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MAKING PAYING TAXES LESS TAXING

A Parliament Street Policy Paper

Authored by

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Introduction

The Office of Tax Simplification was established in July 2010, and in its eight years of existence has had, if anything, a minimal effect on the UK tax code (the laws and regulations relating to tax in the UK). In fact, the UK tax code is passed 17,000 pages in 2015, and has more than trebled in size since 1997[1]. The consequence of this complexity is high compliance costs, fines and penalties for non-compliance, and an uneven playing field which favours multi-national corporations such as Amazon, Google, Starbucks who can take advantage of offshore low tax jurisdictions thus shifting the tax burden to small and medium size enterprises (SMEs).

This paper argues that truly radical transformation of the UK tax system is required if the UK economy is to stay competitive (especially post-Brexit) and if we really want SMEs to continue to be the drivers of growth in the 21st century. References are provided as hyperlinks in footnotes.

The Policy Problem

When Tolley's Yellow Tax Handbook was first published it was merely a pamphlet. The 2017-18 Edition extends to 6 volumes, an increase from 4 volumes in 2009 (even with formatting adjustments to increase the number of words on each page). The UK tax code is arguably the longest tax code in the world[2]. Despite claims by

[1] https://www.theguardian.com/commentisfree/2015/feb/13/britain-tax-code-17000-pages-long-dog-whistle-very-rich
[2] https://www.accountingweb.co.uk/community/blogs/gina-dyer/uk-tax-code-is-longest-in-the-world

the Office of Tax Simplification that the length of tax legislation is not necessarily a measure of complexity[3], the Federation of Small Businesses have reported that the average small business loses three working weeks a year and an average of £5,000 a year on tax compliance[4]. Value Added Tax (VAT) was the most time consuming with PAYE following a close second.

Larger companies, especially multi-nationals with their own internal accounting functions are often able to take advantage of the UK's complex tax system. Firstly, they can understand the extensive list of tax deductions available to support certain type of behaviour, e.g. investing in IT equipment. Secondly, through intercompany transfers (sometimes called transfer pricing) companies can record profits on goods and services in a different country which have a lower tax rate, for example, Ireland or Luxembourg.
In 2011 Starbuck had sales in the UK of £400m but paid no Corporation tax, at all. They did this by transferring money to their Dutch sister company in 'royalty payments' by buying their coffee beans through Switzerland and paid high interest rates on loans to pay for this from other parts of the business[5]. In 2011, Amazon had sales revenue of £3.34bn, and but reported a tax expense of £1.8m. Google paid the most tax of the three multinationals, paying £1.6m on revenue of £395mn. As the BBC rightly reported at the time, everything the companies did was legal. This was tax avoidance, not evasion.

So why is theUK tax system so complicated? The main answer is the UK Government trying to make policy, such as changing company's and people's behaviour, through the tax system. Some behaviour is to be encouraging, e.g. investing in new capital equipment, which be made cheaper through tax deductions. Other behaviour is discouraged, e.g. the sugar tax, which is paid by the manufactures of sugary soft drinks[6].

TheUK tax system has also evolved over time. For example, National Insurance was originally introduced in 1911[7], and has been adjusted on numerous occasions. There are now 6 classes of National Insurance Contributions (if you include Class 1A and 1B, usually called Employer's NICs). Each has different % rates kicking in at different levels of income/self-employment profit.

Corporation tax has (mercifully) begun to be streamlined[8], but as suggested above, as a tax on profit, incentivises companies to behave in ways which minimises their

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[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/193496/ots_length_legislation_paper.pdf
[4] https://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-tax-report---taxing-times-final.pdf?sfvrsn=0
[5] https://www.bbc.co.uk/news/magazine-20560359
[6] https://www.bbc.co.uk/news/health-43659124
[7] http://www.nationalarchives.gov.uk/cabinetpapers/themes/national-health-insurance.htm
[8] https://www.gov.uk/government/publications/rates-and-allowances-corporation-tax/rates-and-allowances-corporation-tax

reported profits before tax, or to use other forms of creative accounting to reduce tax liability.
It can be argued that a massive negative consequence of all of this tax complexity is that many people who would have considered starting a new business in the UKdo not. When they do, they must hire accounts and lawyers whose full-time job is to navigate this complexity. Is it any wonder the UK has an absolute advantage in the provision of accounting and legal services?

So what can we do about our aged, complex and burdensome tax system?

Policy Solutions

To try and make gradual and piecemeal adjustments to the current system would arguably compound the problem of complexity. Instead the UK ideally needs a new system designed from the ground up for the 21st Century.

To design a new UK tax system it is best be to begin with a set of basic principles. From this foundation it is then possible to design the wider structure, while trying to maintain simplicity at all times.

The American Institute of Certified Public Accountants (AICPA) suggest the following 10 guiding principles of good tax policy[9][10]:

1. **Equity and fairness.** Similarly situated taxpayers should be taxed similarly. This includes horizontal equity (taxpayers with equal ability to pay should pay the same amount of taxes) and vertical equity (taxpayers with a greater ability to pay should pay more taxes). Note: Equity is best measured by considering a range of taxes paid, not by looking just at a single tax.

2. **Certainty.** Tax rules should clearly specify when and how a tax is to be paid and how the amount will be determined. Certainty may be viewed as the level of confidence a person has that a tax is being calculated correctly.

3. **Convenience of payment.** A tax should be due at a time or in a manner most likely to be convenient to the taxpayer. Convenience helps ensure compliance. The appropriate payment mechanism depends on the amount of the liability, and how easy (or difficult) it is to collect. Those applying this principle should focus on whether to collect the tax from a manufacturer, wholesaler, retailer or customer.

4. **Economy of calculation.** The costs to collect a tax should be kept to a minimum for both the government and the taxpayer.

[9] https://www.journalofaccountancy.com/issues/2002/feb/guidingprinciplesofgoodtaxpolicy.html
[10] http://scholarworks.sjsu.edu/cgi/viewcontent.cgi?article=1049&context=acc_fin_pub

5. **Simplicity.** Taxpayers should be able to understand the rules and comply with them correctly and in a cost-efficient manner. A simple tax system better enables taxpayers to understand the tax consequences of their actual and planned transactions, reduces errors and increases respect for that system.

6. **Neutrality.** The tax law's effect on a taxpayer's decision whether or how to carry out a particular transaction should be kept to a minimum. A tax system's primary purpose is to raise revenue, not change behaviour.

7. **Economic growth and efficiency.** A tax system should not impede productivity but should be aligned with the taxing jurisdiction's economic goals. The system should not favour one industry or type of investment at the expense of others.

8. **Transparency and visibility.** Taxpayers should know that a tax exists, and how and when it is imposed on them and others. Taxpayers should be able to easily determine the true cost of transactions and when a tax is being assessed or paid, and on whom.

9. **Minimum tax gap.** A tax should be structured to minimize noncompliance. The tax gap is the amount of tax owed less the amount collected. To gain an acceptable level of compliance, rules are needed. However, a balance must be struck between the desired level of compliance and the tax system's costs of enforcement and level of intrusiveness.

10. **Appropriate government revenues.** A tax system should enable the government to determine how much tax revenue it likely will collect and when—that is, the system should have some level of predictability and reliability.

What could these principles mean in reality? Possibly something like this:

- A single flat % rate of income tax with all workers given the same,high tax-free allowance (removing the wide range of allowances and deductions, removing the working poor from tax altogether, and getting rid of the disastrous tax credits system);

- A single rate of National Insurance Contributions for individuals, and a single rate for employers;

- A single % rate of Company Income Tax which taxes the company's income (revenue) and not profits (which can easily be manipulated);

- A minimal number of tax deductions or incentives (a low rate overall tax burden and lower compliance costs should encourage economic behaviour across all sectors anywhere in the UK. The Government should stop trying to pick winners);

- All goods and services be made VAT liable (with a single rate of VAT applied to all. This could replace a complex system of other taxes on things like betting and energy);

- An individual or company tax return fitting on one side of A4 paper;

- Taxes which tax wealth, wealth accumulation,or discourage investment and growth be abolished, for example, Stamp Duty Land Tax, Stamp duty on shares (income gained from dividends should be taxed as income at the flat tax rate), Capital Gains Tax, Inheritance Tax, all other taxes on savings and investment.

Conclusion

As the UK leaves the European Union in March 2019, tax policy is an area where the UK Government could make dramatic and positive steps in terms of policy divergence. An entirely new, simple, transparent, efficient and fair tax system which encourages growth, encourages compliance, and actually maximises tax revenue to fund the services that the British people want and deserve. Although this paper sets only a broad vision of what that tax system could look like, such radical reform is needed, and should be debated.

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