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 20,000 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.

General comments

3. ICAS welcomes the opportunity to give evidence to the Treasury Select Committee. Our answers to the specific questions raised are set out below. We would be happy to discuss our replies in more detail if this would be helpful.

4. In addition to the questions below, we believe that consideration needs to be given to the impact of devolution on tax policy. The decentralisation of certain tax powers, such as income tax to Scotland and corporation tax to Northern Ireland, lacks co-ordination and there does not appear to have been much consideration of any unintended consequences such as tax competition being introduced between the regions of the UK.

5. In relation to tax policy there are often mixed messages from government due partly to a lack of transparency about tax and who pays it, how much is raised and how different taxes interact with one another. The ‘triple lock’ has not been helpful in this respect.

6. There are particular mixed messages for companies and whether Britain offers a competitive environment. For instance, a competitive corporation tax rate has its attractions, but it is not the only aspect of tax policy that is important to companies. Certainty and stability also matter and these appear to be being eroded. Some of our members have concerns that whilst the corporation tax rate keeps being reduced this is accompanied by unexpected changes to the rules, for example, the recent announcement on company losses that affects larger companies. There are also onerous, complex anti-avoidance provisions that all companies have to deal with, not just those trying to avoid tax, and the anti-avoidance messaging can appear to be anti-business. International business may become more cautious about investing in the UK.

7. Companies dealt with by the Large Business Office are often envied by other businesses due to the Customer Relationship Manager (CRM) system. However, recent feedback from companies that do have CRMs suggests that the system is no longer working as well as it used to do and companies are finding it hard to get issues dealt with. Tax legislation is increasingly complex so companies which want to pay the right amount of tax, in the different jurisdictions in which they operate, need appropriate assistance from HMRC, either via their CRM or through other channels within the tax authority.
Specific Questions

Question 1: The making of tax policy

- To what extent, if at all, has the Treasury complied with the principles of tax policy, set out in the annex?

8. Where the approach set out in the 2010 document “Tax Policy Making: a new approach” has been broadly followed the results have been generally good and have produced workable legislation.

9. It is essential that adequate time is allowed at all stages of the consultation process and that wherever possible all stages are included (although in some instances where avoidance is involved we appreciate that this may not be possible).

10. The current ongoing consultations around the changes to Patent Box and the Deductibility of Corporate Interest Expense illustrate the benefits of proper consultation with stakeholders and should result in sensible legislation which delivers the desired results – compliance with the OECD BEPS requirements without putting UK business at a competitive disadvantage.

11. By contrast where the processes set out in the 2010 document are ignored the results are unhelpful to everyone. The FA 2015 changes to various aspects of entrepreneurs’ relief were rushed through without adequate consultation or Parliamentary scrutiny. This gave rise to numerous problems and extensive discussions between HMRC and the professional bodies. Retroactive changes have been announced in the recent Budget. However in the intervening period the uncertainty adversely affected genuine commercial transactions and structures.

- Have the entities involved in tax policy (HM Treasury, HMRC and the Office for Tax Simplification) performed adequately?

12. See our immediately preceding answer.

- Does the Treasury have the expertise to design tax policy? Does it make effective use of HMRC advice?

13. Our experience has varied according to the area of tax policy concerned. The Patent Box consultation mentioned above has benefited from the involvement of Treasury and HMRC experts who have also been proactive in talking to stakeholders with expertise. There have been other consultations where it appears to have been more difficult for the Treasury/HMRC to find relevant expertise internally.

14. We have some concerns about a lack of business and behavioural awareness within HMRC/HM Treasury. All too often, there is a lack of understanding of the operational impact of tax policies on businesses and individuals. For example, the administrative burden of taxation seems to be shifting increasingly to taxpayers – RTI, Making Tax Digital etc – without an appreciation of the effect this will have on businesses and individuals.

- What simplification measures, whether or not considered already by the OTS, now need examination?

15. ICAS supports simplification measures and the work of the OTS and considers that more of its recommendations should be taken forward. For example the OTS work on reliefs identified the huge number of existing reliefs but very few were subsequently removed.

16. To determine effectiveness an analysis of the cost and take up of reliefs should be undertaken, including a review of whether they have had the intended behavioural impact. Those which are infrequently claimed should be dropped – they add complexity for very little benefit. All new reliefs should 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.
17. Much complexity in the tax system is caused by the perceived necessity for detailed anti-avoidance legislation to prevent abuse. Unfortunately this causes problems for compliant taxpayers who want to comply but struggle to understand the resulting complexity – whereas ‘avoiders’ ignore or seek to get round the rules anyway.

18. Tackling complexity is also not helped by distortions in the tax system caused by the differential between CGT rates and income tax rates. Currently the additional and higher rates of income tax are 45% and 40% whereas the CGT rates are 28%, 18% and 10% where entrepreneurs’ relief applies. We commented in our response to the recent consultation on Company Distributions that in view of the differentials between income tax and capital gains tax rates many taxpayers will be inclined towards the less costly option (ie extracting value in forms subject to CGT rather than income tax). Despite the notion of ‘fairness’, very few taxpayers will want to pay more tax than they are legally required to do. As a result more anti-avoidance rules are introduced, leading to more complexity. This will be exacerbated by the further reduction in CGT rates announced in the Budget - to 20% and 10%.

19. In addition to distortions caused by the disparity between income tax and CGT rates differing tax treatments also cause confusion and complexity and distort behaviour. For example:

- Different treatment of the employed and the self-employed. Different NIC rates, different rules on expenses etc.
- Different treatment of dividend income which is only partially addressed by the forthcoming changes to dividend taxation.
- Lack of alignment between tax and NIC rules for employers and employees.
- Different treatment of businesses carried on by companies and by individuals/partnerships (including the differential between the rate of Corporation Tax which it has just been announced will be reduced to 17% and income tax which is currently 20%, 40% or 45%).

20. The Government’s “triple lock” ie the promise not to raise income tax, national insurance or VAT rates during this parliament is also leading to additional complexity. Instead of a straightforward rate increase to a major tax, various less transparent and more complex revenue raising measures are being resorted to in the current Finance Bill. A similar approach can be seen to some relieving measures. For example, instead of a straightforward increase in the IHT threshold the highly complicated residence relief has been introduced.

**Question 2: The problem of the shrinking tax base**

- *To what extent is the UK’s corporate tax base being eroded as business is increasingly conducted globally?*

21. We do not believe that there is conclusive evidence that the corporate tax base is being eroded. As evidence to the committee revealed, opinion is divided.

22. The latest official statistics for corporation tax receipts show that in spite of the steady reduction in rates receipts remain high. Total net corporation tax receipts in 2014/15 were £43 billion. This is an increase of 7% from £40.3 billion in 2013/14 and brings total net corporation tax receipts back up to the amounts received in 2010/11 (£43 billion) and 2011/12 (43.1 billion). Corporation tax receipts were higher in 06/07 (£44.8 billion) and 07/08 (£47 billion) but this was before the recession. Prior to 2005/06 receipts were below £40 billion. Given the reductions in rates it is possible that the corporate tax base has actually been broadened rather than eroded. It is true that as a percentage of GDP corporation tax receipts have been falling since the mid-1980s but it is not clear that this is due to erosion of the corporate tax base.

23. Additionally, whilst corporation tax is important, attracting new business to the UK through a competitive CT regime should increase other tax revenues such as VAT and employment taxes. There needs to be a sensible balance.
24. As noted in our general comments above some of our members are also 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 unexpected changes to the rules on company losses for larger companies. This could have unintended consequences for companies subject to certain regulatory regimes. Again, there needs to be a sensible balance between reducing rates and counterbalancing changes which may have detrimental results.

- Are there particular sectors that are more mobile and do those sectors make a disproportionate contribution to overall tax yield?

25. Digital businesses are more mobile but in spite of BEPS Action 1 there is as yet no global agreement on the approach to digital and whether there is an obvious ‘home’ for these businesses. This is an area which needs additional international work.

- What other changes are occurring in the UK tax base, and how should the UK Government react to these changes?

26. The UK Government has already taken extensive action to tackle avoidance – see our answer to question 4 below.

**Question 3: Radical solutions to the problem of the shrinking tax base**

- Given the inevitability of some sort of tax gap and of differences in interpretation of the “correct amount of tax”, should the Government address the problem of the shrinking corporate tax base through more radical changes to the tax system?

27. As noted above we do not believe that it is clear that the corporate tax base is shrinking. On the tax gap we note that according to HMRC’s latest report (published in October 2015) the overall tax gap has actually been falling in recent years – from 8.4% in 2005/2006 to 6.4% for 2013/2014. The largest reduction in this period was in the Corporation Tax gap which halved from 14% in 2005/2006 to 7% in 2013/2014 of relevant tax liabilities. According to HMRC there had been a sustained downward trend for both large and small businesses, with the overall reduction driven mainly by large businesses.

- If so, what type of corporate tax structure could ensure that revenue is collected in accordance with the principles of tax policy and in a way which minimises the risk of base erosion? For example, should business taxation be based on turnover rather than profits?

28. See our comments below on the BEPS project which is tackling the risks of base erosion. The EU has recently announced proposals which go beyond BEPS but we consider that the current focus should be on implementing the OECD BEPS proposals which have extensive international support without any EU additions at this stage.

29. We consider that there are considerable obstacles to a business tax based on turnover, including:

- Small businesses and start-ups would be liable to tax despite making little or no profits. This could give rise to negative cash flows.
- Different businesses have different margins - basing tax on turnover would mean that low margin businesses pay a disproportionate amount of tax.

- Should the Government consider other forms of taxation (such as the proposals of the 2020 Tax Commission) when considering how to raise tax in the future, particularly from businesses and wealthy individuals?

30. No.

- Is there a case for a wholesale review of capital taxation?
31. There may be a case for a review of capital taxation and the interaction between IHT and CGT. However one cause of complexity in the tax system is constant change, which is particularly unhelpful in an area of tax where long term planning is important. The benefits of any changes would therefore have to be weighed against the disruption caused (for example to business succession planning).

**Question 4: Other mitigations of the problem of the shrinking tax base (addressing tax avoidance and non-compliance)**

- *Have recent initiatives (GAAR, the accelerated payments regime and notifications under the Disclosure of Tax Avoidance Schemes) been effective in tackling avoidance?*

32. Yes. GAAR, DOTAS and accelerated payments have largely eradicated the aggressive, heavily marketed tax avoidance schemes of the past. HMRC has also had considerable success challenging avoidance through the courts. We make some further comments on policy below.

- *To what extent will projects such as the OECD’s Base Erosion and Profit Shifting (BEPS) project and common reporting standards help in tax collection?*

33. It is hard to quantify the precise impact of BEPS at this stage. If consistently implemented by all major economies it should assist in ensuring that profits are taxed where there is economic substance and in tackling tax evasion. The current challenge is to ensure that governments around the world put the OECD’s measures into practice. The current focus should be on implementing BEPS consistently across all major jurisdictions, rather than pursuing policies that go beyond BEPS but which lack international agreement.

34. Common reporting standards should assist tax authorities by providing information about taxpayers across borders. From a UK perspective it is vital that HMRC has adequate resources to enable it to analyse the data comprehensively and to follow up where necessary.

- *What further international cooperation is required?*

35. See our immediately preceding answer – it is important that BEPS is implemented consistently by all major jurisdictions.

- *March 2015 Budget contained a challenge for the tax professional bodies to take a greater lead in setting and enforcing clear standards around the facilitation and promotion of avoidance. Is that likely to succeed in encouraging more responsible behaviour from tax advisors? Do tax advisors need to be regulated?*

36. As noted above, the most aggressive tax avoidance schemes are a thing of the past. ICAS is one of the signatory bodies to Professional Conduct in Relation to Taxation, and has been working with the others to meet the challenge.

37. In addition, ICAS has issued its policy regarding the principles and responsibilities that are required to ensure that the tax system works properly for all interested stakeholders, which is detailed below.

- **The law must work properly**
  We must have simpler, better legislation because it is the law passed by Parliament that the Courts apply and determines the tax HMRC can collect. HMRC has no power to collect sums just based on money being tight, or on prevailing practice by tax advisers, nor on a subjective concept of “fair share”, but only by what the law determines. The accepted principle of us all paying the right tax at the right time has been overshadowed recently, but the right tax means the law has to be right; this means clear and unambiguous drafting of Parliament's intentions.
High standards of behaviour are required all round
From CAs, tax advisers, tax administrations, businesses and individuals: ICAS members are governed by a Code of Ethics and the Professional Conduct in Relation to Taxation guidelines. ICAS supports measures being introduced by government to ensure all those involved in giving tax advice should be qualified and part of the regulated environment. Regulation will not solve the issue of poorly drafted tax laws.

Better information is needed
The public at large deserves to be better informed on tax, with clear explanations being given of business tax complexities and current tax practices. The media bias towards historic and extreme cases is misleading taxpayers as to current levels of tax compliance in the UK. ICAS also has a responsibility in educating and informing the public.

Tax policy needs clarity
Governments need to be clear on the underlying principles which govern their tax policy approach. They also need to be clear on which taxpayers benefit from their tax policies and why; for example when tax relief for high earners or large corporates supports business investment or employment creation.

Businesses need to be transparent
Businesses should consider providing accessible and coherent narrative explanations of their overall tax contributions (not limited to corporation tax) in response to the demand for greater transparency in corporate reporting.

Criminal tax evasion needs greater focus
The debate on tax avoidance vilifies those operating in a legal fashion, whilst ignoring the systematic criminality of those in the black economy. We need to get our priorities clear and focus on the fact that tax evasion costs a lot more than tax avoidance. HMRC should publicise the top 10 things the public can do to tackle evasion, in the same way as they did for avoidance.

- What, if anything, should be done to maintain or improve a culture of compliance or a sense of tax morality among the full range of taxpayers?

38. See our immediately preceding answer.

Question 5: The administration of tax

- Has the merger of the Inland Revenue and Customs and Excise been a success, and have there been too many subsequent reorganisations within HMRC?

39. The formation of HMRC has broadly been helpful for large companies and high net worth individuals – and their agents. There have been some recent issues with the Customer Relationship Manager (CRM) approach due to changes of CRM and lack of capacity. However in general both these groups have benefited from having single points of contact with HMRC which has facilitated efficient working. We have also had positive feedback in relation to some specialist units in HMRC, such as EIS.

40. We do however have concerns about agents and clients who do not have access to the CRM system for companies or the HNWU for individuals. Due to the disappearance of local offices they now have to deal with an impersonal service from HMRC, busy helplines (often subject to lengthy waits and failed call-backs) and it is becoming increasingly difficult to get issues resolved. Cuts to HMRC resources and staff since the merger mean that many experienced staff have left, there is little local knowledge and it is hard to obtain responses from HMRC within appropriate timescales.

41. HMRC has stated that agents are an essential and valued part of tax compliance but feedback from our members indicates that it does not feel as though this is the case. In particular agents have been excluded from Making Tax Digital which has been designed solely for taxpayer access – agents currently cannot access their clients’ online records even though the clients want them to deal with HMRC.
42. The messages being given to the public about the ‘death of the tax return’ and ‘making tax simpler’ imply that agents are unnecessary. We believe that agents will be essential in the digital transformation and the tax authorities should be actively and positively acknowledging the contribution of tax agents.

- Are the Treasury’s and HMRC’s plans for “Making Tax Digital” (as set out in the “roadmap” published on 14 December 2015) adequately designed and acceptable?

43. ICAS supports the overall objectives of Making Tax Digital, 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.

44. While many of the aspects of this proposed digital future hold promise, there is a significant gap between the current digital capability of many businesses and the level of digital and accounting competence required to make the plan work. We have concerns about the likely impact on agents and taxpayers and around the role and resourcing of HMRC. In particular we believe some small businesses (and individuals) are likely to be pushed into non-compliance due to an inability to use the mandatory digital systems in this over-ambitious timeframe. We are also concerned about the negative messages about tax agents which are being suggested by publicity around Making Tax Digital and the current exclusion of agents from viewing their clients’ online accounts. We believe agents are vital to implementation and every effort should be made to work with agents.

45. The challenge of mandatory digital reporting on the proposed timescale is immense. Imposing mandatory quarterly filing by 2020, and in some cases by 2018, allows insufficient time to effect the revolution that is needed, particularly in small business attitudes and capability. The proposed requirements are likely to impose significant costs on business.