Association of Accounting Technicians response to the HMRC consultation document “Making Tax Digital: Simplifying tax for unincorporated businesses”

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1. Introduction

1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the HMRC consultation document “Making Tax Digital: Simplifying tax for unincorporated businesses”, published on 15 August 2016.

1.2. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of taxes.

1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.

1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities of implementing the measures outlined.

1.5. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by our 4,250 licensed accountants.

1.6. AAT is happy to participate in future Making Tax Digital (MTD) consultations and its members are willing and able to participate in any MTD pilots in order to assist with the smooth implementation of this important programme.

2. Executive summary

2.1. **AAT wholeheartedly supports the ambition to make our tax system the most digitally advanced tax system in the world**. However, AAT is concerned about the timetable for implementation.

2.2. **AAT is concerned about the costs MTD will place on businesses and taxpayers.** A recent survey of AAT licensed accountants found that well over three quarters were concerned about software costs and time spent familiarising themselves with the new processes. Almost half are concerned about hardware costs and other, as yet unknown, costs.

2.3. **It has been difficult to fully respond to each of the six MTD consultation documents given so much technical uncertainty remains.** HMRC must delay implementation if significant technical difficulties arise rather than proceeding regardless. Proceeding under such circumstances risks both reputational damage and reduced compliance. Universal Credit (UC) serves as a recent reminder of a less than successful government IT programme where pressing ahead despite the consequences has caused difficulties for recipients, financial losses for the taxpayer, reputational damage for all involved parties and a legacy of mistrust for future large scale government projects. The National Audit Office described the UC programme as beset by “weak management, ineffective control and poor governance” with £34m written off on failed IT programmes and at least one hundred million more on the programme as a whole. It is vital that HMRC learns the lessons from examples such as this.

2.4. **AAT favours a phased implementation programme for MTD.** The threshold should be set at £83,000 (the current VAT threshold) falling to £11,000 (the personal allowance) over a three year period. This will help the business community whilst simultaneously helping HMRC achieve the best possible outcomes. This proposal is explained in full at 3.83-3.84 of AAT's response to "Making Tax Digital: Bringing business tax into the digital age."

2.5. **AAT would like to see the continuation of the link to the VAT threshold** and for this to be reviewed once every five years.

2.6. **The exit threshold should be aligned with the VAT flat rate scheme ceiling (£230,000).**

2.7. **AAT agrees with the proposed approach of following accounting periods**, but only on the basis that existing businesses are allowed to retain the right to deduct overlap profits at the time of a change of accounting.

2.8. **The concept of a reduced reporting framework is attractive as it offers the prospect of simplification, without the drawbacks associated with cash.** If the reduced reporting framework includes an option to account for stock changes it is likely that it would prove an attractive proposition and one that many of AAT's licensed accountants would be likely to recommend to their smaller business clients who have no need for accounts for outside third parties.

2.9. A recent survey of AAT licensed accountants found the following:

- **56.5% considered that the cash basis entry threshold should remain at its current £83,000,** compared to 19.4% who favoured a modest increase to £100,000 while only 10.5% thought it a good idea for it to be doubled to £166,000.

- **47% are in favour of reforming the basis periods for the self-employed.** 40% thought it to be a bad idea and 37% said it would make little difference.

- **55.2% thought that the cash basis should be optional**. Only 7.8% felt it should be compulsory and 37.1% required more information before deciding.

2.10 **AAT and its members can and will play a vital role in helping make a success of MTD.** AAT members are already educating and raising awareness of MTD amongst their client base (and adopting a phased implementation will give them much needed time to do so). In addition AAT is utilising various channels to provide information, advice and guidance to members on successful MTD implementation.

3. AAT response to the HMRC consultation document "Making Tax Digital: Simplifying tax for unincorporated businesses"

Question 1
1a: What level do you consider to be an appropriate turnover entry threshold?
1b: For a threshold not linked to the VAT threshold, should it be reviewed annually in the light of inflation or less frequently (please state recommended interval)?

3.1. The results set out in the above introduction that a majority of AAT licensed accountants do not wish to see any change in the threshold, were reflected in a subsequent AAT roundtable event.

3.2. However, when linked to the government's commitment "to simplifying the tax system and making it easier for taxpayers to fulfil their tax obligations" (2.13, condoc) there was more support for a higher threshold increase.

3.3. On the basis that the VAT registration threshold is a good proxy and it has seen regular increases as part of annual Budget statements, AAT would like to see the link to the VAT threshold continue even if the association does not remain on a one-to-one basis.

3.4. The continuation of the link to the VAT threshold, albeit not necessarily on a one-to-one basis, would have the additional benefit of alleviating the need for frequent reviews.

3.5. After taking the above into account the need for a periodic review of the cash-basis threshold would remain, say, at 5 yearly intervals.

Question 2
2a: If the entry threshold were to be increased, do you agree that the exit threshold should continue to be set at twice the entry threshold?

2b: If the entry threshold were to be increased, do you agree that the UC threshold should continue to be set at twice the entry threshold?

3.6. It is hard to determine the appropriate exit threshold if its reciprocal (the entry level threshold) is not known.

3.7. If the increase to the entry threshold is minimal it would seem to be appropriate for the exit-threshold to remain set at twice that of the entry level.

3.8. Whereas, if the entry threshold were to be doubled it does not seem quite so appropriate to double the exit-threshold.

3.9. Setting the entry level threshold as double the current VAT registration threshold would result in businesses with turnovers in excess of £300,000 being able to report their taxable profits using the cash-basis, which does not seem appropriate.

3.10. Under normal circumstances business with such relatively high levels of turnover would benefit from the discipline of reporting their income and expenditure according UK GAAP.

3.11. To combat these difficulties (3.6-3.11) AAT suggests aligning the exit threshold with the VAT flat rate scheme ceiling which is currently set at £230,000.

Question 3
Do you agree with the proposed approach of following accounting periods? If not, what alternative approach would you support?

3.12. AAT agrees, but only on the basis that existing businesses are allowed to retain the right to deduct overlap profits at the time of a change of an accounting.

Question 4
4a: Are there any other events or situations which would require additional rules?
4b: Would it be helpful to make any changes to tax accounting periods for any other types of income?

3.13. There are not considered to be any other situations which would require additional rules.

3.14. AAT can't envisage any instances where it would be helpful to make any changes to tax accounting periods for any other types of income.

Question 5
Are there other end of year adjustments not listed in paragraph 4.12 which could be simplified within a reduced reporting framework?

3.15. No other areas worthy of simplification have been identified

Question 6
Would you welcome the four relaxations proposed?

3.16. With the exception of the closing stock adjustment the proposals are considered to be an aid to simplification.

3.17. However, the absence of a year-end stock figure could have a detrimental effect on the reporting of profits, which could fluctuate wildly on a year-on-year basis.

3.18. It is therefore essential for taxpayers opting to use the simplified reporting basis to be able to continue to adjust for stock.

3.19. After taking into account the carve-out for stock the proposals are welcomed.

3.20. It should be noted; concerns were expressed among AAT members that a cash basis of accounting for those businesses with significant economic activity would not be a good aid for their owners to accurately monitor their businesses.

Question 7
Do you think that the restrictions proposed are appropriate?
If not, what restrictions would you suggest?

3.21. The proposed restrictions are considered to be appropriate.

3.22. An adjustment period of no more than 12 months achieves simplification and minimises any opportunity to abuse the rules.

Question 8
Do you believe that simplifying the capital/revenue distinction as suggested in paragraphs 5.7 to 5.13 would simplify reporting for businesses within the cash basis?

3.23. It is difficult to see how the proposals set out in the consultation document relate to small unincorporated businesses or if they do how they could be seen to be a simplification.

Question 9
Can you identify any specific caveats which might be needed to ensure that the new rule operates as intended?
Are there any potential tax planning opportunities which the current rules would not prevent?

3.24. No specific caveats or tax planning opportunities have been identified.

Question 10
10a: If the cash basis entry threshold is raised would you consider using the cash basis, or advising your clients or members to use it?
If so please provide details of anticipated impacts, including both one-off and ongoing benefits and costs.

3.25. For the reasons set out below AAT licensed accountants are likely to be cautious when considering whether to recommend that a client use the cash basis (mindful that in the right circumstances for persons such as sub-contractors it is likely that they would):

- The limitation of deductible interest is too restrictive for many with business loans
- A lack of flexibility in respect of capital allowance claims resulting in an inability to restrict claims to avoid their wastage
- The loss of the ability to carry back opening period losses for set off against previous years means that an important source of cash flow (repaid tax) is lost.

10b: If the proposed basis period reform is taken forward, how do you think this would impact on business admin burdens?
If possible, please provide details of anticipated impacts, including both one-off and ongoing benefits and costs.

3.26. AAT's licensed accountants provide accountancy and taxation services to their clients in a variety of different ways. This, coupled with the fact that no one knows exactly what reporting under MTD will look like, means it is impossible to be precise about the anticipated impact on business burdens.

3.27. Where the pre-MTD service provided extends across the whole range from bookkeeping at one end, to the production of year end accounts at the other, it is likely that after incurring some one-off set-up costs the ongoing impact will be minimal.

3.28. The same is likely to be true for the many VAT registered businesses that are already used to a quarterly bookkeeping and reporting regime.

3.29. It should be noted however that a sizeable minority, particularly micro-businesses, may not currently be accounting for VAT using software. These companies are likely to incur one-off costs associated with computerising their accounting function and in learning the new disciplines associated with reporting under MTD. However, once these one-off costs have been met it is likely that their ongoing additional costs will be limited to paying for software licenses and occasional hardware upgrades.

3.30. Where the books and records are only written up after the end of a tax year, often by an accountant as part of the year-end tax compliance process, it is likely that as well as incurring some one-off set-up costs there will also be a significant ongoing impact. In these circumstances it is difficult to see, even with relatively sophisticated software, how the discipline imposed by quarterly reporting is going to be anything other than an ongoing burden.

3.31. It is hard to understand what the benefits of quarterly reporting might be for smaller non-VAT registered traders who are often quasi-employees. The inconvenience, as they are likely to see it, of complying with filing quarterly returns is not going to be outweighed by the benefits richer data.

3.32. While accepting that many are unlikely to suffer an on-going increase in their administration burden it is very difficult to envisage any MTD-related time savings.

10c: If the reduced reporting framework is introduced, please provide details of how this will affect your business or your clients or members, including details of both the expected one-off and ongoing benefits and costs for:

- **Familiarisation with the new scheme and updating software or systems**
- **Having to make fewer adjustments than would be required under UK GAAP**

3.33. The concept of a reduced reporting framework is attractive as it offers the prospect of simplification, without the drawbacks associated with cash.

3.34. If the reduced reporting framework includes an option to account for stock changes it is likely that it would prove to be an attractive proposition and one that many of AAT's licensed accountants would be likely to recommend to their smaller business clients who have no need for accounts for outside third parties.

10d: If the revenue / capital divide is simplified as suggested do you believe that this would simplify reporting for businesses within the cash basis? If so please provide details of anticipated impacts, including both one-off and ongoing benefits and costs.

3.35. Please refer to the response provided under question 8 above.

10e: Please tell us if you think there are any other impacts, benefits or costs not covered above.

3.36. AAT does not have any other comments to make.

4. About AAT

4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and 80,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,250 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact Aleem Islan, AAT Technical Consultation Manager, at:

E-mail: consultation@aat.org.uk   Telephone: 020 7397 3088

Association of Accounting Technicians
140 Aldersgate Street
London, EC1A 4HY