

ICAS

Evidence to the House of Commons Treasury Committee

Tax after Coronavirus

8 September 2020

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 22,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.
2. 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.
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 into the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.
4. ICAS welcomes the opportunity to respond to this inquiry into Tax after Coronavirus.
5. We would be happy to discuss any of our comments below in further detail.

Questions

Question 1: What are the major long-term pressures on the tax system in the UK, including those arising from changes in working practices, demographics, the environment and other factors? How are these affecting the efficiency of the tax base and the overall level of demand for public services?

6. There have been significant changes in the business and broader societal environment in recent years, most notably linked to increasing digitalisation and developments in AI.
7. The UK has become predominantly a service-based economy and is also increasingly an online economy. This presents certain challenges to the UK tax base:
 - Multi-national enterprises operate across the world; governments and tax authorities have difficulties identifying, and agreeing, the territorial source of corporate profits and hence which jurisdiction should be able to tax those profits.
 - Older 'bricks and mortar' businesses with a clearly defined tax presence in the UK have struggled to compete against new global online businesses. Some of these businesses might be able to adapt to survive and could be helped, for example, by changes to non-domestic rates. However, tax changes will not prevent or reverse long term structural changes – some business models may no longer be viable.
 - It can be more difficult to pinpoint whether 'workers' are employed, self-employed or somewhere in between, in the 'gig' economy, which has presented opportunities for some but led to exploitation of others. This in turn weakens the tax base which could be further weakened if there is increased automation and hence less employment income to tax.
8. Environmental concerns will place pressures on the tax system and are likely to reduce tax revenues. There is likely to be decreasing use of petrol and diesel, leading to falling duties and VAT receipts. There may also be strong arguments for introducing new environmental taxes, but to be effective such taxes need to be aimed at changing behaviour and not be primarily intended to raise revenues.
9. The income tax burden is increasingly falling on fewer people. The [IFS noted in 2019](#) that the top 1% of the adult UK population paid well over a third of all income tax and that only 58% of adults were liable to income tax at all. It also noted that the top 1% even of those paying income tax had seen their share of total income tax payments rise from 25% to 30% since 2010. This heavy reliance on a small group of taxpayers presents a risk to tax revenues.
10. The very wealthy have always been mobile, with the ability to leave the UK if they choose to do so (for tax or other reasons). However, one of the effects of Covid-19 has been a rapid shift towards home working – and a realisation that many jobs can be performed effectively without the workers being in the same place, or even in the same country. We already have reports from

members of employees moving across borders whilst continuing to work for the same employer. This presents challenges for the tax system: the existing tax rules are likely to need updating to take account of this new way of working – but the tax base is also at more risk if larger numbers of middle to high earners have the option to move away from the UK.

11. A broader pressure on the tax system is a lack of public understanding and, hence, support: there needs to be a greater level of public debate, public understanding and engagement on public finances and tax, including increasing transparency about the link between raising tax revenues and paying for improved public services.

Question 2: What more can the UK do to protect its tax base from erosion as a result of globalisation and technological change, and what further impacts will the coronavirus pandemic have on our tax base?

12. To protect its tax base from erosion as a result of globalisation and technological change the UK should continue to support the work of the OECD on proposals to reform the international taxation system. An internationally agreed approach to tackling the taxation challenges arising from multinational companies (particularly in the digital sector) is preferable, where this can be achieved. Unilateral tax measures (such as the Digital Services Tax) should be approached with caution; where exceptionally these are deemed to be essential to protect the UK tax base, they should be introduced on a temporary basis and replaced once international agreement has been reached.
13. The government needs to ensure that the UK is a competitive and attractive place to be located, particularly post-Brexit. A key component of this should be a stable and consistent tax system, which allows both corporates and individuals to plan for the long term with certainty. Tax should certainly not be a disincentive – tax administrative systems must work and HMRC needs to provide an effective service to all businesses, large and small.
14. Further impacts from the coronavirus pandemic on our tax base are two-fold. First the pandemic (and the government response) has highlighted points of tension in existing policies, systems and processes. This is particularly so in relation to fairness: on the one hand how much is contributed by those who work in employment, in self-employment or via personal service companies; on the other hand, how much is paid out under the various Covid-19 support schemes.
15. Second, the coronavirus pandemic has resulted in a need for funds to support the rebuilding of the economy and to provide additional public services. At the same time, sources of revenues are likely to be reduced and fragile. This generates tensions which will need to be managed. The government will also need the support of UK citizens in determining where any increased burdens should fall and the appropriate balance between spending and tax increases.
16. It became very clear at an early stage of the pandemic that the UK is heavily dependent on overseas manufacturing and supply chains. Some sectors are already looking at the possibility of 'onshoring' parts of their supply chains. If the government took steps to incentivise and support UK manufacturing and engineering this could keep some businesses here after Brexit and encourage others to locate or return here. This would broaden the tax base. We have had feedback from members that RDECs (Research and Development Expenditure Credits) have been effective in encouraging some businesses to remain in the UK but consideration should also be given to non-tax measures.

Question 3: Do these pressures need to be met with tax reform, and if so, is this the right time for reform?

17. The pressures of the coronavirus pandemic highlight existing problems, and we believe there are a number of areas of the tax system that would benefit from reform. We address these in our paper ['Future of Taxation in the UK'](#), issued in June 2020.
18. When is the right time for reform? Tax reform is always difficult to introduce; it is often noted that those who will gain will be silent, whilst those who may lose from change will be very vocal. However, the impact of coronavirus and the very obvious costs of dealing with it should provide an opportunity for the government to generate public support for tax reform to address some of the issues in our tax system and provide additional tax revenues.

Question 4: What overall level of taxation can the economy bear without undesirable or counterproductive harm to economic growth?

19. In our experience as tax practitioners, there is no single point for all businesses or all taxpayers, where the tax burden becomes counterproductive. The extent of tax avoidance and tax evasion is probably the most reliable indicator that the tax burden is reaching a counterproductive level but that takes some time to become obvious.
20. The key point, however, is to support the economy; the private sector economy needs to be as robust as possible to provide employment and wealth creation. Without this, there are limited sources of taxation revenues to provide government funds. If increased tax revenues are required, the ideal would be to grow the tax base rather than to raise more tax from the existing base. Large increases in tax rates may not generate the expected revenues because of behavioural change and suppression of economic activity. Covid-19 may also change consumer spending patterns in the long term, with varying impacts on different sectors of the economy; tax may need to take account of this, for example, through more tailored VAT rates post-Brexit.
21. A number of elements may be needed in order to support the economy and there needs to be a balance between:
 - any 'kneejerk' reaction to raise taxes to fund the extra borrowing arising from Covid-19,
 - raising taxes to fund the increased cost of public services, and
 - the need to keep the tax burden manageable to support the economy in order to get people back into employment and to support businesses through Brexit.
22. Taxation policy needs to both generate funds and support the economy or, at the very least, not create economic disincentives or distort behaviour. Proper consultation on tax changes is vital to minimise the likelihood of unintended consequences.

Question 5: Which areas of the tax system are most in need of reform, and which are best left alone?

23. The area most in need of reform in terms of tax policy is around income tax, NICs and workers: this area of the tax system is riddled with distortions, which have been highlighted by the provision of the coronavirus schemes. An individual worker may prefer to be self-employed rather than employed because NICs will be lower and the expenses rules are more generous. Lower corporate tax rates and lower taxation of dividends incentivise many businesses to incorporate. Sometimes, however, workers are forced into false self-employment (or into setting up their own personal service companies) because the users of their services want to avoid employers' NICs and employment rights. The growth of the 'gig' economy has also seen increasing numbers of individuals whose tax status can be hard to determine, due to the number of roles in each individual's 'portfolio' and the lack of alignment between tax and employment law.
24. We believe that the fundamental issues of taxpayer behaviour, employment ethics and falling NIC revenues urgently need to be addressed.
25. Increased clarity around employment status needs to be accompanied by measures to improve the alignment of national insurance between employed and self-employed workers. Retaining Class 2 NICs avoided increasing the gap between employees and the self-employed but self-employed workers still continue to pay significantly lower rates of NICs than employees. The self-employed also enjoy more generous relief for expenses. Due to changes to state benefit entitlements it is difficult to continue to justify these differences; if the gap widens further middle to high-earning employees now have more ability to switch locations (as a result of home working). Addressing both these distortions should be a short term ambition and could be achieved without significantly increasing complexity.
26. In the longer term, the cost of employer NICs needs to be addressed, preferably alongside consideration of the likely consequences of increased use of AI and robotics. Currently, the cost of employer NICs is key to exploitative practices in the gig economy and to illegal modern slavery; additional resources should be made available for tackling these. In future AI could reduce the number of workers required, with serious consequences both for tax revenues and wider society. We recommend that full and proper consideration is given to how to address these issues.

27. As noted above, lower corporate tax rates and lower taxation of dividends incentivise many businesses to incorporate. There should also be a review covering this broader area of differences in taxation arising from differing business structures (particularly distinctions between incorporated and unincorporated businesses).
28. In terms of tax administration, the most powerful reform would be to rewrite the Taxes Management Act, which we discuss in our response to Question 6 below.
29. In the short term we suggest that VAT should be left alone: there are ongoing administrative changes that need to be done fully, including Making Tax Digital for VAT, the forthcoming VAT construction industry domestic reverse charge, and there will also be essential post-Brexit changes such as postponed accounting. Rushed, piecemeal changes in response to the many calls for immediate post-Brexit VAT changes would be inadvisable and likely to have unintended consequences.
30. However, once the UK is no longer subject to EU VAT law, we do see scope for VAT simplification and for consultation on whether significant VAT changes would be desirable in the medium to long term. There may be a case for broadening the VAT base but lowering rates – or tailoring rates to particular sectors of the economy; the OTS also made some useful suggestions for simplification in its review of VAT. Changes could apply across the UK or could potentially involve some devolution of VAT powers.

Question 6: What reforms should be considered in response to the pressures on the tax system?

31. **Tax administration:** we suggest that the legislative framework supporting tax administration needs to be reformed. We strongly believe that trust in the UK tax system can be developed and maintained only if taxpayers and their advisers can readily understand HMRC powers, deterrents and safeguards. Transparency should be a key feature but the legislation dealing with tax administration is currently scattered across various statutes, making it difficult for taxpayers to access and apply to their own circumstances. It has also not kept up with technological developments, so it is no longer fit for purpose. Piecemeal attempts to patch up the system, such as the recent announcement of legislation on automated processes, do not address the underlying problems. The time has come for a consolidation of all tax management and administration provisions in a new Taxes Management Act.
32. We note that HMRC issued '[Building a trusted, modern tax administration system](#)' in July 2020 and we support the broad principles set out in this paper. However, proper project management is required with suitable governance, a full articulation of the strategy, a detailed timetable (so taxpayers can prepare) and a full explanation of the desired outcomes.
33. **Income tax and national insurance:** Many argue for merging, or at least a greater alignment of income tax and national insurance contributions and ICAS has supported such proposals for many years. With the devolution of income tax bands and rates to Scotland, and income tax bands to Wales, however, we would now express some caution before embarking on such a reform.
34. Devolution adds further complexity because key elements of income tax are devolved but NICs are reserved. There has been considerable work by the Office of Tax Simplification (OTS) in recent years to examine how income tax and NIC processes could be aligned to improve administration, but a different approach may be required as the two charges increasingly diverge from one another. Divergence manifests itself in the NIC thresholds and their interaction with the income tax higher rate threshold. It also arises at a policy level: in England, in addition to suggestions for merging NICs and income tax, it has also been proposed to 'hypothecate' NICs and increase them specifically to fund healthcare. This appears odd in Scotland because healthcare is a devolved competence whilst NICs are reserved. Further consideration of the impact of devolution is required before undertaking radical change.

Question 7: What is the role of tax reliefs in rebuilding the economy and promoting economic growth and efficiency? Does the current regime of tax reliefs perform this role well?

35. The role of tax reliefs in any tax system needs careful evaluation. If there is to be a strong stance against tax avoidance, legislators should not provide incentives for undertaking it, as can happen with the introduction of some reliefs. Careful consideration needs to be given to proposed new

reliefs – it is questionable whether tax reliefs support the economy, its growth or its efficiency; after all, a tax relief is not available unless a business has already made profits. Other points to consider in relation to reliefs:

- Should there be reliefs and, if so, for what purpose?
- When and how will their effectiveness be evaluated?
- What is the cost of a relief relative to the benefits it provides?
- Will there be sunset clauses?
- How do you prevent reliefs becoming avoidance mechanisms?
- Do they then become unduly complex?
- What are the alternatives – grants?

36. There have been recent studies of the reliefs in the UK tax system, including by the OTS (in relation to complexity in the system) and by the NAO. We agree with the NAO that tax reliefs require careful monitoring and active consideration of whether they provide value for money. It is important to evaluate reliefs regularly to ensure that they meet their original objectives – but also to ensure that those objectives continue to be desirable.

Question 8: What are the areas for simplification?

37. In recent years governments have been unwilling or unable to increase the main revenue-raising taxes but have still needed to raise revenue; the result has been opaque tax changes and a lack of transparency about revenue raising. This has contributed to increasingly complex and lengthy tax legislation, which makes it harder for taxpayers (particularly unrepresented ones) to understand and comply with their tax obligations. There needs to be greater transparency in tax policy and around the amounts of tax being collected, to support understanding of tax and public trust in the tax system.

38. Areas that are ripe for simplification include:

- The rates and allowances attaching to the personal tax computation (with allowances such as the marriage allowance, which is means tested; the blind person's allowance, age allowance, savings rate, dividends rate, 5 main rates in Scotland, 3 main rates in the rest of the UK)
- The rate of corporation tax has been lower in recent years, but at the expense of introducing complications, such as the restriction of loss reliefs (both trading and capital losses)
- Capital gains tax which is the current subject of an OTS study
- IHT
- VAT (the OTS put forward some suggestions in its report on VAT)

Question 9: Is there a role for windfall taxes in the post coronavirus world?

39. We believe that windfall taxes are generally unhelpful. Successful businesses will generate larger profits and pay more tax; they are also likely to take on additional employees (who will pay tax) and pay larger dividends (with investors paying more tax). There are specific issues with the taxation of multinational businesses (particularly in the digital sector) because the international tax system has not kept pace with economic and technological developments. We discussed this area in our response to Question 2 above.

Question 10: What is the right balance between taxation of work, savings/pensions and wealth?

40. We are contributing to the current OTS review of CGT; we note too that there is an open [project](#) on the taxation of capital/wealth which is being conducted by a [team of academics](#). These projects are valuable and should assist in providing input on this question. We suggest that the topic should be the subject of a separate inquiry by the Treasury Committee, once the above projects have reported.

41. We have some general observations:

- The focus should be on reforming and improving existing taxes – rather than introducing new taxes, which inevitably mean more complexity and new administrative mechanisms (and costs).
- Government unwillingness to increase the main revenue-raising taxes may need to be reconsidered in the interests of simplicity, transparency and minimising administrative costs (for taxpayers and HMRC).

- The interaction between taxes needs to be carefully considered when making changes, to avoid unintended consequences or creating new distortions. For example, IHT and CGT need to be considered together.
- There are problems associated with wealth taxes; valuation issues, ability to pay (illiquid assets), disincentivising effect and behavioural reactions (mobile tax base).
- Pensions involve long term commitment and planning; important to have stability and consistency in policy.
- Consideration may need to be given to inter-generational issues and tax. Young people have been hit by the ongoing effects of the 2008 financial crisis and now by Covid-19. Not all tax incentives assist many younger people; for example, the current ISA allowance tends to help older people with money to save but is less useful for the younger generation. Higher taxation of earned income than savings income (which is not subject to NICs) may also disadvantage younger people.

Question 11: What is the best way to tackle tax reform, including what changes might be needed at HMRC to support implementation, and how should the Government consult with stakeholders and parliament?

42. Tax reform needs public support. Lack of understanding of an overly complex system, combined with a perception that there has been widespread abuse, has also contributed to a sense of unfairness amongst the public which undermines voluntary compliance and support of the tax system.
43. There should be a public discussion exploring the role of tax in supporting public services and contributing to the common good. The government should facilitate this discussion through greater transparency about the link between raising tax revenues and paying for improved public services. Media reporting has concentrated on the need for taxes to be paid by large businesses and wealthy individuals, but the public debate should also cover how, and to what extent, everyone should contribute.
44. The five-stage approach to consultation set out in the 2011 'Tax Consultation Framework' is effective when adopted in full. The government, HMT and HMRC should ensure that more consultations include all five stages; omitting Stages 1 and 2, which frequently happens, deprives the government of valuable stakeholder input in clarifying the objectives, identifying the options for implementing them and developing a framework for implementation. This leads to sub-optimal outcomes.
45. A well-resourced and efficient tax authority is essential for the smooth running of tax administration. Reductions in HMRC headcount and diversion of resources to deal with urgent issues (for example, Brexit or Covid-19) cause problems for agents and taxpayers, particularly businesses and individuals who are not large enough or wealthy enough to have an HMRC Customer Compliance Manager.
46. Inability to obtain appropriate support from HMRC undermines confidence in HMRC's ability to deliver a fair and effective system. It also increases compliance risks because many taxpayers (not just those dealt with by HMRC's Large Business and Wealthy units) encounter complex tax problems, but those with limited resources currently find these very difficult to resolve. Named points of contact at HMRC need to be provided for a broader range of agents and taxpayers. For others, HMRC's helplines need to work better and there must be effective escalation of complex queries to the appropriate HMRC specialist. HMRC also needs to invest more in training and development to ensure that it has sufficient specialist expertise available.
47. Digitalisation should not be used to reduce HMRC resources further, without proper consideration of the impact on HMRC service levels: some of any resources freed up, should be redirected to providing adequate service levels and support for all taxpayers.