National Audit Office

REPORT

Progress with Making Tax Digital

HM Revenue & Customs

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Progress with Making Tax Digital

HM Revenue & Customs

Report by the Comptroller and Auditor General

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Comptroller and Auditor General
National Audit Office

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Key facts

£3.9bn

HM Revenue & Customs' (HMRC's) latest estimate in 2023 of additional tax revenue expected from Making Tax Digital for VAT and Self Assessment business taxpayers with incomes over £30,000

4

the number of times the timetable for Making Tax Digital for Self Assessment has been delayed since first announced in 2015

£1.3bn

HMRC's 2023 estimate of its costs to introduce Making Tax Digital for VAT and Self Assessment business taxpayers with incomes over £30,000

£226 million HMRC's original estimate in 2016 of the cost of introducing Making Tax Digital for three business taxes: VAT, Self Assessment for business taxpayers and Corporation Tax

2:1 benefit-to-cost ratio of Making Tax Digital for VAT and Self Assessment for business taxpayers with incomes over £30,000, based on HMRC's estimates

£1.5 billion upfront transitional costs to VAT and Self Assessment business taxpayers with incomes over £10,000 to comply with Making Tax Digital, which HMRC omitted from cost-benefit analysis in its May 2022 business case seeking further investment

£1.2 billion HMRC's provisional estimate of the net cost over the first five years to Self Assessment business taxpayers with incomes between £10,000 and £30,000 if required to comply with Making Tax Digital, equivalent to £460 each on average, based on 2021 costs

3.2 million number of VAT taxpayer records moved onto HMRC's modern IT platform by March 2023

14 million number of Self Assessment and Corporation Tax records on HMRC's legacy systems to be moved onto HMRC's modern IT platform, with dates so far set for moving 1.6 million

Summary

Introduction

1 HM Revenue & Customs (HMRC) is responsible for administering the UK's tax system. Its objectives include collecting the right tax; making it easy to pay the right tax and hard to bend or break the rules; maintaining taxpayers' consent through fair treatment; and protecting society from harm. In 2015 the government announced its ambition to make tax digital by 2020, and in 2016 HMRC said it wanted to become a leading digital tax authority. Digital transformation of the tax system has the potential to provide significant benefits to HMRC, taxpayers and the Exchequer.

2 HMRC launched its flagship transformation programme Making Tax Digital (MTD) in 2015-16. The programme's aims were to maximise tax revenue, make sustainable cost savings and improve customer service by modernising HMRC's systems for three business taxes – VAT, Income Tax Self Assessment (Self Assessment) and Corporation Tax. To achieve these objectives, HMRC intended to move its tax systems and tax records onto a modern tax management platform by 2020. HMRC also planned to require business taxpayers to keep and submit quarterly digital tax records. This was to reduce the amount of tax lost from taxpayers making avoidable or careless errors; help businesses better understand their tax position; and reduce the burden of submitting tax returns.

3 HMRC introduced digital record keeping for VAT for large traders as initially planned in 2019, and three years later for smaller traders (in 2022). Following three previous changes to its plans, the government announced in December 2022 that MTD for Self Assessment business taxpayers (those who are self-employed or landlords) would be introduced more slowly. Requirements for self-employed people and landlords with incomes over £50,000 start from April 2026; and from April 2027 for those with incomes over £30,000. The government is reviewing requirements for those with incomes under £30,000. It has not yet decided when MTD for Self Assessment will be introduced for general partnerships or when MTD will be introduced for Corporation Tax.

4 In 2018 we reported that changes in MTD's scope and delays had deferred the benefits for HMRC, and that overall it expected MTD to cost rather than benefit business taxpayers.[1] Our 2021 report, *The challenges in implementing digital change* highlighted common problems that departments encounter including: having unrealistic ambition and timescales, with unknown levels of risk; not engaging adequately with commercial partners; and underestimating the complexity involved in moving from legacy systems.[2] Tackling legacy systems is costly and complex, but continuing to use them is risky and leaves government facing greater costs and risks in the future, including possible service disruption and cyber-attacks.

Scope

5 This report considers progress to implement Making Tax Digital, and whether HMRC's latest plans provide confidence that the programme will deliver value for money. Specifically, the report looks at:

- HMRC's original vision, options and plans for MTD (Part One);
- HMRC's progress between summer 2017 and the end of 2022 (Part Two); and
- the realism of HMRC's latest plans (Part Three).

6 This report focuses on the MTD programme from 2016 onwards. We do not assess wider changes within HMRC, but we do refer to them where they relate to MTD. Appendix One describes our audit approach and evidence base. Appendix Two shows planned implementation dates for digital record keeping by business taxpayers since 2015.

Key findings

The high-level vision and initial plans

7 HMRC considers digital transformation of the tax system is necessary and the broad aim is supported by key stakeholders. There is a strong case for HMRC's move to modern digital systems. Its legacy systems are costly to run and maintain and lack resilience. Modern digital systems also provide the foundation for improving services, including a joined-up view of taxpayers' affairs. The government's 2020 tax administration strategy said HMRC must have a fully digital tax system able to support taxpayers across the full range of their needs. Key stakeholders, including tax agents and business representatives, support the aim to digitalise the tax system provided that changes improve customer experience and help taxpayers to get their tax right (paragraphs 1.2 to 1.5, 1.14 and 3.33).

1 Comptroller and Auditor General, *Report by the Comptroller and Auditor General: HM Revenue & Customs 2017-18 Accounts*, paragraphs 2.22 and 2.23. Published in HM Revenue & Customs, *Annual Report and Accounts 2017 to 2018,* HM Revenue & Customs, HC 1222, July 2018.

2 Legacy systems are operationally embedded in an organisation but have been overtaken by newer technologies or no longer meet changed business needs.

8 **HMRC's original plan to introduce Making Tax Digital by 2020 was not realistic.** MTD requires significant behavioural, administrative and technological change for the programme to succeed. In 2015, the government announced timescales for HMRC to introduce digital record keeping by business taxpayers for Self Assessment, VAT and Corporation Tax by 2020. Over the same period HMRC planned to move from its internal legacy systems for administering those taxes onto its modern tax management platform. Changes for Self Assessment were most ambitious in timing and scope: they were due to complete by 2018 including requirements for more frequent tax submissions from business taxpayers. The timeframes for MTD were agreed before HMRC had fully explored the range of options. HMRC considered whether to sequence work, by either starting with digital record keeping for business taxpayers, or first replacing its legacy systems, but concluded that sequencing these elements would not meet the published timetable. HMRC therefore proposed to do both at the same time. HMRC did not fully assess the scale of work required at the outset of the MTD programme, or the additional complexity of introducing digital record keeping for business taxpayers at the same time as replacing its legacy systems (paragraphs 1.3, 1.4, 1.6 to 1.9, 1.11 to 1.14, 1.16 and Figure 2).

9 **As it better understood the scale of the task, HMRC took sensible steps to revise its delivery plans for Making Tax Digital, putting changes to Self Assessment behind VAT.** Self Assessment is far more complex than VAT, so it was always likely that these changes would need much more time to deliver. HMRC planned fewer changes for VAT, maintaining the nine data fields to complete returns, and with quarterly reporting already standard practice. MTD for Self Assessment covers more taxpayers and a wider range of circumstances. HMRC's plans for Self Assessment require significant changes for people who are not used to digital transactions, electronic record keeping, and quarterly filing. In March 2017, 15 months after the government first published plans for MTD, HMRC had doubts about whether it could deliver the Self Assessment part of the MTD programme on time. Key risks included that legislation would not be in place and that software providers would not be ready for pilot testing. In July 2017, on the advice of HMRC, the government pushed back changes for Self Assessment until at least April 2020, citing concerns that businesses and tax agents were not ready and the delivery environment was more challenging following the UK's decision to leave the EU (paragraphs 1.6, 1.9, 1.15, 1.18, 1.19, 2.2, 2.6, 2.19, 2.20 and Figure 3).

Progress HMRC made between July 2017 and the end of 2022

10 **HMRC had to redeploy resources in response to EU Exit and the COVID-19 pandemic, which reduced its capacity to deliver Making Tax Digital.** Work associated with the UK's decision to leave the EU reduced HMRC's capacity to deliver wider change. In 2018 it closed early a programme providing digital services so that individuals could self-serve rather than write to or call HMRC. In response to the COVID-19 pandemic, HMRC had to redeploy staff to establish and run the digital systems needed for emergency support schemes. Policy and operational officials worked closely together to rapidly develop and implement these schemes. However, this inevitably drew development capacity away from HMRC's other programmes including MTD. Further changes, including preparations for the Health and Social Care Levy, also required system changes which affected progress on MTD (paragraphs 2.2, 3.28, 3.29 and Figure 3).

11 **HMRC introduced digital record keeping for VAT from April 2019, but it encountered problems moving tax records from the legacy system and the changes cost far more than HMRC expected.** In 2019, HMRC introduced MTD for VAT for larger traders, accounting for almost all (99%) of VAT collected, in line with its original timescale. It introduced MTD for smaller traders in 2022 – three years later than originally planned. This delay was due to HMRC's concerns about its ability to make changes during the EU Exit process, the COVID-19 pandemic, and burdens on businesses during that time. However, the changes involved far more work and cost than HMRC had expected. It estimates MTD for VAT had cost around £295 million (£322 million at 2022-23 prices) by March 2023; around £70 million more than it had originally expected MTD would cost for all three business taxes. HMRC did not anticipate the extent of data issues involved in moving tax records and took 15 months longer than planned to move all 3.2 million VAT records (paragraphs 2.5, 2.9, 2.10, Figure 3 and Figure 4).

12 **HMRC research indicates it is likely that Making Tax Digital for VAT has contributed to generating additional tax revenue.** In March 2022 HMRC reported that there was a high likelihood that MTD was generating additional tax revenue by making it easier for businesses to get their tax right. HMRC estimated this equated to £185 million to £195 million of additional VAT in 2019-20. It compared those who signed up early to MTD with similar businesses that did not. HMRC's modelling suggested that there was a high likelihood that revenue had increased from businesses using MTD, but there remains some uncertainty as to whether some of the increased revenue was due to other factors. A new VAT service in August 2022 introduced some extra controls, such as requiring identification for registration and additional verification checks for log-ins but did not introduce other controls, such as requiring proof of address, which may have helped to achieve additional tax revenue (paragraphs 2.14 to 2.18).

13 **Making Tax Digital for Self Assessment is at least eight years behind the original timetable and HMRC has not resolved some important elements of its design.** The government initially planned to introduce MTD for Self Assessment from 2018. HMRC launched a pilot in April 2017. Despite the range of potential scenarios to test, the scale of testing and piloting was limited – in part because HMRC set restrictive requirements including that participants must have an accounting year that aligns with the tax year. Since 2017, more than a thousand taxpayers signed up for the pilot but HMRC needed to remove most of these due to ineligibility, leaving only 15 participants when the pilot was closed to new entrants in 2022. Delays in moving VAT records in 2022-23 reduced HMRC's capacity to build its Self Assessment system and support development of commercial software. HMRC has not yet resolved some design issues including how to: allow for multiple agents to represent taxpayers; handle jointly owned property; and deal with changes in taxpayers' circumstances. In August 2022 HMRC concluded that MTD could not be delivered by 2024 (paragraphs 2.11, 2.19 to 2.25, Figure 5 and Figure 9).

HMRC's current plan for Making Tax Digital

14 **In December 2022, the government pushed back the timetable for Self Assessment for the fourth time, delaying benefits and increasing costs further.** On the advice of HMRC the government announced it would delay the start date for MTD for Self Assessment and take a phased approach to introducing it. This was to give more time for business taxpayers and HMRC to prepare. Doing so reduced pressure on HMRC to move tax records and limited the impact on its wider operations. The announcement meant that rather than requiring all Self Assessment business taxpayers with incomes over £10,000 to keep digital records from April 2024, only those with incomes over £50,000 would be required to do so from April 2026, and those with incomes over £30,000 from April 2027. HMRC is reviewing what requirements might be placed on those with incomes under £30,000. In 2016 HMRC had expected MTD would generate an annual return of £600 million in additional tax revenue from VAT and Self Assessment by 2020-21. It now expects to reach this level in 2027-28. HMRC's estimated costs have increased to £1.3 billion (a 400% increase in real terms since 2016), with £642 million already spent by March 2023 (paragraphs 3.3, 3.5, 3.6 and 3.10, and Figure 7).

15 **HMRC's business cases have omitted significant costs to customers from its cost-benefit analysis. This means that the case for further investment was based on an incomplete picture of the costs and benefits. HMRC told us it does not believe this would have affected the decisions that were taken.** MTD was originally approved with the expectation it would reduce burdens on business taxpayers because digital record keeping would make tax submissions easier. After challenge from stakeholders, HMRC revised its approach to estimating costs to these customers. In 2021 it published policy papers which estimated upfront transitional costs to Self Assessment customers with incomes above £10,000 would be around £1.4 billion and net ongoing costs would be around £150 million a year to comply with MTD. However, it did not carry upfront transitional costs through to its cost-benefit analysis in its May 2022 and March 2023 business cases seeking further investment in the programme. In its May 2022 business case HMRC forecast total net ongoing costs to taxpayers would be around £900 million over five years to comply with MTD. While it quantified upfront transitional costs to customers in an annex, it excluded these from the main body of the business case and from its cost-benefit analysis. This included significant upfront costs such as purchasing computers and getting support from agents to comply with MTD. HMRC's 2021 research indicated these costs could average £330 for each business affected and be almost £1,000 for some people. It did not include any transitional costs in its March 2023 business case. The exclusions mean that HMRC's 2022 and 2023 business cases presented partial analysis of the costs and benefits of MTD when requesting further investment in the programme. HMRC's May 2022 business case contained the most significant omission, with around £1.5 billion of forecast costs to VAT and Self Assessment customers excluded from the cost-benefit analysis. The business case should have shown that the combined costs to HMRC and customers of proceeding with MTD for Self Assessment were greater than the additional tax revenue expected. HMRC told us that it did not believe presenting the upfront transitional costs to customers within the cost-benefit analysis would have resulted in any different decisions being taken. It was able to provide us with some evidence that decision makers were sighted on the full upfront transitional costs to customers ahead of some key decisions (paragraphs 3.13 to 3.16 and Figure 7).

16 HMRC still expects the programme will generate a positive return, which has improved following a recent change in methodology for estimating tax revenue. HMRC now expects MTD will achieve £3.9 billion of additional tax revenue by 2033-34, up £0.6 billion on its March 2023 business case. HMRC had assumed that less compliant taxpayers would sign up later for MTD, delaying the reduction of errors attributable to the programme. Evidence from MTD for VAT indicates this has not been the case and HMRC removed this assumption from its latest estimate of additional tax revenue for Self Assessment. HMRC numbers now indicate MTD will achieve a benefit-cost return of around 2:1. Provisional HMRC numbers indicate the case for mandating MTD for those with lower Self Assessment income may be more marginal. HMRC estimates that in the first five years it would generate £1.6 billion of additional tax revenue from business taxpayers with incomes between £10,000 and £30,000 but complying with MTD might cost these customers £1.2 billion (£460 on average) over this period, based on research published in 2021. HMRC has yet to estimate how much extending MTD to more Self Assessment business taxpayers would increase its own costs. Direct comparisons of additional tax revenue to HMRC and customer costs is made more difficult because HM Treasury Green Book rules do not count additional tax revenue as an economic benefit. There may be a case to include revenue from reduced error and fraud on the grounds this represents a benefit to government and society as a whole but not a genuine loss to customers (paragraphs 3.10, 3.11, 3.14, 3.17 to 3.19, and Figure 7).

17 HMRC has set a very challenging plan to implement Making Tax Digital for Self Assessment from 2026-27, delivering many aspects of the programme in parallel. The scale of work required remains uncertain. HMRC's plans still require it to simultaneously move from legacy systems to a modern platform and introduce digital record keeping by business taxpayers. It has not been able to provide us with any measures of progress to the end of 2022, so it is not clear how much its investment to date has advanced its system development. HMRC's current plans indicate it has major work to complete on all the significant elements (restarting its pilot with business taxpayers, moving tax systems and records, and changing its internal processes), and this must all be done in parallel. It plans to move the tax records of all 740,000 Self Assessment business taxpayers with incomes over £50,000 in 2026-27; and the 870,000 business taxpayers with incomes between £30,000 and £50,000 in 2027-28. In March 2023 HMRC was seeking a better understanding of the quality of Self Assessment tax records prior to moving them, learning from its experience with MTD for VAT. It was considering, but had not yet decided, whether to get independent technical assurance over its plans. In 2022 HMRC started work on a new initiative – 'Income Tax Service Transformation' – which will look more fundamentally at how income tax is designed and operates. This initiative may continue much of the work initially envisaged under Making Tax Digital, including streamlining and simplifying the income tax regime (paragraphs 2.10, 3.21 to 3.25, 3.37 and Figure 8).

18 Stakeholders important to the success of Making Tax Digital want HMRC to be more collaborative and transparent about progress. HMRC meets frequently with stakeholders including tax agents, taxpayer representative groups and software developers. Developers and tax agents will be important both in developing and using software and in communicating changes and supporting taxpayers to make quarterly updates for the first time. Stakeholders have repeatedly raised concerns with HMRC about the added administrative burden and their own capacity to support taxpayers with quarterly updates. Stakeholders told us they valued consultations but wanted to be involved meaningfully on design decisions including income thresholds for inclusion in MTD for Self Assessment, quarterly updates, and how to support taxpayers with multiple tax agents. They were also concerned about whether free to use software would be available. All the stakeholders we spoke to would like to see a more comprehensive pilot, a detailed plan and more transparency on HMRC's progress. Since the December 2022 announcement, HMRC started working more closely with stakeholders to resolve issues such as how quarterly updates would work in practice (paragraphs 2.19 to 2.21, 3.27 to 3.29, Figure 6 and Figure 9).

19 HMRC will need to keep running most legacy systems alongside its modern tax management platform. HMRC completed the important task of moving 3.2 million VAT records on to its modern tax management platform by March 2023, against its plan to do this by December 2021. It has 14 million more records to move from legacy systems for Self Assessment and Corporation Tax. However, it has not set a new timetable or outlined plans to move Corporation Tax, and the 3 million related records, onto its modern tax management platform, or to move the 9.4 million Self Assessment taxpayers who have trading or property income below £30,000 or those with other forms of Self Assessment income. Until these records are migrated, HMRC will continue to have the costs and complexity of running its legacy systems alongside the new system (paragraphs 1.15, 2.10, 3.4, 3.7, 3.23 and 3.24).

Conclusion on value for money

20 HMRC's vision to digitalise the tax system has the potential to bring about a step-change in the system's efficiency and effectiveness. The principle of digitalising tax has broad support among stakeholders provided it makes it easier to pay tax. HMRC launched digital record keeping for VAT for larger businesses on time, but it needed more time to move taxpayer records off legacy systems due to the extent of data issues it had to deal with. HMRC's initial timeframe for MTD was unrealistic. It did not allow sufficient time for HMRC to explore the full range of options that would achieve the programme's aims and select one that it could implement.

21 Each announcement has set an ambitious timeframe for delivery, with several aspects of the MTD programme to be delivered in parallel. The repeated delays and rephasing of MTD has undermined its credibility and increased its costs. There is a risk that delivery partners and taxpayers disengage from a programme that can only succeed if those groups significantly change their behaviour. Higher costs were not inevitable, had HMRC taken more time to plan and consider the realism of the options. HMRC has not demonstrated the programme offers the best value for money for digitalising the tax system, with later business cases significantly underplaying the total cost to customers of making the change. The programme should now develop a robust business case which includes a comprehensive and up-to-date assessment of the costs to customers of implementing MTD. Planning has been too high-level and the risk remains that further delays will add costs and defer benefits. HMRC is reviewing how MTD will work for businesses and landlords with lower Self Assessment income. It should take this opportunity to assess how far the programme is improving services, reducing burdens, and making the tax system easier to comply with and use lessons from this review to ensure the wider programme is finally on track to secure the benefits it has long promised.

Recommendations

22 HMRC's ability to secure value for money from the remaining spend on MTD – forecast at £620 million at March 2023 – now depends on developing a more robust business case exploring the options for progressing MTD, resolving questions about design, and rigorously managing risks to delivery. HMRC should:

Testing the options and design

a Prepare a separate business case for Making Tax Digital for Self Assessment so that decision makers can understand the costs and benefits (excluding those already incurred or secured) and delivery risks for the full range of options. This should include greater clarity on how different groups of business taxpayers are affected.

b Identify and challenge whether each discrete element of the programme merits inclusion. Tests should include whether the change is: business critical or offers a benefit-cost return; meets the policy objectives of the programme; cannot be done better another way; and can be delivered with confidence.

c Reassess what scope the move to a modern tax management platform offers for: achieving additional tax revenue from improved controls and risk assessing of claims; greater efficiency gains; and benefits to business taxpayers by offering a more streamlined service. Consideration of the value for money of alternative options should include the full costs to both HMRC and customers.

d Resolve questions of design and the mechanics of the Self Assessment regime as a strategic priority. HMRC can learn from its success in resolving design issues quickly when implementing the COVID-19 support schemes by bringing together those with expertise in policy, tax, IT and operational delivery (including delivery partners). For MTD and other digital programmes it should develop and test the concept iteratively before committing to large-scale projects or finalising deadlines.

e Ensure it follows through on its public commitment to work collaboratively with stakeholders on how best to create the new system. HMRC changed its approach in early 2023 and must now work with stakeholders and relevant experts to quickly address the specific unresolved design issues, including how HMRC's systems will allow for taxpayers with different year-ends or jointly-let property, or those represented by multiple agents, and develop and test how the arrangements would work in practice for taxpayers, their agents and HMRC.

f Resolve questions around the choice of accessible software options and provision of free software, for self-employed people and landlords under Making Tax Digital and assess the implications on functionality and costs to customers if HMRC relies on software providers to deliver all MTD software, including for the smallest businesses with the most straightforward affairs. HMRC must establish the costs and time required if it needs to develop or procure its own software, and assess these alternative options in the business case.

On delivery

g Reassess its existing delivery plan to test whether it is realistic and offers the best value for money. In particular HMRC should:

- work with software providers to agree an approach for the pilot. Working through the more complex cases first may offer the best value for money and reduce the total cost for the programme;
- review its approach to moving taxpayer records from legacy systems and consider whether it needs more time and resources to cover this element;
- model the cost and time sensitivities around the plan to identify the areas of greatest risk and ensure the plan contains sufficient contingency; and
- use projections of further cost as a trigger to assess the continuing viability of the programme, should these threaten to outweigh the benefits.

h Seek independent technical assurance of its plans and monitor progress closely throughout. It should develop robust metrics to report progress against.

i Develop an end-to-end plan with the detail that delivery partners need and work with software developers on the sequence of work and testing that will be most likely to achieve value for money.

j Develop plans for how it will help taxpayers prepare for MTD. This should include a particular focus on those who are less digitally able and ensure the process for seeking exemptions is sufficiently accessible.

On appraising MTD and other programmes

k Investigate how incomplete and inaccurate information on upfront transitional costs to customers was presented in programme business cases and take any necessary corrective action.

l Review all its major programmes that are imposing costs on taxpayers and ensure it has correctly accounted for these costs when assessing the programmes' economic benefits and financial affordability.

m Review with HM Treasury how additional tax revenue from reduced fraud and error can be included in business case analysis so business cases for MTD and other HMRC programmes aiming to reduce fraud and error can provide decision makers with a clear view of all benefits and costs. The benefits of reducing fraud and error have been central to analysis for business cases prepared elsewhere in government.

23 For many of these recommendations, guidance can be found in our 2021 good practice guide on *Managing the commercial lifecycle* and our 2023 insights report *Lessons learned: Resetting major programmes.*