

TAXREP 10/06

BUDGET 2006 REPRESENTATIONS

*Memorandum submitted in February 2006 to the Chancellor of the
Exchequer by the Tax Faculty of the Institute of Chartered
Accountants in England and Wales*

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1. INTRODUCTION

THE WIDER ECONOMIC CONTEXT

The ICAEW believes that in the Budget 2006, the Government should set in train steps to:

- enhance the rate of UK economic growth through improving the environment for business; and
- announce that it will use the forthcoming Comprehensive Spending Review to stabilise public spending growth in line with economic growth.

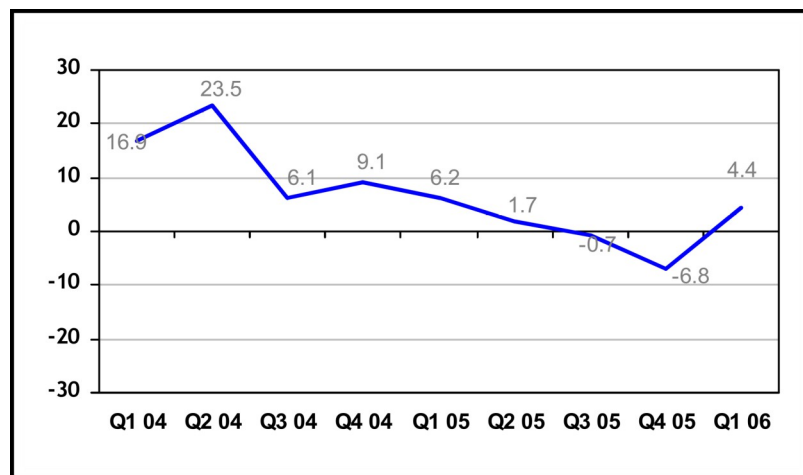
The Pre-Budget Report 2005 (PBR) correctly identified the need to raise the sustainable rate of productivity growth in the UK and gave appropriate importance to the long-term global challenges the UK faces, as already demonstrated by the economic rise of countries such as India and China. Investing in the skills of the UK workforce, tackling the numbers of people on disability benefit and reforming the public sector to raise productivity are appropriate responses to these global challenges.

The PBR did not recognise, however, the fundamental choice the UK faces over the proportion of its income that should be spent by the public sector in the medium and long-term. Nor did the PBR, we believe, adequately identify the potential to improve the UK environment for business investment and growth. In order to highlight that potential for higher growth, this year's ICAEW submission builds on the themes of our PBR submission to lay out practical steps for improving the tax system for large and small business alike and delivering a reduced burden of regulation where it most matters to the economy.

Measures to Enhance the Platform for Growth

In order to improve economic growth, long term higher business growth must be achieved. However, business confidence has declined significantly over the past two years. At the time of the 2005 PBR, the ICAEW's Business Confidence Monitor (BCM), indicating confidence for the year ahead, reached its lowest score since it began. It has risen in the latest quarter but is still well below the levels to which business and Government alike might aspire.

Figure 1: UK Business Confidence - ICAEW Confidence Index of Members in Business



The ICAEW BCM Index goes from a possible +100 to -100

The ICAEW Business Confidence Monitor is developed by surveying our members who work in businesses of all sizes in every economic sector, across the whole of the UK, and weighting the results to reflect the economy as a whole. It is through these members' experiences as owners, finance directors and entrepreneurs that the ICAEW understands the impact the tax system and regulation have on business growth.

Accountants believe that if these issues are tackled, business and the economy will be able to grow at a higher sustainable rate. This submission sets out a number of concrete steps the Chancellor could take

to systematically improve the environment for business growth whilst still maintaining sound public finances. The areas we have focused on include:

- The corporate tax system.
- Small business tax and regulation.
- Tackling tax fraud.
- HMRC and its relationship with the taxpayer.
- Tax credit support for low income working families.

A Note on the Balance of Public Spending

The recent indication by the OECD that the proportion of UK income taken in public spending is to rise above Germany's highlights the need for the UK Government to set clear objectives for an appropriate medium and long-term fiscal balance. At a time when some fiscal reform in Germany has reduced government receipts from 46.4 per cent of GDP in 2000 to a likely 42.1 of GDP this year, UK receipts have increased from 41.4% of GDP in 2000 to a forecast 42.4 per cent of GDP in 2006. The UK is still relatively well placed compared to the many other EU 15 countries. But we will increasingly also have to compete for investment with new accession countries, many of which have relatively lower public spending.

The ICAEW is concerned that higher public spending may be contributing to lower-than-hoped-for economic growth even after taking account of high oil prices and reduced house price growth. The PBR announcements of further tax charges on the oil industry, the proposed planning gain supplement and above inflation council tax rises will only increase the overall fiscal burden. Furthermore, the current levels of taxation and public spending, at a time of historically low unemployment, reduce the Government's ability to respond fiscally to any future global or domestic economic downturn. Whilst raising investment levels in education, health-care and tackling poverty have been justified, the ICAEW believes these goals now need to be enhanced through increased public-sector efficiency with spending no longer increasing more than GDP. Improved efficiency and higher sustained levels of UK growth will be the key to the long term ability of Government to fund ever-increasing aspirations for public services.

2. POLICY ISSUES AND RECOMMENDATIONS

GLOBAL COMPETITIVENESS OF THE UK CORPORATE TAX SYSTEM

The ICAEW believes that current UK tax policy is focused too much on the short-term need to fill Budget gaps and not enough on the long-term need to further encourage investment and growth in an increasingly global and competitive economy. The latter is also essential for maintaining sound public finances for the long-term. The need for more simplicity and certainty are areas where there is the most untapped potential for improvement.

We believe the increasing complexity of the tax system is hindering business and hampering growth. We believe there is a pressing need for action. We welcome the Government's commitment to tax simplification and recognise that simplification is not easy to achieve. We also recognise that any major change which benefits all in the long-term may be problematic for special interests in the short-term. The ICAEW is ready to assist HM Treasury in building the necessary business consensus to achieve real simplification and help overcome any short-term interests. We have suggested below a suitable method to help achieve this aim, the establishment a consultative Corporate Tax Forum, with membership drawn from business, tax experts and Government.

The tax system also lacks certainty, both in terms of how the tax rules apply in a particular situation and because the UK tax regime appears to be in a constant state of flux. Uncertainty undermines the ability of both business and Government to plan and make investment decisions, and increases the unpredictability of tax receipts. The decisions of the European Court of Justice and the UK policy reaction to them also continue to contribute to uncertainty. The proposed Corporate Tax Forum could help reduce uncertainty, by helping Government understand the impact of decisions on business and identify and prepare solutions to major challenges such as upcoming ECJ rulings.

The concern over certainty in the tax system has recently focused around the Government's measures to tackle tax avoidance. Despite some initial problems, the ICAEW believes that the new tax avoidance disclosure regime has contributed to a culture change in tax planning by businesses and tax advisers. The sharp drop in the number of disclosures is, we believe, an indication of that change in culture.

The ICAEW is therefore concerned about many of the proposed changes to disclosure rules announced in the PBR. Rather than again increase uncertainty and costs for the majority of businesses and advisers who are working in line with the new disclosure regime, we believe the Government should let the current scheme bed down. Instead, the Government should focus specific action on the minority not working in line with the intentions of the new regime, for example, those firms willing to run the risk of paying a fine rather than disclose schemes. Government should work with advisors and businesses on this issue because it is also not in the interests of the compliant majority to have a small majority stretching or disregarding the current rules.

Key Policy Recommendations

In tandem with its Comprehensive Spending Review, the Government should update and publish its policy strategy for business taxation over the same period. This will give greater certainty to business for forecasting and investment in the UK.

The Government should create a consultative Corporate Tax Forum that brings together representatives from business, professional bodies, Government and other stakeholders.

The proposed Corporate Tax Forum should be charged with determining whether the UK's tax system is fit for the purposes of an increasingly global economy, make recommendations as to how the fundamental structure can be made simpler and more certain and help build consensus for change.

The ICAEW is prepared to act as a convenor to bring this forum together, working in partnership with HM Treasury and HMRC.

SMALL BUSINESS TAXATION AND RED TAPE

In the latest ICAEW Annual Enterprise Survey, the cost of new legislation on business reached £7 billion. The proportion of that cost realised by micro businesses with under 10 employees went from 69% in 2004 to 73% in 2005. Whilst the measures of the 2005 Budget will not have fed through to these figures, they do still signify the challenge that Government faces to reduce the regulatory burden. Furthermore, the recent public debate over removing a statutory need for an OFR is largely irrelevant to the greater need for tackling the greatest regulatory issue - the need to free-up the smallest enterprises. Not only do they realise the greatest proportion of the administration cost of regulation but the full economic cost for them and the country is far greater. In a small business, it is the entrepreneur rather than the administrator whose time is distracted by new regulations.

We welcome the project being undertaken to measure the actual costs of complying with the administration burdens imposed on business by the UK tax system (and the complementary study being undertaken into non-tax issues across Government). This is a vital but still only preliminary step in tackling the current regulation led culture.

In our PBR submission, we made a number of policy recommendations designed to reduce the regressive costs of tax compliance for small enterprises which would help stimulate employment at the smaller end of the economy and generate growth. Subsequently, through discussions with Treasury, the ICAEW has further appreciated the need for a consensus across business and Government to take the difficult but necessary steps to simplify the tax system at the smaller end. The Institute is ready to assist in building this consensus.

The ICAEW has also supported the passage of the Legislative and Regulatory Reform Bill at its Second Reading in the House of Commons, but we highlighted fundamental concerns over the breadth of powers granted by the current Bill. The Bill represents an important step in enabling Government to carry out, and act upon, post-implementation reviews of regulations that impact upon business. The Bill does not, however, tackle the remaining, and more critical need, to consider alternative options to regulation and improve regulatory proposals before they are implemented. The ICAEW looks forward to further dialogue with the Better Regulation Executive on how this wider cultural change can be achieved.

Key Policy Recommendations

Government needs to ‘think small first’ throughout its better regulation plans and policy pronouncements. Small businesses represent the greatest need for change and getting it right at this level should also help medium and larger-sized businesses.

To take the difficult but necessary decisions to simplify tax for small business, Government needs to work with business organisations to build a consensus for change that will be resistant to pressure from vested interests. The first step is to develop a joint understanding of the need for small business tax to be fundamentally simplified in order to encourage growth.

Government needs to examine how the role of the Better Regulation Commission can be enhanced, both to give credence to efforts to reduce regulation and to provide a credible challenge and check to Departments’ plans to reduce regulation.

TACKLING TAX FRAUD

All stakeholders have a shared responsibility to help tackle tax fraud, which aside from being illegal undermines legitimate businesses. The ICAEW does not condone fraud under any circumstances and works actively against it in a number of ways but we do suspect that some taxpayers and intermediaries become unwittingly involved with fraudulent transactions (for example in Missing Trader Intra-Community Fraud (MTIC)). We have welcomed already the Government’s decision (as announced in a press release dated 26 January 2006) to tackle MTIC fraud by seeking a derogation from the European Commission to amend the UK’s VAT rules. We also believe improved education can help unwitting taxpayers and advisers to avoid such situations and assist in the wider tackling of fraud.

The ICAEW believes that there are a number of factors that may contribute to some taxpayers committing tax fraud, including the costs and complexity of compliance burdens. The Lord Grabiner Review in 2000 into the ‘informal economy’ made a number of recommendations, including new powers to prosecute tax fraud and the need for businesses to compulsorily register for tax/NIC within three months of starting business.

A more thorough review into the nature and causes of tax fraud and how it should be tackled is overdue. The measures introduced as a result of Lord Grabiner’s Report also need to be examined to see whether they have been successful in deterring and countering fraud. A thorough examination of the costs and benefits of various methods to tackle fraud and its results should help to inform the current review into HMRC’s powers. Business and tax professionals have a large stake in seeing fraud reduced and so it is essential that these issues and possible solutions are considered jointly with taxpayers and their advisers.

Key policy recommendations

There needs to be improved education for businesses and intermediaries about what they should look for in order to deal with fraudulent individuals and businesses. There should also be more effective targeting of those who perpetrate tax fraud.

There should be an in-depth review into the causes of tax fraud and the ways that it can be tackled. Government needs to work more closely with the many stakeholders who also wish to see tax fraud reduced.

HOW HMRC DEALS WITH TAXPAYERS

The ICAEW's PBR submission supported the Government's desire to encourage more use of e-services and we are awaiting with interest the final report of Lord Carter's latest review. But we are still of the opinion that more needs to be done to remove the barriers that discourage taxpayers from using electronic services. Before further moves to make e-services mandatory, HMRC needs to address the current barriers to the take-up of electronic services. These include:

- the need for adequate capacity at peak filing times;
- the need for robust and reliable systems;
- a user friendly interface; and
- that taxpayers can make full and complete disclosure.

We remain convinced there is a need for a new Taxpayers' Charter/Bill of Rights, and note that many other countries and the OECD support such an approach. This could be included into the HMRC review of powers and taxpayers safeguards to which we have extensively contributed. Otherwise, this project appears to be heading broadly in the right direction and we look forward to continuing this work.

We also welcome the separate commitment in the Pre-Budget Report to a new Taxes Management Act. This will build upon the powers review and should help facilitate HMRC's provision of a unified service. We welcome the commitment to consult on this issue.

Key Policy Recommendations

The Government should create a Taxpayers' Charter which defines the relationship between HMRC and taxpayer, setting out rights and responsibilities for both parties. Full consultation and testing with end users would be essential.

The development of e-services should be assisted by an advisory body that includes independent stakeholders who represent end users. This will help ensure this crucial development of the UK tax system enhances rather than undermines the relationship between the taxpayer and the tax authority.

The Government also needs to continue to consult on the proposed New Taxes Management Act and this work needs to be undertaken in conjunction with the ongoing HMRC powers review.

SUPPORT FOR WORKING FAMILIES

The ICAEW believes that effective operation of tax credits and support for childcare is essential for supporting the most vulnerable in our society.

We remain concerned that childcare tax policy is being developed without proper consideration of its interaction with tax credit policy. Unless the two are considered together, this could put vulnerable working families in a difficult financial position. The tax/tax credit reliefs and rules for childcare are also still too complicated. We now have tax relief for childcare vouchers, exemption from income tax

for employer provided childcare and the tax credit rules for childcare costs. The existence of these separate regimes makes it difficult for parents to understand and discourages take-up. Further, the introduction of childcare vouchers have opened up considerable differences in treatment between the employed and self employed, thus creating distortions and unfairness.

We welcome the announcements that were made in the PBR to reduce the uncertainty of the operation of the tax credits system and reduce the likelihood that tax credits will have to be paid back. However, we remain concerned that the system should be designed so as provide finality at the date of payment. We are also concerned that the proposed reduction in the time period for notification of a change in circumstances from three months to one month is likely to prove problematic in practice.

Key Policy Recommendations

Childcare policy and its interaction with tax and tax credits needs to be reviewed in detail in order to simplify the rules, remove anomalies and reduce unfairness.

Government needs to examine whether the tax credit system can still be improved to give more finality at the point of payment in a more cost efficient manner.

The Government should not proceed with reducing the notification period of changing circumstances for tax credits from three months to one month

3. ANNEX

THE ICAEW AND ITS TAX FACULTY

The ICAEW works in the public interest to promote enterprise, innovation and sustainable growth in a socially responsible business environment. Our strength and knowledge are drawn from the expertise of our members who hold world class finance qualifications. They work in every sector of the economy, size of business and public body, from global company boardrooms and government departments, to small businesses and charities

On tax matters, the ICAEW's expertise is drawn from its Tax Faculty. It brings together the expertise of members dealing with tax issues in business as well as the tax profession. It is concerned with the practical implications of taxation, particularly the impact on business and the economy, as well as the principles of good tax law

FURTHER CONTACT DETAILS

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