



ICAEW REPRESENTATION 198/16

TAX REPRESENTATION

SIMPLIFICATION OF THE CORPORATION TAX COMPUTATION

ICAEW welcomes the opportunity to comment on the progress report and call for evidence [Simplification of the corporation tax computation](#) published by the Office of Tax Simplification in November 2016.

This response of 30 December 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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MAJOR POINTS

Key point summary

1. ICAEW welcomes the opportunity to comment on the Office of Tax Simplification (OTS) progress report and call for evidence [simplification of the corporation tax computation](#) published in November 2016.
2. We are pleased to see that simplification of corporation tax is being considered well before corporates are introduced into Making Tax Digital (MTD), compared to unincorporated businesses where simplification measures were consulted on by HMRC alongside MTD for unincorporated businesses. However, we believe that while some of the proposals within this consultation document could simplify tax for incorporated businesses, the details and timetable for implementing any planned simplification measures should be considered in concert with the plans for MTD. To make changes without MTD in mind will be confusing and could actually increase the burden on companies
3. We welcome simplification where it is achievable, however we are concerned that too many different sets of rules for different business structures and sizes could lead to confusion. We are aware that the OTS is no longer taking forward its Lookthrough proposal, but that a formal paper will be written on SEPA (Self-employed with Protected Assets). This is in addition to the existing regime for unincorporated businesses (which may or may not choose to adopt the cash basis) and the current regime for corporates. We note from the MTD consultations that HMRC has raised the suggestion of “simpler reporting” for unincorporated businesses, which would eliminate the need for some adjustments to be carried out. If the OTS does propose simplification measures for corporate entities, it will be important to consider how any changes are relevant to the other business structures described above.
4. We expect to see the number of incorporations increase in the next 12 months. In addition to the usual business reasons for incorporating, some of these will be due to the new income tax rules for taxing property income, some because tax rates generally are lower for corporate structures, but others will be businesses seeking to delay the start date of MTD. At present incorporated businesses are scheduled to come into MTD in April 2020.

RESPONSES TO SPECIFIC QUESTIONS

ADJUSTMENTS BETWEEN ACCOUNTING PROFIT AND CT PROFIT

Q1a: Considering these adjustments, where does the burden feel disproportionate to the outcome or value?

5. We have considered the adjustments set out in para 2.2 of the OTS document and consulted with our members. We have identified a number of adjustments which could be removed to simplify the calculation of tax adjusted profits.

Accrued pension contributions and remuneration

6. We believe that simplification could be achieved by removing the need to disallow accrued pension contributions not paid by the year end and accrued remuneration that has not been paid within 9 months of the year end. The record keeping burden is disproportionate and tax rules should follow the accounting principles in this particular area.
7. We accept that these rules were originally introduced as anti avoidance measures, but any abuse is likely to be possible only by smaller owner managed enterprises and the restriction should not be necessary for larger companies. One solution might be to extend the time periods for payment to have been required.

Pension annual allowance

8. Given that the pension annual allowance has reduced over the years we think that the pension spreading rules for companies should be re-evaluated. This is an issue more for close company contributions to participants pensions than for larger entities.

Legal and professional fees, capital or revenue

9. A disproportionate amount of time is spent determining whether legal and professional fees are capital or revenue in nature. The rules are based on legislation and facts of case law. A refined set of rules would reduce the administrative burden.

Payment of interest

10. From 6 April 2016, banks and building societies are no longer required to tax individuals at source on their interest income. We note Finance Bill 2017 introduces draft clause 12 to extend the rules to other common interest sources such as open ended investment trusts, authorised unit trusts and investment trust companies.
11. We believe the rules should be extended to companies to remove inconsistencies in the treatment of interest payable. This would remove the need for many companies to complete and file forms CT61.

Q1b: Which adjustments are not clear in their purpose, or don't fully align with business activities?

Transfer pricing

12. From 1 April 2004, and following a series of judgments by the European Court of Justice, in particular Lankhorst-Hohorst GmbH v Finanzamt Steinfurt C-324/00 ([\[2003\] STC 607](#), ECJ), s30(2) Finance Act 2004 applies the transfer pricing provisions to UK-to-UK transactions. As the UK makes plans for Brexit and with a flat rate of corporation tax in the UK, there is now an opportunity to reflect on whether transfer pricing adjustments between UK companies are still required.

Sundries and materiality

13. Much time is spent analysing small balances on sundry expenditure accounts and small provisions. While we accept that materiality in the context of large businesses could mean that large sums are involved in absolute terms, for small companies the amounts are trivial.
14. Accounting adjustments will always have been subject to materiality and it would be helpful to explore how tax might follow this to save the administrative burden for smaller companies. Following the accounting change from provisions to impairment the need for special rules on bad debts are unclear. The rules should follow GAAP for any company except for the smallest.

Changes in trading stock

15. HMRC's [Technical Guidance for small unincorporated businesses using the cash basis](#) at paras 27 and 28 provides an exemption from Sharkey v Wernher (1955) 36 TC 275 for those business. It allows the adjustments to trading stock taken for own use rule to be disapplied in calculating the profits of a trade on the cash basis. It goes on to state *'The intention is to simplify the treatment of stock taken for own use by small businesses using the cash basis. Current rules require stock taken for own use to be valued at market value, which may be more than was paid for the stock, and this places a burden on businesses both to determine a market value and make an adjustment.'*
16. The Sharkey v Wernher adjustment costs are excessive for other businesses too and as part of any corporation tax review should be reconsidered. The amounts involved are usually minimal and the logic of legislating the case rather than following the accounts is opaque to most business owners. Currently people are taxed on a profit from their own services and in some cases, such as restauraners who are being charged for a meal at sales value, the business owners do not understand why. A better treatment would allow an adjustment at the lower of cost and market value.

17. A similar problem applies to appropriation of development property stock to investment property where tax is due without any means to pay it. An election to transfer at book value should be available to mirror the election to holdover the gain when transferring from investment stock to development stock.

Scheduler system

18. For smaller entities the scheduler system can be an overly time consuming activity whereby the various forms of income and expenditure are split out into their respective schedules only for the resulting total taxable profit to be the same as they would have been had the process not been carried out.
19. For these smaller companies in particular, relaxing the rules on the schedules would reduce the burden that these businesses face, making compliance simpler and reducing the administrative cost burden.
20. Certain sectors in particular, for example, farming and estates, where land previously farmed is used instead to earn rental income, this can be particularly burdensome.

Charitable donations

21. Making charitable donations tends to form part of company's wider role in a community and should be encouraged.
22. Charitable donations should be allowed on an accruals basis.
23. The current system can mean that although a loss making company has made a charitable donation it will not get any loss relief for the contribution. This seems at odds with the wider responsibilities of the business and we believe the tax rules should follow the accounting treatment. This would also reduce the administrative burden on companies.

Entertaining expenses

24. We understand the original purpose behind disallowing the provision of basic meals was to prevent corruption. This aim is now better fulfilled by the Bribery Act and so in practice, the corporation tax disallowance is targeted only at minimal sums for 'hospitality', much of which is reciprocal in nature so has no significant beneficiary.

RELIEVING OR INCENTIVISING CAPITAL EXPENDITURE

Q2a: What key improvements could be made to simplify the current system and ease the administrative burden?

25. We do believe that there are areas of the capital allowances regime that could be simplified.
26. The combination of advances in technology and complex capital allowances rules can be a disincentive for some businesses to engage with the system. We have been told of cases where businesses choose not to invest in particular assets as they are unsure what relief they will be entitled to. Integral features are particularly complex and difficult for companies to understand without guidance from a capital allowances specialist. The information needed to make such claims can be difficult to obtain without commissioning a report, which can be too costly, especially for smaller companies.
27. The current higher rate of annual investment allowance (AIA) is usually sufficient to give immediate relief for most smaller companies. The cash basis, if it were allowed, would achieve the same effect.
28. For larger entities a fundamental review of the deductibility of capital expenditure is needed. Replacing capital allowances with accounts depreciation has been considered and rejected in

the past, but that does not mean that it should not be looked at again now. The government could incentivise certain favoured investment with an up-front deduction, if it chose to do so. We would be concerned however if another set of rules were introduced for one size of business, but not all, as this creates more complexity.

29. Fledgling businesses do not grow smoothly. For example, a medium business needing more premises does not buy/lease more to accommodate one additional employee, but will double floor-space holding the excess capacity while turnover catches up. This is a critical stage for an expanding business and very often a period of growth is followed by a period of retrenchment before stability or a resumption of growth occurs. The AIA may have been insufficient to cover the initial outlay needed, while the writing down allowance gives insufficient relief to help in future years.
30. Constantly changing the AIA can lead to complicated transitional adjustments which are time consuming for businesses and practitioners. It can also mean that two companies with same capital expenditure in a given period may receive different capital allowances based upon the timing of the expenditure. Changing the AIA frequently means that it is harder for businesses to plan their future capital expenditure and therefore they may not be fully incentivised to invest in assets for the business.
31. We believe that it would create a greater degree of certainty if the future rates of AIA were published a couple of years in advance in order for businesses to plan their expenditure with some degree of certainty.
32. The cost of second-hand features in buildings causes significant professional costs for little benefit and s198, Capital Allowances Act 2001 elections often cause disproportionate difficulties for the inexperienced business, with little overall change to the tax position.

Q2b: Do you think the current system incentivises businesses, or could this be done in a different way?

33. The current system doesn't always incentivise a business to invest in capital expenditure. A business will generally only buy what it needs and can afford. Tax relief may make it possible to buy a better and more expensive item, but good business sense should still dictate what is purchased and when.
34. The promise of tax relief can influence when the purchase takes place, so buying before the company's year end will bring the effect of the relief forward a year, or buying before a scheduled fall in the AIA can mean more relief, but this presupposes that the business owners will know the detailed rules or will have consulted with their adviser when drawing up their business plan. This is especially true for smaller companies.
35. At times, in order to maximise relief, capital expenditure can be spread over a number of years. Lower AIA limits in some years can act as disincentive to incur capital expenditure earlier and so expenditure is deferred.

THE SCHEDULAR SYSTEM

Q3: Are there any particular obstacles to its removal that we need to consider?

36. Moving away from a scheduler system would achieve simplification. Expenses would be deductible from total income rather than having to re-allocate, for example, interest payable.
37. The main obstacle would appear to be the treatment of pre-April 2017 losses. These are not currently pooled and are worked out with slightly different rules for each of the schedules. However, with the impending changes to the carried forward loss rules a much greater degree of amalgamation should be possible anyway in the future.

MAKING TAX DIGITAL – OPPORTUNITIES FOR A SIMPLER ROUTINE

Q4: With a particular focus on the CT computation process, what simplifications could be introduced to make the most of MTD and help its implementation?

- 38.** UK GAAP uses the concept of materiality to help reduce the information gathering process so that accounts show a true and fair view. If this concept is made available when preparing the corporation tax computation, it would effectively reduce the data gathering burden on companies. While materiality might not be appropriate for larger and more complex businesses it could be considered for smaller companies, for example those with turnover below the VAT threshold.

REPORTING AND COMPLIANCE PROCESSES THAT COULD BE SIMPLIFIED

Q5a: Are there aspects of reporting and compliance that could be simpler?

- 39.** A radical simplification measure would be to allow small companies to file a return rather like the self assessment income tax return. It would have a detailed business income schedule, rather like the self employment pages of the SA return and could be used by smaller privately owned companies, saving the need to file iXBRL accounts.
- 40.** Close company loan reporting could be simplified. Where a loan to a participator is repaid to the company, the tax could be reclaimed through the CT600 in the same way that the initial tax was collected.
- 41.** Quarterly instalments payments for companies should be calculated in a similar way to income tax self assessment where payments are based on the previous years' tax with the ability to reduce the quarterly payments if profits are envisaged to fall in the next year.
- 42.** It would be helpful for small businesses to have basic free software that is provided by HMRC and available for use by the company's agent, with simplified checklists built in so that common errors are dealt with before the CT600 is submitted to HMRC. Since use by agents has been removed, it has become impossible for accountants to file corporation tax returns for pro bono cases using free software unless they have the business owner present and that other person uses their own company login.
- 43.** The online system for companies in liquidation, administration and being struck-off needs to be digitised properly and the latter in particular should be exempt from the iXBRL online filing requirements.

Q5b: What are the benefits vs the risks of simplifying these processes?

- 44.** The benefits of simplifying the process would greatly reduce the administrative burden on the companies especially with Making Tax Digital on the horizon. Reducing the burden for smaller companies would allow individuals to spend more time concentrating on developing and growing their business.

SIMPLER TAX FOR SMALLER COMPANIES

Q6a: Could the complexity of the CT computation for smaller companies be almost entirely removed, whilst retaining a clear and simple set of incentives such as AIA? What benefits and concerns would this give rise to?

- 45.** This is an area that smaller companies would welcome. If the corporation tax computation was more aligned with the accounts, it would much simpler for smaller companies to calculate the corporation tax. This would allow businesses to prepare the return on a more timely basis and be able to budget for the corporation tax more easily while also have more time to focus on their core business. However, we would reiterate our concerns that creating a set of rules for small businesses and one for large businesses brings more complexity to the system. Rules would also need to be in place when a company transitions from "small" to "large."

Q6b: Could smaller companies operate a cash based system? What problems would this create? Would cash basis remove the need for AIA?

- 46.** A cash based system is not currently appropriate due to the need to prepare accounts on the accruals basis.
- 47.** Significant differences in rules between smaller and larger companies would not be attractive, because this would effectively entail two sets of rules and complications in dealing with the transition of companies between the two.

Q6c: Can we create a more appropriate series of definitions for small or simpler businesses, to better target policies and processes according to different needs and circumstances? Where would the boundaries be?

- 48.** The introduction of MTD will change the ways in which businesses operate, maintain records and report information to HMRC. We believe that while some of the proposals within this consultation document could simplify tax for incorporated businesses, the details and timetable for implementing any planned simplification measures should be considered in concert with the plans for MTD. To make changes without MTD in mind will be confusing and could actually increase the burden on companies.

Q6d: What are the implications of simpler CT for unincorporated businesses, where the rules read across to income tax, and how could these be addressed?

- 49.** No comment.

STREAMLINING TAX PROCESSES FOR LARGE AND COMPLEX COMPANIES

Q7: Our report identifies some priority areas for simplification: do you agree with this list (in paragraph 2.53) and are there other areas that you think should be included in our review, and why?

- 50.** No further comments.

INTERNATIONAL ASPECTS

Q8: Are there any international comparisons that can be made or case studies that we can learn from where other regimes have implemented simplifying changes to their CT system?

- 51.** We are not aware of any international comparisons.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).