



# SME Budget Proposals

## THE ISSUE

Small business tax administration is one of the key areas where Government can make a significant impact on the competitiveness of UK's small and medium sized enterprises (SMEs). Latest government figures show that almost all UK businesses (99.9%) are small or medium sized (0-250 employees), accounting for more than half of UK employment (58.7%) and turnover (51.1%). Their contribution to the UK economy is therefore vast but despite this, there is a need for greater recognition amongst policy makers that compliance burdens, such as tax, are not absorbed by these businesses in the same way as their larger counterparts<sup>i</sup>.

Research has consistently shown that the compliance cost of tax regulation is one of the top SMEs' concerns, incurring net costs that may be several times higher than those born by large businesses.<sup>ii</sup> Their limited capacity and lack of specialist staff (such as in-house financial expertise) invariably affect their ability to deal with the tax system. The Small Business Research Trust Quarterly Surveys consistently consider Tax as the main challenge to business growth. In their most recent survey, 63% of small businesses consider tax as one of their key concerns with one in five of micro businesses citing taxation as their main barrier to growth.<sup>iii</sup>

Addressing the complexities and inequalities of the tax system and the consequent disproportionate impact on SMEs ought to be recognised as a significant factor in the success and growth of small firms, and consequently to the overall health of the UK economy. Looking towards the forthcoming budget announcement, ACCA Small Business Committee and ACCA Tax Committee outline the measures they would like to see announced by the Chancellor of the Exchequer in the forthcoming 2007 Budget. ACCA Small Business Committee and ACCA Tax Committee are a unique voice on small business and tax issues with a wide membership including leading accountants, academics and representatives from the main small business organisations.

## RECOMMENDATIONS

1. Government should recognise how the small business community can help play an active role in working towards achieving a number of Government targets and policy initiatives by encouraging the greater participation of SMEs through appropriate tax incentives. There are a number of policy areas which would particularly benefit from this approach including:

- Micro business can make a valuable contribution towards meeting the Government skills agenda as recommended by the Leitch Review if adequate incentive measures are provided. Currently, however the self employed are unable to benefit from the Train to Gain scheme, excluding 3.5 million enterprising individuals. In addition, firms with fewer than 10 employees are not able to benefit from the leadership and management programme for SMEs, excluding 24% of UK enterprises. These schemes must be available to small businesses across the board and should not ignore a quarter of the working population.
  - Government's Welfare to Work strategy which aims to assist the long-term unemployed and disadvantaged groups into employment should be modernised. This includes raising the 'earnings disregard', which has remained the same for 25 years, and under which individuals can earn just £5 a week after which they lose their entitlement to benefits. Raising this limit would encourage more business start-ups as a way into self-employment and motivate individuals to move out of the informal economy. In the current environment, it does not pay for many who are on benefits to be entrepreneurial and start up their own business.
  - Another measure to encourage work and enterprise would be raise tax thresholds substantially for both income tax and NI. These are applied at far too low a level and are a contributory factor to the benefits trap and a disincentive to honest enterprise.
  - Additionally , SMEs ought to be incentivised to take on the long-term unemployed but have the risks associated with such employment shared by government.
2. A modernised approach is needed within the tax system to reflect the growing demands on small business owners and the nature of the businesses they run. For example, increasing numbers of small business owners operate from home and networking or meeting with clients is often conducted through lunch meetings. Government needs to ensure that businesses which incur costs in this way are able to claim them as part of their usual business expenditure, rather than disallowing them by classifying them as entertaining.
  3. The level of change in the tax system and its overall complexity is often one of the major concerns for small businesses. The difficulties experienced by small business owners in keeping up with compliance requirements could be eased significantly if Government adopted a longer term approach to tax policy with less frequent Budgets, and introduced sunset clauses for anti-avoidance legislation. This would ensure that tax compliance is more manageable for small businesses and would go some way towards deleting unnecessary and outdated anti-avoidance legislation.

4. Commitment in last year's budget to address the technical differences in the rules for pay as you earn (PAYE) income tax and National Insurance should be addressed as a matter of priority. Small business owners would benefit from the merger of the two "accounting" systems especially as the future implementation of a National Pensions Savings Scheme would further complicate the system and create a three tier payment system. Government reforms in this area are long overdue and we would urge the HMRC to address the National Insurance simplification issue as a matter of urgency.
5. There are currently significant delays to the issuing of new VAT registration numbers, which typically takes several weeks and in some sectors up to several months. This can severely interfere with normal trading practices and these delays ought to be addressed urgently.
6. Tax incentives currently available ought to be more effectively promoted to small businesses. For example, levels of business transfers could be stimulated through effective promotion of tax incentives such as the Capital Gains Tax Business Asset Taper Relief. Businesses also need to have some level of certainty that the reliefs which are currently available will continue in years to come, instilling greater confidence in the tax system and encouraging enterprise, secure in the knowledge of a stable and reliable tax system.
7. Government also must ensure that future tax policy changes do not adversely affect the business succession climate and any potential future reforms, such as Inheritance Tax, do not jeopardise the business transfer environment. We also consider that the UK is falling behind the rest of Europe in providing tax free business transfer. Business Property Relief, Agricultural Property Relief and VAT exemptions do not cover all the tax costs. For instance Stamp Duty Land Tax may still be payable among other taxes and these should be removed from causing tax obstacles to succession planning. The issue of succession will become ever more urgent as the "baby boomers" are now starting to retire and we should, as a matter of national and European policy, ensure that their businesses continue so that the employment levels are maintained.
8. Business angel finance has proved an effective mechanism for closing finance gaps and enabling the UK's most innovative new companies to develop and grow. An important tax relief that has facilitated this angel finance has been the 'Enterprise Investment Scheme.' First introduced in 1994, this scheme has been broadly successful yet many investors argue that it is particularly complex. Worse still, investors can lose the relief they were entitled to when firms they invest in acquire further growth finance. We recommend that, provided the investment remains risk capital, investors should keep their relief. Further clarification of the existing rules should also be provided.
9. Businesses in deprived areas suffer greater problems when accessing finance due to a number of factors including a scarcity of collateral and a more fragile local economy. There is a problem in the provision of bank lending given the high unit cost of making small loans<sup>iv</sup> and the comparatively high credit risk associated with some of these businesses. Micro-credit schemes and Community Development Finance Institutions

(CDFIs) often represent the best source of lending for these entrepreneurs. However CDFIs have not attracted the scale of investment originally envisaged; only £38 million of a £1 billion target in five years. We therefore recommend that the Community Investment Tax Relief (CITR) which provides 5% relief per year over 5 years is raised to 8% per year over 7 years, in order to better meet the needs of SMEs in deprived communities.

10. Achieving a level-playing field in the tax system is imperative if the Government is to ever meet its own target of making the UK the best place in the world to start and grow a business. In general, the tax burden falls more heavily on a small business. An example being the VAT loophole for Low Value Consignment Relief that is unfairly exploited by some larger businesses, distorting the market and making it extremely difficult for small businesses to compete on an equal footing.
11. The tax benefits associated with small businesses adopting limited company status ought to be equalised through the tax regime, as the level of taxation is now an influencing factor in the business decision to incorporate for tax rather than operational reasons.<sup>v</sup> Government ought to recognise how this affects business decisions and equalise taxation of the different legal structures, including similar protections for personal home ownership that are currently enjoyed by directors of limited companies but not by sole traders and partnerships. In addition to this, the tax-free disincorporation ought to be introduced in order to redress the imbalance in the current system.
12. Access to good tax advice can play a crucial role in the competitiveness of SMEs and the skills which are offered by qualified accountants, such as ACCA members in practice, and other professional advisers ought to be adequately recognised. Considering that the Government is currently spending some £2.6 billion a year on supporting small business with limited success<sup>vi</sup>, Government ought to consider whether making better use of private sector resources would be a more effective measure. Professional advisory services, such as tax planning, could be subsidised for certain groups enabling access to valuable external advice to greater number of businesses.
13. Finally, tax policy should **not** be used as a political tool to generate 'quick wins' for political parties. This approach seriously harms small businesses and more generally, affects the relationship between the tax payer and the tax system. There ought to be a greater level of transparency and stability in the tax system where small businesses feel that the tax system will support their competitiveness, regardless of the political environment in which they operate..

### ACCA'S INVOLVEMENT

ACCA (the Association of Chartered Certified Accountants) is the largest and fastest-growing global professional accountancy body with 296,000 students and 115,000 members in 170 countries. Independent research shows consistently that qualified accountants are the first choice advisors of small businesses. ACCA has over 100 years' experience of working with and providing professional advice to small and medium-sized firms. In the UK over 56% of ACCA members (over 25,000) work in or for SMEs.

## ENDNOTES

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<sup>i</sup> Chittenden, F., Kauser, S. and Poutziouris, P. (2002), Regulatory Burdens of Small Business: A literature Review, Small Business Service and Poutziouris, P, Chittenden, F., Oakey, R. P, and Michaelas, N., Taxation and the Performance of Technology Based Small Firms, Small Business Economics, Volume 14, Number 1, 2000, pp 11-36.

<sup>ii</sup> Chittenden, F., Kauser, S. and Poutziouris, P. (2002), Regulatory Burdens of Small Business: A literature Review, Small Business Service

<sup>iii</sup> SBRT Quarterly Survey Q4 (2006)

<sup>iv</sup> National Strategy for Neighbourhood Renewal: Policy Action Team 3 (1999)

<sup>v</sup> Chittenden, F., Sloan, B., (2006), Budget Report 2006, The Small Business Service

<sup>vi</sup> National Audit Office, (2006), Supporting Small Business