

ICAS

**Evidence to the House of Lords Economic Affairs Finance Bill
Sub-Committee**

Draft Finance Bill

12 October 2021

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 22,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England.
2. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.
3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and regulatory system design, and to point out operational practicalities.

General Comments

4. ICAS welcomes the opportunity to provide evidence to the Sub-Committee on the draft Finance Bill.
5. We believe that basis period reform is sensible in principle. It would be a useful simplification for most new businesses. Basis period reform, or at least the introduction of full equivalence of 31 March and 5 April year ends, is essential to make MTD for income tax workable.
6. However, it is vital that adequate time is allowed to refine the proposals and implement basis period reform (if the decision is taken to proceed with it) - and to conduct a full pilot of MTD for income tax (which is open to all businesses) - before MTD becomes mandatory. The rushed six-week consultation on the basis period proposals did not allow adequate time to consider important principles or practical details. Problems with HMRC's service levels also need to be rectified before agents and businesses are asked to implement these two significant changes.
7. We therefore welcome the Government's announcement that the start date for MTD for income tax will be delayed for 12 months – and that basis period reform will not come into effect before April 2024. However, the one-year delay to MTD may not be long enough to allow successful implementation of basis period reform and a full MTD pilot.
8. The notification of uncertain tax treatment (UTT) measure also illustrates the importance of following the full consultation process set out in the [Tax Consultation Framework](#) to improve the likelihood of arriving at a satisfactory outcome. Stage 1 of the process - setting out objectives and identifying options – was omitted for the UTT measure. As a result, other options which would not have imposed unnecessary burdens on all large businesses, never seem to have been properly considered by HMRC, leading to poorly targeted legislation and an unsatisfactory outcome.
9. We welcome the reduction in the number of triggers. However, having dropped several proposed triggers (apparently because they were not sufficiently clear and targeted), the new 'substantial possibility' third trigger has been introduced. This is unclear, less targeted, and highly subjective; it is unlikely to be workable in practice and adds significant uncertainty to the UTT regime. Serious problems also remain with the second trigger (HMRC's known position). If radical changes are not possible at this stage, HMRC at least needs to address problems with these triggers.
10. We continue to believe that the UTT measure imposes unnecessary administrative burdens on the open and transparent majority of large businesses instead of being properly targeted at the uncooperative minority. Implementation will require additional HMRC resources; it would be far more constructive, and more likely to achieve the stated objectives of the measure, if those additional resources were instead directed to the existing HMRC Customer Compliance Manager and Business Risk Review regime.

Income tax basis period reform

Question 1: How far does the reform represent a useful simplification?

11. Adopting the tax year basis is a sensible approach in principle and would remove a number of complications which have been in the system for a long time. For most new businesses it would be a

useful simplification. Even if full basis period reform does not proceed, we believe that some adjustment to the rules will be necessary to facilitate the implementation of MTD for income tax.

12. The consultation proposed to extend the equivalence of 31 March and 5 April beyond the opening years of a business (and to extend it to property income). If the wider proposals for basis period reform do not proceed, we believe that legislating for equivalence is essential to make MTD for income tax workable. The Income Tax (Digital Requirements) Regulations 2021 do introduce an option to elect for 'calendar quarters', solely for MTD quarterly reporting purposes, but this is not an adequate substitute for full equivalence for self-employment and property businesses.
13. There are practical issues around the timing of any reform, the transitional rules and interaction with the start of MTD. There will also be an ongoing administrative burden for businesses which do not make up their accounts to 31 March or 5 April and would find it difficult to switch to one of these accounting dates. For these businesses, basis period reform will not be straightforward.

Question 2: To what extent would the reform deliver a fairer result than the current rules?

14. The current system is designed to ensure that profits earned over the lifetime of a business are taxed in full and taxed only once. This should generally produce a 'fair' result. However, it necessitates complex opening and closing year rules, which can distort the tax outcome for some businesses.
15. Businesses which are profitable in their early years of trading are likely to have some profits taxed twice. Corresponding 'overlap relief' will usually be given against profits in the final period of trading (or sometimes earlier where the business changes its accounting year end) – but by then inflation will often have eroded the economic value of this relief, distorting the outcome.
16. The proposed reform would remove problems arising from overlap relief but could give rise to other distortions, particularly through the additional costs and administrative burdens imposed on businesses whose accounting date is not 31 March or 5 April.

Question 3: Would either of the alternative options mentioned in the consultation document be a better solution? If so, why?

17. It is difficult to see how a system analogous to that for Corporation Tax would work for income tax. Tax rates, reliefs and allowances and non-trading income (such as employment, property, and savings income) are all linked to the tax year to 5 April, as are capital gains.
18. The alternative of mandating businesses to adopt the tax year as their accounting reference period, though superficially attractive, would prioritise tax administration over business management and commercial considerations. Some businesses, such as those which are part of international firms or those with seasonal trades, would find it difficult to use 31 March or 5 April as their accounting date.

Question 4: Are the transitional provisions sufficiently robust? If not, how do they need to change?

19. The proposed approach – spreading the excess profits of the transitional year - is not unreasonable in principle. The impact will vary from business to business, depending in part on the overlap relief available for offset against additional profits. Inevitably, some businesses will see higher tax bills than would otherwise have been the case, where the additional profits push them into higher tax bands.
20. The impact could be particularly severe for some established businesses with year ends early in the tax year. We believe that adverse outcomes could be mitigated by allowing five year spreading for all businesses with excess profits, with spreading over ten years available in exceptional circumstances. 'Exceptional' could be defined by reference to a set percentage increase in taxable profits.

Question 5: 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?

21. Apportionment will impose a significant administrative burden on businesses which do not have a 31 March or 5 April year end. According to the consultation, this is estimated to be 7% of sole traders and 33% of trading partnerships. Some of these businesses may choose to change their accounting dates but, as noted in our response to Question 3, this would be difficult in some cases.

22. Businesses with accounting dates later in the tax year will be particularly badly affected because they will need to use provisional figures to complete their tax return initially – with an amended return being submitted when the final figures for the second accounting period are available. Partnerships will have to submit amended returns both for the partnership and for individual partners. Extra work will be generated for businesses and HMRC.
23. We suggest that some of the negative impact could be avoided if businesses were permitted to adjust the provisional figures in the following year's tax return, rather than by amending the current return.
24. The additional costs incurred will vary from business to business and will depend on whether the business is able to deal with apportionment and estimation in-house or will need professional help from a firm of accountants. Larger businesses may be better placed to manage the cost implications than some smaller ones, which will need to source outside help on an ongoing basis.

Question 6: How manageable is the timetable, especially vis-à-vis the introduction of Making Tax Digital for income tax?

25. Many of the concerns we have raised about basis period reform arise from the interaction with the start date for MTD for income tax and HMRC service standards. The original timetable involved several significant changes being compressed into a very short timeframe. This would increase pressure on agents and taxpayers in the aftermath of the pandemic when many are still struggling to recover. At the same time HMRC is failing to deliver adequate service levels for routine work – and appears under-resourced to rectify these problems whilst also dealing with the additional demands which will arise from the introduction of MTD for income tax.
26. We welcome the Government's announcement that the start date for MTD for income tax will be delayed for 12 months – and that basis period reform will not come into effect before April 2024. However, a one-year delay to MTD may not be enough. There should be further consultation on basis period reform and amendments to the proposals, to mitigate some of the problems identified for businesses which do not have 31 March or 5 April year ends. After that – and assuming that either basis period reform or equivalence of 31 March and 5 April is introduced – the full pilot of MTD for income tax described in our response to Question 7 should take place before MTD becomes mandatory.

Question 7: What is Her Majesty's Revenue and Customs doing to support businesses in making the change?

27. To date, HMRC support for businesses seeking to prepare for MTD for income tax has been limited. Very little software is available and access to the pilot is restricted. Adding basis period reform to the mix will increase demand for HMRC support. The deferral of both changes provides more time for HMRC to improve its service levels for routine work – if this does not happen agents and their clients will struggle to prepare effectively for MTD (and basis period reform) on top of dealing with day-to-day tax matters. HMRC must also increase support for businesses to make the transition.
28. A major HMRC communications campaign will be essential, alongside expansion of the MTD pilot so that all businesses which want to do so can join the pilot for a full year's cycle ahead of the mandatory start date. Availability of software is critical – currently the lack of appropriate software is a major obstacle to preparation and to joining the pilot. HMRC does not provide software itself so will need to work closely with third party software providers to ensure that a wide range of products becomes available quickly. The lack of certainty about basis period reform is likely to be deterring providers from finalising and releasing their MTD products. Whilst regulations for MTD have now been laid, this uncertainty is likely to remain until a final decision on basis period reform is announced.
29. The requirement for all businesses to enter MTD for income tax at the same time and report for the same quarters will cause a considerable bunching of work at the outset but also on an ongoing basis. We have concerns about the capacity of HMRC and agents to deal with this. Full basis period reform will impose additional burdens on businesses not using a 31 March or 5 April year end.

Question 8: How important is reform of the basis period rules in the context of the Government's 10-year strategy for the tax administration framework?

30. Basis period reform itself is a sensible move towards an efficient modern tax administration. Our concerns largely relate to timing, transitional provisions (the period for spreading excess profits needs

more flexibility), HMRC service levels and capacity, and the interaction with MTD for income tax. The issues faced by businesses which would find it difficult to use a 31 March or 5 April year end also need to be mitigated as far as possible. We have mentioned one possible mitigation in our response to Question 5; other mitigations (for MTD and basis period reform) could be identified through further consultation. For example, the introduction of a 'single rural business unit' approach to taxing rural businesses with multiple different income streams (from a mixture of different trades and different types of property letting) could be considered.

Question 9: How much of a problem are the existing basis period rules in practice?

31. According to the consultation, HMRC estimates that 93% of sole traders and 67% of partnerships use 31 March or 5 April as their accounting date. The existing basis period rules do not generally present problems for these businesses, although there is scope for confusion for new businesses.
32. For other businesses, the opening and closing year rules are complex and can cause difficulties. However, once businesses have been trading for a few years a routine is established and the existing current year basis of assessment generally works well. As noted in our response to Question 1, some change to the existing rules will be essential to make MTD for income tax workable.

Question 10: 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?

33. The OTS assessed the benefits and costs of changing the tax year either to 31 March or 31 December. Its report noted that there are 'clear benefits in adopting a tax year which is either aligned with the calendar year or with a calendar month-end'. However, it also noted that the costs for government and businesses would be significant (along with reduced capacity to undertake other significant changes) and concluded that no change should take place in the immediate future.
34. As a practical measure to facilitate MTD for income tax, the OTS recommended that HMRC and the Government should legislate to introduce equivalence for 31 March and 5 April year ends (for the self-employed and landlords), whether or not the wider basis period proposals go ahead.
35. We agree that equivalence should be introduced, if wider basis period reform does not proceed – we believe it will be essential to make MTD workable. The Income Tax (Digital Requirements) Regulations 2021 introduce an option to elect for 'calendar quarters', solely for MTD quarterly reporting purposes, but this is not an adequate substitute for full equivalence.
36. In the longer term, changing the tax year to match the calendar year, could assist some businesses which would be disadvantaged by the proposed basis period reforms. Many seasonal businesses and some businesses which are part of international organisations already use an accounting date of 31 December for business and commercial reasons.

Notification by large businesses of uncertain tax treatment

Question 1: 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?

37. There have been some improvements to the proposals in response to concerns raised in the consultations, for example, the number of taxes within scope has been reduced and a single notification is no longer proposed. However, the most significant concerns have not been addressed.
38. The measure remains poorly targeted and will impose increased administrative burdens on all large businesses rather than being properly targeted at the uncooperative minority. We do not agree with the latest impact assessment when it says that there is not expected to be a significant increase in the administrative burden for businesses which are already open and transparent with HMRC. This is unrealistic and fails to acknowledge the extra work which will be required. Open and transparent businesses will make every effort to comply and are likely to find the requirement more onerous than uncooperative businesses which are unlikely to make the same effort.
39. Another major concern which has not been addressed, arises from difficulties interpreting and applying some of the triggers for notification. We welcome the reduction in the number of triggers, in response to the earlier consultations - from seven (in the second consultation) to three. However, having dropped several proposed triggers (apparently because they were not sufficiently clear and

targeted), elements of these triggers have been swept into a new 'substantial possibility' third trigger, which is unclear, less targeted, and highly subjective. This trigger is unlikely to be workable in practice and adds significant uncertainty to the uncertain tax treatment (UTT) regime.

40. The second trigger (HMRC's known position) would be relatively easy to apply if the legislation clearly defined 'known position' and that position could be readily ascertained. Unfortunately, concerns about how to establish the known position have not been addressed. There is still a lack of clarity around which HMRC guidance and other material businesses are expected to consult. Problems also arise because HMRC guidance is not always kept up to date and is sometimes unclear or contradictory.
41. HMRC appears to envisage that some of the concerns identified during consultation will be solved by the general exemption from notification. This is available where it is reasonable for the business to conclude that HMRC already have available to them all, or substantially all, of the information relating to that amount that would have been included in the notification if it had been required to be given.
42. In practice, we believe this exemption will be of limited usefulness. In many cases information will be made available through discussion with a company's Customer Compliance Manager (CCM). However, for exemption to be available, draft HMRC guidance (published in August) states that the company must make clear that the discussion is to avoid the requirement to notify, and the conclusion must be documented.
43. Feedback from our members suggests that holding specific discussions and documenting the conclusions in a reasonable timeframe is likely to be impracticable due to constraints on CCM resources. These constraints are already making it difficult for businesses to engage with their CCMs reliably and consistently to discuss and clarify tax treatments, or for business risk review purposes.
44. The combination of two uncertain triggers and practical problems with the general exemption, reinforces the concern we have raised throughout, that HMRC will receive a large number of unnecessary notifications. Open and transparent businesses which want to work cooperatively with HMRC are likely to err on the side of caution in terms of notifications (particularly under the subjective and unclear third trigger) increasing the workload for both sides. There is also a risk of duplicate disclosures where these businesses disclose information to their CCMs but cannot obtain a documented conclusion in time so disclose again through notification.
45. Additional HMRC resources will be required to sift through the notifications, as recognised in the impact assessment for the second consultation. These resources could be more constructively employed by directing them to the existing CCM and Business Risk Review regime instead.
46. The unsatisfactory outcome of this consultation illustrates the importance of following the full process set out in the [Tax Consultation Framework](#). In this case, Stage 1 – setting out objectives and identifying options – was omitted (the first consultation on UTT took place at Stage 2). As a result other options, which would not have imposed unnecessary burdens on all large businesses, never seem to have been properly considered by HMRC, even when raised in consultation responses.

Question 2: Is sufficient support being given to businesses to help them comply with the measure?

47. No, we do not believe that sufficient support is being provided. We see three main areas where HMRC and the Government should do considerably more to help businesses to comply and to minimise the additional burdens which the measure will impose on cooperative large businesses.
48. Firstly, HMRC needs to provide robust, helpful guidance on the UTT regime, setting out clearly its interpretation of the triggers and how it expects businesses to apply them. The draft guidance on UTT published in August fails to address some important issues.
49. Improved guidance is particularly required to support businesses trying to understand the new third trigger which suffers from a fundamental lack of clarity and objectivity. The legislation states that notification will be required under this trigger if it is reasonable to conclude that there is a substantial possibility that a court or tribunal would find the treatment adopted to be incorrect. This is unlikely to be workable in practice and adds significant uncertainty to the regime. It also increases the risk that HMRC will receive a large number of unnecessary notifications because the wording of the trigger is highly subjective, and it is unclear how HMRC expects it to be interpreted.

50. One example of the difficulties arising, can be seen from the statement in HMRC's draft guidance that it does not expect that legal advice would be necessary in order to comply. This is unrealistic; forming any opinion about whether a tribunal or court would find the treatment incorrect would normally require an approach to Counsel for many large businesses. A treatment deemed to have less than 50% likelihood of being correct would not be adopted. Above that, even if the business is confident, there will still always be the possibility that a court would take a different view. It is unclear whether it is HMRC's view that where a treatment has been adopted after taking advice from Counsel it will invariably need to be notified, or what degree of certainty of treatment HMRC has in mind.
51. It would be preferable to remove the third trigger - or at least amend it to make it clearer and more objective. If that is not possible, HMRC should explain the rationale behind the drafting of this trigger, give better guidance on what HMRC expects to be reported and improve the illustrative examples provided. The current draft guidance is of very limited usefulness.
52. In the context of the second trigger (HMRC's known position), HMRC should use the UTT guidance to provide certainty and a level playing field for all businesses by explicitly listing the guidance and other material businesses are expected to consult in order to ascertain HMRC's known position. As far as possible the list should be restricted to formal, well known and readily accessible material. HMRC could have included such a list in the draft guidance but has not done so. Instead, some non-exhaustive examples have been given and many questions have been left unanswered.
53. Secondly, HMRC should improve its published guidance and ensure that it is kept up to date. The draft UTT guidance suggests that businesses should assess whether published HMRC guidance is out of date or contradictory when seeking to establish HMRC's known position. This is unfair (some businesses will be better placed than others to do this) and unreasonable - and creates more uncertainty.
54. HMRC has recognised that the introduction of the UTT measure means that it is important that taxpayers can rely on its published guidance. It also accepts that there are areas of guidance which can be improved and has committed to carrying out a programme of 'material improvements' prior to implementation. We welcome this acknowledgement, and we are aware of existing work within HMRC to improve guidance. However, it is unclear what can realistically be achieved before implementation.
55. There are also longer-term issues with the updating of guidance – both when legislation is amended and when HMRC changes its view. To support businesses in applying the notification requirement HMRC needs to commit sufficient resources on an ongoing basis to ensuring that guidance is swiftly updated and reflects its view – where that view is changing, the affected guidance should immediately be annotated (to make clear that it cannot be relied upon), or withdrawn, pending a full update.
56. Thirdly, it is essential that increased investment in HMRC's Customer Compliance Manager (CCM) resources takes place. Unless this happens, we do not believe that the notification regime can function effectively, in a way which keeps to a minimum the increased administrative burdens for open and transparent large businesses.
57. Increased resources are particularly important to support businesses which are within the scope of the notification requirement but do not currently have a CCM. It appears, from the response to the second consultation and the draft guidance, that HMRC and the Government currently envisage that those without CCMs will need to use a route involving completion of an online contact form to discuss uncertainties. This is inadequate and no substitute for the ability to have regular interaction with a CCM (who develops an understanding of the business). These businesses should be provided with a CCM, or they will be at a considerable disadvantage compared to others within the regime.
58. Additional CCM resources are also required to address the problems already being experienced by the majority of cooperative large businesses which cannot always obtain adequate, timely engagement with HMRC due to CCM resource constraints – and to ensure that there is no further deterioration to service levels as a result of resources being diverted to dealing with notifications.
59. We continue to believe that the stated objectives of the UTT measure would be more likely to be achieved if the additional HMRC resources which will be required to implement UTT were directed instead to the existing CCM and Business Risk Review (BRR+) regime. The majority of large businesses would then be able to engage with HMRC in real time, reliably and consistently, with a greater likelihood of resolving uncertainties quickly – and HMRC could also increase its engagement and compliance activities with currently uncooperative large businesses.