resources into making all this possible.
- b) Since overlap profits are not index-linked, and in many cases will have arisen many years ago, the value of it is likely to be very low compared to the (more than 12 months) profits arising in the transitional year, meaning that for some affected businesses the excess profits in the year of transition will be significant. Whilst the five-year spreading is helpful, we welcome the assurance from HMRC that businesses will be able to seek further time to pay these additional liabilities.

**7 How onerous is apportionment of profits between tax years likely to be for businesses which do not have an accounting period aligned with the financial/tax year?**

7.1 We would expect that most software will be able to apportion profits between tax years, although businesses that are using less-sophisticated tools such as spreadsheets (or, pre-Making Tax Digital for Income Tax (MTD for ITSA), manual records) may have to undertake these calculations themselves.

7.2 However, the greatest difficulty will be the work involved in preparing estimates, where actual figures are not yet available. Estimation, and the need to amend those estimates later, will be a significant burden for affected businesses.

- 7.3 Whilst HMRC state that the reforms will only affect around 7% of sole traders, and 33% of partnerships, it does not state how many individual partners will be affected and we expect that to be a considerable number. The practical impact on partnerships, particularly large partnerships who may be unable to change their accounting period end – for instance if they are part of an international partnership, is significant.
- 7.4 We have suggested a number of ways to mitigate these impacts, including allowing the estimate to ‘stand’ until the following year’s return is filed, or extending the self-assessment filing deadline (eg 31 March instead of 31 January).

## **8 How manageable is the timetable especially vis-à-vis the introduction of MTD for ITSA?**

- 8.1 The recent announcement of the deferral of the start of MTD for ITSA until April 2024, and the consequent delay to basis period reform (should it go ahead following the consultation) was a sensible decision by the Government. This will give time for more thorough consultation, greater understanding of the wider impacts of the change (including the interaction with MTD for ITSA) and a longer lead in time to allow businesses, agents and HMRC sufficient time to prepare. Such preparation is not solely related to the tax position, but - for those businesses that move their year end to 5 April or 31 March - to deal with the significant practical issues which will arise from such a change.
- 8.2 It is imperative that HMRC publish a more detailed timetable or roadmap, setting out key milestones, to enable businesses and agents to make adequate preparations for the new regimes. Detailed technical guidance also needs to be published before accounting periods that will be affected by the change begin, so that businesses can prepare ahead of time – it will be easier for businesses if at the start of their transitional period they understand how this change will affect their tax declarations and payments.

## **9 What is HMRC doing to support businesses in making the change?**

- 9.1 If a decision is made to proceed with the change, HMRC recognise that they need to do a significant communications and educational exercise to raise awareness. This should involve targeted communications to those businesses they know do not use the tax year as their basis period (as well as the 22% of businesses who HMRC say do not complete the accounting period boxes on the tax return); rather than just general announcements on GOV.UK which are unlikely to be read by those affected.
- 9.2 As well as raising awareness many businesses, particularly those not represented by an agent, will require additional help. HMRC will need to consider the extent to which they themselves can provide that guidance and support, using examples to illustrate the impact of the new rules, or whether HMRC will recommend that businesses seek advice. In the absence of support, we fear that unrepresented taxpayers will either overlook the change or make uninformed and detrimental decisions.
- 9.3 As noted above, it is imperative that HMRC follow through on their assurances that they can make overlap figures available to businesses which do not have them readily available.

## **10 How important is reform of the basis period rules in the context of the Government’s 10-year strategy for the tax administration framework?**

- 10.1 Reform of the tax administration framework is part of the Government's commitment to creating a trusted, modern tax administration system. It is a substantial project addressing fundamental aspects of the tax system including how taxes are calculated, paid and assessed. This is a welcome, but long term, project, looking at the tax system 'in the round'. It is potentially unhelpful, therefore, if major changes are made to elements of the tax system, which are within the scope of the framework project, before this bigger picture has been fully explored.
- 10.2 The reform of basis periods, acknowledged by HMRC to be one of the 'fundamental building blocks of the tax system', pre-supposes that it neatly fits within this bigger picture. MTD, clearly a Government priority, is progressing on a similar basis. If the basis period reforms (and MTD) go ahead, there is a risk that they are inconsistent with the direction of travel determined by the wider review.

## **11 How much of a problem are the existing basis rules in practice?**

- 11.1 We do not think that the existing basis period rules are overly complicated and they have generally worked well since they were introduced in the mid-1990s. There may be some issues with calculating and storing overlap profits but, in our experience, we do not think they are particularly problematic. We were surprised to see in the consultation document HMRC's statements that most eligible businesses do not claim the relief when they should, and that many self-employed individuals are making mistakes with basis periods each year. If this were the case, we would have expected to see a programme of education or simplification much sooner.

## **12 How does the proposal fit with the work the Office of Tax Simplification is doing on the date of the end of the tax year?**

- 12.1 We think it is time for the UK to change its tax year to either 31 March or 31 December. A 5 April tax year end (and equivalent monthly/quarterly period ends) makes no sense in today's world, and increasingly complicates interactions with other countries' tax systems.
- 12.2 Changing the tax year could present an opportunity to reform basis period rules but it is not necessary to change the tax year to reform basis periods. It would be preferable, however, to change the tax year before reforming basis periods and introducing MTD for ITSA.

## **Notification by large businesses of uncertain tax treatment**

### **13 To what extent do the current proposals for notification by large businesses of uncertain tax treatment take account of concerns raised in the two consultations there have been on the measure?**

- 13.1 The original proposal set out in the first consultation document contained a very unsatisfactory definition of uncertain tax treatment that was itself inherently uncertain and unclear. This was refined into seven 'triggers' in the second consultation document and, refined even further in the draft legislation which reduces the number of triggers to three.
- 13.2 While we welcome this development, the triggers in the draft legislation are not without their difficulties. The second trigger (known HMRC interpretation) may require a thorough review of published material, as well as consideration of whether it is up to date – although we welcome HMRC's creation of a new working group to

consider areas of HMRC guidance that would benefit from improvement. It is also vital that businesses can rely on the various forms of guidance published by HMRC, and that HMRC provide timely and transparent updates when guidance changes.

13.3 The third trigger (what a tribunal or court would find) is incredibly imprecise, requiring a number of subjective judgements to determine whether a tax treatment is notifiable.

13.4 The measure will still result in significant compliance burdens (and costs) for businesses in scope, lead to over-notification by businesses who wish to avoid the reputational risk of being non-compliant, and overwhelm HMRC with notifications that they do not want or are unable properly to review. We remain unconvinced that it will achieve the stated policy aims effectively or proportionately.

#### **14 Is sufficient support being given to businesses to help them comply with the measure?**

14.1 HMRC have recently published draft guidance on the measure, on which we have commented. It is vital that this guidance helps overcome some of the subjectivity in the legislation itself, so that affected businesses can decide with greater certainty whether a tax treatment is notifiable.

14.2 We remain concerned about the parity of treatment between large businesses that have a Customer Compliance Manager (CCM) and those that do not. This discrepancy has been recognised throughout the consultation process, in particular in relation to the general exemption, which will apply in circumstances where a business has already told HMRC about the tax treatment. HMRC will need to ensure there is a workable system where those businesses that do not have a CCM can have a meaningful dialogue with HMRC, as well as ensuring that there is adequate CCM capacity (we are already aware of existing concerns around this) as the demands on their time increases.

14.3 It is also important that HMRC implement a notification process which is clear, easy to use, and accessible to business's appointed agents.

The Chartered Institute of Taxation

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