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ACCOUNTANTS FOR BUSINESS

Tax, fair tax and the coalition government

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ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies at all stages of their development. We seek to develop capacity in the profession and encourage the adoption of global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We seek to open up the profession to people of all backgrounds and remove artificial barriers, innovating our qualifications and their delivery to meet the diverse needs of trainee professionals and their employers.

We support our 140,000 members and 404,000 students in 170 countries, helping them to develop successful careers in accounting and business, based on the skills required by employers. We work through a network of 83 offices and centres and more than 8,000 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

ABOUT ACCOUNTANTS FOR BUSINESS

ACCA's global programme, Accountants for Business, champions the role of finance professionals in all sectors as true value creators in organisations. Through people, process and professionalism, accountants are central to great performance. They shape business strategy through a deep understanding of financial drivers and seek opportunities for long-term success. By focusing on the critical role professional accountants play in economies at all stages of development around the world, and in diverse organisations, ACCA seeks to highlight and enhance the role the accountancy profession plays in supporting a healthy global economy.

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Introduction by Helen Brand

The coalition government has used its first months in office to set out its approach to tax policy making, focusing on certainty and consistency. It has done this mainly through the setting up of the Office of Tax Simplification the Emergency Budget in June. The pressing need to grapple with the enormous financial deficit means the Coalition's first Budget was a painful one, although there were some silver linings. We consider the implications of the Budget later in this paper.

The coalition government also used the last day before Parliament rose for the summer to publish nine consultations that amount to a radical shake-up of the tax system including overhauls of the National Minimum Wage; the Controlled Foreign Company regime; inheritance tax and reform of the PAYE system, in order to fulfil its pledge to simplify the tax system.

ACCA welcomes the coalition government's objectives of simplifying the system and reducing burdens on business and individual taxpayers and we welcome the focus on these issues.

We also welcome many of the individual measures the coalition government has announced, although we have concerns in some key areas. This paper outlines ACCA's specific views and recommendations on the key areas covered in the coalition government's new policies. If taken on board, these recommendations would, we believe, assist the coalition government in achieving its objectives.

ACCA has also identified five principles it believes the coalition government should consider in its tax policy making.

1. Tax policies should be transparent and non-discriminatory – unless part of a declared discriminatory policy, such as one intended to encourage new enterprise. ACCA considers such use of tax by elected governments to be legitimate, so long as the measures are as transparent, simple and effective as any other. The coalition government should be wary of increasing the complexity of the tax system through excessively tinkering to 'reward' or 'punish' certain groups of taxpayers.

2. Consultation processes on tax policy are all too often token exercises, where government policy has already been decided; for example, though the summary of responses to the Restriction of Pensions Tax Relief consultation was unable to quote a single positive response, the measure was passed in the Finance Act 2010 without addressing any of the fundamental concerns raised by the hundred or so written respondents. On major issues of tax policy, there must be clear consultation: different options should be specified at the start, and then properly considered with an audit trail including unambiguous minutes and written responses. As an example of good practice in this area, we would cite the consultation on Capital Gains Rules for Groups of Companies – a measured, collaborative and consultative process resulting in draft legislation that all parties agree needs only minor revision before presenting to Parliament.

3. There should also be openness on the application of tax policy. So-called 'stealth taxes', such as the quiet reduction of tax exemptions and the phenomenon of 'fiscal drag', cannot be justified. Tax rises should be agreed upon only after full and open debate.

4. Areas of tax law relating to long-term activities and planning, such as pensions and capital investment, should benefit from long-term stability. Withdrawal of tax allowances from capital expenditure with a projected life of up to 25 years significantly affects the economic outturn of businesses' long-term investments. Those beginning their working lives today can expect to be paying into pension funds (or the National Insurance scheme) for up to 50 years. Just five years since the fundamental simplifications of A-Day the coalition government should be looking to further simplify the tax regime for pensions to encourage saving, not introducing complex administrative provisions that will divert contributions from savings funds into payment of management costs. Changes in these areas of long-term planning should in particular be subject to open and measured consultation, which takes into account all their collateral implications for long-term investment in the UK.

5. There needs to be a positive prompt for justifying the existence of legislation. All anti-avoidance legislation should have sunset clauses attached to ensure both its content and the need for it to remain in place is regularly and actively considered. All tax legislation should be subject to a review principle, whereby it is periodically overhauled and consolidated to make it up-to-date and easier to follow. Outdated laws should be removed. The coalition government, in conjunction with HM Revenue and Customs, must devise clear metrics to gauge whether the tax system is being appropriate and sufficiently reviewed.

ACCA looks forward to working with the coalition government, Parliament and the Office of Tax Simplification (OTS) in order to ensure that the UK has a tax system that is both competitive and easily understandable by those that use it.

Summary of recommendations

1. ACCA urges the OTS to try to make the tax system more consistent. In recent years, the UK tax policy has changed as often as the people in charge of it. But to make this initiative truly of benefit to businesses of all sizes, it is vital that the work of the Office remains politically independent and that its recommendations do not fall by the wayside as the coalition government shifts its focus to other areas of the UK economic recovery.

2. 'Simplification' must not be used as an excuse to scrap tax breaks.

3. Currently, the coalition government has a top down approach for business tax. In keeping with the UK's recent approach to the reform of company law, ACCA believes that the OTS should 'Think Small First' and that the coalition government should start with small and medium-sized enterprises (SMEs) when designing taxation policies for business: It needs to create a foundation of principles that can apply to all businesses, based on the needs of the smallest, with additional layers added for larger, more complex companies.

4. We consider any further VAT rise beyond 20% would be counterproductive to the image of the UK as a competitive tax jurisdication. The new rate is the same as that of Italy and the business image of that EU member state is one not to be considered especially enviable.

5. ACCA urges the coalition government to consider reversing this and other tax rises once public debt levels have been significantly reduced. We would like to see the coalition government state that is their intention.

6. Long-term capital assets need long term certainty. ACCA considers the changes to Capital Gains Tax, a tax which was only changed two years ago, unwelcome. In addition to this, the 28% rate is out of line with many of the UK's competitors which either have no Capital Gains Tax or lower rate.

7. The married couples' tax allowance should not be implemented – at least until the deficit has been brought down and the economy has stabilised as it would be expensive to administer and there is no evidence that it will encourage people either to marry or to remain married.

8. Once the deficit has been reduced, the coalition government should consider other ways to achieve the goal of recognising marriage, rather than adding more complexity to the tax system.

9. The coalition government must take care when implementing the bank levy, especially as it will be on balance sheets rather than profits. It must not inhibit banks' ability to assist the recovery.

10. Although the coalition government has secured a partial international agreement on the implementation of the levy, broader international agreement is needed on banking sector reform to ensure that the UK's status as a financial centre is not undermined.

11. The Budget also announced that the coalition government would be exploring the costs and benefits of a Financial Activities Tax on profits and remuneration, alongside a review of remuneration being conducted by the Financial Services Authority (FSA). It is essential that the coalition government remains focussed on addressing the key issues of systemic risk and regulatory reform.

12. Measures such as a bank levy are likely to incentivise banks find ways to move assets off balance sheet, by setting up separate vehicles, or by making use of the shadow banking system which may result in increased risk to the financial system, rather than a reduced risk.

13. Furthermore, it is not the bankers who will pay the tax, but the customers, although under the Commission proposals, the funds will be 'ex ante' – up front and not passed on to the taxpayer.

14. Clearly a low level of corporation tax is one factor involved in promoting inward investment. We should be aware however, that businesses are concerned about the total tax cost in an economy. The Irish experience has shown that international investors can desert at the first signs of an economic down turn.

15. We need to be careful that we do not end up in a race to the bottom. We may have a highly competitive tax rate when we reach 24% but by the time we attain that we will have set in motion a race where others will have caught us up or even under cut the UK rate.

16. Consideration must now be given to the design of a more permanent finance guarantee scheme that could come into operation after the Enterprise Finance Guarantee extension period.

17. Research has shown that the smallest companies incur five times the administrative burden per employee than larger firms[1] and so every effort must be made to increase efficiency of the tax system.

18. ACCA recommends that there should be a greater level of transparency and stability in the tax system where small businesses feel that the tax system will support their competitiveness. Above all, the coalition government should employ the 'Think Small First' principle in all of the legislation they bring in, rather than creating legislation appropriate for larger companies and adapting it for small businesses.

19. Although ACCA appreciates the challenge the coalition government faces in terms of the economy, sustainability issues cannot be put on 'the backburner' and any planned changes will also need to ensure a consistent approach for the long term.

20. The coalition government must ensure that moving to a low carbon economy is not slowed down by cutting the budgets of Defra and DECC.

1. OECD, *Businesses' Views on Red Tape*, 2001.

The Office of Tax Simplification

The new Office of Tax Simplification (OTS) was launched by the coalition government on 20 July with the aim of providing the coalition government with independent advice on simplifying the tax system. The body will draw from expertise across the tax and legal professions – as well as the business community and other interested parties.

ACCA has long held the view that the coalition government should create an independent body to provide advice on tax policy, with a specific focus on:

- reducing the complexity of legislation
- simplifying the drafting and language of existing legislation
- a review of the existing legislation from a structural perspective
- pre-legislative scrutiny, leading to more considered legislation – specifically, the requirement for an annual Finance Bill should be removed

We applaud the Treasury's decision to establish the OTS.

Our specific recommendations on this area are:

RECOMMENDATIONS

- ACCA urges the OTS to try to make the tax system more consistent. In recent years, the UK tax policy has changed as often as the people in charge of it. But to make this initiative truly of benefit to businesses of all sizes, it is vital that the work of the Office remains politically independent and that its recommendations do not fall by the wayside as the coalition government shifts its focus to other areas of the UK economic recovery.
- 'Simplification' must not be used as an excuse to scrap tax breaks.
- Currently, the coalition government has a top down approach for business tax. In keeping with the UK's recent approach to the reform of company law, ACCA believes that the OTS should 'Think Small First' and that the coalition government should start with SMEs when designing taxation policies for business: It needs to create a foundation of principles that can apply to all businesses, based on the needs of the smallest, with additional layers added for larger, more complex companies.

ACCA is also calling for more clarity around the following areas of business legislation:

- The PAYE system
- Income tax bands
- VAT flat rates for small businesses
- The employee benefits system
- Deductions from business tax profits.

VAT

Tight finances meant a move on VAT was inevitable, especially since an increase of only 1% raises around £5bn for the Treasury's depleted coffers. The announcement in the Emergency Budget means that the VAT rate will rise from 17.5% to 20%, due to start from 4 January 2011.

The VAT rise is easily the largest revenue generator in the Budget, far outweighing sums raised through a 'supertax' on banks and housing benefit cuts. Indeed, the 2.5 percentage point increase will generate almost the same revenue as 3p on income tax.

It will raise £13.4bn a year by 2014 and will come into force on 4 January next year, giving some time for retailers to prepare and leaving the crucial Christmas trading period unaffected. The delay is also designed to engineer a spending boom before January to boost the economy through the next few months.

In announcing the rise, Chancellor George Osborne said:

'That is £13bn we don't have to find from extra spending cuts or income tax rises...The years of debt and spending make this unavoidable.'

Deloitte has calculated[2] that the average worker earning £24,000 will pay an extra £183 a year as a result of the VAT rise. It will push up the average price of petrol from £1.18 a litre to £1.21, adding £1.50 to the cost of filling up the average family car. For the first time, the average pint of beer will rise above £3.

The impact of the VAT rise may go even further than this. Retailers still struggling due to the recession could be hard hit by the VAT rise. This may, as a consequence, delay the recovery and affect jobs and consumer spending.

However, the coalition government has no easy options. The increase was expected and Mr Osborne has eased the pain by delaying it until the start of next year.

RECOMMENDATIONS

- We consider any further VAT rise beyond 20% would be counterproductive to the image of the UK as a competitive tax jurisdication. The new rate is the same as that of Italy and the business image of that EU member state is one not to be considered especially enviable
- ACCA urges the coalition government to consider reversing this and other tax rises once public debt levels have been significantly reduced. We would like to see the coalition government state that is their intention.

2. http://www.deloitte.com/view/en_GB/uk/index.htm

Capital Gains Tax

In the 2010 Queen's Speech, the coalition government announced plans to raise Capital Gains Tax (CGT) for non business assets from 18%, to a level closer to the 40% income tax rate – a move seen as a concession to the Liberal Democrats' plans to rebalance the tax system to give lower and middle income earners a tax break.

This was clarified in the Emergency Budget, with the announcement of a new higher Capital Gains Tax rate of 28% for those paying higher-rate income tax, with immediate effect.

The aim of this measure, which has caused unrest amongst Conservative back benchers although it was less than the 50% some feared, is to find additional revenue to enable the income tax threshold to be raised.

The tax increase will hit only well-off investors. However, although investors cashing in will pay more, those in shares and funds can drip sell, transfer assets between married or civil partners and use Isa allowances to ease the pain.

Those whose income and capital gains amount to as much as £53,975 a year could avoid any tax rise. For most people, their position will not change – as long as their combined capital gains and income are below the £43,875 at which the higher income tax rate kicks in. Basic-rate taxpayers will continue to pay Capital Gains Tax at 18% – the same as the current rate – on any gains above £10,100.

Before the Budget, there had been speculation that the rate of Capital Gains Tax could rise to 40% or even 50%. This saw a number of big investors selling or transferring shareholdings in order to avoid the risk of facing a far higher tax bill on their gains. However, research suggested that a higher rate could actually reduce the coalition government's takings. This is in line with the 'Laffer Curve' theory, named after Professor Art Laffer, which demonstrates that lower tax rates change economic behavior and stimulate economic growth and that tax rates increasing over a certain level encourage people to work less, thereby reducing tax revenue. The Treasury now expects to raise more through income tax as a result of the Capital Gains Tax increase.

ACCA's main concerns with the rise are as follows.

- Many who have invested savings in property in order to finance their retirement are concerned that they will be penalised unfairly. The changes will hit these better-off investors who cash in gains by disposing of assets at a profit. They will be able to pocket £10,100 of gains without paying tax, but if the gain plus their income lifts them into the higher income tax bracket, they will pay a new, higher rate of 28% on any capital gain above the £10,100 threshold.

- Prudent long-term savers will be punished by the new measures which would make no distinction between short-term speculation and the profits that come from productive businesses.

- As a consequence of the increase in Capital Gains Tax, the coalition government will be taking more and more money out of the investment arena, thereby reducing investment levels in the medium to longer term. So aside from hitting more people than ever before, an increase in Capital Gains Tax could actually lead to a reduction in direct and indirect investments in the UK.

- The narrowing of the gap between Capital Gains Tax and income tax rates will reduce the incentive for people take money out of a company as a capital gain rather than income.

- It remains to be seen whether a 28% rate will tackle tax avoidance, as individuals may still be tempted to reclassify income as a capital gain. They could also create artificial tax schemes to create losses which would minimise the amount of Capital Gains Tax they would have to pay. ACCA's view is that HM Revenue and Customs should clarify and update the definition of a capital gain under the tax system in order to make it harder for people to pay less tax by reclassifying income as a capital gain.

ACCA has previously warned about making constant minor tweaks to the taxation regime and to Capital Gains Tax, as this can inadvertently force people to keep switching from product to product purely for tax purposes, which is not in anyone's interest.

However, ACCA does welcome the coalition government's commitment to a longer-term approach on CGT. Addressing the Treasury Select Committee, the chancellor said: 'I certainly regard [the change] as permanent and am not planning to revisit this decision in this parliament.'[3]

This news means that investors and their advisers now know where they stand until at least May 2015, giving them more stability and certainty when it comes to their tax and investment planning.

RECOMMENDATIONS

- Long-term capital assets need long term certainty. ACCA considers the changes to Capital Gains Tax, a tax which was only changed two years ago, unwelcome. In addition to this, the 28% rate is out of line with many of the UK's competitors which either have no Capital Gains Tax or lower rate.

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3. http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/uc305-ii/uc30501.htm

Married couple's tax allowance

The tax regime in general still treats married couples and cohabiting couples in different ways. This difference would be emphasised even further under a Conservative manifesto[4] commitment to support marriage through the tax system. Under this pledge, approximately 4m basic-rate taxpayer married couples and civil partners earning under £44,000 a year would receive a tax break worth around £150 a year.

The tax break would be achieved by allowing an unworking person to transfer £750 of their tax-free personal allowance to their spouse or partner, which, the Conservatives say, will amount to £150 a year.

According to the Institute for Fiscal Studies (IFS), the measure would cost £550m in 2011/12 if it were brought in.[5] Also according to the IFS, around 32% of all married couples would be likely to qualify for the tax break, although there are no clear indications of whether the measure would encourage people to marry, to stay together, or whether it will encourage one partner to stay at home rather than working.

Issues surrounding the married couples' tax allowance have not yet been agreed upon by the coalition government, according to the Minister of State for Children and Families.

If the proposal were introduced, then the Liberal Democrats would be able to abstain on any vote 'without prejudice to the coalition government agreement'.

ACCA's view is that this policy should not be implemented, for the following reasons.

- The amount – £3 a week – is too small to either incentivise people to marry or remain in marriage. Indeed, the vast majority of people who would qualify to receive this are married already and need no incentivising, yet the amount is too small to qualify as a reward.

- The scheme would be very expensive to administer and for little gain to those who qualify for it.

- In the current economic climate, spending £550m on such a scheme (not taking the administration costs into consideration) would be frivolous.

- It would also add further complexity to the already complex tax system. There are simpler and more transparent ways of delivering behavioural change or supporting behaviours other than delivering them through the tax system.

As Jim Pickard and Alex Barker wrote in the Financial Times: '...the £150 break is too small to change behaviour, either in favour of marriage or staying at home to bring up children. Given the state of the public finances, it may be an expensive political gesture.'[6]

RECOMMENDATIONS

- The married couples' tax allowance should not be implemented – at least until the deficit has been brought down and the economy has stabilised as it would be expensive to administer and there is no evidence that it will encourage people either to marry or to remain married.

- Once the deficit has been reduced, the coalition government should consider other ways to achieve the goal of recognising marriage, rather than adding more complexity to the tax system.

4. http://www.conservatives.com/Policy/Manifesto.aspx

5. http://www.ifs.org.uk/pr/marriage_pr.pdf

6. http://www.ft.com April 9 2010.

The bank levy

The coalition government has agreed a package of reforms to banking regulation. This includes the introduction of a bank levy from January 2011, which will apply to the balance sheets of UK banks and building societies and the UK operations of foreign banks from January 2011. Smaller banks will not have to pay.

Mr Osborne has said that this will raise £2bn a year once it is fully in place.

The move is intended to reduce the riskiness of bank funding profiles and, the coalition government claims, shows that the UK is leading the debate in the European Union (EU) and G20 on strengthening the resilience of the banking system.

The EU, the US and the G20 are considering similar measures, although no consensus was reached on the introduction of a global transactions tax at the G20 summit meeting in Toronto earlier this year. Barak Obama for example, has outlined plans for a bank levy, or a 'Financial Responsibility Fee' on financial firms with assets of over $50bn, in the Volker Plan. The US tax proposal is aimed at recouping the $700bn the US taxpayer spent bailing out the banks and restoring confidence in the financial system through the Troubled Asset Relief Program (TARP). Rather than punishing the banks, Obama claims that this is aimed at preventing the situation from happening again, saying that: 'My commitment is to recover every single dime the American people are owed.'[7]

However, many questions remain to be answered before these measures can be implemented.

- How large will the funds be?
- Will this be a permanent tax – how long will banks be expected to pay into the fund?
- Will funds raised be kept for later or spent now?
- Should all banks, including those that did not require bailout assistance, be subject to the levy?
- Should the bank levy be punitive or preventative?
- Should levies be based on bank assets, liabilities or profits?
- Will savings banks and other institutions such as building societies and cooperative banks operating in lower risk areas, have to pay as much as those with greater risk exposure?
- How will leaders tackle the 'moral hazard' issue – ensuring that the fund is not be viewed as a rescue fund, leading banks to take extra risks?
- If the proposals are not adopted globally, how will leaders including the UK coalition government ensure that the competitiveness of their own financial service industries is not damaged?
- How will leaders ensure that banks subject to a levy do not stop lending to businesses as a consequence, particularly the essential lending to smaller businesses?

ACCA believes that the bank levy is dealing with the symptoms rather than the cause and we would not support a ring-fenced levy that is not used.

Furthermore, taxing the banks is a balancing act and the coalition government must consider these key points in implementing the levy.

RECOMMENDATIONS

- The coalition government must take care when implementing the levy, especially as it will be on balance sheets rather than profits. It must not inhibit banks' ability to assist the recovery.
- Although the coalition government has secured a partial international agreement on the implementation of the levy, broader international agreement is needed on banking sector reform to ensure that the UK's status as a financial centre is not undermined.
- The Budget also announced that the coalition government would be exploring the costs and benefits of a Financial Activities Tax on profits and remuneration, alongside a review of remuneration being conducted by the FSA. It is essential that the coalition government remains focussed on addressing the key issues of systemic risk and regulatory reform.
- Measures such as a bank levy are likely to incentivise banks find ways to move assets off balance sheet, by setting up separate vehicles, or by making use of the shadow banking system which may result in increased risk to the financial system, rather than a reduced risk.
- Furthermore, it is not the bankers who will pay the tax, but the customers, although under the Commission proposals, the funds will be 'ex ante' – up front and not passed on to the taxpayer.

7. http://www.whitehouse.gov/the-press-office/president-obama-proposes-financial-crisis-responsibility-fee-recoup-every-last-penn

Corporation tax

George Osborne announced in the Budget, that corporation tax, the levy on business profits, will be cut from 28% to 27% next year, and by 1% annually for the following three years, following the example of the previous government, which cut the burden on company profits soon after taking power in 1997, and reduced the rate again from 30% to 28% three years ago.

According to Mr Osborne, the aim is for: '...a sign to go up over the British economy that says 'open for business.'[8]

This measure, which will be paid for in part by deep cuts to capital allowances, raising £1.8bn, will cost £4.1bn a year in lost tax receipts according to official estimates.[9] It will leave Britain offering companies the lowest rate of corporation tax ever as well as the best in the G7 and the fifth lowest in the G20.

Business is becoming increasingly global as companies increasingly trade across national boundaries. In response to these developments, governments around the world have lowered corporation tax rates in order to entice businesses to locate in their countries.

A recent IMF paper stated, however, that: '...lower corporate income tax rates and longer 'tax holidays' are effective in attracting Foreign Direct Investment (FDI), but not in boosting gross private fixed capital formation or growth.'[10]

In other words, such tax cuts generate interest and investment initially, but fail to secure long-term commitment. This is apparent as businesses increasingly consider the whole cost of the tax environment in which they operate, including compliance costs and favourable treatment of cross border transactions, alongside the traditional factors of the tax base and effective tax rate.

This is further backed up by looking at some of the world's most successful economies, such as Germany, Japan, the US and China, all of which have higher rates of corporation tax than the UK even beffore the reduction. The rate of corporate tax in Japan, for example, is 40%.

Although the five-year route map for corporation tax provides consistency and certainty and may have a positive impact on investment in the short-term, it will come at a cost.

The loss in terms of corporation tax receipts could prove a drag on the economy at a critical time. In spite of low profits across the private sector, the Office for Budget Responsibility anticipates that corporation tax receipts will raise £43bn this year, or 8% of the total tax take.[11]

RECOMMENDATIONS

- Clearly a low level of corporation tax is one factor involved in promoting inward investment. We should be aware however, that businesses are concerned about the total tax cost in an economy. The Irish experience has shown that international investors can desert at the first signs of an economic down turn.
- We need to be careful that we do not end up in a race to the bottom. We may have a highly competitive tax rate when we reach 24% but by the time we attain that we will have set in motion a race where others will have caught us up or even under cut the UK rate.

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8. http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100622/debtext/100622-0006.htm

9. http://www.bbc.co.uk/news/mobile/10390823

10. IMF publication, *Empirical Evidence on the Effects of Tax Incentives*, Alexander Klemm and Stefan Van Parys, 1 July 2009. http://www.imf.org/external/pubs/cat/longres.cfm?sk=23053.0

11. http://budgetresponsibility.independent.gov.uk/

Tax and small business

Under measures announced by the coalition government, up to a million jobs could be lost in the public sector, which accounts for one in five of Britain's workforce. The coalition government is keen for the private sector to hire many of these workers to prevent an unemployment explosion and will be looking to the small business sector to play a key role in this job creation under what George Osborne has called 'enterprise-led recovery'.[12] The coalition government is therefore looking for ways to support the UK's small and medium-sized enterprises (SME).

However, the problem with providing support to SMEs through the tax system is not only that this can add to the complexity of the system, but also that it can create unanticipated loopholes which can be exploited for tax avoidance purposes by others. Research has shown that the smallest companies incur five times the administrative burden per employee than larger firms[13] and so every effort must be made to increase efficiency of the system.

The Open University's Quarterly Survey of Small Business in December 2009 highlighted that 26% of small businesses identify the tax burden as one of the top three issues facing their business at the moment, while amongst the most entrepreneurial firms, 31% cite the tax burden as a top-three problem.

Other ways in which the coalition government can particularly help small business include the following:

- Reduce the number of different contact points with the tax authorities.
- A single point of online or telephone access to all the business's tax records would improve efficacy.
- Tax enquiries should be targeted and coordinated, with departments responsible for the different heads of duty communication with each other before, during and after any enquiries.
- The size and number of returns made by small business should be critically reviewed and reduced, rationalized or simplified where possible. Information should be provided only once.
- Consider the difficulties for small business caused by mandatory online filing. Taxpayers should have more flexibility to file on paper, otherwise they are being forced to foot the bill for government's efficiency savings and inevitably, the net cost to the economy will be higher.

ACCA's views on the specific measures impacting SMEs in the Budget are as follows.

Struggling small businesses will be spared a rise in corporation tax from 21% to 22%, which was due to come into force next April. In fact, under announcements in the Emergency Budget, the rate will be cut to 20% for all companies making profits of up to £300,000. Around 850,000 firms will benefit from the tax cut, which Treasury forecasts say will cut a total of £3.8bn from their tax bills over the next four years.

ACCA welcomes the reduction in the small firms rate of corporation tax to 20%.

Plans to boost private sector investment in the regions, where the economy is more dependent on the public sector, formed one of the set pieces of the budget. According to the Chancellor, between 1998 and 2008, for every private sector job generated in the North and Midlands, 10 were created in London and surrounding regions. Therefore, small business start-ups outside the south will be offered a £5,000 tax break on National Insurance contributions for each of the first 10 people they employ.

12. http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100622/debtext/100622-0006.htm

13. OECD, *Businesses' Views on Red Tape*, 2001.

ACCA believes that the regionalisation of National Insurance contributions, could confuse issues for small businesses struggling under the burden of the system. We believe both that a consistent approach should apply across the country and that all small businesses, not just start ups, should be able to take advantage of the scheme.

There will be an extension of the Enterprise Finance Guarantee scheme (EFG), providing a boost for 2,000 small businesses. Under the scheme the coalition government offers to guarantee of 75% of loans to small firms with turnover of £25m or less. It allows small companies to spread tax payments over a longer period.

ACCA welcomes the extension of the EFG, which has helped to counter some of the negative effects of tighter lending conditions. However, consideration must now be given to the design of a more permanent finance guarantee scheme that could come into operation after the EFG extension period.

VAT will be increased to 20% from next year.

ACCA believes that this is a negative step as the rise will hit small businesses disproportionately. SMEs will find it more difficult than larger firms to absorb this hit.

There is also an increase in the insurance premium tax from 5% to 6%.

ACCA's view is that this is additional burden for small businesses.

The chancellor also announced that the Capital Gains Tax 'entrepreneurs' relief' rate of 10% on the first £2m of gains will be extended to the first £5m.

ACCA welcomes this measure.

RECOMMENDATIONS

- Consideration must now be given to the design of a more permanent finance guarantee scheme that could come into operation after the Enterprise Finance Guarantee extension period.
- Research has shown that the smallest companies incur five times the administrative burden per employee than larger firms[14] and so every effort must be made to increase efficiency of the tax system.
- ACCA recommends that there should be a greater level of transparency and stability in the tax system where small businesses feel that the tax system will support their competitiveness. Above all, the coalition government should employ the 'Think Small First' principle in all of the legislation they bring in, rather than creating legislation appropriate for larger companies and adapting it for small businesses.

14. OECD, *Businesses' Views on Red Tape*, 2001.

Tax and sustainability

The coalition government had already outlined some potential changes to green taxes ahead of the Emergency Budget. These measures would not only be effective in raising revenue, but would also assist the UK in meeting its environmental goals.

Although some of the proposed measures have been announced, such as a Green Investment Bank which will generate more money for investment into renewable and 'green' technologies such as wind farms, other environmental initiatives have so far taken a back seat to the VAT increase and other tax measures and ACCA is concerned that there was nothing about the need for a rapid transition to a low-carbon economy in the Emergency Budget.

What the coalition government has pledged to do since then is to explore changes to the aviation tax system such as switching from a per-passenger to a per-plane levy, and to look at reforming the climate change levy to provide more certainty and support to the carbon price. The Office for Budget Responsibility will also assess the effect of oil price fluctuations on the public finances over the summer, before the coalition government looks at options for a 'fair fuel stabiliser' – which would see fuel duty fall when prices go up, and vice versa.

Many of these proposals are subject to consultation and the full proposals will not emerge until the autumn. ACCA hopes that this process will help to ensure that policies are able to deliver low carbon investment at the speed and scale required to tackle climate change, while also creating the industries and jobs of the future.

Furthermore, there will be at least 25% cuts in the non-ring fenced government departments responsible for delivering environmental outcomes and a low carbon UK, Defra and DECC, which may negatively impact the delivery of measures to protect the environment. The coalition government must ensure that moving to a low carbon economy is not slowed down by cutting the budgets of these departments.

RECOMMENDATIONS

- Although ACCA appreciates the challenge the coalition government faces in terms of the economy, sustainability issues cannot be put on 'the backburner' and any planned changes will also need to ensure a consistent approach for the long term.
- The coalition government must ensure that moving to a low carbon economy is not slowed down by cutting the budgets of Defra and DECC.

Tax fairness

Making his Emergency Budget speech, George Osborne said that: '...everyone in our society has had to make a contribution...' and that he had '...tried to be as fair as possible.'[15]

Deputy prime minister and Liberal Democrat leader Nick Clegg added that the Budget had taken: '...difficult decisions in an honest and fair way and with the clear stamp of Liberal Democrat values running through it.'[16] citing examples including the restoration of the pensions and earnings link and the tax boost for the low paid.

ACCA has considered the fairness of specific measures announced so far by the coalition government.

THE VAT INCREASE

The VAT rise from 17.5% to 20% was largely inevitable due to the tight financial situation. The Treasury's own figures suggest that the VAT increase, which will raise circa £13bn, will mean an average tax hike of about £400–£450 for those on average incomes, with the poorest 10% losing £200 and the richest £1,800, although the poorest will be hit harder than most as a percentage of their income. Increasing VAT is a regressive step, as it hits the poorest hardest. For example, Office for National Statistics[17] figures show the richest 10% spend £1 in every £25 of their income on VAT, while the poorest 10% spend £1 in £7. The VAT rise will also hit pensioners and those who have to rely on benefits, as they will not gain from other tax breaks announced today.

Verdict: unfair for the poorest.

INCOME TAX

Mr Osborne has announced plans to help the low paid by raising personal tax allowances by £1,000 in April to £7,475, taking an estimated 880,000 people out of the tax system and give millions of basic-rate taxpayers a tax cut of £170 per year. This will benefit low earners, with almost 880,000 expected to be taken out of the income tax net. But higher earners have been hit and freezing the rate at which this is paid will pull more in through fiscal drag. The change will be worth £170 a year to 23m basic-rate taxpayers, according to the Treasury and is a step towards the Liberal Democrat pledge to raise the income tax threshold to £10,000. However, the level at which higher rate tax kicks in will be reduced by £1,500 to £42,375. This will prevent higher-rate taxpayers benefiting from the personal allowance increase. That move, combined with the decision not to increase tax thresholds with inflation next year, could mean up to 700,000 more people paying higher rate tax.

Verdict: fair for the poorest.

COUNCIL TAX

Council tax may be frozen for one year from April 2011 in England, but extra funds will only be offered to councils which keep their own costs down. This is worth about £35 per household.

Verdict: neutral for the poorest.

TAX CREDITS

Although tax credits will be reduced for families earning over £40,000 next year, low income families will receive more Child Tax Credit. This is worth £20.30 per week for a first child and £13.40 for others at an annual cost of £2bn. Although this is not a huge amount, there will be an extra £150 a year for the poorest families, through changes to family tax credits. Tax credits were always going to bear the brunt of the coalition government's changes; both Nick Clegg and David Cameron indicated they wanted to see cuts during the election campaign.

Verdict: fair for the poorest.

15. http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100622/debtext/100622-0006.htm

16. http://www.libdems.org.uk/news_detail.aspx?title=Liberal_Democrat_policies_at_the_centre_of_the_budget_says_Nick_Clegg&pPK=a3056093-81bf-47b0-b9c3-e55ca98b8109

17. http://www.statistics.gov.uk/downloads/theme_social/Taxes-Benefits-2007-2008/Taxes_benefits_0708.pdf

Conclusion

Faced with a deficit of £155bn, George Osborne might have been tempted to impose large increases in taxes in order to reduce it as quickly as possible. However, this might have increased avoidance and caused public uproar. Instead, the coalition government's approach to reducing the deficit combines hikes in some taxes with large cuts in public spending.

This will put some areas of the economy under more pressure, which consequently means that issues such as thorough consultation with business, reducing complexity, increasing stability in order to enable business planning and ensuring that all existing tax legislation is up to date and necessary, become key.

Especially important but often forgotten, governments should also ensure that they employ the 'Think Small First' principle when considering tax legislation.

On the administrative level, ACCA believes that there is much that could be done to improve the design of tax legislation, from removing the bulk of corporation tax legislation from the Finance Bill to removing outdated laws and ensuring that there are clear metrics to gauge whether the tax system is being appropriately and sufficiently reviewed.

ACCA is keen to engage with policy makers and to offer its expertise on these issues wherever it can add value, and we urge the coalition government and Parliament to consider the recommendations outlined in this paper and to take action to implement them.

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