House of Commons

Treasury Committee

UK tax policy and the tax base

Further call for evidence
UK tax policy inquiry: sustainability of the tax base

1 March 2017

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The ICAS Tax Board, with its five technical 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 board and committee members.

2. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

General comments

4. ICAS is grateful for the opportunity to contribute its views to the further call for evidence for the 'UK tax policy inquiry: sustainability of the tax base', as requested on 2 December 2016. ICAS also gave written evidence to the earlier stage of the inquiry on 31 March 2016.

5. We have responded to questions 1, 2, 7 and 8, and made some very brief comments in relation to questions 4 and 5.

6. We agree that attitudes to 'avoidance' have changed significantly over the last decade amongst taxpayers, tax advisers and the general public. We are concerned that a stage may be reached where the publicity around tax avoidance becomes counterproductive. The majority of taxpayers are subject to PAYE or self-assess their taxes: they pay the right amount at the right time and ongoing publicity about avoidance by relatively small numbers of individuals should not be such that it damages this voluntary compliance. ICAS members support tax compliance and compliant taxpayer behaviour; making complex tax systems workable for businesses and reducing the risk of unexpected tax costs for all taxpayers.

7. With approximately half our members based in Scotland, we have had extensive dealings with the new devolved tax powers. There are a number of consequences yet to flow from this in relation to the UK tax base, which have not had the full consideration that they warrant. These include the introduction of tax competition which can have a number of consequences; for example, between different income tax rates or air passenger duty rates in different parts of the UK, or the impact of income tax becoming Scottish whilst both dividends and corporation tax remain UK based. If tax costs diverge, differences may lend themselves to tax planning.

Specific questions

Question 1: How big is the threat to the base for income tax and National Insurance from the changing patterns of working (for example increased levels of multi-jobbing and self-employment and different ways of working, to which the Chancellor referred in his Autumn Statement)?

8. We do not have statistical evidence concerning the shift from employment to self-employment; however, there will always be behavioural challenges to the tax base if there are significant differences in tax costs, for employees and employers, between employment and self-employment. This is driven by cost management – why pay more than you have to? Decisions about work patterns are also driven by non-tax factors such as employment rights and other employment costs (apprenticeship levy, auto-enrolment, holiday pay, etc). Some workers also have little choice but to become "self-employed" if this is the only way they can obtain work.

9. ICAS is a strong supporter of the Office of Tax Simplification and commends the report 'The closer alignment of income tax and national insurance', issued on 14 November 2016.

10. Part of the threat to the tax base is the opaque presentation of 'tax' to the taxpaying population. For taxpayers, and particularly for those on PAYE, NIC seems to be largely invisible but this has not gone unnoticed by governments – NIC has increased considerably over the last couple of decades whilst income tax has reduced. For example, in the Autumn Statement, the income tax higher rate threshold increase from £43,000 – £45,000 was widely publicised: it offers a saving of up to £400 to each affected taxpayer. At the same time, the NIC threshold for Class 1 employee contributions was also increased to £45,000 but this has the opposite effect and negates over half the income tax saving. This was not publicised.

11. There is also a new element of tax policy that has yet to be factored in. The devolution of income tax may alter the presentational elements around income tax and NIC. So far, income tax has been brought into sharp focus in Scotland with the recent discussions of whether/how the new devolved income tax powers over rates and bands should be exercised. However, some commentators have also noticed that changing the thresholds for income tax has wider cost implications – not only will higher rate tax be payable over £43,000 at 40% but so will Class I NIC at 12% up to income of £45,000, ie an overall rate at 52%. The thresholds are now out of alignment; tax is devolved but NIC is reserved. It may be that with different jurisdictions having different responsibilities the presentational elements will change, as either government seeks to distance itself from the costs of a 'tax' it is not responsible for. We discuss the potential consequences of devolution of tax powers further under question 8 below.

Question 2: What are the consequences of the divergence of the rates of corporation tax, income tax and CGT? Are the proposed reductions in corporation tax rates likely to encourage tax-motivated incorporations - as happened after the introduction of a nil rate of corporation tax for the first £10,000 of profits in 2000? Have the recent reductions in CGT encouraged the taking of income as capital gains?

12. Any taxpayer who views a tax bill as an unwanted cost will seek to minimise this and so divergent rates across income tax, corporation tax and capital gains tax lend themselves to tax planning behaviours.

13. Recent reductions in corporation tax, compounded with the expense of income tax and NIC for the self-employed, may continue to drive businesses towards incorporation. In Scotland, the matter has been discussed in relation to what, if any, impact divergent income tax rates might have – will Scottish income tax be avoided by operating through a company and paying dividends (dividends being liable to 'rest of UK' rates)? The change to the higher rate threshold announced for 2017/18 is unlikely to have much impact but it remains to be seen whether there will be greater divergence of income tax rates and thresholds in future and, if so, what influence this may have on behaviour. It is however, another element to factor into the discussion and may also be relevant in Wales in due course.

14. The proposed reductions in corporation tax may provide a headline rate that is lower but there are further tax costs to take into consideration. For OMBs, the owners will need to consider the post-tax costs after extracting funds from the company so there is either the salary route which is expensive when NIC is included or dividends. Recent changes to the taxation of dividends make this route less attractive than in the past. If owners want to convert their income into gains they need to wind up the company, which has a commercial impact and there is also tax anti-avoidance legislation to be navigated.

15. When CGT was originally introduced its objective was to block income tax leakage. To do this effectively the rates need to be similar to the main rates of income tax. However, the current differences in rates lend themselves to tax planning and consequential problems. The additional and higher rates of income tax are currently 45% and 40% whereas there are three possible CGT rates, depending on the level of taxable income and the availability of entrepreneurs' relief: 28%, 20% and 10%. This clearly creates an incentive to extract value from a company in forms subject to CGT rather than income tax.

Finance Act 2016 therefore introduced changes to the rules applying to distributions in a liquidation, including the introduction of a TAAR, to try to tackle perceived abuses arising from this differential. This of course simply adds to complicated legislation, adversely affects non-tax motivated transactions and it remains to be seen whether significant numbers of businesses will continue to seek to use the CGT route to extract value. We have not seen clear trends emerging yet.

16. For large corporates, a lower headline rate comes at the expense of other measures that restrict reliefs and will actually increase the corporation tax take. Some of our members have expressed concerns that continuing reductions in the corporation tax rate are being pursued at the expense of certainty and stability. For example, Finance Act 2017 changes to the rules on company losses for larger companies may deter foreign investment rather than encourage it. There needs to be a sensible balance between reducing rates and counterbalancing changes which may have detrimental results.

Question 3: What is the incentive effect of the tax on all dividends above £5,000? Given that the dividend tax is not restricted to dividends from "close companies", is it harmful to businesses which rely on attracting personal investments in shares?

17. We do not have any comments on this question.

Question 4: What are the implications for the exchequer of the changing pattern of home ownership, in particular the reduction in owner occupation?

18. We do not have comments on this specific question; however, there is concern that the tax system is used to direct housing policy, which leads to both tax and housing policy objectives that lack clarity and are unduly complicated. Nor do we believe that the tax measures around housing objectives are properly coordinated.

19. Tax rules are used to incentivise or disincentivise certain behaviours in the housing market. So, potential first time buyers are incentivised with 'Help to Buy' ISAs, and then Lifetime ISAs, but there are also disincentives for homeowners such as the cost of Stamp Duty Land Tax (SDLT) (or in Scotland Land and Buildings Transaction Tax (LBTT)). There are also increasing disincentives around buy-to-let properties, such as the new 3% supplement on SDLT/LBTT, and restrictions on tax relief available on buy-to-let landlords' finance costs are being phased in from 1 April 2017.

Question 5: How effective and economically efficient are Capital Gains Tax and Inheritance Tax as a means of taxing capital in the UK? Are their bases under threat as people live longer or as wealth is reduced, or spread more thinly, from one generation to the next?

20. Our observations on the capital taxes, from the perspective of tax advisers, are that both CGT and IHT can be very expensive for those who are liable to pay them but the vast majority do not pay them. It is, however, questionable whether CGT was primarily designed to tax capital gains or whether its effectiveness should be considered in relation to preventing income tax leakage (see Q1 above).

Question 6: How effective is the way that the UK taxes land? Is it economically efficient?

21. We do not have any comments on this question.

Question 7: Attitudes to "avoidance" have changed significantly over the last decade. In what ways have the actions of the Government and HMRC contributed to this? Is there a clear distinction between what is acceptable and what is not? Can one be formed?

22. We agree that attitudes to 'avoidance' have changed significantly over the last decade amongst taxpayers, tax advisers and the general public. This is in part due to government and HMRC measures which have driven changes in behaviours. It is also due to decisions from the tax tribunals and courts.

23. We believe that there are a number of parties with a role to play in encouraging different behaviour in relation to tax compliance and planning, which include:

    - The tax law must work properly: The UK needs simpler, better tax legislation because it is the law passed by Parliament which the Courts must apply and which determines the tax revenues that HMRC can collect.
    - High standards of behaviour are required all round: from accountants, tax advisers, tax administrations, businesses and individuals.
    - 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, or the applicability of certain taxes as discussed in question 1 above in relation to income tax and national insurance.
    - 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.
    - Businesses need to be transparent: Businesses should consider providing accessible and coherent narrative explanations of their overall tax contributions. For instance, the cost of employment and business rates is considerable; corporation tax is not the only tax paid by businesses.
    - Criminal tax evasion needs greater focus: Public debate on tax avoidance tends to vilify those operating in a lawful fashion, whilst ignoring the systematic criminality of those in the black economy.

24. We believe there is a distinction between tax planning that is acceptable and that which is not. This has been addressed in the revised Professional Conduct in Relation to Taxation Guidance, issued by the main tax professional bodies including ICAS. A new standard has been inserted '*Members must not create, encourage or promote tax planning arrangements or structures that i) set out to achieve results that are contrary to the clear intention of Parliament in enacting relevant legislation and/or ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.'* This is directed at changing behaviours, and is in the same territory as the General Anti-Abuse Rule (GAAR).

25. We are also concerned that a stage may be reached where the publicity around tax avoidance becomes counterproductive. At public events, and in the press, all too often there is an impression given that many taxpayers – companies and individuals – do not pay their fair share and are simply avoiding their taxes. This can lead to the compliant wondering if they are paying too much or missing a trick. The majority of taxpayers are subject to PAYE or self-assess their taxes: they pay the right amount at the right time and publicity about avoidance by relatively small numbers of individuals should not be such that it damages this voluntary compliance.

Question 8: What other threats to the UK tax base should the Committee consider?

26. With approximately half our members based in Scotland, we have had extensive dealings with the new devolved tax powers. There are a number of consequences yet to flow from this, some of which may not have had the full consideration that they warrant. Scottish experience illustrates some of the key topics around the devolution of tax powers, although this affects the decentralising of powers to all parts of the UK including Wales, Northern Ireland and, last but not least, the powers that are retained in England.

27. A clear understanding of the intricacies of policies that contain both reserved and devolved elements is needed to ensure the tax base is protected and is not eroded inadvertently due to a lack of understanding or consideration. For instance, income tax has been partially devolved meaning that this involves joint responsibilities. The UK Parliament is responsible for the tax base, ie what is considered to be income, how it is measured, and the decision to provide reliefs from the tax. All these elements can impact on the amount of income tax raised. At the same time, the Scottish Parliament is responsible for the rates and the bands of income tax, allowing it to exert some control over how much is assessed for collection and from which taxpayers (e.g. basic or higher rate taxpayers) and it will receive all income tax on the non-savings, non-dividend income of Scottish taxpayers.

28. The presentational elements may also change as income tax becomes hypothecated to Scottish Parliament spending responsibilities whilst national insurance may become more closely associated with UK policy, as discussed in question 1 above.

29. With the Scotland Act 2016 measures being implemented, accountability for tax raising is brought closer to spending decisions but it also introduces tax competition. Tax competition is usually effected by reducing rates or offering attractive reliefs from tax but this can encourage a damaging “race to the bottom” between different jurisdictions which would reduce tax receipts for both the devolved and UK Governments.

30. Tax competition can also lead to tax avoidance and tax planning. For example, tax can be more competitive in one jurisdiction compared to another, in order to attract inward investment or the use of, say, a particular airport. The attraction to the potential taxpayer is a reduction in their tax bill, but it also encourages that taxpayer to avoid a less competitive tax.

31. The decentralisation of taxes requires stronger coordination across the UK and particularly so if further powers are to flow back from the EU following Brexit in a way that marries up with devolved powers and at the same time supports the tax base.