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Via Email to: itsaregistrationconsultation@hmrc.gov.uk

FSB Response to the consultation on Income Tax Self Assessment registration for the self employed and landlords

FSB is a non-profit making, grassroots and non-party political business organisation that represents 160,000 members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

Question 1 – How simple and well understood are the current legislation and processes for notifying liability and registering for ITSA? What are the benefits and/or drawbacks of the current system?

The primary drawback of the current registration process, as outlined in the consultation document itself, is that newly established businesses can have up to 18 months from when trading began to register for income tax and then another three months before liabilities need to be paid. This is a very significant period in which new businesses need to be aware of and plan for their eventual liabilities for their first tax year plus a payment on account of the current year, if above the threshold. If unaware of these requirements, businesses can come to a pinch point when their liabilities are due, creating cashflow issues right at the start of the business' journey.

FSB conducted a tax survey in June 2021, asking about views on the current tax system and how small businesses engage with it. One of the questions asked was how much the business agrees with the following statements, with one being "*As a business, I am fully aware of what taxes I owe, how much I owe and when these need to be paid*". The overall result found that 79 per cent of small businesses on net agreed and 13 per cent on net disagreed. However, when splitting this by the length of time the business has been established, an interesting trend emerges. For those businesses that have only been established for up to two years, the net rate of agreement falls to 62 per

cent and net disagrees grows to 35 per cent i.e., over one third of new businesses are not fully confident on how much they owe and when the taxes need to be paid. In contrast, for businesses established between 3 to 4 years prior, the net disagree falls to 18 percent – a full table of results is provided below.

Table 1. Q. To what extent do you agree with the following statement: As a business, I am fully aware of what taxes I owe, how much I owe and when these need to be paid. Split by how many years the business has been operating for

	Total	Up to 2 years	3 – 4 years	5 – 9 years	10 – 19 years	20 – 49 years	50 years or more
Strongly agree	46.7%	25.8%	38.2%	46.9%	47.4%	47.0%	64.3%
Slightly agree	32.2%	36.7%	36.8%	35.3%	33.3%	31.5%	15.9%
Neither agree nor disagree	8.3%	2.1%	7.4%	3.5%	8.7%	9.9%	8.0%
Slightly disagree	9.5%	20.7%	17.6%	12.8%	6.7%	8.6%	9.0%
Strongly disagree	3.4%	14.7%	0.0%	1.7%	3.9%	3.0%	2.7%
NET Agree	78.9%	62.5%	75.0%	82.1%	80.7%	78.5%	80.3%
NET Disagree	12.9%	35.4%	17.6%	14.4%	10.6%	11.6%	11.7%

Source: FSB Tax Survey, June-July 2021

As illustrated, awareness of tax liabilities increases as the length of activity increases, which is not a surprising result as business owners will be finding their feet in the first instance, but the length of time from registering to payment does not help in the first instance.

This issue of under awareness of tax liabilities can be significant if it means that the business owners are not setting aside money to pay their liability once due. Given the time horizon, it is likely that many small businesses struggle to adequately assess the level of which they need to save.

In the same survey, we found that 75 per cent of small businesses agreed that their financial security fluctuates and that 72 per cent struggle to accurately forecast their earnings for the year. For businesses that were established within the previous two years, 82 per cent cite difficulty in forecasting their earnings for the year compared to 72 per cent of those established between 10 and 19 years prior. Given this, the time lag between registering and first payment can create quite a significant financial issue on small businesses who are not accustomed to tax liabilities nor forecasting earnings for the period.

Question 2 – If you have experienced registration processes across different UK taxes or internationally please tell us more about how they compare. What works well and what could be better?

The fact that there are multiple channels of registration for different taxes is confusing. The Government could streamline the process significantly by creating a single avenue for registration of all taxes for businesses, minimising the chance of missing a registration period.

Question 3 - What are your experiences of closing an ITSA record of self-employment or property income? Is it easy to understand and complete?

We have heard from our members that there have been cases where a cessation date of business is simply ignored by HMRC, and they are issued a Return the following year – this appears to be a greater issue with partnership businesses. This wastes both time and resources of individuals and HMRC.

Question 4 – What difficulties do taxpayers new to ITSA face in complying with their obligation to notify liability? What are the causes of these issues?

Some small businesses have mentioned that they were under the impression that the Government was already aware of them as a result of other communications with Government departments. Those new businesses are not always aware that they need to register for ITSA regardless of other communications with Government. Clear communication that registration of their liability needs to be expressed going forward to ensure that this simple misunderstanding does not persist.

Another separate issue is when a new business defines its starting point of trading. Many small businesses emerge from individuals expanding a hobby. Defining the exact point in which their hobby transforms into their business can be very difficult and be quite muddled leading to a situation where it can be seen as non-compliance, when this is not the case. The Government should seek to provide clarity around what businesses in this situation should do, be that through a better definition of what trading entails or providing case studies as worked examples that individuals in similar circumstances can relate to. Guidance is crucial, small businesses are not actively avoiding registering or paying for tax, mistakes occur often due to confusion around requirements.

Question 5 – How do customers new to self-employment or property income learn about the ITSA registration process and associated tax obligations? What are the issues with this?

Many small businesses are run by business owners who had a good idea and took the leap to make a business out of it – they are often not experts in finance and tax and

are learning on their feet when it comes to compliance. Many rely on the expertise of friends and family, paid for accountants or their own research, but despite this, gaps in knowledge can, and do, persist.

A very large proportion of small businesses rely on the expertise of accountants to engage with the UK's tax system. Although not a perfect proxy, we found in our Tax Survey that 82% of business owners go to their accountant for information on tax reliefs that may be available to them – by extension we can assume that similar shares are doing the same for their compliance and general tax advice.

Especially given the confusing deadlines when establishing a business with respect to registering and paying first liabilities, many newly established small businesses will not fully understand the requirements without third-party help or previous experience.

A significant issue with this current format is for those who are setting up a new business may simply be unaware of the registration requirements before paying liabilities. The more Government can do to increase awareness of this, the better the outcomes for new businesses will be. Small businesses, as a whole, want to comply and pay their taxes – missed tax deadlines are not a result of malicious intent but often, rather inexperience with the system. The current format of heavy reliance on accountants to engage with the tax system implies that specialist knowledge is required to fully understand what is needed from the business. The more transparent and concise this can be made, the easier small businesses will find dealing with their compliance.

Question 6– What challenges do taxpayers experience as a result of the delay between a business starting and the deadline for notification?

As mentioned in the consultation document, given the timing between registration and payment of liabilities, many small businesses can come under a pinch point of payments, having to pay their previous year's tax plus anything above the threshold of the current year. This can be especially difficult for those businesses that are not fully aware of the caveat of paying both the past liability and current portion above the threshold.

We asked in a survey in October 2017 how small businesses pay their tax liabilities, and although the results are somewhat dated and need to be taken with caution given the economic impact of the pandemic, the results are still a useful insight into how small businesses operated during more usual times. We found that 36 per cent pay their liabilities with whatever they have at the time, only 34 per cent save specifically throughout the year for their liabilities, 31 per cent always have savings, but not necessarily set aside specifically for tax and that 6 per cent borrow money to pay liabilities.

As illustrated, only a relatively small share of small businesses plan and save accordingly for their upcoming tax liabilities. This trend exists across all small businesses, not exclusively for newly established ones. However, the fact that 6 per

cent of small businesses pay their liabilities through borrowing is a worrying fact; this is equivalent to approximately 300,000 of the UK's 5.5 million small businesses not having the resources to pay their liabilities when due without additional finance.

It is worth noting that early registration is unlikely to remedy ability to accurately forecast earnings and hence tax liabilities due. We found that, on average, small businesses struggle to accurately forecast their earnings for the year – true liabilities are likely to only be accurately estimated at the end of the trading year.

As with many areas of the tax system, awareness is a lifeline for small businesses. The Government should seek to create better awareness of exactly what liabilities are owed and when for newly established businesses. This would aid in new businesses having the foresight to adequately save towards their liabilities without any surprises causing cashflow issues. This awareness could be done through better information at the outset of registering alongside more regular updates and prompts about the financial year ahead, for example, an explanation of what liabilities from the past year are owed plus the requirements to pay if above the threshold on the current year.

Question 7 – Are taxpayers clear on what trading is, and when they started or stopped trading? What factors about trading make it difficult to decide whether or not to register?

Awareness of trading and when the small business was effectively established can be split into two groups. The first is the well-defined group – these are small businesses that establish a new business with a clear date from which trading began. This is a group of small businesses where registering within the set time from first established is much easier to do as there is less ambiguity. However, even within this group, awareness of registration deadlines may still be lacking, especially for first time businesses.

The second group, however, is where small businesses develop out of a hobby or side income stream. If an individual decided to take the step to moving to their hobby or side income stream full time, it can be very difficult to establish when they first started trading as it is very ambiguous. This is the subset of small businesses that will struggle to adequately register with HMRC in line with the tax requirements. This is not a group that is actively concealing their starting date, but rather will find it very difficult to pin down and thus create complications for the period after which they need to register and pay their first liabilities.

The Government should establish clear guidance for those businesses that establish out of hobbies. A clear and easy to understand definition on what trading entails is needed such that the ambiguity around the transition from hobbyist to business is minimised. Likewise, case study examples across the industry spectrum of the transition and when to engage with HMRC would be highly beneficial as this would provide clarity for those in a similar situation.

Question 8 - What are taxpayers' experiences of interacting with different government departments when starting self-employment?

Question 9 - Do you agree that chapter 3 sets out the challenges presented by the current registration system? Are there others?

Yes, chapter 3 does largely lay out the primary issues faced by individuals when registering for income tax. The main one being awareness of the need to register by a set date after trading began - we find that small businesses tend to rely very heavily on accountants and intermediaries for engaging with the tax system and would expect a very similar trend within the realm of tax registration too.

The other major issue, as referenced in chapter 3, is distinguishing when trading began. For many, this will be a transition from a hobby to a business and this can be very difficult to accurately establish a starting point for their business, creating difficulties in deadlines for registration. Fixing this ambiguity would significantly aid this tranche of newly established businesses.

Clear communication to new businesses on these fronts is crucial and will support many in correctly engaging with the tax system and paying liabilities going forward. Small businesses do not have dedicated tax teams like larger organisations do - time spent understanding and engaging with the tax system comes out of the owner's own time and resources. We found that the average small business spends 52 hours per year completing their tax liabilities at an average cost of £4,100 - this is the cost of software, accountants and resources spent on completion rather than the liability itself.¹ The resource toll of tax compliance is already significant, the Government should seek to make registration and compliance as smooth a process as possible to reduce this administrative burden.

Another significant issue, not cited in the consultation document, is how individuals that are digitally excluded engage with the tax system and how they will continue to engage with the tax system as Making Tax Digital is rolled out. This is a segment of the population that should not be disproportionately burdened or excluded simply on the basis of their inability to access computers, the internet or digital bookkeeping.

Question 10 - Are these the right options for changing the obligation? Which is better? Are there others?

Reducing the deadline for notifying liability from 6 months from the end of the tax year to something lesser would not serve any purpose - it would just mean that more businesses would fall foul with respect to compliance.

¹ FSB, A Duty to Reform, October 2021, <https://www.fsb.org.uk/resource-report/a-duty-to-reform.html>

Equally, we do not support a notification obligation based on income as this will create a situation where the actual start date can be quite uncertain. It may also stimulate a situation whereby there are incentives to provide an incorrect start date or discourage registration itself. These issues realistically could lead to an increase in taxpayer disputes which may put into formal appeals and go to tribunal.

Question 11 - What is the right period after the start of the new self-employment or property income for the obligation to be triggered?

FSB does not support an obligation to register which is based on the start of an income source. If HMRC do wish to change the registration system, we favour a date which is common across all taxpayers, is more certain and is easier to communicate clearly to small businesses.

Question 12 - Do these ideas for using intermediaries and third party data to improve tax registration merit further exploration? Are there others?

Yes, there are likely to be efficiency gains through utilising available data from non-HMRC sources. As stated in the consultation, many new businesses will set up new bank accounts, digital record keeping – moving forward this is likely to be in line with Making Tax Digital requirements and thus represents a very obvious way to merge record keeping and submissions with notification of new businesses – tax reliefs and general interaction with Open Banking.

Administration is resource heavy for small businesses, especially for newly established ones. Creating a system that is more fluid and interacts with multiple sources will have the dual benefit of reducing administrative resources needed to fully establish as a business and create a system whereby a lack of awareness of requirements to notify and when liabilities are due is reduced.

The assumption that HMRC knows about the business and therefore the business does not need to register is a primary reason for missing the deadlines for newly established businesses. Utilising third-party data could rectify this – instead of insisting that all newly established businesses directly register with HMRC, it could be the case that establishing new business bank accounts, applying for reliefs or setting up a digital bookkeeping software automatically offers a notification to HMRC thereby indirectly registering the business.

Small businesses do not have dedicated tax teams, time spent complying with tax is often time not spent productively on their business – minimising this resource loss will be beneficial to both the business itself and the economy overall. The average small business spends 52 hours a year on tax compliance.² Given this, with the UK's 5.5

² FSB, A Duty to Reform, October 2021, <https://www.fsb.org.uk/resource-report/a-duty-to-reform.html>

million small businesses,³ this time spent equates to approximately 285 million hours spent on compliance per annum that could otherwise be spent productively, bolstering business outcomes and the entire economy.

As also noted in the consultation document, not all business navigate the same touchpoints – the ones mentioned, business bank accounts, digital record keeping, tax reliefs and Open Banking software, all (generally) require a presence online. There is always going to be a minority of businesses that fall outside this scope and need consideration, for example, the digitally excluded. The main emphasis of the above is that further exploration of third-party data usage should be done as it is likely that it will reduce the need to register and complete administrative tasks by newly established businesses.

Yours sincerely,

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Federation of Small Businesses

³ Department for Business, Energy & Industrial Strategy, Business population estimates for the UK and regions 2021: statistical release, October 2021, <https://www.gov.uk/government/statistics/business-population-estimates-2021/business-population-estimates-for-the-uk-and-regions-2021-statistical-release-html>