ICAS Autumn Statement Representation

7 October 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. Evidence provided by ICAS aims to inform in a positive and constructive manner. ICAS is apolitical and will not take a stand for or against a particular political position. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in the design and implementation of fiscal measures, and to point out operational practicalities. Our representatives also contribute based on the collective experience of decades of work which ICAS members and staff have undertaken with both the UK and Scottish Parliaments and tax authorities, and other European and worldwide institutions, on a shared agenda that seeks better outcomes for all stakeholders.

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3. This representation sets out some policy suggestions for the Autumn Statement reflecting the key concerns of the ICAS Tax Committee. We would be happy to discuss these further with members of HM Treasury or HMRC.

4. We are grateful for opportunities to raise issues through the normal tax consultative process but there remain a number of wider policy matters that we believe should be addressed, which are outlined below.

5. In summary, our members continue to ask for stability, certainty and significantly less change to the UK tax system. However, a number of factors militate against this, including the following:
   - The Brexit vote generates a wider backdrop of uncertainty
   - The implementation of significant new tax powers that are being devolved to Scotland and to other areas in the UK will inevitably mean change and potential differentiation, and
   - The Making Tax Digital agenda sets out to be transformational but will create change in both process and underlying legislation to an unrealistic timescale.

6. Against this background we would like to see the following areas (discussed in more detail below) addressed in the Autumn Statement and longer term tax policy making:
   - Develop intergovernmental machinery to ensure proper cooperation and coordination in the implementation and operation of devolved taxes;
   - Extend the timetable for Making Tax Digital, start on a voluntary basis and ensure agents are properly included in the process at every stage;
   - Give an indication of the intended strategic direction for business taxes;
   - Consider tackling underlying distortions in the tax system which drive complexity and frequent change;
   - Avoid frequent and unpredictable changes to the corporate tax regime which are likely to deter foreign investment rather than encourage it;
   - Consider setting up an independent pensions/retirement savings commission which will seek to achieve long-term stability for the UK pensions system;
   - Give the Office of Tax Simplification a role in challenging HMRC and Government on whether proposed tax changes will achieve simplification or at least are not introducing excessive and unnecessary complexity;
   - Ensure HMRC is adequately resourced to provide acceptable service levels to all taxpayers, to implement measures to tackle tax evasion and to rebuild trust in HMRC.

Devolution and tax policy

7. The devolution of a number of different tax powers has gained momentum in recent years, with measures such as those contained in the Scotland Act 2016 and in the Corporation Tax (Northern Ireland) Act 2015, and we believe there should be stronger coordination around such devolution. This is needed to make sure the decentralisation of taxes is sensibly managed across the UK and particularly so if further powers are to flow back from the EU. There is also a need to make sure that the consequences of devolving tax powers are properly taken heed of in future UK tax legislation, and to ensure there is effective, timely intergovernmental cooperation around administrative and budgetary procedures.

8. A clear understanding of the intricacies of policies that contain both reserved and devolved elements is needed. For instance, income tax has been partially devolved meaning that this involves joint responsibilities. The UK Parliament is responsible for the tax base, ie what is considered to be income, how it is measured, and the decision to provide reliefs from the tax. All these elements can impact on the amount of income tax raised. With the Scotland Act 2016, the Scottish Parliament will be responsible for the rates and the bands of income tax, allowing it to exert some control over how much is assessed for collection and from which taxpayers (e.g. basic or higher rate taxpayers) in order to pay for Scottish expenditure.

9. Consideration of devolved tax powers and the exercise of the remaining reserved powers requires recognition that the different components are intricately intertwined. This applies to taxes, such as income tax, and also to other measures such as the apprenticeship levy (which is collected through UK powers but disbursed by the devolved jurisdictions).

10. There need to be sound intergovernmental relationships between UK and devolved fiscal teams so that they all have an understanding of prospective measures and can plan accordingly. For example, advance knowledge of proposed UK measures that may impact on a devolved jurisdiction, such as an increase in the personal allowance at UK level, needs to be shared to permit effective planning. Likewise, with any new UK proposals that may result in a devolved tax being indirectly affected, as happened with the new SDLT 3% higher rate on additional residential properties. To manage this effectively requires intergovernmental machinery that is designed to facilitate the sharing of powers between different governments and their respective tax authorities.

Making Tax Digital

11. ICAS supports the overall objectives of 'Making Tax Digital' (MTD), as set out by HMRC in December 2015. The four 'foundations' are laudable goals, but we have significant reservations about the timescale and the mandatory approach and particularly so for small and medium enterprises. To describe MTD as a reform of tax compliance obscures the reality that it is a colossal IT and change management project affecting some 5.4 million businesses and many more taxpayers.

12. Use of MTD should be voluntary. Whenever a secure, user-friendly digital solution addresses a tedious chore, it should attract willing users among businesses and individuals alike. Also, if a voluntary approach is adopted, those creating the new system face the invigorating challenge of making it attractive and easy for users. To achieve this, they are likely to set realistic goals, aiming initially at those most likely to become enthusiastic early adopters. By trailblazing the system in this way, they should create a natural following among others eager to experience the advantages they might otherwise miss. This would also focus attention on addressing HMRC service standards for taxpayers and businesses.

13. ICAS is concerned that MTD proposes that full accounts may be dispensed with for many unincorporated businesses. However, accounts are not simply about tax. They are about profitability, the need for accurate information for decision making, and lending and creditor decisions. We believe it is a mistake to view the proposed changes in tax-only terms and that whilst cash accounting should be a useful simplification for micro businesses, it is not appropriate for more substantial businesses. Without full accounts

there is a danger that far too many businesses will have a lack of understanding, and hence control, over their affairs.

14. Making Tax Digital is something of a misnomer. The key business impact is making accounting digital, within narrowly defined parameters. For business currently using accounting software and preparing quarterly management figures, the transition to quarterly digital tax submission may be relatively straightforward. The businesses primarily falling within this category would be those with a turnover of around £1.5 million or more. For small business, particularly those with a single owner manager, the challenge in terms of available time, and the costs of maintaining real-time digital records and making quarterly tax submissions is immense. Rather than tackling the tax gap, there is a grave danger of currently compliant businesses moving into the shadow economy.

15. For some small businesses and individuals non-compliance may become increasingly attractive. The 2016 Budget announced the introduction of a £1,000 allowance for property income and a £1,000 allowance for trading income from the 2017 to 2018 tax year. The new allowances will mean that individuals with property income below £1000 or trading income below £1,000 will no longer need to declare or pay tax on that income. This is clearly an administrative simplification for those who will never make more than these amounts but those who go on to establish more significant businesses will not have been encouraged into compliance from the start. At the point they realise they have exceeded the £1,000 allowances they will be confronted with a mandatory digital reporting regime, backed by penalties. This will impose significant costs and some may well be tempted to opt out.

16. We also remain very concerned about the negative messages about tax agents which are being suggested by publicity around MTD, and also the exclusion of agents from viewing their clients' online accounts. Development of agent services consistently runs behind the development of the business and personal tax accounts. This is causing major problems for agents which need to be addressed urgently. We believe agents are vital to implementation and every effort should be made to work with agents and ensure that they can assist their clients in dealing with the huge challenge of MTD.

Strategic direction for business taxes

17. The 2010 Corporate Tax Roadmap was very useful in setting out long term strategic aims and direction of travel for corporation tax - and was widely welcomed. In 2014 ICAS called for a Business Tax Roadmap to provide a similar long term strategy for business taxes. Unfortunately, the Business Tax Roadmap issued earlier this year seemed to take a far less strategic approach, appearing more like a list of short term policy proposals. It would be helpful if the Autumn Statement included some indication of the long term strategy for business taxation.

The current tax regime can incentivise tax avoidance

18. A business tax strategy could include a review of the different treatment of unincorporated and incorporated businesses. Corporate tax rates have been significantly reduced and are set to reduce further – this has resulted in a substantial difference between the corporation tax rate of 20% (due to reduce to 17%) and the highest personal tax rate of 45%. The absence of a level playing field distorts decisions about business structure and leads to frequent legislative changes, such as the recent changes to dividend taxation, driven by the need to tackle some of the problems attributable to this differential in rates.

19. A strategic review could also consider similar problems for businesses caused by differences between the CGT and income tax rates. The additional and higher rates of income tax are currently 45% and 40% whereas the CGT rates are 28%, 18% and 10% where entrepreneurs' relief applies – and the CGT rates for most assets are due to reduce further. This clearly creates an incentive to extract value from a company in forms subject to CGT rather than income tax. The recent Finance Act therefore introduced changes to the rules applying to distributions in a liquidation, including the introduction of a TAAR, to try to tackle perceived abuses arising from this differential. Unfortunately, as noted in our response to the Company Distributions consultation the new rules will adversely affect non-tax motivated transactions and could inhibit genuine commercial

transactions – particularly as the clearance mechanism ICAS called for has not been provided.

20. It is not helpful for the majority of compliant businesses if underlying distortions in the tax system, like those highlighted above, constantly lead to anti-avoidance legislation being introduced to tackle abuse. This causes problems for compliant businesses which want to comply but struggle to understand the resulting complexity and find it hard to deal with frequent changes. By contrast determined 'avoiders' are likely to ignore or to seek to bypass the rules. Consideration should be given to overall business tax strategy and the possibility of removing some of the distortions – rather than continuing with the cycle of increasing distortion, followed by exploitation which is then counteracted by more anti-avoidance legislation.

Certainty and Stability

21. Over recent years the corporation tax rate has been significantly reduced, as part of government plans to make the UK corporate tax system competitive. It is clearly important that the UK has a regime which attracts investment. However, some of our members are now concerned that continuing reductions in the corporation tax rate are being pursued at the expense of certainty and stability. For example, the Budget announced a further reduction in the corporation tax rate but also introduced the unexpected changes to the rules on company losses for larger companies discussed below. These changes could have unintended consequences for companies subject to certain regulatory regimes. Frequent and unpredictable changes also tend to deter foreign investment rather than encouraging it. There needs to be a sensible balance between reducing rates and counterbalancing changes which may have detrimental results.

22. Another area of the tax system which would benefit from a period of stability is pension taxation. There have been major reforms to pension tax in the last few years; some of these linked to pension freedoms have been welcomed but others (frequent changes to the annual and lifetime allowances for example) have added complexity. At the same time we have seen increases in the State Pension Age, the abolition of contracting out and the introduction of auto-enrolment. The 2016 Budget announced the introduction of lifetime ISAs which may be seen as supplementary to, or an alternative to, traditional pension saving by some. Frequent changes and complexity make long term planning for retirement difficult. ICAS has called for the Government to consider setting up an independent pensions/retirement savings commission as a standing advisory body which seeks to achieve long-term stability for the UK pensions system and cross-party consensus.

Tax Simplification and the work of the Office of Tax Simplification

23. We believe that too little is being done to address complexity in tax policy and legislation. There seems to be a reluctance to simplify existing legislation and a tendency to introduce additional complexity in new legislation.

24. ICAS responses to several recent consultations have noted that in spite of lip service being paid to simplification the actual proposals either fail to simplify the tax regime in question, or worse, propose to introduce greater complexity. For example, the introduction to the recent consultation 'Reforms to corporation tax loss relief: consultation on delivery' referred to the Government's specific objective of 'simplifying and modernising the tax system'. The proposals in the consultation document however outlined an excessively complex approach to imposing restrictions on loss set off for the largest companies. Also, as noted in our response to the consultation, it makes no sense to introduce such complex, major changes at a time when the OTS is conducting a review of the corporation tax computation and is due to report before Budget 2017.

25. ICAS supports the work of the Office of Tax Simplification (OTS) and welcomes the fact that it has now been placed on a permanent footing.

26. ICAS is concerned that the OTS conducts extensive research and consultation to identify problems with an area of the tax system and makes suggestions for change, but the opportunity for genuine simplification is then missed. For example, the current proposals for 'simplification' of the tax and National Insurance treatment of termination payments. Some OTS suggestions have been adopted in part but these are mainly those which will increase revenue, rather than the more radical reform of the entire regime proposed by the OTS, which could have included far more simplification. Additionally, whilst some aspects of the proposals do represent simplification other aspects will make the treatment of termination payments more complicated, producing new uncertainties for employers and employees.

27. We believe that if the government is serious about simplifying the tax system there should be a role for the OTS in considering all forthcoming legislation. In the past it has examined existing law with a view to simplification measures but the Government continues to introduce further complexity with each new Finance Act. The OTS should be asked to consider proposed changes, preferably before they go out for consultation, to challenge HMRC and Government on whether the proposals will achieve simplification or at least are not introducing excessive and unnecessary complexity.

28. Finally, we believe an analysis should be carried out of the cost and take up of reliefs, including a review of whether they have had the intended behavioural impact. The OTS carried out a significant project on tax reliefs in 2011 but very few reliefs have subsequently been removed, and new reliefs have been introduced. Reliefs determined to be ineffective should be removed because they add complexity for very little benefit. All new reliefs should also include a 'sunset clause' so that they are reviewed after a set time; if they are not delivering the expected benefits they should be allowed to expire.

Administrative Burden of Taxation and HMRC resources

29. In our briefing paper on the recent Finance Bill (now the Finance Act 2016) we noted that there appears to be a lack of understanding, amongst policy makers, of the operational impact of tax policies on businesses and individuals. We would like to see more business and behavioural awareness amongst policy makers.

30. The administrative burden of taxation is shifting increasingly to taxpayers – VAT and PAYE always placed administrative burdens on businesses which were then increased and extended to individuals by the introduction of self-assessment. Real Time Information (RTI), and now Making Tax Digital, continue this trend without any apparent appreciation of the effect this will have on businesses and individuals.

31. We believe it is vital that HMRC is properly resourced. HMRC staffing levels have been significantly reduced since 2010. This is already having an adverse impact on service levels provided to smaller businesses and individuals who do not have access to the personal service provided by HMRC's customer relationship managers (large companies) or High Net Worth Unit (wealthy individuals). Recently there have also been worrying signs that even the service provided by customer relationship managers to large businesses is deteriorating, with companies experiencing increased turnaround times and difficulties in obtaining responses.

32. Lack of HMRC resources may undermine key measures to tackle tax evasion. For example, common reporting standards should assist tax authorities by providing information about taxpayers across borders. It is vital that HMRC has adequate resources to be able to analyse the data comprehensively and to follow up where necessary.

33. The UK tax system depends on a degree of trust and voluntary compliance – coercion alone is not enough. The erosion of any personal contact between the majority of taxpayers and HMRC undermines this vital trust. It also fuels distrust of those, like large companies, who still have a personal relationship with HMRC. We comment on 'Making Tax Digital' (MTD) above but in the context of HMRC resourcing we believe it is essential that MTD is not used as an excuse to reduce HMRC staff numbers further in the short to medium term. It should instead be used to free up staff for interaction with larger

numbers of taxpayers to provide vital assistance to those struggling with the transition to MTD and to rebuild trust in HMRC.