MTD: Making Tax Difficult – and demanding and deceptive

What is the point of the MTD? Tony Monger dissects the initiative and fails to come up with a single positive

Like a lot of the British public, I found myself glued to the television watching Mr Bates v the Post Office, which tells the story of the Horizon software scandal. In turn astonishing, frustrating, angering and heartbreaking, a persistent theme throughout is the supposed infallibility of the Horizon system. One comment by the head of Fujitsu allegedly compared Horizon with the imperviousness of Fort Knox – although the man who made that comment now explains that he was talking in relation to its impregnability to "cyber and physical security".

Of course, setting aside the despicable manner in which the Post Office acted against its employees, the primary lesson of the Horizon scandal is that computer programmes are not infallible. But it seems that there came a point relatively early on in the process where one of the motivating factors for the Post Office was the amount of money that they had already spent on developing Horizon. Scrapping Horizon when they had already spent tens and tens of millions upon it – if not hundreds of millions – was too horrible to contemplate. So they kept on with it. And, tragically, they even kept on with it when they had learnt that it didn't work.

Don't ask me why but, when I learnt that, I began to think about HMRC's plans to Make Tax Digital.

The vision that is MTD

Readers might be surprised to know that MTD for ITSA has now been postponed five times from its initial target date of April 2018. The current plan is that MTD for ITSA will be introduced for self-employed individuals with turnover of over £50k in April 2026. That's just over two years away.

Then in April 2027 it will drop to a turnover threshold of £30k. They are apparently still thinking about people whose turnover is less than £30k but have already realised they need to exempt some people such as foster carers who would otherwise have been caught in the MTD net on the basis that it would have been 'burdensome' for them to maintain digital records considering their specific responsibilities.

But a point to note is that these threshold levels relate to turnover and not profit. So, if you are selling something with a low markup, you might well have a turnover of over £30k but a net profit of, say, less than £10k – covered by personal allowances – but you are still going to have to comply with MTD. And what exactly does that mean? What will you have to do?

The MTD nuts and bolts

Under MTD, taxpayers will have to submit four quarterly returns, followed by an End of Period Statement (EOPS) and a Final Declaration (FD) that consolidates all of the necessary information for the final tax declaration. Initially, the EOPS and FD were to be separate but, following representations raised by taxpayers, HMRC have now kindly agreed to allow taxpayers to 'integrate' their EOPS into their FD, so they will only have to file a mere five returns a year instead of the one that they submit now.

But why? It's a logical question – what is the point of all this?

Well, the official HMRC answer is that it will:

- make it easier for individuals and businesses to get their tax right;
- mean customers can integrate tax management with a range of business processes through software; and
- contribute to wider productivity gains for businesses by encouraging digitalisation.

They go on to quote how it will help to reduce tax loss, but let's consider these three claims first. I'll take them in reverse order.

Wider productivity gains for businesses by encouraging digitalisation
Really? How exactly does that work for, say, a plasterer? Bricklayer? Violin repairer? To be honest, I'm struggling to envisage how 'digitalisation' – for which, read 'putting your records on a computer' – will result in wider productivity gains.

The reality is that anyone who is above the VAT threshold has probably already got a computer system for their quarterly VAT Returns. And these days, even your plasterer or bricklayer or violin repairer has probably got an Excel sheet on which they record their income and expenses. But the idea that forcing taxpayers to put their records on a computer will actually result in 'productivity gains' is somewhat imaginative.

Now, I appreciate that by digitalisation they actually envisage things like scanning invoices direct into your accounting records – and swiftly adjusting for any private usage element – but anyone who has this vision has clearly never seen the paint smeared or cement covered invoice that a builder has thrown onto the dashboard of his van after the urgent trip to the DIY store for some extra materials.

Integrating tax management with a range of business processes through software
Really? Really? Might I perhaps mention that I have been self employed and have managed to manage my tax management with nothing more than a diary – on which I made notes of when to pay my tax and when to submit my returns. I'm afraid that this entire heading of "integrating tax management with a range of business processes through software" is clearly one of those that has been made up by a group of civil servants who have been tasked with coming up with a list of benefits from MTD. The fact that they have come up with something as vague and meaningless as this shows how difficult it was to come up with actual benefits.

Making it easier for individuals and businesses to get their tax right
This, of course, is the big one. But the start point is that the taxpayer will now have to do five tax returns per year instead of the one that they submit now. I would suggest that increasing their administrative burden five-fold will not make it easier. But will it help them to get their tax right? Well, consider the following…

Alfred and Bert are book sellers, each with their own book shop. On Monday, each of them goes to a wholesaler and buys £1,000 worth of books. Throughout the week, they each sell books for £500 – but Alfred makes a profit of £300 whereas Bert makes a loss of £200. How is this?

Well, Alfred has sold books that cost him £200 for £500, making a profit of £300. At the end of the week, he still has £800 worth of stock on hand.

Bert, on the other hand, has sold books that cost him £700 for only £500, making a loss of £200. He only has stock of £300 left at the end of the week. The difference is in the amount of closing stock which is typically measured at the end of the accounting period.

Now, if books carried VAT, their VAT position would be identical – purchases of £1,000 and sales of £500, resulting in a VAT reclaim. But VAT is a largely transactional tax. You might get arguments about whether something is standard rated, or zero rated or exempt, etc., but apart from the joys of such things as partial exemption claims, or mixed rate schemes, usually the most complex issue that arises for the majority of taxpayers is a bad debt relief claim when a customer fails to pay an invoice. Income tax, on the other hand, is a much more complex arena. Anyone in doubt needs just compare the thickness of the yellow tax books with the orange tax books and the number of tax cases on income tax and the number on VAT.

In income tax, for example, apart from the fact that accounts are prepared to a complex set of accounting standards, it is necessary to measure such things as Stock on Hand or Work in Progress at the end of the year. And then there might be claims to things such as R&D or, heaven forbid, Capital Allowances. And taking Capital Allowances as an example, you need to determine whether you can claim an Enhanced Capital Allowance, or a First Year Allowance, or the Annual Investment Allowance or a Writing Down Allowance. And if it's the WDA, then you have to determine whether it goes into:

- a main pool with a rate of 18%;
- a special rate pool with a rate of 6%'
- a single asset pools with a rate of 18% or 6% depending on the item.

Accountants will appreciate that I am simplifying greatly, but I'd just mention that lurking further down the line is the prospect of MTD for companies and, of course, in terms of Capital Allowances that raises the prospect of the super-deduction of 130% or the 50% special rate first year allowance. As the meerkat would say, "Simples…"

And there's more

As mentioned above, MTD works on the basis of four quarterly Returns per year. Nobody has actually said it out loud, but the assumption has to be that this will then link to making four quarterly payments of tax – because, frankly, otherwise what is the point? But there are plenty of businesses where a single annual event determines the eventual annual profit.

Take farms, for example, where you might get a grant payment of one sort or another once a year. These grants are taxable and often mean the difference between success and failure, and although, say, received in January, serve to defray the costs throughout the whole year. So what happens with MTD? Does the whole grant get taxed in the quarter in which it is received or can you defer tax on three quarters of it to other quarters? A bit more complex than VAT, eh?

The once-a-year payment is not limited to farms but many sectors that receive taxable grants – such as bursaries, for example. There are also plenty of rental agreements where one lump sum is paid once a year. You can imagine the impact on the cash flow for any business that has to pay tax on that annual lump sum in the one quarter in which it is received – especially if they then have to make loss claims in the next three quarters (with the consequent delay in waiting for repayments from HMRC...).

But the sector that might be most impacted by this could be that part of the retail sector that depends on the profits made at Christmas to support the business throughout the rest of the year

– which is a large chunk of the retail sector. Under MTD, are they going to have to pay over the lion's share of their Christmas profits straight away? And then scrimp and save through the next three quarters? Has anyone in HMRC given any consideration to this? Or, worse, is anyone in HMRC sufficiently acquainted with actual business practice to recognise the problem?

Taking these considerations into account, you start to wonder what exactly are the benefits of MTD? But, as I mentioned, HMRC goes on to claim benefits from "reduction in the amount of tax lost". Their actual heading is: 'Reducing the amount of tax lost to avoidable errors'.

And they suggest that this might be achieved by:

- improved accuracy of digital records;
- additional help built into many software products;
- digital records being sent directly to HMRC.

Again, let's consider these in turn.

<u>Improved accuracy of digital records</u>
Not wishing to pour salt into an open wound, but dare I mention the Post Office and the Horizon software again? Dare I also point out that when I was studying computer programming in the 1970s (yes, I am that old!) one of the first phrases we learnt was GIGO, which stands for 'garbage in, garbage out'. What this means is that if you put rubbish into a computer, you will get rubbish out. Of course, you can also have programmes like Horizon where, although you put the right figures in, you still get garbage out. The simple point is that computers are not infallible. And the people who have to put the numbers into computers are not infallible, either.

<u>Additional help built into many software products</u>
Really? Has anyone here seen a programme that covers all the joys of, say, Capital Allowances? Will it tell you whether you can claim Capital Allowances on a roller shutter blind or a movable partition wall? I mention those two particular items because they are both items where I have had an argument with a tax inspector where the inspector got it wrong.

Of course, as an alternative you could always ring up the HMRC help line. Except, of course, they aren't answering and even when they do, they don't seem to know the answer. (I say that as someone who has actually had to explain to the person on the HMRC end of the call that a Month 1 PAYE code was non-cumulative.)

Or you could try the HMRC website? Just for the purposes of this article I put "Capital allowances on roller shutter blind" into the HMRC search. I got 16,861 results, the first being about a VAT Tribunal decision on the VAT liability on installation of blinds, the second being to the Construction Industry Scheme, the third referring me to the Super Deduction (which, of course, relates only to companies). The fourth, my favourite, being advice in an alert to be followed by those responsible for the selection of healthcare beds. I scanned down the next 50-odd headings and all of them were similarly useless. And that leaves us with…

<u>Digital records being sent directly to HMRC</u>
To remind you, the claim is that sending digital records to HMRC will result in a reduction in tax lost through avoidable errors. But, as Andrew Park reported in his excellent article in January's edition of this magazine, the Public Accounts Committee has recently highlighted some dispiriting statistics produced by the National Audit Office which show that 114,000 fewer compliance cases were opened by HMRC in 2020/21, compared with the previous year, and the drop in compliance yield for 2020/21 and 2021/22 represented a loss to the Exchequer of around £9 billion.

The problem seems to be that they have lost so many staff, and so many experienced staff in recent years, that they haven't got the capacity to carry out anywhere near the number of investigations that they used to. And yet they are talking about increasing the number of tax returns five-fold?

The monetary benefit of MTD

There is one bit of the HMRC website that I haven't mentioned. If you go to their 'Overview of Making Tax Digital' you will find there is a part that says "HMRC recently published evidence of Making Tax Digital reducing the tax gap". If you follow the hyperlink it takes you to a paper from March 2022 entitled 'Evaluating additional tax revenue from Making Tax Digital for VAT" .

Now I need to point out that this report stresses at several points that the paper is a technical paper and contains estimates. Indeed, it concludes with the phrase: "Please note that this is a technical report that contains some complex statistical terms". We shall put to one side the Mark Twain quote that "There are three kinds of lies: lies, damned lies, and statistics", and focus on what the report says. It claims that, for taxpayers with a turnover of under £85,000, their estimate of the average additional tax revenue from MTD is – wait for it – a whole £19 per business per quarter; and for those over the £85,000 threshold, the estimated additional tax revenue from MTD is £57 per business per quarter.

Wowee! That's a whole £76 per year for smaller businesses and £228 per business per year from bigger ones. Well, that's going to make the country solvent, isn't it!

No, of course it isn't. These numbers – which are almost buried beneath hyperlinks in the HMRC website – suggest that the financial benefits of MTD are miniscule. And certainly not worth the estimated cost to HMRC of £1.3 billion of introducing MTD for VAT and Self Assessment. But, in addition to the costs to HMRC, we have the costs for the taxpayer. Because one of the concerns recently raised by the Public Accounts Committee was that HMRC had excluded over £2 billion in upfront transitional costs for customers from its business case for MTD.

The Public Accounts Committee report of 24 November 2023

I really do recommend that everyone who might be impacted by MTD – accountants and taxpayers alike – read this report. The fact that the PAC refers to MTD as Making Tax Difficult speaks volumes.

I do not think I can do better than quote the comments of Dame Meg Hillier MP, Chair of the Public Accounts Committee, who said: "When reporting on proposals for digitalising the tax system, our Committee should not have to be recommending that HMRC start with what taxpayers need – in an ideal world, one would hope this would simply go without saying. But seven years and £640 million into the Making Tax Digital programme, we are concerned HMRC is also succeeding in making tax difficult.

"Imposing significant additional burdens on customers in the middle of a cost of living crisis could not be less welcome. HMRC must now look up from what it is doing and research what services customers would actually find most helpful. We are also concerned at the substantial costs to be imposed on many taxpayers. HMRC's exclusion of billions of pounds of projected costs when seeking investment for the programme is utterly extraordinary, and future transparency on costs and benefits must be non-negotiable."

'HMRC must now… research what services customers would actually find most helpful'
What a telling remark! And how astonishing that the Chair of the PAC feels it necessary to make it!

I can make a few suggestions. How about a help line manned by people who understand tax? How about more and better trained HMRC staff? How about a specific HMRC website (rather than a generic Gov.UK website) where you can actually find answers to tax questions, rather than being led down the rabbit hole of healthcare beds? How's about dropping all those useless 'nudge letters' and the pretence that these actually improve compliance? How's about insisting that every letter you send out contains the direct email address, name and telephone number of the individual who sent it so that taxpayers and agents can contact them?

And here's a revolutionary idea – How about scrapping the whole idea of MTD for ITSA and CT? Learn the Post Office lesson; when you find yourself at the bottom of a deep and expensive hole, stop digging.

• *Tony Monger is a former HMRC investigator and investigation team leader, and worked for PwC, Irwin Mitchell, Deloitte and Mazars. He can be contacted at* antonymonger@virginmedia.com