

Thursday 3 August 2017

Dear Paul,

**RE: TAX COMPLEXITY**

Thank you for setting out your key areas of focus for the remainder of 2017 at the AAT/OTS focus group on tax complexity held at AAT last month.

Having recently responded to your VAT consultation, to your Gig Economy papers in January 2017 and having advised of our work in seeking to simplify the savings landscape with particular respect to the ISA regime, it is clear that all of your key areas of focus tie in neatly with areas of AAT interest.

With specific regard to general complexity in the tax system, I know you will be aware of the points raised at the recent focus group but thought it might be helpful to highlight some of the key issues raised.

**Income Tax & National Insurance Contributions**

Merging the two taxes was first suggested as long ago as the 1940's and several Chancellors have looked at doing so since without any real progress. This in itself indicates the scale of the challenge.

There are very sound policy reasons for merging the two. NICs no longer cover the costs of the benefits they were set up to cover despite public perception. They are complicated and costly to administer and considered by many to be a stealth tax due to the obvious lack of transparency. There was broad support for change amongst focus group participants.

As your colleagues highlighted at the focus group, 7.1 million workers would pay less (an average of £175pa less, amounting to £1.2 billion in total), and 6.3 million workers would pay more (on average £275pa more NICs, amounting to £1.7 billion in total). Given the winners are largely women and part-time workers and the average loss to the 6.3m "losers" is relatively small, these figures do not appear to be sufficient to prevent further work being undertaken to merge NICs and Income Tax.

Employers NICs were deemed a particularly complex area and it was suggested at the focus group that this could be simplified by being calculated on the total amount of the payroll. This simplification measure would therefore continue to be a tax upon employers.

AAT agrees with the 2016 recommendation from the OTS that you should continue to work on fully exploring the impact of these changes on individuals, businesses, the exchequer and the administration, and that you should then set out options and choices for consideration prior to any implementation.

**Self-assessment**

Problems with the online SA calculations and SA returns for 2016/17 were raised. Affected taxpayers, and often the agents acting on their behalf, are likely to have to revert to filing paper returns. The problem stems from the interaction between the separate allowances for savings and dividends, the personal allowance, and the additional rate of tax on income over £150,000.

Successive government initiatives and tax changes have often resulted in there being a number of alternative ways of calculating a person's tax liability. The net result of which is the introduction of additional layers of complexity.

Group participants felt that if the OTS had a more direct role in reviewing and commenting on emerging tax policy, such problems may at least be reduced if not entirely avoided.

**Gig economy**

As highlighted in our January 2017 response to the OTS paper on the Gig Economy, employer national insurance contributions (NICs) are one of the most influential drivers of employer's behaviour in this area, so scrapping employers NICs would seem like an obvious starting point. However, scrapping NICs for all employers would result in tens of billions of pounds worth of lost revenue and would therefore only be considered if it could realistically be recouped easily elsewhere.

As a result, rather than scrapping NICs, simplification and reform are in order.

Lower tax receipts, especially via employer NICs, is an inevitable consequence of an unreformed gig economy. Billions of pounds are currently being legitimately avoided in NIC contributions and income tax with more being evaded in other areas e.g. overseas sellers evading VAT. This has to stop if the tax base is to be maintained and if a sense of fairness in business is to be restored. The proposed Taylor reforms do not adequately address this situation.

A further point of interest raised by several present at the focus group was the inherent unfairness and built-in risk of avoidance/error/difficulties in tax payment, brought about by the fact the self-employed will often pay no tax until 12-18 months after the event, unlike the employed who have their tax taken automatically on a weekly or monthly basis via PAYE.

### **CIS**

The group considered that Construction Industry Scheme (CIS) information submitted through Real Time Information (RTI) should be visible on the Tax Accounts of sub-contractors.

If this recommendation was adopted it would have the following positive outcomes:

- A drop in main-contractor non-compliance as a result of sub-contractors being able to see whether details of the payments made to them and the tax withheld have been reported to HMRC at the correct time.
- The ability for sub-contractors to request in-year repayments in limited circumstances

### **Incorporation**

Previous discussion papers from the OTS have suggested the most common reason for small companies to incorporate was for limited liability rather than tax reasons. Those present found this did not reflect their experience, with most wanting to incorporate for tax reasons. It was acknowledged that whilst there was a very simplistic understanding that there may be tax advantages, most clients were unaware of the associated costs and the administrative burden or the fact that these could in many cases wipe out or at least seriously impede any tax savings. The benefits of limited liability were also often unknown until explained by an accountant/agent.

Furthermore, focus group participants highlighted that many of their clients do express concerns about the obligations imposed by becoming a company director and others suggested that information being made publicly available via Companies House sometimes discouraged incorporation too.

AAT and the OTS held a focus group on SEPA and Lookthrough in 2016.

There was no support for Lookthrough because it was likely to negatively affect cash flow; would disadvantage higher rate taxpayers; would discourage entrepreneurs; would be very difficult to advise on in practice and would be “...a complication, not a simplification”.

The focus group had mixed views on SEPA.

On one hand, it was considered to be a simplification as there would be no need to form a limited company or to undertake the onerous tax and statutory compliance work associated with the operation of one.

On the other, introducing another form of entity was seen as adding complexity rather than simplifying matters (although it was suggested that the ordinary sole trader regime could be replaced with SEPA as there would seem little reason not to go for SEPA if available and by doing this it could more robustly be argued that introduction would be a simplification).

It is also worthy of note that two issues were prominent in the SEPA discussions.

Firstly, whether or not suitable insurance products would be a simpler approach to dealing with this perceived problem - in many cases it was suggested this would be a more appropriate remedy, and secondly, the potential impact on the availability of credit owing to fear among lenders that they would not get their money back if unable to place a charge on the individuals property – this was deemed uncertain. The OTS assurance that the matter was being discussed with the BBA was considered to be helpful and their views would be very interesting to note.

It was not clear to the group whether or not a new form of business vehicle would encourage entrepreneurialism in reality.

So, whilst there is undeniably interest in the idea of protecting business owners main assets i.e. their principle private residences, there is not widespread support for the wholesale change necessary to effect this. The benefits do not appear to outweigh the risks and likewise this does not convincingly meet the stated objective of simplification.

All were agreed that dealing with a single flat rate of corporation tax (currently 19%) was seen to be simpler for most micro-companies than dealing with employees who could be paying 20%, 40% or 45% tax. Especially when coupled with varying NIC rates.

It was also highlighted that calculating corporation tax liabilities was incredibly simple. Particularly, when it is undertaken as part of the year-end statutory accounts production, by practice-software.

### **Disincorporation tax relief**

Take-up of Disincorporation Relief is minimal and it is therefore right to question whether or not is it worth retaining.

Focus group participants suggested that the primary reason for a low take-up was a lack of awareness of the relief. This may in part be explained by the fact it has only been available since 2013 or because there are less cumbersome alternatives. AAT is currently exploring the issue further with a view to providing a more detailed response to the recently published OTS review on the subject.

### **Minimum level for incorporation**

Many of those present at the focus group suggested that imposing a minimum level of activity for incorporation would act as a barrier to entrepreneurialism.

Some entrepreneurs may not fully appreciate the advantages or disadvantages of incorporation but improving this situation requires information, advice and guidance rather than the imposition of a barrier that discourages incorporation.

### **Same bank account for personal and business transactions**

The use of separate bank accounts for business and personal transactions was considered useful for the purposes of record keeping, tax, avoiding confusion and increasing professionalism.

However, it was noted that there is no legal requirement for a sole trader or a partnership to operate using a business bank account. Although, many banks insist on it and will close personal accounts being used for business purposes.

The fact that a company is a separate legal entity to its shareholders imposes a strict requirement for a limited company to hold bank accounts in its own name.

It was also noted that where a personal account is used on behalf of a company it could prove problematical in the event of insolvency.

Furthermore, considerations including anti-money laundering regulations among others, mean that those contracting with a company will refuse to pay funds into a personal bank account.

Focus group participants felt that technology is likely to make this apparent problem even less of an issue given cloud accounting products like Xero can tag individual transactions.

### **VAT**

The VAT threshold was briefly discussed.

There is considerable evidence to suggest small firms reduce output to fall under the threshold and this was reinforced by licensed accountants present at the focus group. As indicated in our VAT consultation response, this clearly has a damaging impact on the productivity of British companies as well as tax receipt implications for the exchequer.

More than a third of AAT members (36%) who responded to the *AAT 2017 VAT Survey* would like to see the VAT threshold substantially increased to £500,000 as in Singapore.

Some of those present expressed support for such an increase whilst others were sceptical.

Irrespective of whether the threshold remains the same or is substantially increased, there will always be a cliff edge that impacts upon behaviour. This could be avoided by having a £0 threshold as in Sweden and Spain but this was not supported by those present at the focus group and was supported by only 9% of members via our 2017 VAT Survey.

Those present expressed dismay at the complex nature of the various different VAT rates and the numerous exemptions available. These were described in terms ranging from “nightmare” to “unnecessarily complex.” Examples given included those for dentists and tour operators.

Applying the standard rate of VAT to all Vatable items would be a radical but highly successful simplification measure but there would inevitably be political implications.

Abolishing the 5% reduced rate, the zero-rate and exemptions (including obscure ones such as the 4% agricultural rate) and ensuring fiscal neutrality by reducing the standard 20% rate was strongly supported by those present at the focus group, more so than our member survey which indicated taking such action is supported by almost a quarter of AAT members (22%).

### **Miscellaneous**

Database of tax legislation - although this was not discussed by the group, AAT strongly supports the OTS suggestion that a database of all definitions in tax legislation be created. A definitions database would be useful to myriad stakeholders from policy makers, civil servants, accountants and businesses.

Group participants agreed that guidance on [www.gov.uk](http://www.gov.uk) lacked technical detail and was often circuitous. By following cross referencing the user often ends up back at their original starting point without having gained any relevant information. Something that was viewed as being time consuming as well as immensely frustrating.

Some information required by paper returns was not required online. An example of this was provided in the form of Box 56. These anomalies made the return process more complicated than necessary.

Those present were encouraged to hear that the long-awaited HMRC Agents Strategy is starting to be delivered. They hoped that as part of it this strategy it would be possible to see all the taxes that their clients are registered for via a single dashboard referred to as a “one stop shop” throughout the group meeting. Some concern was expressed about the likelihood that taxpayers are going to be able to see more of their own affairs via their HMRC tax accounts than agents, at least in the short-term although AAT does understand that HMRC is working on a “landing-page” solution for agents to access their clients’ information as an interim solution. It is important that a full suite of APIs are released and adopted by agents’ practice software providers, for integration into their practice software solutions, as soon as is reasonably practicable.

### **About AAT**

AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,250 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

I sincerely hope the above proves helpful but as always please do not hesitate to contact me should you have any queries or require any further information.

Yours sincerely,  
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