The slow ascent up Mt Digital

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"All revenue bodies," reads an OECD forum on tax administration white paper (http://www.oecd.org/ctp/administration/36280368.pdf), "are confronted with the goals of making it easier for taxpayers to comply with law (i.e. reducing their compliance burden), improving taxpayers' compliance and increasing administrative efficiency."

Without knowing it, the OECD described the professed aim of Making Tax Digital, the government's frustratingly elusive, epochal tax transformation.

We don't know much about MTD. That's not a stunning admission, perhaps; the information drip from Whitehall has been but a slender trickle.

We know that the consultation documents are ready but will only be released in July, after the Brexit referendum's purdah (http://www.accountingweb.co.uk/tax/hmrc-policy/panama-papers-fall-out-delays-mtd) is lifted.

> **"We know, for a fact, that the digital tax wheel *is* turning."**

We also know some fundamentals like: HMRC will gradually introduce quarterly reporting from April 2018 onward for income tax and NI, culminating in April 2020 when everyone (from corporation to landlord) will report quarterly.

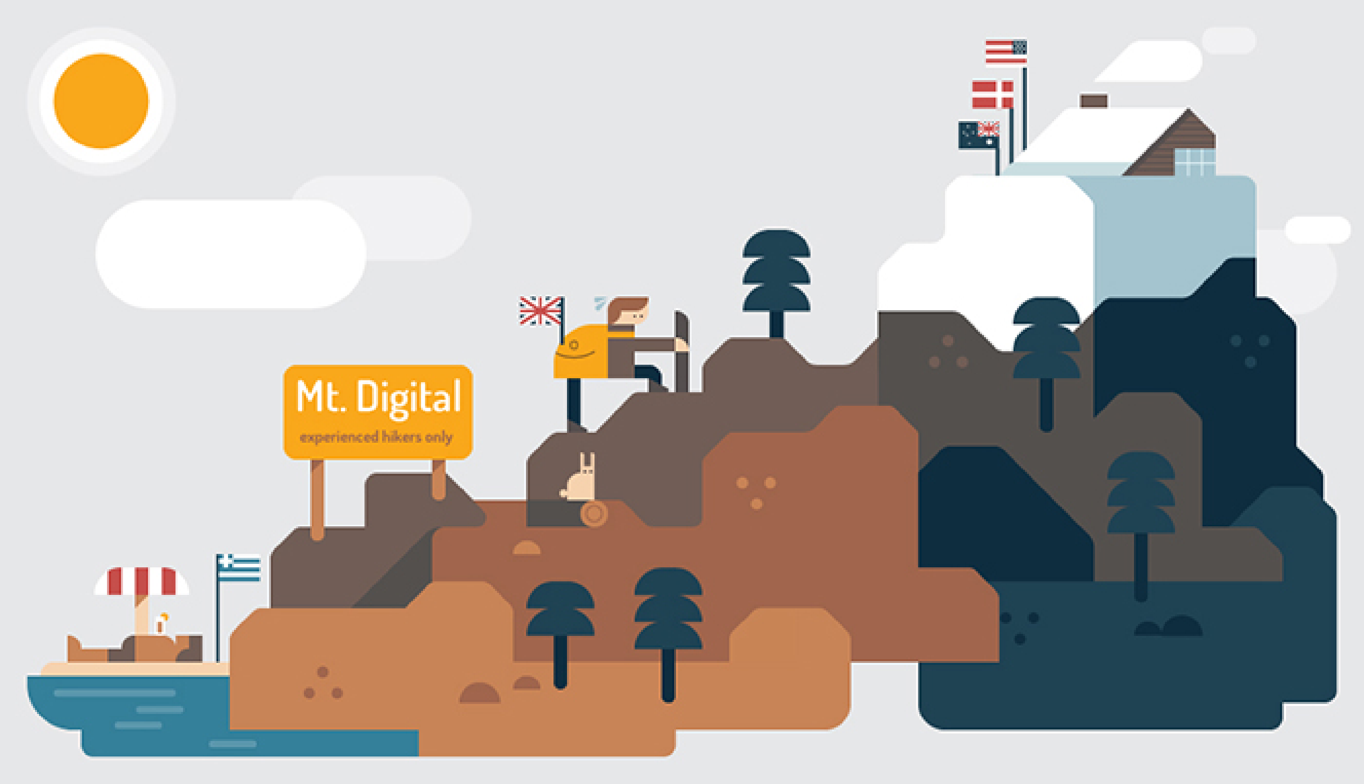
That's largely it. But as frustrating as it is, there is another way we can attempt to make sense of digital taxation.

The UK isn’t the first country to move to a digital tax system. Other countries have already - some quite a while ago, in fact - made the daring trek up Mount Digital.

What do we know about the countries' tax administrations and what does it mean in practice?

Let's look at three examples:

Denmark, Australia and the United States



Denmark

When it comes to digital taxation, the Nords – as with many other things – have led the way. The tax innovations in these countries have fascinated policymakers for years.

Reporting on the Nordic tax administrations, the OECD said, “Over the last decade or so, revenue bodies in all of the Nordic region countries have been revolutionising their personal tax arrangements through the development of pre-filled tax return systems”.

> **“Since 2002, the Danish tax authority has presided over a system of pre-filled tax returns."**

Of these digital tax administrations, Denmark has led the way. Taxation in Denmark is administrated by Skat, literally Danish for “tax”. Since 2002, Skat has presided over a system of pre-filled tax returns.

“Every year, the Danish tax administration generates a tentative personal income assessment, which you need to verify,” explains Rasmus Corlin Christensen, a Danish political economist. “For the vast majority of individual taxpayers, they’ll have almost all details needed from your bank, employer, union, etcetera.”

For Danish small businesses it’s only slightly more complex. Small business owners, for obvious reasons, need to supply more information on the accounts of the business and their income. “There are also, of course, more favourable tax rules for certain small businesses/entrepreneurs,” says Christensen, thus leaving a gap for advisory services.

> **“The largely digital and automatic tax system means there is no great need for special treatment for SMEs."**

Denmark also has what Christensen describes as a “very integrated public digital service set-up for small businesses”. “There’s a one-stop-shop website for registration, reporting,” he explains. “But otherwise, the largely digital and automatic tax system means there is no great need for special treatment for SMEs in terms of the tax administration itself.”

The Danish tax authority is extremely adept at handling and answering queries. “Any changes to your personal or business tax assessment are easily handled through an online self-service platform,” says Christensen. “If there are any questions from the taxpayer side, the tax administration can be contacted through the self-service platform, via Facebook or Twitter, or in person at one of a number of tax centres throughout the country.”

Denmark has one of the most robust welfare states in the world. It’s an aspect of Danish society that Danes are very passionate about. To sustain the welfare state, Denmark is a high tax society. Despite the high tax, Christensen says Danes have a positive attitude towards tax collection. “It’s helped by most Danes having to do very little actively,” he says.

> **“Danes have a positive attitude towards tax collection."**

It’s not perfect, of course. There have been a few administrative scandals over the past few years, namely the dividend tax refund fraud case where foreign companies drained 800m euros from Skat (https://www.theguardian.com/business/2015/aug/27/denmark-fears-it-has-been-victim-of-biggest-ever-800m-tax). “They’ve also had major issues collecting billions in outstanding tax debts due to technical system failures; and the property valuation system has been heavily criticised due to unequal treatments,” says Christensen.

Largely, though, the system has been extremely successful. As the OECD commented, “Considerable resources, effort and persistence are required over a fair period of time to establish a comprehensive system of pre-filled tax returns.

“However, the potential benefits to be realised, as evidenced by countries such as Denmark and Sweden, are enormous and clearly justify the investments required.”

Australia

Since July 2005, Australia’s taxpayers have had online access via the Australian Taxation Office (ATO) to limited third party information to assist them prepare their tax returns.

"From this time, taxpayers filing electronically and in receipt of payments from Centrelink, the government’s welfare payment agency, were able to access payment information online through the ATO’s e-tax (electronic filing) capability," says Chris Hooper, chief executive of Accodex, an accounting firm in Adelaide. "Similarly, they also had online access to medical expenditure information from the government’s Health Insurance Commission via e-tax when preparing their return."

Hooper describes the ATO as "almost digital". The ATO's approach is probably the clearest picture we have of what HMRC's approach will have to be. Australia, much like the UK, struggles with potential digital exclusion.

> **But according to Hooper, the ATO has been succesful at managing digital disparity."**

But according to Hooper, the ATO has been succesful at managing digital disparity. "I respect that they still need to meet needs of taxpayers and agents that aren't digitally inclined. They have made a commitment to a digital first policy through their digital transformation office and we're seeing continuous improvement from there."

The Australian example perhaps most closely mirrors what MTD could be. The main taxes all centre on a quarterly reporting regime. Income tax is collected by employer at payroll and remitted by employers each month/quarter through a system called Pay as You Go. "Goods and Services Tax," explains Hooper, "is remited by businesses each month/quarter on a Business Activity Statement. Typically calculated in an accounting app like Xero. It's pretty easy for tax agents to file the BAS to the Australian Taxation Office online."

As a final step, all taxable entities must complete a tax return at the end of the year. "The majority of these are filed online these days," according to Hooper and they can be "pre-filled" with all the data the ATO.

> **One day, simple taxpayers won't need to file returns."**

The data for the pre-filled returns is "collected from different government agencies and corporations (salary, interest, dividends)," says Hooper. "This data can be loaded into tax software to reduce data entry and human error. Each year the amount of data increases. One day, simple tax payers won't need to file returns."

Notably, accountants have not been pushed aside. Throughout the ATO's transformation, it has been, explains Hooper, accountants "driving the dialogue with the ATO". "As our software becomes more sophisticated so do our expectations of the tax office."

The United States of America

In 2015, the American Internal Revenue service (IRS) collected $3.3 trillion in gross taxes (https://www.irs.gov/pub/irs-soi/15databk.pdf) from individuals, businesses and estates.

That astrononomical tax figure comprises 243.3 million federal tax returns and supplemental documents. Of that figure, 163.5 million returns and other forms were filed electronically.

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In the US, everyone files a return to the IRS. If a person earns less than $62,000 a year, then you can use a system known as Free File. Under the Free File system, the IRS has partnerships with commercial software providers who provide free mobile apps. For most people with simple tax matters, software like TurboTax's free app, for instance, works fine.

American employers are obliged by law to provide employees with a form called Form W-2 (https://www.irs.gov/uac/about-form-w2) before the end of January. Form W-2 has all the information required to file, and the individual slots in the information into their app. This information must be filed by April 15.

> **But instead of killing off compliance, the profession is still booming."**

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Many people have more complex affairs, explains Denver-based accountant Jim Marty. "For people who don't own real estate etcetera these apps are fine," he says. "For people who have complex affairs, though, they can't use TurboTax unless they really know what they're doing."

So in the US, practitioner-led filing is still very prominent. According to the IRS's data, 78.3m returns were filed by hired professionals. The IRS requires professionals like to file digitally with a system called e-file. Paper returns can be sent if "there's some special reason I need to file with paper," says Marty.

E-file was introduced in 2003. Tax preparers use commercial software that are, what the IRS calls, "authorised e-file providers". "I prepare the taxes in a commercial software. It's offered by private companies and it interfaces with the IRS system and files digitally." This is very similar to HMRC's proposed API strategy (http://www.accountingweb.co.uk/practice/practice-strategy/hmrcs-new-api-strategy-explained).

> **The IRS requires professionals like to file digitally."**

To be a paid professional tax return preparer, Marty requires an IRS Preparer Tax Identification Number (PTIN). The IRS also provides a "Directory of Federal Tax Return Preparers with Credentials and Select Qualifications". "The directory," reads the site, "can help you find preparers in your area who currently hold professional credentials recognized by the IRS, or who hold an Annual Filing Season Program Record of Completion".

Professionally, Marty has no complaints. The e-file system is also very satisfying. "It's very accurate. You get a notice from the IRS right away that your e-file has been accepted.

"People complain about the tax system, of course," says Marty. "But whenever a politician wants to step in and change it, it never prevails.

"So it's here to stay."

Tags Making tax digital (/tags/making-tax-digital)

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How to recognise an ordinary share

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Rebecca Cave explains that shares are not always all they appear to be.

Several tax reliefs depend on the shareholder holding ordinary shares, or more precisely “ordinary share capital”. For example, to qualify for entrepreneurs’ relief on the disposal of any shares or securities in a company, the taxpayer must hold at least 5% of that company's ordinary share capital and 5% of the votes relating to those shares.

Where the company has issued various types of shares it is essential to understand which classes of shares are counted as part of the company's ordinary share capital, to calculate whether the taxpayer held at least 5% for the required 12-month period to the date of disposal.

An ordinary share

This was the issue in Castledine v HMRC (TC04930) (http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j8909/TC04930.pdf). In 2011/12 and 2012/13 Alan Castledine disposed of loan notes worth £1.1m in Dome Holdings Ltd (DHL) and claimed entrepreneurs' relief on the gains. DHL had issued A and B ordinary shares, as well as 2,000 deferred shares, and a large number of fixed rate cumulative preference shares. Castledine held exactly 5% of the total of the A and B ordinary shares, but none of the deferred shares.

The tax tribunal had to decide whether the deferred shares counted as part of the ordinary share capital of DHL. The deferred shares carried no rights to votes or income, and could only be redeemed at par once the B ordinary shares received a distribution of £1m.

The definition of ordinary share capital is now found in ITA 2007, s989: "*Ordinary share capital, in relation to a company, means all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits.*"

The tax tribunal agreed with HMRC that the fixed rate cumulative preference shares where not part of the ordinary share capital, but the deferred shares were. Using that as a basis of the valuation of the ordinary share capital, Castledine was found to have held only 4.99% at the time he disposed of the loan notes, so entrepreneurs' relief was denied.

Not an ordinary share

The definition of ordinary share capital is also relevant for share loss relief (ITA 2007, s131), but you have to look really closely at the definitions in ITA 2007 s151(1) to find it. There it says: "*Shares –*

a)includes stock but

b)*does not include shares or stock not forming part of the company's ordinary share capital".*

For the definition of "ordinary share capital" you have to go back to ITA 2007, s989 quoted above.

In Bielckus, Arnell & Taylor v HMRC (TC05044) (http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j9025/TC05044.pdf) the three taxpayers claimed share loss relief on shares they held in a travel company. Those shareholders initially received 12,500 ordinary shares each and later were each allotted a further 55,000 £1 cumulative redeemable preference shares, which had no rights to share in the company's profits other than in relation to a 7.5% fixed dividend.

The tribunal accepted that the ordinary shares were qualifying shares for s131, but the judge concluded that the preference shares did not qualify as ordinary share capital as those shares had a right to a dividend at a fixed rate. As a result the shareholders did not receive share loss relief in respect of the value of the preference shares.

Zero is number

Ordinary shares normally carry a right to vote at formal meetings held by the company, but not all the shares that form part of the ordinary share capital of the company will also carry voting rights. This was the case in McQuillan v HMRC (TC05074) (http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j9055/TC05074.pdf).

Mr & Mrs McQuillan formed a company with 100 £1 ordinary shares. They held 33 shares each. Another couple: Mr & Mrs Pennick each held 17 shares. At a later stage the Pennicks lent the company £30,000 as an interest free loan. In June 2006 this loan was converted into redeemable non-voting shares as a condition to receive a grant from Invest NI.

On 14 December 2009 the £30,000 non-voting shares were redeemed at par. The company was sold on 1 January 2010, and the purchasers acquired all 100 ordinary shares. The McQuillans claimed entrepreneurs' relief, but HMRC said the relief was not due as they had not held at least 5% of the ordinary share capital for 12 months to the date of disposal.

HMRC's analysis was that the £30,000 non-voting shares formed part of the ordinary share capital for 11.5 months of the final 12-month period. This made the total value of the share capital for that period: £30,100. As the McQuillans held 33 shares each, they effectively held only 0.1% of the ordinary share capital for that period.

The taxpayers put forward the ingenious argument that the £30,000 non-voting shares were entitled to a fixed dividend set at 0%, and as such they had "*a right to a dividend at a fixed rate.*" Amazingly the tax tribunal accepted this argument which meant that the non-voting shares could be ignored in the calculation of ordinary share capital. The McQuillans' appeal was accepted and they were granted entrepreneurs' relief.

Tags Entrepreneurs' relief (/tags/entrepreneurs-relief) Tax tribunal (/tags/tax-tribunal)

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