

**13 July 2021**

Via Email to: [adminframeworkreview@hmrc.gov.uk](mailto:adminframeworkreview@hmrc.gov.uk)

## **FSB Response to the Consultation on the tax administration framework: Supporting a 21<sup>st</sup> century tax system**

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to the consultation on the tax administration framework. The Federation of Small Businesses (FSB) is the UK's leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that's led by our members, for our members.

### Consultation Questions

#### **Chapter 2: Reviewing the tax administration framework**

Q1. Are there reforms which HMRC should focus on for the framework review? Which changes should we prioritise to drive improvements in the taxpayer experience?

FSB has recently undertaken a tax survey of our members, asking about at their perception of the current system. It was found that only 35% of businesses think their current level of tax they pay is fair given the risk of owning their own business, 63% believe that the number of different taxes is too confusing, 52% believe the UK's tax system for paying tax is too complex and only 30% believe the tax system is broadly transparent.

Complexity of the system is one of the largest issues we commonly hear from our members. This arises in several ways; as shown above, a large share considers the variety of taxes makes the system, as a whole, confusing. Equally, there is a large gap in knowledge around available reliefs small businesses are entitled to and can apply for.

In our tax survey, small businesses reported that certain taxes were more difficult to understand when and where they are applicable across their businesses than others. IR35 had the highest share of businesses reporting difficulty in understanding (69%) followed by capital gains tax (42%) and Self employed national insurance (26%).

In addition to this, we asked small businesses about their view on the £85,000 VAT threshold; 23% reported that it presented a barrier to growth of their businesses. A significant share of small businesses avoid business expansion to minimise the administrative burden they face that accompanies crossing that threshold. The threshold thus acts as an artificial barrier to growth, incentivising slowing business activity down to avoid the administrative burden that they would otherwise face with expansion. An increase in the threshold would likely see a significant boost to the economy as smaller businesses can expand with less administrative burden to facilitate.

We fundamentally believe that the complexity of the system and how small businesses operate within the tax sphere needs to be improved. On a basic fairness principle, small businesses should have better knowledge of and access to the reliefs they are eligible for given that they are required and expected to pay their liabilities. If the liabilities get paid, reliefs should also be rewarded.

The complexity of the system also has the subsequent effect of making paying liabilities administratively burdensome and costly. It was found in the same survey that the average small business spends approximately £4,100 on tax compliance each year and that 10% of businesses spend in excess of £10,000. In terms of time spent, the average small business spends 52 hours per year on compliance with 35% of businesses spending more than 70 hours – almost two working weeks.

Ways in which to reduce these costs would be very positive for small businesses. The tax system is disproportionately costly to small businesses. Larger organisations often have dedicated tax teams. That is a luxury most small businesses cannot afford and so it tends to be the business owner using their own time to pay liabilities rather than using that time for productive activities.

Q2. Where is the tax administration framework creating challenges to the trust that taxpayers place in the tax system and HMRC's administration of it? How could the framework be reformed to address these challenges?

Q3. Do you agree that these are the right overarching objectives to guide this review or do you believe there are others it should consider? Do you feel that some of these objectives are more important than others?

Yes, we agree that these are broadly the right overarching objectives to guide the review. We would urge emphasis on “be as simple and transparent as possible” as this was an area highlighted in the tax survey that small businesses have less faith in the current system. Of equal importance is “help reduce the cost for taxpayers of meeting their obligations and drive down costs to the exchequer”; small businesses spend a lot of time and money on compliance – these are resources that could be better spent on productive activities. The more this is reduced, the better small businesses will fare.

Q4. How could the review ensure the best coverage of viewpoints and expertise from those who depend upon the tax administration framework? Are there particular models of consultation engagement or collaboration that could work well?

Q5. Are there other international examples or models of tax administration that could inform this review of the UK's tax administration framework?

### **Chapter 3: Ensuring consistent obligations for people to enter and exit the tax system**

Q6. What are the key challenges with the current legislative provisions relating to the identification and registration of taxpayers?

One current issue regarding registration of taxpayers arises with the VAT threshold. The current threshold of £85,000 acts as a barrier to growth; 23% of small businesses surveyed stated that the VAT threshold was a barrier to the growth of their business. This threshold therefore acts as a deterrent to many small firms wishing to expand their business but do not want the added administrative burden associated with it. A higher threshold would spur business growth up to that next level but would not solve the issue of businesses not wanting to cross it due to the added administrative costs. A way in which to reduce the administrative burden of VAT could be very beneficial to both small businesses and the economy as a whole.

Q7. What benefits of the current legislation should be preserved?

Q8. What likely changes and developments will the framework need to handle? What are the key priorities for framework reform in the area of identification and registration of taxpayers?

Q9. Are the current approaches to the timing of registration still appropriate, or are there opportunities for reform?

There may be scope to reform the registration and payment times for ITSA individuals. As it stands, an individual starting a business may only be liable to pay their first bill up to approximately two years after they initially started trading depending on when in the tax year the business was registered. This can create cashflow issues for the business owner as it can create a large lump sum payment which may be difficult to budget for. Simplifying the process would ease the administrative burden and budgeting needed by new businesses, allowing them to focus on more productive activities related to their new business.

### **Chapter 4: Improving the way tax liabilities are calculated and assessed**

Q10. What key issues relating to the way tax liability is established arise within the existing legislative provisions?

Tax compliance is a very burdensome activity for small businesses and 63% of businesses have stated they find the variety of taxes difficult to understand. It was found that tax compliance for the average small business costs £4,100 and 52 hours per year. As a result of the complexities of registration and compliance to the variety of taxes, it is not surprising to see that 82% of small businesses get their tax advice regarding reliefs from accountants. The fact that such a large share of small businesses rely on external expertise means that they incur a significant cost which could otherwise be mitigated if the processes were made simpler and easier to implement by businesses themselves.

Q11. What benefits of the current legislation should be preserved?

The ability to amend returns within a 12-month period is particularly useful for businesses. A business that makes an honest error on their filings is able to correct said error without facing any penalty. This is a good system and particularly helps new businesses that take time to adequately learn the processes

of tax compliance. Likewise, businesses with volatile incomes may incorrectly assess their liabilities, not out of malicious intent to avoid tax, but out of genuine error. This gives them an opportunity to correct errors and comply with their liabilities correctly.

Q12. What likely changes and developments will the framework need to handle? What are the key priorities for framework reform in the area of calculating and assessing tax liabilities?

There is significant emphasis on digitalisation of the tax system, and rightly so. However, it is important to note that there is a subset of businesses who are digitally excluded for one reason or another. These businesses cannot be forgotten about in the shift to a digitalised framework; processes need to be put into place such that these businesses are not at a disadvantage simply for being digitally excluded. It was found in our tax survey that 43% of small businesses still record transactions with paper receipts, 41% still rely on paper bank statements and 12% still use handwritten logs. It is not a small proportion of businesses that still rely on hard copies of processes even if the true digitally excluded is a small subset. It will be important for the government to aid businesses to become digital as much as they can as many businesses will be very used to the current ways in which they operate, and digitalisation is a significant change.

Q13. How could tax return obligations and processes be updated? What should a 'tax return' look like in a digital tax system?

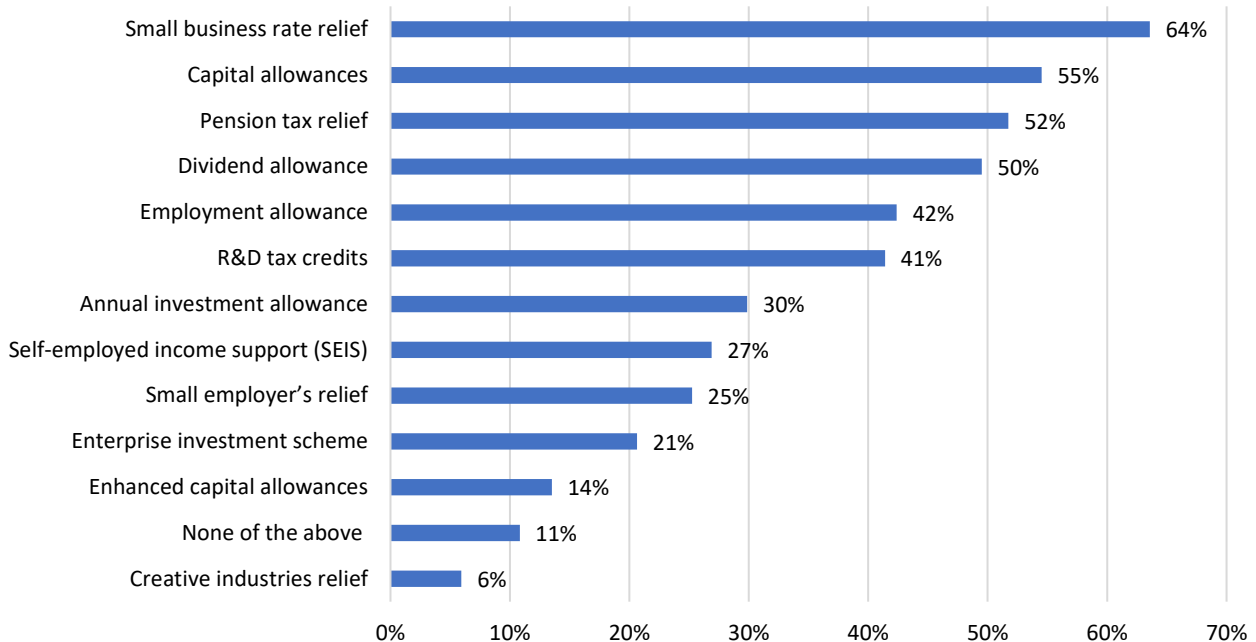
Q14. How could HMRC better establish tax liability in future, to help build trust in a tax system that people see as fair and even-handed?

One of the major issues with the current tax system to small businesses is the unfairness of liabilities versus reliefs. Small businesses are required to pay their liabilities without fail or face penalties, however, awareness and eligibility of reliefs is very complex. This leaves small businesses in a situation where they are paying their fair liability but are not receiving their entitled fair share of reliefs. The graph below highlights the lack of awareness of some of the relief's businesses may be entitled to.

The complexity in the system rigs it against small businesses. Larger organisations often have the dedicated tax teams and resources to explore all relief options available to them. Smaller organisations overwhelmingly rely on their accountants for information on reliefs (82%) which therefore can come as a cost to the business itself or act as a barrier.

Reducing this complexity and making the eligibility of reliefs easier to understand and navigate would go a long way to raising the trust small businesses have in government and address the issue around fairness.

### Awareness of different tax reliefs



Source: FSB Tax Survey, 2021

## Chapter 5: Using data and information to make tax compliance effortless for the majority

Q15. What key issues do the current legislative provisions relating to the provision and use of data and information present?

Q16. What benefits of the current legislation should be preserved?

Q17. What likely changes and developments will the framework need to handle? What are the key priorities for framework reform in the area of data and information?

Q18. What principles should govern HMRC's collection, use and onward transmission/sharing of taxpayer data?

Q19. What additional safeguards would be needed for taxpayers and third parties if the role of third parties/intermediaries was expanded?

## Chapter 6: Tax payments and repayments

Q20. What key issues do the current legislative provisions relating to payments present?

In FSB's 2018 "Taxing times" report, it was found that 36% of businesses pay their liabilities with whatever they have at the time, 30% always have savings, but not specifically for tax, 34% specifically save throughout the year for tax and 6% borrow money to pay their liabilities. It was also found that 63%

of businesses have never paid their taxes late. Of those that have, 36% stated it was due to cashflow issues and 17% due to confusion about deadlines.

In addition to that, from our 2021 tax survey, it was found that 52% of small businesses find the current system for paying tax too complex. However, only 23% of small businesses expect Making Tax Digital to reduce the complexity in the tax system and only 27% expect any efficiency gains (in terms of hours spent on compliance).

Q21. Are there any particular benefits of the current legislation that should be preserved?

Q22. What benefits could a single/reduced set of payment rules, applied across the taxes, bring?

As stated, 52% of small businesses find the current system for paying tax too complex. Reducing this complexity has the potential to ease up time spent on compliance and potentially reduce late payments of tax. Given that the average business spends approximately 52 hours per year on tax compliance, this is equivalent to just over a normal working week in hours. This is time that could be better spent on productive activities if compliance were made simpler.

Q23. What likely changes and developments will the framework need to handle? What are the key priorities for framework reform in relation to payments?

Any reform of tax needs to be undertaken with a significant transition period to allow businesses to adapt to the new systems. Regardless of the development and changes taken, small businesses need time to adequately change their processes. As stated previously, these are businesses that are disproportionately impacted by tax; they do not have dedicated tax teams to fully develop their processes as large organisations might. As such, along with a long transition period, we would urge a soft-landing approach too. Small businesses should not be penalised for getting things wrong at the outset of new changes; the mistakes are unlikely to be malicious in intent, rather genuine. A soft-landing aids this process and gives small businesses additional faith in the system.

## **Chapter 7: Building in effective methods of verification, sanctions and safeguards to promote compliance**

Q24. What key issues do the current legislative provisions relating to powers, sanctions and safeguards present?

In the case of penalty notices, the deadline of payment does not always take into account the delay in time the letter takes to be received by the business, leaving very little time to either make arrangements for payment or query the penalty itself. We would expect this issue to begin resolving itself as the tax system moves towards digital processes as the delay would naturally disappear. However, there will always be the digitally excluded who need provisions and this issue may continue for them.

Q25. What benefits of the current legislation should be preserved?

Q26. What likely changes and developments will the framework need to handle? What are the key priorities for framework reform to support taxpayers to get their tax right and deter non-compliance?

Q27. What principles should govern HMRC powers, sanctions, and safeguards, to build trust in the tax system?

Q28. How should the framework maintain consistency and fairness between taxpayers and groups of taxpayers, while also providing HMRC with appropriate discretion to enable them to take account of individual taxpayers' circumstances and wider concepts of fairness?

### **Chapter 8: Further Suggestions**

Q29. Are there any further suggestions that you have for how the Tax Administration Framework could be reformed?

We trust that you will find our comments helpful and that they will be taken into consideration.

Yours sincerely,

Tony Baron, Tax and Finance Chair

Federation of Small Businesses