ICAS response to the House of Lords Select Committee on Economic Affairs

Call for written evidence on
‘Taxing corporations in a global economy: is a new approach needed?’

26 April 2013
About ICAS

1. The Institute of Chartered Accountants of Scotland ("ICAS") is the oldest professional body of accountants. We represent nearly 20,000 members who advise and lead businesses. Around half our members are based in Scotland, the other half work in the rest of the UK and in almost 100 countries around the world. Nearly two thirds of our members work in business, whilst a third work in accountancy practices. ICAS members play leading roles in around 80% of FTSE 100 companies. ICAS is also a public interest body.

Introduction

2. ICAS welcomes the opportunity to contribute to an informed debate on one of the most topical tax issues of the day; the tax contribution that businesses should make to UK tax revenues.

3. ICAS believes that much of the recent media and political debate has been ill-informed, sometimes deliberately and provocatively so. We are concerned that ill-informed commentary, often in direct contrast to stated policy intentions about the UK aiming to have a highly competitive tax regime, are unhelpful to international businesses investing in the UK. If there is to be a new approach to taxing corporations in a global economy it must embrace developments in international policy and agreements in a cohesive fashion; provide adequate resources for HMRC to implement policies at a domestic level; and issue higher quality communications.

4. Any examination of business tax in the global economy needs to be based on the facts and a clear view of the current situation. The appointment of Professor Michael Devereux as Specialist Adviser for the inquiry is welcomed given his highly informative work, particularly "Corporation Tax in the UK" in 2011. We note in particular the observation in that report that the majority of UK corporation tax charges were paid by companies under the control of foreign multinationals. Without wishing to pre-empt Professor Devereux's contribution, we would expect that the factual analysis necessary for, and preparatory to, this debate includes the shape and trends of the UK corporation tax base, illustrations of the impact of particular tax incentives or reliefs on effective and cash tax rates, and the relative contribution of corporation tax in relation to other UK taxes to the UK Exchequer.

5. The opportunity arises through this process to inform taxpayers, the media and other stakeholders simply and honestly about those corporation tax facts, the international business landscape, and why the UK tax policy decisions made are considered appropriate. The difficulty in explaining a tax regime as complex as that in the UK is perhaps one of the reasons that there is such limited understanding or information in the debate at present. That is no longer a reason to avoid the debate, but the communication role is not just for individual businesses, but for their industry and representative bodies, the tax profession, Government and HMRC as well. ICAS members are willing to contribute constructively and their observations are included below.

International tax competition and the UK

6. It has been a matter of policy for successive UK Governments to make the UK an attractive business location for business investors and the tax system has been used as one lever in that policy. As examples, the deductibility of interest on borrowings, the holding company regime, the latest controlled foreign company’s regime, and the patent box tax rate, were all introduced or amended in recent years to improve the attractiveness of the UK tax system for international businesses.
7. Anecdotal evidence is that a sizeable number of international businesses are considering locating, or returning, to the UK because of this increased attractiveness of UK corporate tax regime. The extent, and cost and benefit of recent policy changes are worth further exploration and analysis to arrive at a balanced view, particularly when the full range of taxes paid by international companies (employers national insurance contributions and VAT for example) are taken into account.

8. The UK has not been alone in this; a range of competitive stances are taken by different countries through their tax system, whether the headline rate of corporation tax, the scope of the tax base, or special tax incentives. There is a point however at which the increasing competitiveness could become a destructive “race to the bottom”; wherever reducing rates decreases overall tax revenues below a level required to meet social payment obligations for any or all of the competing countries. Whether or where this happens on an international basis is not something we have the expertise to analyse or predict, but it may take international co-operation to call a halt to the general downward pressure. National governments may also decide to adjust the focus to employment, property or indirect taxes for example.

9. International businesses have discretion in where to locate and how to structure their operations internationally, and the tax cost of operations is one, but usually only one, of the factors. It is unrealistic to consider that any taxpayer will consistently and deliberately inflate their tax costs. Locational decisions may ultimately be around the rate of tax to be paid, and the timing of tax payments around the world; global tax planning in this regard is a matter of economic choice and it is difficult to see how tax system changes can alter this as long as countries operate on an individually competitive basis.

10. The Organisation for Economic Cooperation and Development (“OECD”) agreements on international tax matters are now out of date; the guidance does not adequately reflect recent commercial developments, such as in internet based businesses, nor in the seemingly increasing values attributable in a supply chain to ownership of intellectual property. These manifest in, respectively, challenges seen around the lack of UK taxable presence or “permanent establishment” when internet businesses sell directly to customers in the UK, and from the extraction of UK tax deductible royalties paid for intellectual property held outside the UK tax net. The UK Government’s participation in the forthcoming OECD discussions on Base Erosion and Profit Shifting seek to address these and we support the Government’s approach of seeking international agreement.

11. It is one thing to arrive at an agreement in principle between different jurisdictions on the principles of allocating profits between them; it is another for the taxpayer to achieve a financial settlement through the “competent authority” procedure on that split. Any increased scope or focus arriving out of the forthcoming discussions will need to be resourced and applied in practice, which may take some time.

**Corporation tax in the UK – the current state**

12. The rationale for taxing corporate bodies was eloquently described in the 2011 Institute for Fiscal Studies Mirrlees Review “*Tax by Design*”. ICAS considers the administrative efficiency of collecting profits belonging to shareholders as soon as they are realised, rather than paid out, remains a valid one.

13. In 2011 ICAS submitted a response to the Economic Affairs Committee Finance Bill Sub Committee supporting the Government’s approach to tax policy making, particularly encouraging predictability and stability in the tax system.
14. Our detailed comments on the November 2010 publication “Corporate Tax Reform; delivering a more competitive tax system” from HM Treasury and HM Revenue & Customs were included in that response. One of the most widely welcomed measures to emerge from that was the “Corporate Tax Roadmap”, setting out the policy principles and directions, including what would not change. It seems appropriate, less than three years on, to consider firstly whether and how that approach has been implemented, its success or otherwise, and whether the approach simply needs further elaboration in the light of the current business landscape, rather than launch into major reform.

15. The feature of the UK tax system which arguably is most in need of attention in the current debate is transfer pricing. OECD agreements, as reflected in UK tax legislation, require an arm’s length approach to be adopted in cross-border transactions and are the primary means of ensuring each regime achieves its fair share of revenue. As noted above, the scope of such agreement requires updating.

16. At a practical level for HMRC, we seriously question whether transfer pricing specialists exist in sufficient numbers within HMRC to adequately address the issue of the operation of the current rules, even before any revisions may be implemented. For intellectual property royalties, it has been suggested that it has become “almost standard” for taxpayers to be permitted a deduction for a payment of 5% of turnover, rather than any lower or routinely or rigorously tested amount.

17. Corporation tax is a self-assessed tax and generally ensures that companies will undertake an often costly transfer pricing review on their activities to determine a sustainable filing position. However, for the inexact science transfer pricing is, a sustainable filing position may be at one end of a range whilst a rigorously debated position could sit somewhere else. It is reported by our members that the level of challenge by HMRC on transfer pricing outside large businesses is extremely limited. Rather than rely on anecdotal reports, it would be interesting to see an informed assessment of the scope of the work of the HMRC specialists as well as the tax revenue benefits, in relation to costs, that greater HMRC resources in this area might deliver even if more taxpayers were moved along that transfer pricing range.

18. As noted above, the “Corporate Tax Roadmap” has given certainty and stability to the UK tax system, in the main. It contained an assurance that the overall deductibility of interest would not be considered again in the life of the Parliament, due to the significant changes in the introduction of the worldwide debt cap limits on deductibility already introduced from 2010. Whilst debt financing can be more tax effective than equity, depending on the investor, we are not convinced that removing the preferential tax treatment is necessary. The transfer pricing treatment of debt is another area where effective resourcing of HMRC may achieve UK tax revenue protection.

19. As a matter of pragmatic financing as well as stability of the business environment, we do not expect there to be any appetite for radical reform of the corporate tax system. It would also risk a reduction in tax revenues which have been broadly in the low £40bn per annum for the last seven years, regardless of recent rate reductions.

Corporation tax in the UK – future structural options

20. Whilst open and wide ranging enquiry into the future direction of corporate tax is welcome on an intellectual and progressive basis, we consider the reality is that substantial step change could be risky. On balance we have not seen any evidence that would recommend a change in basis from the profits basis.
21. **Source based:** An interesting exploration could be on whether tax which should be based not just on an entity’s accounting profits, but on its activities in certain areas. In particular, the value extracted through the extractive industries or precious natural resources might be taxed on a production value basis. The risk is that this may be seen as an additional or alternative tax source, rather than a replacement for corporation tax.

22. **Turnover based:** ICAS would not favour a move to shift the corporate tax base from profit to sales unless there was a move by the majority of OECD countries which levy similar taxes to do the same. The disruption to business structures and certainty would be considerable and the benefit difficult to ascertain. Such a move would also eliminate the link between tax levied according to the ability to pay.

23. Struggling businesses, for example those in a start-up phase or beginning to commercialise valuable research and development, might have no funds to pay a tax, or such funds might have to be diverted from other areas such as pay and investment. Alternatively, the costs would be passed on differentially through the supply chain and could reduce the entities’ competitiveness, or increase costs, so the economic implications could be considerable.

24. This also needs to consider what is turnover? For an overseas company selling into the UK the intention would perhaps be to assess UK delivered turnover. Whilst tax would be gained on the turnover on UK imports, tax on profits from exports by UK businesses might be lost and the net benefit or cost would be the relevant one. Rules would also need to take account of specialist sectors, such as life assurance. Significant administrative effort would arise, although some information may already exist in relation to VAT on imports. A bigger question might be how HMRC might assess and recover tax due from an overseas based business selling to customers directly into the UK.

25. The consequence for international corporate groups, noted above as being the biggest payers of UK corporation tax, would be greater. The UK’s network of Double Tax Treaties would also have to be renegotiated due to the changed nature of the tax, or significant double taxation might arise on entities operating across jurisdictions. Overall this would add even more complexity to businesses, and vastly increase the administrative burden.

**HMRC and large businesses**

26. Large international businesses will generally have an HMRC Customer Relationship Manager (“CRM”) to coordinate the management of their UK tax affairs across the different parts of HMRC and different taxes. This engagement and contact process is generally regarded positively as it brings time and cost savings to businesses and greater knowledge sharing within HMRC.

27. Large businesses are generally dealt with by the most experienced HMRC staff. Andrew Park QC’s report in 2012 to the National Audit Office and the Public Accounts Committee was that he did not feel there were inappropriate agreements and therefore inappropriate relationships between HMRC and large businesses in general, and that is reflected by comments from ICAS members.

28. Businesses not served by HMRC CRMs, yet potentially with sizeable corporation tax contributions, receive much less attention and support; often less than they should.
Aggressive tax avoidance schemes

29. By the term “aggressive tax avoidance schemes” we take the question to be addressing artificial planning wholly within the UK tax system, rather than tax savings arising from the international tax system choices noted above. We understand the use of such schemes has decreased over the last few years.

30. The suggested reasons for this are; a sense of widespread planning having “gone too far”; the financial needs of the UK rendering such an approach less appropriate – “the dial has moved on acceptability”; the requirements of the Disclosure of Tax Avoidance Scheme (“DOTAS”); and a focus on corporate social responsibility.

31. ICAS provided comments in October 2012 in response to HMRC’s consultation “Lifting the Lid on Tax Avoidance Schemes” which addressed possible improvements to the effectiveness of DOTAS. These can be found at http://icas.org.uk/home/technical-and-research/technical-information-and-guidance/tax/tax-submissions/.

32. Broadly, ICAS supports HMRC in addressing its challenges with the DOTAS scheme, but suggested a review of its usefulness, with identification of the key factors that contributed most to the policy objective of countering tax avoidance.

33. In particular the very limited commentary follow up on submissions appears to have led to misperceptions around HMRC’s approach in practice to disclosures. For example, where a scheme has been disclosed to HMRC and has not been counteracted by legislation, perceptions form that it is open to use. For non-specialist taxpayers, as suggested recently in the press, “disclosed to HMRC” if not counteracted is perceived as “approved by HMRC”, and therefore acceptable. This is the opposite effect to that intended, where the expectation of counteraction and challenge, following disclosure, might have deterred some from entering into such schemes at the outset. Better communication was the recommendation to improve the credibility of the regime as a deterrent and steps have been taken as the wider public debate on this has developed.

34. In overall terms, HMRC’s aims of DOTAS should not just be to ensure it is provided with more timely and relevant information on tax avoidance, but that it should act, and be seen to act, promptly and effectively in counteraction and be more open about the DOTAS regimes’ performance and effectiveness measures.

35. The “naming and shaming” of promoters of tax avoidance schemes is in danger of being another popular phrase used without clarity of purpose or consideration of the optimum effectiveness of different policy options. Initial thoughts are that for some promoters “naming” could be the best free advertising they get, and “shaming” a non-event. The behaviours of concern would need detailed definition, and we note the ongoing difficulties in determining what is and is not “unacceptable tax avoidance”. A detailed consultation is expected this summer on this from HMRC and ICAS will contribute constructively, as we have in the past, to assist HMRC in achieving an effective policy decision.

Transparency of tax payments by multinationals

36. Most comments we have received from members on these proposals support voluntary actions being taken by organisations and question the need for statutory requirements. The rationale is that content should be determined by what is appropriate given the industry sector, business structure and public engagement profile already adopted. Many companies already offer wider information than is required by existing statute. There is a concern over commercial confidentiality and competitiveness if a very detailed level, such as project by project reporting, were to be required.
37. Many members report a greater awareness of the appetite for information on tax transparency and have no objection in principle to providing more relevant details, if they are useful and informative. Questions arise about what information is really important, and ICAS members have concerns over the bureaucracy and cost of any exercise. The most frequent concern was that in calls for greater transparency, commentators often ignored information already available within the statutory accounts. Adding to those disclosures, which might equally be ignored, was not seen as productive.

38. The amount of UK corporation tax paid in a year by a business is not necessarily informative of its approach to meeting its UK tax obligations. Additional details would have to be given to avoid misguided criticism. For example, a business making sizeable capital investment in infrastructure, which attracted capital allowances, could pay no current year tax. The accounting principles behind deferred tax provisions aim to address this concern, for anyone who seeks to read the accounts.

Small and medium sized enterprises

39. There seems little benefit to be gained from a different corporation tax regime for small and medium sized companies, as this can give issues of complexity as they grow from one regime to another.

40. We welcome the tax reliefs which have been provided to make the UK a more attractive place to start business, such as the Seed Enterprise Investment Scheme (SEIS). However, given the current economic situation there is still a need for a step change to encourage investors in SMEs.

41. Demand for growth finance needs to be stimulated. Large levels of cash are held in companies, which could be available to invest but are being held back in case the economy worsens, there is also increasing deployment of cash in share buy-backs, which tend to inflate the stock market rather than feed the real economy.

42. Wider targeted tax incentives should be aimed at encouraging those companies and high net worth individuals who are sitting on large amounts of cash to invest – a catalyst to unlock the funding blockages for SMEs at a quicker rate than is presently occurring.

43. To facilitate access by the SME sector to some of the billions of pounds in personal savings accounts in UK banks (at low interest rates) we need to push lending by high new worth private individuals to SMEs. A suggestion is that the interest they receive on loans for three or more years to SMEs should be eligible for tax relief. We would also suggest extending the eligibility criteria of EIS to remove restrictions on non-executive directors. This would help to mitigate the problems of attracting non-executive directors to EIS companies as the conditions of eligibility for EIS relief are a minefield.