

Association of Business Recovery Professionals

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## **Sent by email**

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Comments by the Association of Business Recovery Professionals (R3) in response to the Consultation papers issued by HM Revenue and Customs regarding Making Tax Digital (MTD).

### **Making Tax Digital consultations**

R3 is the leading professional association for insolvency practitioners (IPs) in the UK, promoting best practice for professionals working with financially troubled individuals and businesses, promoting the work to Government and key policy makers, producing guides for insolvency professionals and members of the public, running courses and conferences to promote learning and best practice within the insolvency profession. Our members (approximately 3,000) work in firms of all sizes, from the global legal and accountancy firms through to smaller local firms and sole practices, and include , insolvency practitioners, insolvency lawyers and other professionals working in the insolvency and restructuring professions. Our members cover the whole spectrum of work with financially distressed businesses and individuals including advice, rescue and turnaround, and formal Insolvency Act 1986 appointments (administrations, liquidations, administrative receiverships, bankruptcy, individual and company voluntary arrangements).

In a member survey undertaken by R3 last year some 77% of those responding expressed some level of frustration in their dealings with HMRC and we are aware that the 400,000 items of correspondence generated each year from insolvency practitioners significantly adds to the burdens experienced by HMRC.

Together, via working party groups set up over the summer of 2016, R3 and HMRC have made some very positive steps towards identifying the cause of those concerns and seeking ways of addressing them. Many of the difficulties arise because the entering into an insolvency process by an individual or company is often not recognised by the tax legislation. Historically local offices have developed working practices to work around this, however, with the recent movements of HMRC staff and closures of offices, many of these established working practices have been lost, and there appears to be little practical insolvency knowledge to assist HMRC staff in dealing with the queries raised by insolvency practitioners and their staff. Of great concern is how the moves to make tax digital are going to compound those difficulties as insolvency procedures do not fit neatly into current tax practices.

Given the spectrum of areas in which our members operate, rather than respond to each consultation separately, we set out below our key areas of concern/comment with regards to MTD. R3 believes that MTD is, overall, a positive step and one which should aid its members, as well as HMRC. A move to digital tax records will create an upfront cost to each IP (eg in establishing IT systems and training of staff). However, once established a move to digital should allow for future efficiencies in tax reporting

for IPs and, hopefully expedite access to information held by HMRC. The consultation document makes reference to 'special arrangements', without such arrangements, there is a risk that MTD solely increases the administrative burden, time and costs for an IP in handling cases.

With this in mind, it is welcomed that HMRC has already been liaising with R3 as part of the ongoing MTD process, as it is important that HMRC understands the various issues at the design stage such that, if required, bespoke solutions can be brought within the build process rather than trying to alter the system at a later stage.

Businesses within an insolvency process are very varied and will be subject to many different processes within the insolvency legislation, which are all anticipated to have their own specific issues and practicalities to meet obligations under a MTD regime. The appointment of an IP effectively draws a line in the sand for the debtor over which they have been appointed, and the way that pre appointment matters are dealt with is different to post appointment matters, especially with regards to tax. We have therefore divided our comments between the issues for IPs in dealing with the tax in periods before and after their appointment.

### ***Tax considerations pre insolvency:***

At the date of insolvency the business, or individual in the case of a bankruptcy, is likely to have outstanding tax returns, be they, inter alia, VAT returns, corporation tax returns, income tax returns or RTI returns. Any tax which may be payable for periods prior to the insolvency would be an unsecured claim in the insolvency and therefore the extent to which the IP will bring the tax affairs up to date will depend on whether or not there are funds for the unsecured creditors.

Under MTD, it is likely that the business will be behind with its quarterly accounting requirements. It is important to note that common features of distressed companies are volatile trading results, normally within a relatively short concentrated period, poor quality of information, a changing management team and a generally unstable business environment. Therefore, the information available to agree the tax position may not be readily available.

Currently, pre insolvency periods are often agreed by way of letter rather than through a formal filing of a tax return. It would therefore be beneficial for IPs to have a means of being able to 'skip' periods such that the IP can agree to what extent a tax liability may or may not have arisen, but not have to make a formal submission.

However, IPs often require brought forward figures from pre insolvency returns for use in post insolvency returns, for example capital allowance pool values and losses carried forward. There would therefore need to be a means of preserving these tax attributes for use by the IP as appropriate.

### ***Tax considerations post insolvency:***

#### **Access to digital records**

Under current legislation, IPs are not solely responsible for tax reporting in all insolvencies. For example if a sole trader is the subject of an IVA, the individual generally remains responsible for income tax returns and not the IP. As such, it seems appropriate in some scenarios for the IP to assume responsibility/control of the digital account – but not in all cases.

Tax for trustees in bankruptcy is currently a mix between the income tax regime and the trusts and estates tax regime. The IP does not take over the bankrupt's tax affairs *per se*, but is solely responsible for tax on the transactions arising in the insolvency process and where returns are required, a separate UTR is set up for the IP. This is impractical and unworkable when filing online as neither the personal tax return nor the trust tax return is wholly relevant for bankruptcy cases. R3 has raised this issue with HMRC and hopes to work with HMRC to address various issues relating to tax and bankruptcies, not only for the purposes of MTD but also to make the overall regime more fit for purpose.

Where an IP is responsible for tax then he will need access to the digital account, but under current HMRC procedures, this is a very cumbersome and time-consuming process. In addition, HMRC's current permissions vary between taxes and insolvency processes. For example, administrators are not allowed online access to a company's records whereas liquidators are. We believe that as the 'proper officer' of a

company (as defined in s108 TMA 1970), online access should be extended to administrators as well as liquidators.

In a corporate insolvency, it is likely that the company would have an online account with HMRC which the IP could take on. The records of a company in an insolvency process are rarely up to date or readily accessible, especially in the case of a hostile appointment. As a result, it is therefore difficult to obtain the relevant log in details for the account and it is often desirable to remove access from any company staff who may still be in place. Will HMRC's system allow for a third party to take control of/assume responsibility for an online account? Assuming this will not be the norm outside of insolvency, what system will be in place to allow for this to happen smoothly and efficiently?

IPs are usually reliant on HMRC to obtain the relevant references required to deal with the company's affairs, eg corporation tax UTRs, and registering for online access is therefore delayed while the references are obtained from HMRC. That in turn is delayed as HMRC will only post UTRs to the company's registered office. The registered office is generally changed post insolvency to the IP's office, but it takes a while for HMRC's systems to reflect the updated address, resulting in UTRs having to be sent several times. As each tax has to be registered for separately, the issues are amplified. A more streamlined system whereby access can be requested once for all relevant taxes would be beneficial to both IPs and HMRC.

There are also issues of confidentiality where HMRC advise IPs that they are unable to release information about the tax history of a company or debtor over which an IP has been appointed. This means that IPs are often unable to make the relevant returns during the insolvency procedure because of a lack of information. Often appointments are made at a time when directors of a company are unable or unwilling to assist an IP or a debtor is unco-operative. In the case of a fixed charge receivership the IP is not recognised as a taxable person for VAT and this means that IPs are often unable to pay over VAT which is due as there is no process in place to allow for it to happen.

Once IPs have access to online records then this should reduce the amount of information requests they need to make to HMRC as they should be able to see the company's tax position for themselves. This will be beneficial to both HMRC and IPs.

### **Providing HMRC with updates**

The consultation refers to businesses making quarterly updates and then finalising the position this at the end of a year. However, in an insolvency process, especially in a corporate insolvency, accounting periods rarely last a year. Similarly, a year may include both pre and post insolvency receipts which will be accounted for in different ways. How does HMRC propose to treat accounting periods which are less than a year in length?

Businesses often cease trading either before or shortly after entering into an insolvency process. After cessation of trade there is little activity to report to HMRC. Does HMRC require IPs to provide quarterly updates? If so, at what frequency? An IP would only be able to provide updates based on their actions post insolvency, so this would require the period to which updates are required to be changed.

IPs have reporting obligations to creditors and these include publishing their receipts and payments accounts for set periods, the length of which depend on the type of insolvency. As a result, IPs already have mechanisms by which they publish the relevant financial information and this could be used to update HMRC at the same time. To help facilitate this, we would recommend that HMRC liaises with the insolvency software providers to assess the compatibility of the software with HMRC's. One of the most popular software with our members is a programme called IPS which is developed by Turnkey.

### **Filing returns/end of year activity**

IPs are not required to, and therefore do not, make up accounts under UK GAAP. They are therefore unable to file online returns with iXBRL accounts and the necessary tagging. Currently IPs file online tax returns for solvent liquidations with pdf 'accounts' and, to the extent that tax returns are required post MTD, it would be helpful if this ability was extended to all insolvencies.

We should be grateful to receive some guidance as to what constitutes the end of a year. A company entering into an insolvency process can have several accounting periods in a short space of time. For example, if a company enters administration, ceases to trade and then exits administration within the course of a year, it will have at least two accounting periods in that period, if not three. To what date would HMRC anticipate receiving information?

IPs will also often need to make terminal loss claims as trading has ceased. The detail to loss carry back claims are not actually in the return and despite filing everything possible through the gateway, the set-off (or in some cases cash repayment) only arises with a significant amount of follow up paper correspondence (usually at HMRC's request during a telephone conversation). What process will be in place to be able to deal with claims outside a return?

Before an IP can close an insolvency they need to obtain clearance from HMRC that they have complied with their statutory obligations. Currently clearance is sought from each HMRC department in turn, leading to duplication of post. For example corporation tax clearance is sought when the final corporation tax return is filed. Under MTD will there be mechanisms through which IPs can seek the required clearance to wind the company up in respect of all taxes? While online reporting provides comfort that HMRC has received information, it does not provide confirmation that it has been agreed. How will this be dealt with going forward?

### **Cash accounting**

Many IPs make returns based on their receipts and payments account and this practical and proportionate approach has historically been accepted by HMRC. The MTD proposals suggest that small businesses could use a cash basis of accounting, consideration should be given to formally extending this approach to all insolvencies.

### **Exemptions**

A large number of insolvency cases may have minimal or no income during the course of a year, often for many years while investigations are carried out. The cost of filing tax returns when minimal income has been received is detrimental to the company's creditors (including HMRC) and therefore we welcome the suggestion that businesses with income below a *de minimis* do not have to comply with the MTD provisions and would request that insolvencies with income below the *de minimis* are included within this exemption.

Historically both HMRC and IPs have found it useful to mark insolvencies as dormant for what could be several post appointment accounting periods as income or gains may take some time to achieve. Notwithstanding the exemption mentioned above, would this still be possible under the making tax digital regime? Currently it can be difficult to "re-instate" the active tax status of the insolvency when income or gains are received so the ability to do this via the online portal would be beneficial.

We accept that it may not be possible to give insolvency a blanket exemption from on-line filing as currently exists. However, as noted above, there are various practical issues which need to be addressed in order to enable IPs to comply. HMRC is already liaising with R3 on these topics and as long as the issues are resolved, the need for total exemptions in an insolvency situation should be limited.

### **Conclusion**

There are many advantages to be found in MTD for both HMRC and IPs and as a result, we do not consider that insolvencies require a blanket exemption from the new regime although cost versus reward suggests that a *de minimis* income limit below which returns are not required should be agreed. However, in order for MTD to work effectively there are several issues which need to be overcome, not least how tax is accounted for in bankruptcies, how HMRC can efficiently provide IPs with the information they require to operate MTD and how IPs can deal with the insolvent's tax affairs in as cost effective manner as possible.

This document highlights some of the practical issues which we already face and anticipate arising under MTD. We are grateful for the opportunity to feed into HMRC's plans for MTD and welcome the ongoing dialogue which has started. We look forward to working more with HMRC to make MTD practical for IPs. If you would like more information on any of the points raised please do not hesitate to contact Caroline Sumner on 020 7566 4207 or at [caroline.sumner@r3.org.uk](mailto:caroline.sumner@r3.org.uk).