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House of Commons Treasury Committee Inquiry

Tax after coronavirus

Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 We are pleased to set out our comments in relation to the Committee's inquiry 'Tax after coronavirus'. The CIOT's Tax Policy Director, John Cullinane, will be giving evidence to the inquiry on 15 September.
- 1.2 The Inquiry is wide-ranging. Our response therefore addresses a number of different matters. We have sought to keep comments on individual areas relatively brief, and we are willing to elaborate on these should the Committee find this helpful.
- 1.3 Whilst we have sought to address the questions raised in the inquiry, there is inevitably some overlap. For instance, some of the major long-term pressures on the tax system may also be areas in most need of reform. We have also, as always, tried to focus on matters within our areas of expertise and (for example) have not commented on those which are primarily for economic analysis. However, given the broad nature of this inquiry, we have indicated possible areas which are contentious but would merit public and political debate.
- 1.4 We have prepared a separate response which focuses solely on devolution. The purpose of this is to highlight the importance of the UK, Scottish, Welsh and Northern Irish governments working together to ensure that any reforms to the UK tax system take account of the interactions between devolved and reserved taxes.
- 1.5 We also draw the Committee's attention to our responses to the Committee's 2016 Inquiry 'The shifting sands of UK tax policy and the tax base'¹ as the themes underlying those comments remain relevant today.
- 1.6 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the

¹ See <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/shifting-sands-an-inquiry-into-uk-tax-policy-and-the-tax-base/written/31139.html> and <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/shifting-sands-an-inquiry-into-uk-tax-policy-and-the-tax-base/written/48431.pdf>

authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

1.7 Our stated objectives for the tax system include:

- A legislative process which translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

1.8 ***In this response we highlight areas which may warrant review, and give examples of existing inconsistencies and oddities. In some places we suggest possible reforms. Some of these areas are inherently political, and potentially controversial. Our suggestions are not intended to be recommendations for specific action, but rather areas for potential exploration, and prompts for discussion and debate.***

2 Executive summary

2.1 There is a need to deal with some structural problems with the tax system. This, and the post-COVID budgetary position, present the government with some difficult choices. These should be faced head-on, identifying the key fault lines within the current regime, carrying out open and widespread consultation, and setting out a plan or roadmap for how the government will proceed.

2.2 An individual doing the same activity can be taxed very differently depending upon whether they are an employee, are self-employed, or operate through a company. A key question is whether the tax and benefits systems should aim for a level playing field between these different structures or whether differentials should be accepted and the focus put on trying to reform and clarify existing distinctions. Additionally the tax take from self-employment is less reliable for a number of reasons than that from employment. To tackle this we need measures to make compliance easier as well as tackling illegal activity.

2.3 We need a coherent long-term strategy for environmental taxation. It is questionable how effective complex environmental incentives, regularly tinkered with at Budget times, are. Similarly we need to consider the fairness and effectiveness of policies to encourage home ownership. In particular, recent tax changes designed to encourage owner occupation by discouraging multiple home ownership have probably done more to complicate the taxes concerned than to make a serious impact.

2.4 VAT is not only a complicated tax, it is littered with seemingly illogical borderlines and differences in treatment, and the answer may be to remove some of the reliefs so that more goods and services attract the standard rate of VAT. There are also gaps in income tax and national insurance, particularly in the area of pensions.

2.5 In protecting the tax base, more attention should be given in the future to multinational planning around intellectual property, to the increased mobility of individuals given 'working from home' is now so much more widespread, and to the ease of buying online, including from offshore.

- 2.6 We consider that a proper rigorous analysis and assessment is required to evaluate the feasibility of a wealth tax. We would have concerns over the rationale and operation of a 'windfall tax', including identifying the tax base, the extent of retrospection / retroaction and whether it would disincentivise entrepreneurialism and value creation.
- 2.7 There is no formal framework governing the administration or oversight of tax reliefs. More systematic post-implementation reviews should be undertaken. There is a lack of reliable, accurate evidence surrounding the take up and cost of reliefs. Tinkering constantly with rates and allowances undermines the principles of stability and certainty that taxpayers need.
- 2.8 The complexity theme runs through many aspects of our response – both around the technicalities of tax, as well as the requirements of compliance. We remain concerned at the impact this has, particularly on small businesses and individuals. We are not surprised that small businesses are the greatest contributor to the tax gap as a result of mistakes. Our evidence suggests that technology is not the answer to complexity, and indeed in the short term could increase errors. The tax system is in need of radical simplification. Traditionally the problem has been that simplification creates winners and losers, and losers shout louder. If COVID requires the tax burden to rise, simplification will need to level up the burden. It remains to be seen whether this is a greater challenge or presents an opportunity to reform.
- 2.9 Not only is tax law complex, but in recent years there have been problems with the obvious things that might mitigate this problem. Official guidance has deteriorated, in part because it has not kept pace with the rate of new legislation, and in part because of the house style of GOV.UK. For most people, telephoning HMRC with a question is difficult and time-consuming. HMRC's geographical network of local offices has been rationalised but the online systems developed to replace them are not always easy to use correctly without specialist knowledge - yet do not always accommodate access by a qualified agent on the taxpayer's behalf.

3 General remarks

- 3.1 Coronavirus has had, and will continue to have, a significant impact on individuals and business. Inevitably this will impact on tax receipts and the Committee is right to consider where these pressures might arise and what reforms should be considered.
- 3.2 We assume that at some stage it will be necessary to raise additional revenues from taxation (though we recognise that how much and how soon are, as they should be, matters of significant political and economic debate). This is an opportunity to make structural changes and improvements to the tax system, identifying the key fault lines within the current regime, and setting out a plan or roadmap for how these will be addressed.
- 3.3 The government faces some difficult choices. Historically, there has been a tendency to make surprise Budget Day announcements, presenting them in the best possible light. But then downsides are identified - most tax changes have them - and detailed consequences that perhaps had not been anticipated by those who had contributed, in secrecy, to the Budget decisions. In some cases announcements are withdrawn in response to criticism (such as the increase in class 4 National Insurance contributions announced by Philip Hammond), or amended when (after the event) limited consultation takes place (such as the 'death of the tax return' announced by George Osborne). Frequently however the government of the day faces down criticism, and taxpayers have to live with sometimes bad consequences, whether anticipated or not. This approach has consistently tended to lengthen the tax code and make it more complex, a process which had begun to feed

upon itself as the need to maintain the system and deal with anomalies that emerge over time is largely subsumed into the Budget decisions with secrecy prevailing at crucial times.

- 3.4 The better approach would be to deal with problems in the system head-on; raising them publicly, having open consultation, with no pre-determined detailed solution. There is evidence that individuals' understanding of the tax system is reducing. We believe that a greater awareness of the issues, and the need to make changes, will better enable the government to make difficult decisions – not necessarily in confidence that they will be welcomed – but in confidence that they will be understood. To achieve this we urge the government to follow its Tax Consultation Framework,² to which it has re-committed,³ and be mindful of the recommendations of the CIOT/IFS/IfG Better Budgets report,⁴ to ensure that any reforms are evidence-based and benefit from widespread consultation.
- 3.5 The Committee will be aware of a number of other inquiries and reviews which are currently underway. We have recently responded to the Public Accounts Committee's inquiries into the Management of tax reliefs⁵ and Tackling the tax gap.⁶ This latter evidence has not yet been published by the PAC, and so we have sent it to the Committee under separate cover. Many of the comments in those submissions overlap or are relevant to the present inquiry. The Office of Tax Simplification is undertaking a review of capital gains tax,⁷ to which we have provided an initial response⁸ and we will respond more fully in due course. As noted later in this evidence, a review of business rates is currently being undertaken⁹ and again we will respond in due course. All of these form part of the overall tax 'picture' and will help inform the future shape of the tax system.

4 *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?*

4.1 Working practices

- 4.2 There is a growing trend away from long term employment, towards multi-jobbing / short term employment and self-employment, or a combination of employment and self-employment. This reflects broader changes in the economy, but must be influenced by the fact that employment is more heavily taxed than self-employment.
- 4.3 Broadly there are two significant impacts on the tax base of changing patterns of working from employment toward self-employment (whether substantive, or contrived).

² See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/89261/taxconsultation-framework.pdf

³ See <https://www.gov.uk/government/publications/the-new-budget-timetable-and-the-tax-policy-making-process/the-newbudget-timetable-and-the-tax-policy-making-process#tax-policy-making-principles>

⁴ See <https://www.instituteforgovernment.org.uk/publications/better-budgets-making-tax-policy-better>

⁵ See <https://www.tax.org.uk/policy-technical/submissions/management-tax-reliefs>

⁶ See <https://committees.parliament.uk/work/475/tackling-the-tax-gap/>

⁷ See <https://www.gov.uk/government/consultations/ots-capital-gains-tax-review-call-for-evidence-and-survey>

⁸ See <https://www.tax.org.uk/policy-technical/submissions/capital-gains-tax-simplification-review-stage-1-high-level-business>

⁹ See <https://www.gov.uk/government/consultations/hm-treasury-fundamental-review-of-business-rates-call-for-evidence>

- 4.4 First, because employment is more heavily taxed - we address this in the 'three person problem' section below – public revenues are reduced even if all tax due is received in full.
- 4.5 Second, the tax take in respect of employment is received by HMRC through the PAYE system, with less need for intervention, and more reliability and regularity than that from self-employment. The tax gap from PAYE is estimated at just 1% of total PAYE liabilities, whereas the tax gap from self-assessment is some 12.9%, and indeed 22.9% for self-assessment from business taxpayers.¹⁰ The Office of Tax Simplification was mindful of these factors during its 2019 review 'Tax reporting and payment: Simplifying tax for self-employed people and residential landlords'.¹¹
- 4.6 More needs to be done to identify the causes / behaviour contributing to these differentials, and to take steps accordingly. For example:
- Payment of tax – Would the self-employed be helped by a system of deduction from 'earnings', or a requirement to pay tax at more regular intervals, or a more real-time system of taxation? Many, particularly the unrepresented, struggle to know how much to set aside for tax. (Just one consequence of a complex system.) But others would resent being made to pay tax earlier and indeed this could affect businesses' cash flow. We look forward to HMRC's call for evidence on this, as set out in their ten year tax administration strategy.¹²
 - Mistakes – HMRC state that small businesses are the single greatest contributor to the tax gap behaviours of error and failure to take reasonable care. The complexity of the tax system and challenges in accessing guidance on GOV.UK are undoubtedly factors in this. We are sceptical as to whether Making Tax Digital will make as significant in-roads into the tax gap as quickly and as much as HMRC estimate.
 - Illegal behaviour – Levels of evasion and operation in the hidden economy remain stubbornly high. There appears to be insufficient deterrent / risk of being caught, which means that the cash economy has continued to thrive.
 - Ease of compliance – Whilst measures such as simple assessment are designed to reduce the number of people in self-assessment, different working practices (as well as, for example, pensioners having multiple pensions from many previous employments over their career, and more of them continuing to work in order to maintain their lifestyle) mean that millions of people still need to complete a tax return, and the process should be continually reviewed to ensure it is as simple as possible. One of the promised benefits of Making Tax Digital for Individuals was increased pre-population of figures by HMRC, and it was disappointing when funding constraints curtailed this work.
- 4.7 So, even if the rates of taxation across employment and self-employment are aligned, this will not necessarily equalise actual tax receipts across working practices. That said (and subject to other issues such as employment law) there would be less of an incentive to claim self-employment status, and it is likely that more individuals would be taxed through the more 'secure' PAYE system.

¹⁰ See Table 1.1 'Tax gap components' of Measuring tax gaps 2020 edition at <https://www.gov.uk/government/statistics/measuring-tax-gaps>

¹¹ See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/843531/OTS_Tax_reporting_and_payment_review.pdf

¹² See paragraph 5.4 at <https://www.gov.uk/government/publications/tax-administration-strategy/building-a-trusted-modern-tax-administration-system#our-10-year-strategy>

4.8 Demographics

4.9 As noted in paragraph 1.4 we have prepared a separate submission on devolved taxes, which highlights some demographic issues.

4.10 Another factor is the ageing population in the UK. For example, the Office for National Statistics estimates that in 50 years' time, there will be an additional 8.2 million people aged 65 years and over in the UK.¹³ We do not have the expertise to comment on the economic cost of this change in demographic, but we observe that income generated by those over pension age is typically subject to less overall 'taxation' as they currently do not pay National Insurance. Taxation of those over pension age may need to be reviewed if the tax burden is to be fairly spread across the adult population.

4.11 Environmental and other 'sin' taxes

4.12 We have become accustomed to increased levels of taxation, and indeed new taxes, to deter 'bad' behaviour. These can encompass environmental protection measures (such as fuel and air passenger duties, landfill and aggregates taxes, and benefit in kind charges based on levels of emissions), as well as health protection measures (such as excise duties on cigarettes and alcohol, and the soft drinks industry levy).

4.13 Some of these taxes, particularly fuel duties and excise duties on cigarettes and alcohol, are so significant they have essentially become a 'structural' part of the tax system, and are estimated to collect in 2019-20 £27.5bn, £8.8bn and £12bn respectively.¹⁴ But changes in behaviour and technology – welcome as these are in terms of the objectives of these taxes - put these receipts in danger. For example, revenues from fuel duty (and some other taxes) are threatened by the advent of electric cars and the prospect of petrol and diesel cars being displaced.

4.14 A long-term tax strategy for climate change / environmental taxation should be developed. At the moment, we have a variety of taxes which increase as environmental behaviour worsens, along with a number of reliefs and incentives for 'good' environmental behaviour, but these do not necessarily represent a coherent whole, nor address how tax revenues will be replaced if behaviour improves and climate change goals are achieved. It is questionable how effective complex and detailed environmental incentives, which are regularly tinkered with at Budget times, are as compared with significant charges on things known to be 'bad' – such as fuel duty has been: there has to be a suspicion that tinkering is favoured because it attracts positive headlines and less political resistance. Taxation is just one element of the environmental 'piece', and should form part of a wider climate change strategy.

4.15 How should 'sin' taxes be evaluated? It is inherent in their design that they seek ultimately to change behaviour and therefore undermine themselves as revenue-raisers in the process. They are 'successful' if they achieve the behavioural change they encourage, but raise less taxation as a result. For example, the soft drinks industry levy was expected to raise £520m in 2018-19 and £500m in 2019-20.¹⁵ In fact levy receipts were £240m in 2018-19 and £336m in 2019-20, largely we are told, due to producers reducing the amount of sugar in their drinks. Therefore, something else will need to plug the gap in tax revenues if the behavioural

¹³ See

<https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/articles/overviewoftheukpopulation/august2019>

¹⁴ See [Tax and NIC receipts: information and analysis \(March 2020\)](#)

¹⁵ See [Tax and NIC receipts: information and analysis \(March 2020\)](#)

change is greater than expected, unless there is an equivalent reduction in government spending (on, say, healthcare costs).

4.16 So in the development of such taxes, particularly if they are very significant, do we need some scenario planning, where the consequences of different outturns are considered, both in terms of alternative revenue sources and in terms of potentially offsetting impacts on expenditures (such as tobacco duties on health)? This is another example of where a more transparent approach would help public debate: currently on Budget Day and with similar ‘fiscal events’ a single projection is published predicting the net impact on government revenue and spending of proposed changes, but it is rare to see much published about the inherent uncertainties or any post hoc review of how things went.

4.17 Home ownership and other factors

4.18 Over many decades the tax system has been used to support public policy to promote home ownership. For example, in 1963 the ‘Schedule A income tax charge’ on the benefit of owner occupation was abolished; later, when capital gains tax was introduced, gains on disposals of a ‘principal residence’ were, and remain, exempt; in recent years an additional allowance has been introduced to protect more family homes more fully from falling within the charge to inheritance tax, while council tax has become increasingly regressive. Since the 2008 financial crisis, it has seemed more clearly unlikely that home ownership is a realistic objective for everyone, and indeed it has declined proportionately due to the rise in house prices. On the other hand, over a decade of very low interest rates has benefited mortgage payers more than renters and many older and wealthier people in particular now own property outright. One might view the 2015 changes to restrict interest deductibility for buy to let landlords and introduce a new stamp duty charge on second home owners as in part a response to these developments but they have probably done more to add further complexity into the taxes concerned than to make a serious impact on these issues. All the elements of this issue are undoubtedly matters of significant political and economic controversy and of conflicting considerations, but there is a case for a comprehensive look at the fairness of this aspect of the system overall, encompassing all the relevant taxes (and potentially relevant proposals, such as wealth tax).

4.19 Other factors include the impact of the current recession (the last recession was in 2009 and understandably led to a reduction in tax receipts), developments such as cryptocurrencies and how their use might be monitored and the associated transactions taxed, the longer-term impact of Brexit and changes to customs and VAT regimes as well as the impact on treaties and mutual assistance provisions with other EU countries.

5 ***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?***

5.1 It is by no means clear that globalisation and new technology are systematic threats to the tax base. Insofar as they create more economic value, there is more value available to tax. They may require more taxation, to enable governments to compensate particular groups who lose out as a result of globalisation and new technology, and they may threaten the tax base of particular taxes, which are based on activities that get superseded (as with fuel duty). But other new activities appear and other groups benefit. Thus the maintenance of the tax system may require new taxes, levied on activities that result from globalisation and new technology, and the people who have benefited from them. This is the case even if these activities are, on balance, ‘good’ and even if the people who have done well from them are ‘deserving’. Sometimes it seems

from public discussion of tax that there is a presumption that it should only be levied on ‘bad’ people or activities; this approach is likely to be too limiting to give practical answers.

- 5.2 It is true that globalisation and digitalisation have led to some ‘new’ activities being concentrated in a small number of companies, which have been able to direct much of their profits to low tax jurisdictions. (Although it is likely that the US has been the main tax authority losing from such activity, as until recently it retained a relatively high corporate tax rate and, because of deadlock in Congress, a tax system that was vulnerable to artificial planning.) The most effective route to combatting profit shifting has been and is likely to remain multinational agreement through the OECD. But the existence of effective monopolies or near-monopolies cannot be solved entirely through taxation, and may require wider intervention to be considered.
- 5.3 Tax competition does act as a constraint on tax policy, but its impact can be exaggerated. Other countries need to collect tax revenues too. Corporation tax, which is levied to a considerable extent on the profits of multinational businesses, is perhaps the most affected by globalisation, particularly as the UK’s is a very open economy, but reductions in the rate over decades have very largely been accompanied by broadening of the base and it has therefore continued to generate significant revenues (much more significant in recent decades than in the 1970s). Indeed, anticipated total corporation tax receipts are £61.3bn in 2019-20, nearly twice what was collected in 2000-01, and over 40% higher than in 2015-16 – just four years previous¹⁶ - though recent increases are due in particular to growth in companies’ profits and the introduction of the Bank Surcharge. Although it is a lower percentage of GDP than for most of the first decade after 2000,¹⁷ reflecting a clear policy priority of the then government, corporation tax remains a major contributor to the tax take and the general picture remains that this has increasingly been the case over the last 50 years or so.
- 5.4 Taxation of multi-nationals
- 5.5 An approach to relaxing the constraint posed by tax competition, and one that could in principle lead to the UK collecting more revenue from multinationals, is to seek either to plug gaps in the taxation of their international profits; or to seek to renegotiate the allocation of profits between jurisdictions such that the UK gets a larger share.
- 5.6 The OECD is continuing to work towards a consensus-based, long term solution which address the tax challenges raised by the impact of digitalisation of the economy and its effect on the sharing of international profits arising from multinationals. This is being done through the Programme of Work for Addressing the Tax Challenges of the Digitalisation of the Economy adopted by the Inclusive Framework on BEPS in May 2019 (‘Base Erosion and Profit Shifting’ - the process is of course directed at combatting, rather than promoting, these things albeit it is always referred to by the BEPS acronym). The work is developing two strands – a Unified Approach under Pillar One and the Global Anti-Base Erosion Proposal (‘GloBE’) under Pillar Two. Together these two new sets of rules for international taxation are intended to address remaining BEPS concerns and provide an agreed reallocation of taxing rights, reflecting the changes to the global economy caused by digitalisation. Currently, although the work is progressing, international agreement on these new rules by the target date of the end of 2020 looks increasingly unlikely.
- 5.7 The UK has been at the forefront of implementing the recommendations of the BEPS project; indeed the UK government’s policy could often fairly be described as ‘going first’, and also in many cases the furthest, in implementing the BEPS recommendations.

¹⁶ See [Tax and NIC receipts: information and analysis \(March 2020\)](#)

¹⁷ See <https://data.oecd.org/tax/tax-on-corporate-profits.htm#indicator-chart>

- 5.8 There are obvious limits to negotiating a larger share for the UK, because to 'succeed' requires other countries to acquiesce in a lower share, or at least to miscalculate in their negotiating positions. The UK could seek to impose effective double taxation, either by imposing unilateral requirements such as the recent Digital Services Tax, but this risks retaliation by other countries (currently threatened by the US), and incurring economic costs and competitiveness effects comparable to what would arise from simply increasing the tax rate. We would also note that a change to the international allocation of profits could be negotiated that is net neutral today (for all) but it is much more difficult to address unforeseen developments in either technology or the global economy which might affect the jurisdictions to which multinationals' profits are allocated in the future. So the most apparently hopeful focus is in plugging gaps.
- 5.9 Historically a major area in which such gaps have arisen is that of capitalisation and in particular intercompany debt. Generally, interest and other costs of debt are deductible and, before the 2008 financial crisis, market interest rates were from time to time quite high. Multinationals could achieve a significant tax break by loading debt finance into relatively high tax countries, or even achieving effective tax deductions for economically the same debt costs in multiple jurisdictions. However there are multiple heads under which such debt deductions can be denied in the UK and indeed in most countries. These have accumulated over decades (including many in the recent past) in the form of anti-avoidance legislation. Some have been introduced to implement aspects of OECD initiatives such as BEPS. Others have been introduced unilaterally, but accepted or acquiesced in by OECD and/or other countries and, to an extent by multinationals, as being legitimate anti-avoidance which should be accepted without attempts at retaliation, workarounds or simply avoiding investing in the UK. In addition to all of which, market interest rates have been very low now for over a decade. So all in all, this line of enquiry, while it has been essential, may be close to being an exhausted seam in terms of seeking additional revenues; although consideration might be given to whether an increase in interest rates might necessitate further intervention.
- 5.10 What may be a more fruitful area for consideration is intellectual property ('IP'). Multinational groups can, generally speaking, impose charges on one group company for the use of IP owned by another and achieve a tax deduction for that in the jurisdiction of the paying company. To the extent that this simply rewards the receiving company for R&D that it has undertaken this could be entirely legitimate. But there is a potential for abuse if they can then construct means of being taxed on a more favourable basis (or in the extreme case avoid tax altogether) in the jurisdiction of the receiving company. Tackling such abuse could increase revenues with likelihood of international acceptance of that outcome. There are existing anti-avoidance measures in the IP field and current OECD activity is in part directed at it. However IP can be attributed with potentially very large and fluctuating values so the amounts at stake from aggressive avoidance could be large. Historically, it may fall behind debt financing costs in terms of the level and persistence of anti-avoidance efforts that have so far been directed at it.
- 5.11 Taxation of individuals
- 5.12 Globalisation and digitalisation affect not only business taxation, but also the taxation of individuals. Certainly the past six months suggest that an individual can be as effective when working at home, or remotely, as they are when in a physical office.

- 5.13 As our evidence¹⁸ to the Finance Committee of the National Assembly for Wales earlier this year explained, rates of taxation can be a factor in determining where an individual lives and works. Whilst for most people it will not be the determining factor (those being family ties and responsibilities, housing costs etc), it can be influential particularly considering the ability to commute between England and Wales, or England and Scotland, etc. As the need to commute reduces, this opens up much greater choice in terms of where to set up home.
- 5.14 High earners / wealthy individuals in particular are typically more ‘mobile’ as regards choosing where they live and work, and so more able to respond to changes in rates of taxation where it would be sufficiently advantageous to do so.
- 5.15 We suggest, therefore, that there will be an increasing flexibility over where individuals choose to locate themselves, as it becomes less necessary to be physically close to an employer / clients. For most this remain a domestic choice, but for some it could include a move overseas to a country with lower rates of taxation.
- 5.16 Consumption taxes
- 5.17 Online purchasing intensified during lockdown, accelerating a trend toward the physical location of the seller becoming less important. Whilst many consumers will have purchased from the online presence of their usual supermarket or department store, it can be as easy to buy online from other sellers, including those overseas. The tax system (largely through VAT and import duties) broadly levels the playing field in this regard (along with the measures in place to ensure compliance), but the ease of buying goods and services from abroad, and consumers’ willingness to do so, should not be underestimated.

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

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

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

- 6.1 We take these three questions together. And to reiterate what we set out above, the following comments are not intended to be recommendations by the CIOT, but are included in order to prompt discussion and debate
- 6.2 The three largest taxes are Income Tax, VAT and National Insurance. They raise over 60% of all tax receipts (almost a quarter comes from income tax and a little less than 20% each from VAT and NICs.) They are very broad taxes which is why they raise a lot of revenue. However there are some categories of income and expenditure which are outside the scope of these taxes. These reflect political choices made, or left unchallenged, in the past. There is no tax technical ‘right answer’ to whether these should be maintained in light of the effect of COVID on the public finances. However there is something to be said for at least debating whether these exclusions - which are significant in terms both of revenue impact and of the broader issues involved – continue to make sense in the modern world.

¹⁸ See

<https://www.tax.org.uk/sites/default/files/200113%20Wales%20Impact%20of%20variations%20in%20national%20and%20sub-national%20income%20tax%20-%20CIOT%20and%20LITRG%20joint%20response.pdf>

6.3 The 'three person problem'

6.4 The 'three person problem' is that an individual doing essentially the same activity can be taxed very differently depending upon whether they are an employee, are self-employed, or operate through a company.

6.5 The CIOT considers that there needs to be a wide, open and very public debate on the tax treatment of different kinds of work structures. A key point is whether the tax and benefits systems should aim for a completely level playing field between employment and self-employment – and if 'self-employed' whether within or without a corporate 'wrapper' - or whether differentials should be accepted and the focus put on trying to reform and clarify existing distinctions. If significant differentiation is to remain in terms of the tax treatment and benefits entitlements of different working statuses then we think they should be redesigned so that there are much clearer definitions around the borderlines.

6.6 There are different aspects to this issue, but the main themes revolve around employment versus self-employment, and incorporation versus non-incorporation.

6.7 *Employment versus self-employment*

6.8 The imbalance between the tax burdens on employment and self-employment remains very large, mainly because of the 13.8 per cent cost of employers' national insurance contributions (NIC). This may be the biggest issue to be addressed if the tax system is to keep pace with evolving working practices. Other aspects include the regimes for deductibility of expenses (stricter for employees) and, for larger employers, the 0.5 per cent Apprenticeship Levy which came in in April 2017.

6.9 As a starting point in the debate as to how the system could be reformed, one could consider adapting the present narrow scope of employers' NIC (and the Apprenticeship Levy) to broaden it beyond employed workers so that businesses pay a new 'business social contribution' instead. If, however, we move away from the existing scope of this tax, based on the existence of a legal employment relationship, to try to deal with the issues which it raises of fairness, economic distortion, and erosion of the tax base, we do need to recognise that there will be difficult issues in defining the expanded scope of a replacement. Consultation is essential if a better result is to be achieved, and public confidence in the new scope of the tax established.

6.10 We expanded on the above in our response to the Independent Review of Employment Practices in the Modern Economy (Taylor review).¹⁹

6.11 Attempts to address this issue to date have taken the form of anti-avoidance, most recently focused on ensuring compliance with the 'IR35 rules' to ensure that a worker operating through a company, who would have been an employee if they were providing their services directly to the client, pay broadly the same tax and NIC as employees.

6.12 These measures have introduced significant complexity, and remain unpopular. Identifying whether a worker is, or would have been, an 'employee' is not straightforward, and the Check Employment Status for Tax (CEST) tool remains distrusted.

¹⁹ See <https://www.tax.org.uk/policy-technical/submissions/independent-review-employment-practices-modern-economy-taylor-review>

- 6.13 But even if a worker is ‘caught’ by the off-payroll rules, they only become a deemed employee for employment taxes purposes. This has the following effects:
- The parties bear the tax consequences of employment, but not the employment law consequences. Many engagers have started to put these individuals on their payrolls, no doubt providing the result sought by HMRC, and we recognise the significant additional tax revenues this measure has generated / expects to generate.²⁰ But a closer approximation of the overall tax burden between the employed and self-employed would help curtail the desire, particularly by employers, to keep workers off the payroll – or at least it would do so to the extent that the motivation for this is tax related rather than for other commercial reasons.
 - The position for other taxes, particularly VAT, remains unchanged. Whilst it would add further complexity to also unwind the VAT position, it results in the undesirable position of an individual being treated as an employee for one tax, but self-employed for another. It could also lead to double taxation, particular where the engager works in the VAT-exempt sector, where in addition to the irrecoverable VAT cost, it will also then bear employment costs.
- 6.14 We are not necessarily advocating full alignment of tax and employment law rules, which for valid reasons may need to be different. (Though policymakers certainly need to consider the interaction between the two.) It is the significant differentials of overall treatment within the tax system that need to be addressed.
- 6.15 *Incorporation versus non-incorporation*
- 6.16 Tax rates remain one of the factors motivating businesses to incorporate.²¹ A number of changes in recent years have mitigated the tax benefits of incorporation, such as the introduction of the dividend rate in April 2016, the reduction in the dividend allowance to £2,000 in April 2018, and cancellation of the proposed reduction in the corporation tax rate to 17%. But there remains, for some, a clear tax benefit in operating what is broadly the same underlying business, but within a corporate ‘wrapper’.
- 6.17 Whilst Entrepreneurs’ Relief (‘ER’) has recently changed to become business asset disposal relief (BADR), we do not think this will have a significant impact on the level of incorporations. This is largely because evidence suggests that the availability of ER is not one of the drivers for incorporating or setting up in business in the first place.
- 6.18 Customer pressure has also historically fuelled incorporations, largely to protect the customer from employment taxes and obligations. However, the off-payroll working rules are expected to significantly curtail this demand. Other factors motivating incorporation are limitation of liability, and the desire to appear ‘bigger’ or more substantive.
- 6.19 The number of privately incorporated businesses continues to rise, increasing from 3,642,429 in 2016/17 to 4,058,637 in 2019/20.²² Indeed, the number of incorporations in 2018/19 (672,490) – ie after the reduction in the dividend allowance to £2,000 – was the highest for nearly ten years.

²⁰ See the estimates at <https://www.gov.uk/government/publications/rules-for-off-payroll-working-from-april-2020/rules-for-off-payroll-working-from-april-2020>

²¹ See, for example, HMRC Research Report 317 ‘Reasons behind incorporation’ at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/342335/HMRC_Research_Report_317_-_Reasons_behind_incorporation.pdf

²² See <https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2019-to-2020>

- 6.20 It is also remarkably easy to incorporate a company – a ‘do it yourself’ incorporation of a private company costs just £12, and many businesses might incorporate simply because it seems to be becoming the ‘norm’, rather than through any conscious decision. Considering it is so easy to incorporate, we suspect that the commitment to rolling out Making Tax Digital to income tax from April 2023 will lead to more businesses incorporating.
- 6.21 The Committee will be aware that, in 2016, the Office of Tax Simplification (OTS) undertook a review of small company taxation²³ which discussed the prospect of ‘Lookthrough’ taxation²⁴ as well as possible alternative business structures such as a ‘sole enterprise with protected assets’ (SEPA). The CIOT responded to this review.²⁵ Whilst we did not support a completely new taxing mechanism, such as Lookthrough taxation, we considered (and remain of the view) that there is an intellectual appeal – as well as issues of fairness - in trying to even out the taxation treatments of different businesses structures.
- 6.22 It might be necessary to draw a distinction between companies which employ individuals who are generally quite distinct from its owners (who may be widely distributed, especially in the case of quoted groups); and those where there is substantial overlap between owners and employees (who in the extreme case, might be the same one individual). We recognise there could be issues around complexity and cliff-edges, but these could be explored through consultation.
- 6.23 If a legally robust way of distinguishing between the two types of company could be established, it would be possible to determine the tax rate for owner/worker companies primarily by reference to the need to keep the tax burden on the employer, the self-employed, and owner/managers operating through a company broadly comparable; while setting the rate for companies where ownership and employment are separate set with an eye to international competitiveness.²⁶
- 6.24 There would then be a political challenge that the owner/manager companies would likely be subject to a higher corporation tax rate than multinationals (or perhaps instead, their owners would be subject to a higher dividend tax rate than applied to portfolio dividends). The justification for this would be that in the case of multinationals, corporation tax is in addition to (for example) employers’ national insurance in respect of their UK employees, and the fact that their employees pay full employment income tax rates on their earnings from the company, whereas for owner/manager companies the corporation tax rate is in part a substitute for these taxes and contributions.
- 6.25 VAT
- 6.26 There are numerous exemptions, or zero or reduced rate goods and services, for VAT purposes. One of the largest (at nearly £19bn pa, equivalent to something like a 3% change in the headline rate) and one often regarded as a political taboo, is zero-rating on food. Presumably the logic for this is that food is a necessity. VAT is not a particularly progressive tax, as people’s spending does not rise fully in proportion to increases in their income. However, the distributional effect of a tax depends on what the money is spent on, and on what is the alternative way proposed of raising revenue. Even if they do not spend more as a proportion of income than the poor, the rich spend more on food in absolute terms. So the benefit of the relief is inherently

²³ See <https://www.gov.uk/government/publications/small-company-taxation-review> and

²⁴ See <https://www.gov.uk/government/consultations/lookthrough-discussion-document#history>

²⁵ See <https://www.tax.org.uk/policy-technical/submissions/ots-discussion-document-lookthrough-taxation-ciot-comments>

²⁶ Technically, existing definitions of ‘close company’ might be a first draft of such a distinction, though given that there is a spectrum of types of company, rather than companies who are very clearly in one or other of two categories, it will be challenging to conclude on a tight distinction which will also command respect.

untargeted. Those on lower incomes could be more than fully compensated for the end of food zero rating, for only modest proportions of the overall saving.

- 6.27 There is also the question of who benefits from the relief. Because identifiable non-necessities such as sweets, chocolates and alcoholic drinks are excluded from zero-rating, there is a long history of disputes and litigation between retailers and manufacturers, and HMRC, as to whether it applies to particular product lines. Retailers inevitably take a view as to the likely outcome of these disputes (which can take many years to resolve) at the outset and charge the customer accordingly – often simply the price that the market will bear. When they either win or lose their dispute with HMRC, they do not trace the individual customers to refund, or seek to surcharge them, which would anyway be wholly impractical. So irrespective of the dispute, the customer may in fact have seen no difference in price.
- 6.28 Similar arguments arise, with varying force, with most (if not all) of the other zero or reduced rate or exempt items. The policy rationale which underpins each of these items should be reviewed, to determine whether a blanket relief in the form of no or reduced VAT is the right approach.
- 6.29 The zero and reduced rates also promote behaviours which make no sense other than to fall within these lower rates. For example, Pringles in the UK contain high levels of rice starch (rather than potato starch), in order to meet the (arguably irrational) rules to qualify for zero rating. Indeed, across the VAT system there are numerous seemingly arbitrary distinctions between one activity or product which has one VAT treatment, and a similar one which has a different treatment. In the twenty-first century it seems odd to have a tax system with such eccentricities.
- 6.30 National insurance contributions
- 6.31 NICs are functionally very hard to distinguish from taxation. Even though important elements of a contributory principle remain, and it is clear what benefits contributions pay for²⁷, it is hard to avoid the perception that they are simply an additional tax.
- 6.32 Media commentators periodically argue that they should be merged with income tax. The Office of Tax Simplification produced a more modest proposal in 2016²⁸ that the bases for calculating income tax from employment and employees' NICs should be aligned. There would be 'winners and losers' from this change - generally, some with fluctuating incomes, varying around the upper threshold, would lose out - and the report has not been implemented.
- 6.33 There are wider gaps, some inherent in the original design and purpose of NICs - unearned income is excluded, income above the upper threshold is excluded from the all but the 'surcharge' element of employee contributions, earnings of people aged over 65 are excluded, and pension contributions are excluded while pension income is not included either - so lifetime earnings that are saved through the pension system and enjoyed later receive an absolute break from this 'tax'.
- 6.34 Pensions
- 6.35 The system of relief from income tax and NICs in relation to pension saving was last comprehensively reviewed in 2006. Within very generous limits, exemptions were given during working life to income

²⁷ See <https://www.gov.uk/national-insurance/what-national-insurance-is-for>

²⁸ See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/567491/OTS_report_web_final.pdf

reinvested into pensions, then pensions were taxable as drawn down. Subsequently, there has been commentary that this system most benefits those on higher earnings. This is indeed an inherent feature - the more one earns and can effectively defer till drawing a pension, the bigger the tax deferral - though this is subject to annual limits on contributions and to lifetime limits on aggregate amounts, assessed at various defined times. Since the 2008 financial crisis, these limits have been tightened significantly (though in complicated ways, and with the 'tapering restrictions' to annual contributions being partially relaxed in the March 2020 Budget), and 'pensions freedom' have been introduced, but all within the architecture of the 2006 system, which has now become very complex as a result. All these changes have been Budget 'surprises' with little or no consultation, particularly in advance.

- 6.36 While mostly the system operates to defer tax, there are elements of absolute tax breaks to it, which do not generally have an obvious rationale, and it benefits higher earning people relatively more (though as partially tempered by the complexity of the limits). First, as noted, there is a complete exemption from NICs. Second, 25% of accrued pension rights can be taken as a tax free lump sum. Third, people with very high earnings for some years during working life can get relief at the highest rates and then pay tax at relatively lower rates during retirement if they then enjoy more modest incomes.²⁹ Finally, deferred incomes left in the fund on death can be left to be enjoyed by one's heirs, usually free of IHT, subject to their own marginal rates of income tax which may be lower than the rate of relief applied to the original contributions.
- 6.37 These are politically and economically sensitive matters in which it will be difficult to achieve consensus and in which technical issues of various disciplines interact with political choices. People have expectations developed over many years and it is clearly undesirable to 'chop and change' too often. However comprehensive, public, consultative review seems overdue.
- 6.38 There has been one attempt at consultative review in this area. In 2015 the then Chancellor George Osborne consulted³⁰ on how the system could be reformed, including the possibility of fundamental reform moving to a system which is 'taxed-exempt-exempt' (ie pension contributions would be made out of taxed income, but then the income accruing from such savings within the fund, and the pension income derived from it, would be tax free). The reaction to the proposal was generally extremely hostile, and it was dropped. However, one merit of the proposal from the standpoint of a Chancellor concerned about public borrowing levels, is that for an entire generation, as the focus of the relief moves from pension savings to pension drawings, the cost of relief to public funds would be significantly reduced, benefiting the Exchequer greatly. (Income tax pension reliefs alone are estimated to cost well over £40bn pa.). This does seem worth revisiting in current circumstances. It may also offer a way of addressing the absolute tax breaks inherent in the current system, without needing to 'attack' one or more of them on an isolated basis. No doubt there were good reasons for the thumbs-down given to the earlier consultation but since then we have had the COVID crisis and the partial retreat in the 2020 Budget from the piecemeal complex measures taken over the last 12 years to reduce the weighting of benefits in the system toward the higher paid.
- 6.39 The taxation of pension contributions themselves is another area where anomalies exist which mean people in comparable situations are not treated comparably. A glaring example is the flaw in the tax system which means that many of those whose employer operates or contributes to a 'net pay' pension scheme (NPS)

²⁹ One might take the view that this particular benefit does have a rationale, in compensating for what might otherwise be seen as excessive weight given by an annual progressive income tax system to very high earnings enjoyed for only a few years' period in life

³⁰ See <https://www.gov.uk/government/consultations/strengthening-the-incentive-to-save-a-consultation-on-pensions-tax-relief#history>

rather than a relief at source (RAS) scheme are being unfairly charged 25 per cent more for their pension contributions. Around 1.7 million low-income workers (mostly women) are affected by this injustice. The CIOT's Low Incomes Tax Reform Group has identified a possible solution to this anomaly which would allow HMRC to identify which savers, earning below the income tax threshold, have contributed to a net-pay scheme and therefore effectively been charged more than similar savers contributing under a relief at source scheme. HMRC could then provide that government incentive, worth 25% of each low-paid worker's pension contribution, through an existing process. LITRG will cover this issue in more detail in their own submission to the inquiry.

6.40 Business rates

6.41 Business rates are already to be reviewed.³¹ These are payable by occupiers of business property. They display four key features distinguishing them from land value tax (LVT - which is widely promoted by economists and others as an intrinsically sounder system):

- Business Rates do not cover residential property, to which a separate system of Council Tax applies. (Historically residential rates, a predecessor to Council Tax, diverged from business rates because of the difficulty of imposing higher rates on domestic occupiers for many of whom this is by far the largest tax they pay that is not normally deducted in some way at source. Ireland has tried to address a similar issue by arranging for an option to have this tax deducted from salaries. This has some interactions with the issues around home ownership referred to in section 4 above.)
- There are exemptions from Business Rates, notably for agricultural land and in the case of occupiers who are charities (whereas the arguments on which LVT are based would tend to suggest there should be few if any exemptions). Exemptions based on the type of occupier would be harder to incorporate into LVT, but in any event it is debateable who economically benefits from exemptions anyway – is it the 'exempt' occupier or is the landlord thereby able to impose higher rent? (Though the prevalence of charity shops on some high streets, perhaps reflecting the competitive advantage derived from the exemption, suggests that this question should be approached carefully and on the basis of evidence.)
- Business Rates are based on rateable values - the amount which they could be let out for - so any building or improvement which increases the rent-earning capacity of the property leads to a higher rateable value. This is in contrast with LVT, the base for calculation of which is the notional value of the land alone, although there is a practical issue around the valuation excluding non-land elements of value.
- Business Rates are charged on the occupier rather than the landowner. (The Government is consulting on changing this.)

6.42 The last feature is the only one that the Government's current proposal would, broadly, change. (As regards exemptions, it would seek to apply them more consistently). This last feature is of considerable importance, but maybe not as much as it first appears. Whenever a business takes a lease of a property on which it will pay rent, the business rate cost that will also be taken on in consequence, is known within a much greater range of certainty than many other costs and benefits of taking out the lease of that property in that location. It seems reasonable to suppose that there is a strong inverse relationship between rental and Business Rates levels, such that a great deal of the effective economic cost falls on the landowner. This is often forgotten in calls by hard pressed business sectors for Business Rates relief.

³¹ See <https://www.gov.uk/government/consultations/hm-treasury-fundamental-review-of-business-rates-call-for-evidence>

- 6.43 If particular businesses which occupy high value property struggle, the Business Rates will appear a huge burden but other businesses are around to take over the leases which generate the liability. But if whole sectors of the economy find high value premises of less business value to them, one would expect rents to fall and so the base for Business Rates to decline, implying that more revenue will have to be sought from elsewhere.
- 6.44 Under LVT, owners of land apt to be used by sectors in decline would also likely pay less, as land values might fall (though perhaps the value of the land element might fall less than the overall property value). However the fact of having a particular struggling business tenant would have little impact.
- 6.45 The argument that we ought in some sense to 'save the high street' (or more accurately, save the current way of using the high street) from the impact of people changing their preferences (accelerated by the COVID crisis) toward online shopping is a curious one - why shouldn't we respect people's preferences and not try to penalise them? However insofar as the old pattern of behaviour generated more tax through Business Rates than the new pattern does, we will perhaps need to look at new sources of tax.
- 6.46 Commenting on the launch of this Inquiry, the Chair of the Treasury Committee noted the difficulties being faced by many high street businesses which are struggling to remain competitive, and the substantial financial burden that Business Rates can represent on the high street.
- 6.47 This is often the starting point in the current debate on fairness in relation to Business Rates which focuses on a comparison between businesses that may be similar in very high level terms (such as the broad category of a retail business selling to customers in the UK) but operate in wholly different ways, such as high street retailers that are reliant on retail outlets versus online retailers with lower reliance on commercial property. Some perceive that Business Rates operate unfairly because online retailers pay much lower rates on the UK warehouses or distribution units that they use than high street retailers pay on their premises, reflecting the lower amounts that could be charged as rent for them in the market. This raises wider questions. Should Business Rates be seen as a payment for local public services, or as a tax? If a tax, is it reasonable to base it on the use of physical premises in particular locations? And who, effectively, is suffering the burden of Business Rates anyway, when the interrelationship with rent to the landowner is taken into account?
- 6.48 Such debates around the competition between high street retailers and online retailers are often conflated with the quite separate issue around the recognition of value created by business activity in highly digitalised businesses and the extent to which it may not currently be recognised in the UK corporation tax base under internationally negotiated principles of allocation of taxing rights. It is this latter point that the Digital Services Tax ('DST') is intended to address and this is a very different target to the focus of property-based taxes.
- 6.49 The aim of the DST, which came into force in April 2020, is to devise a system that recognises value created by business activity in highly digitalised businesses that is not recognised in the current tax base. In this aim it is an adjunct to corporation tax and has no direct bearing on property-based business taxes (though of course a government may choose to use revenue raised by one tax to enable cuts in another). Specifically, in relation to online sellers, the DST is aimed at taxing the perceived value created by users (which are the buyers and sellers for online market places) and not the sales/profits from the sellers themselves; the DST is not a tax on online sales. There is little crossover in the tax base of Business Rates and that of the DST.
- 6.50 Income tax – progressivity
- 6.51 One of the key issues with the current tax (and benefits) system is its haphazard relationship with progressivity. Public discussion often assumes that the higher your income, the more your marginal rate of

tax will be. But this is not the case. For example, the personal allowance reduces by £1 for every £2 that an individual's income exceeds £100,000 (so that no personal allowance is available for those with an income over £125,000). But this results in an increased effective marginal rate of tax for those within that income range (generally 60%, as compared to the 45% highest headline rate on incomes fully above that level). For those on low incomes, the interaction between the tax and benefits system can result in an effective tax and benefits claw-back rate of over 80% as income increases. And in between, those parents caught by the High Income Child Benefit Charge can face very high marginal effective rates, depending on their numbers of children and the distribution of earnings between couples. High marginal rates can discourage responsible income growth and encourage behaviours to plan around the tax rules. The case for progressive rates is that the broadest shoulders should bear the biggest burdens but this objective is only served if they are imposed transparently and comprehensively and not as random traps for groups of people who are not at the very highest income levels and indeed in many cases are on very low incomes. These issues already tend to undermine the perceived fairness of the system and people's willingness to accept higher tax burdens and it will be even more important to address them if the fiscal environment becomes more challenging.

6.52 Certainty and stability

6.53 At this point it is convenient to remind ourselves of the Committee's principles of tax policy, and in particular the principles of certainty and stability.

6.54 Tinkering regularly with tax rates and allowances undermines the constancy and predictability that taxpayers and businesses crave – and even risks reducing the international competitiveness of the UK's tax system. For example, the seemingly constant chopping and changing of reliefs relating to capital allowances brings additional complexity and uncertainty to the UK tax system. It undermines investor confidence in the UK as most businesses cite certainty as more important than the precise amount of relief available.

6.55 So whilst we have set out above a number of areas potentially in need of reform, any attempt to address these should be done in a consultative manner, over a manageable period of time.

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?*

7.1 The effectiveness of the current regime of tax reliefs is difficult to evaluate. We have a number of observations (below) about why this is and how it might be improved. We set out our thinking in more detail in our response³² to the recent Public Accounts Committee inquiry 'Management of tax reliefs'³³. We endorse the findings of the National Audit Office report³⁴ which inspired that inquiry.

7.2 Evaluation of tax measures and reliefs - there is no formal framework governing the administration or oversight of tax reliefs. Governance of tax reliefs in the UK is not systematic or proportionate to their value

³² See <https://www.tax.org.uk/sites/default/files/200605%20Management%20of%20tax%20reliefs%20-%20CIOT%20comments.pdf>

³³ See https://committees.parliament.uk/work/330/management-of-tax-reliefs/?_cldee=aHZlcm1hQHRheC5vcmcudWs%3d&recipientid=contact-6a55978641c6e711810f70106faa2721-d22a686af4da4ce8a76afcc4d23b10da&esid=1e790c28-c9a1-ea11-a812-002248007f84

³⁴ See https://www.nao.org.uk/report/the-management-of-tax-expenditures/?_cldee=aHZlcm1hQHRheC5vcmcudWs%3d&recipientid=contact-6a55978641c6e711810f70106faa2721-884131f85aaa4e02b9f3948b2f6bbd6c&esid=c1d17590-0b4f-ea11-a812-000d3a86d581

or the risks they carry, and there is a mismatch between the significant effort in government (and to an extent Parliament) that rightly goes into new tax measures – albeit that the first three stages of the tax consultation framework (which relate to that stage of the process) are themselves rarely fully and satisfactorily respected - and the almost total lack of attention, at least so far as is visible to the outside world, as to how effective those measures prove over time. More systematic post-implementation reviews should be undertaken, either by HMRC, or independently of government, and then form the basis of scrutiny in Parliament.

- 7.3 Availability of data - Key to evaluating tax reliefs is the availability and accuracy of relevant data, but there appears to be a real lack of reliable, accurate evidence surrounding the take up and cost of tax reliefs (whether structural or non-structural). Over recent years significant proportions of tax reliefs are noted as being ‘particularly tentative and subject to a wide margin of error’. For proposed tax reliefs, we suggest that determining the data provision requirements could represent a mandatory part of the tax consultation process. This would ensure that the means of evaluating the relief are also explored, alongside the pros and cons of the relief itself. For existing reliefs, HMRC should engage with claimants and other stakeholders to determine how this information can be obtained in the future. Informed policy decisions can only be made if the underlying costings data is available.
- 7.4 Certainty and stability – as alluded to above, reliefs will have a limited behavioural effect if they are volatile and unpredictable. Tinkering constantly with rates and allowances in unexpected ways undermines the principles of stability and certainty that taxpayers need, and reduces the international competitiveness of the UK’s tax system. For example, in just over ten years, the level of Annual Investment Allowance (AIA) has changed five times, to amounts ranging from £25,000 to £500,000. The right level for AIA is a matter of political judgment but it is damaging if it is repeatedly altered, and causes complexity where a business’s accounting period spans changes in the AIA.

8 What are the areas for simplification?

- 8.1 Addressing some of the issues outlined above should in itself bring simplification because it would remove the necessity to make a tax-driven choice in order to avoid being disadvantaged compared with others. For example, if the taxation of ‘owner managed’ incorporated and unincorporated business was more closely aligned, the choice of business structure may be easier as it will be motivated by non-tax matters.
- 8.2 The taxation of small businesses is certainly an area that would benefit from simplification. The government was mindful of this in 2016 when it launched the consultation ‘Simplifying tax for unincorporated businesses’³⁵ as part of the raft of consultations around Making Tax Digital.
- 8.3 Our response³⁶ called for real simplification of the tax system, particularly for small businesses, such as a simple income-minus-business expenses model. The simplifications proposed in the consultation, and subsequently implemented, simply scratch the surface of what is necessary; particularly faced with the prospect of MTD for Income Tax from April 2023 which will have to deal with basis periods, private use adjustments, revenue versus capital distinctions and so on. Whilst simplification sometimes comes at the expense of detailed accuracy, and inevitably there will be winners and losers compared with the current

³⁵ See <https://www.gov.uk/government/consultations/business-income-tax-simplifying-tax-for-unincorporated-businesses>

³⁶ See <https://www.tax.org.uk/policy-and-technical/making-tax-digital/ciot-submissions-material>

position, these issues should become less problematic over time as the new simplified regime becomes the 'norm'.

- 8.4 As is widely accepted, the tax administration system is in need of simplification and reform. We are pleased that this is part of the government's plan to build a trusted, modern tax administration system.³⁷ There are many different compliance rules across the different taxes, which (ignoring the underlying tax rules themselves) can make compliance challenging – both for businesses and their agents, and for HMRC.
- 8.5 Rather than taking steps to align compliance obligations, recent changes have introduced new, one-off obligations (such as the new 30 day reporting for capital gains tax). Compliance is made more difficult when additional obligations and deadlines are introduced, especially when they represent a departure from the 'norm'.
- 8.6 We are concerned that this problem may become more acute under Making Tax Digital, particularly due to the quarterly reporting requirement. Even a simple business (eg a self-employed plumber who owns a buy to let property) could have a reporting obligation every month if it is not possible to align the trade, VAT and property reporting periods. Part of the simplification consultation referred to above suggested possible changes to the basis period rules. Whilst we had concerns over what was proposed, we understand that no further reform is expected before MTD is rolled out to income tax.
- 8.7 We have already set out above complexities caused by the different rates of VAT. We also endorse the findings of the OTS in its VAT review interim report,³⁸ especially around partial exemption and the capital goods scheme. We are pleased that HMRC subsequently launched a call for evidence in this area,³⁹ to which the CIOT responded,⁴⁰ and we are awaiting the outcome of this review.
- 8.8 As a general principle we do not believe that it is possible to make substantial progress in simplifying the tax system by 'adding simplicity', rather it requires 'removing complexity'.

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

- 9.1 Windfall taxes aim to tax gains which are unexpected and have either partially or wholly escaped general taxation or are so large and unexpected that it is felt legitimate to subject them to an additional levy to direct some of the benefit to the public purse. Often the wider public or significant sections of society will have lost out by the underlying events producing the windfall, so there is felt to be an element of levelling, both up and down.
- 9.2 In concept windfall taxes are retroactive in intent, even if not formally retrospective. Retrospective taxation is vulnerable to challenge on human rights grounds, which typically revolves around the legitimate expectations that the taxpayer has developed and which the legislation is frustrating. Such an argument also arises in principle with retroactive legislation (though with much less legal force: and with some taxes, such as capital gains tax on disposals of assets which have previously grown in value, retroactive taxation would

³⁷ See <https://www.gov.uk/government/publications/tax-administration-strategy/building-a-trusted-modern-tax-administration-system>

³⁸ See <https://www.gov.uk/government/publications/ots-publishes-interim-paper-on-review-of-value-added-tax>

³⁹ See https://www.gov.uk/government/consultations/call-for-evidence-simplification-of-partial-exemption-and-the-capital-goods-scheme?utm_source=22f672bd-e392-4b56-b204-832ef00e731e&utm_medium=email&utm_campaign=govuk-notifications&utm_content=immediate

⁴⁰ See <https://www.tax.org.uk/policy-technical/submissions/simplification-partial-exemption-and-capital-goods-scheme>

be very hard to avoid for a government which needed to increase revenue). Broadly a significant defence of windfall taxes against this argument is that if the tax was unexpected, so was the windfall, and the wider public, particularly those who have lost out, are entitled to their share. Although we note that the Committee's principles for taxation include certainty and stability which would seem to suggest caution as regards windfall taxes.

- 9.3 We would have concerns over the rationale and operation of a windfall tax: identifying the tax base (ie what is a 'windfall'), the extent of retrospection / retroaction, whether it would disincentivise entrepreneurialism and value creation, to what extent it could be budgeted for in the government's finances.
- 9.4 Take the example of a producer of alcoholic beverages, who adapted its manufacturing processes in order to produce hand sanitiser and, as it transpired, made a greater profit than it would normally have made producing alcohol. Should the business's ingenuity be 'punished' by a windfall tax? And should an online retailer who experienced greater demand for its products due to the restrictions on 'physical' shopping suffer a 'windfall' tax?
- 9.5 Alternatively, increased savings by those whose income is relatively stable and whose 'consumption' of meals out, sporting and cultural events has been forcibly curtailed as a result of COVID, might be viewed as a 'windfall' – but almost certainly not by those concerned, who would say they have simply been forced to save as a result of consumption foregone. All in all, it is easier to say who has lost out as a result of COVID than who has unexpectedly benefited, and it is difficult to see a convincing tax base being identified which would yield worthwhile revenues. There is a further point that windfall taxes generate one-off sums, with correspondingly limited impact on securing the government's finances for the future.

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

- 10.1 The balance between different sources of taxation is clearly highly political. It should however be common ground that the tax system should be internally consistent and not provide unjustified advantages to people who are able to structure their income or assets in a particularly tax-efficient way (especially where these structures are artificial). This does not apply to situations where government is deliberately seeking to incentivise certain behaviour, such as saving towards a pension or investing in research and development.
- 10.2 There is renewed interest in the taxation of wealth and its distribution on efficiency and equity grounds. Some see such a tax as a panacea, particularly in the current climate; taking the most from those who have the most to give seems fair, and is certainly popular (especially amongst the vast majority who would not be liable to pay it).
- 10.3 However doing so, in an equitable way, without creating anomalies, presents particular challenges. It is nearly 50 years since a wealth tax was last considered in the UK. Some of the reasons for abandonment of the idea of wealth tax in the late 1970s were discussed by Howard Glennerster, a Professor at the London School of Economics, in a 2012 article and these may be of interest to the inquiry.⁴¹
- 10.4 One of the lessons to be drawn is that the administrative costs and practical implications involved in assessing individuals' wealth on a regular basis need to be given appropriate weight in conjunction with defining policy

⁴¹ See http://eprints.lse.ac.uk/42582/1/Why_was_a_wealth_tax_for_the_UK_abandoned_%28Isero%29.pdf

objectives, as well as what represents ‘wealth’.⁴² Any assessment of alternative or existing forms of wealth tax is inextricably linked to wider current structural issues such as the boundaries between the taxation of self-employment and employment and tax rate-motivated incorporation. We consider that a proper rigorous analysis and assessment is required to evaluate a wealth tax. We note that one such project is underway.⁴³

10.5 One particular aspect which requires study is the extent to which the great strides that have been made in the last 20 years toward greater exchange of information between tax authorities (notwithstanding huge differences between them in the levels and types of tax they impose), and the systematic reporting requirements successfully imposed extraterritorially by the US, UK and others on financial institutions in respect of their clients’ income, could successfully be extended from income to underlying wealth. This is closely related to the perceived reasons for which other countries have tended in recent years to remove rather than impose such taxes. It is also relevant to the question of whether a wealth tax would in practice relate solely to real estate – which is the predominant form in which modest owners hold their wealth, or could also be applied to financial assets, which is highly relevant because the very wealthiest tend to hold wealth in more diversified forms than do the ‘mass affluent’. One of the reasons often cited for the unpopularity of inheritance tax is that the burden of it is felt disproportionately by those whose wealth consists disproportionately of a family home and less by the mega-wealthy.

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?*

11.1 We have already highlighted above the need for broad and timely consultation, in line with the government’s tax consultation framework. Other areas for review include Parliament’s role in tax policy and HMRC resourcing and expertise.

11.2 Parliament and tax reform

11.3 Parliament’s role in tax policy is limited by a range of factors including (but not limited to): a paucity of resources, the technical complexity of tax legislation (and limited budgets for technical support to Parliamentarians), the wide range of issues that the Treasury Committee has within its remit competing for attention, the secrecy and exceptionalism of the Budget process, the traditional constitutional importance of ‘supply’ and the greater implications felt for confidence in the Government if a tax measure fails to get through, and the limited role that the House of Lords in particular is able to play in relation to tax legislation. Additionally big tax choices tend to be major political dividing lines between the parties, making cross-party consensus building harder than on most other issues (though cross-party campaigns do happen, most often where constituency issues emerge, such as with the loan charge and, in a very different way, the ‘pasty tax’). Notwithstanding these challenges we believe there are a number of ways in which Parliament’s engagement in tax reform could be strengthened. These can broadly be grouped into: greater resources, more effective Finance Bill scrutiny and a strategic approach from government.

11.4 **Greater resources.** There is a strong case for increasing the resources available to Parliament for scrutinising tax matters. This covers both public bill committees and select committees as well as, potentially, costing of policies for opposition frontbenches and support for individual backbenchers wishing to propose measures.

⁴² For example, if money in savings accounts is included then what about money in pension schemes, even if it might not be accessible for decades? Should people’s main homes be included? What about wealth invested overseas?

⁴³ See <https://www.ukwealth.tax/>

The availability of drafting expertise in the House Service to assist members with amendments to the Finance Bill and other highly technical measures, and perhaps with the drafting of Private Members' bills, could be expanded.

- 11.5 **More effective Finance Bill scrutiny.** The length of most recent Finance Bills and the highly technical nature of most clauses does not make effective scrutiny of the legislation easy. Additionally – and regrettably – restrictive resolutions (specifically the absence of an Amendment of the Law resolution) tabled by the Government have limited the scope of amendments to recent Finance Bills. The absence of meaningful House of Lords scrutiny of Finance Bills during their passage means that more weight falls on such Commons scrutiny as is achieved. These deficiencies are only partly compensated for by the pre-legislative work of select committees and other earlier consultation.
- 11.6 We welcome the fact that it is now possible to submit written evidence to public bill committees, including the Finance Bill Committee. CIOT takes regular advantage of this facility. We also welcome the granting of the ability for public bill committees to take oral evidence. However we are disappointed that the Government has – despite cross-party pressure – so far been unwilling to do this for Finance Bill committees.
- 11.7 Whereas most bills go through a full set of parliamentary stages in both Houses, Finance Bills and other tax bills get just a cursory debate in the Lords, with no ability for the upper House to reject or amend. We understand the reasons for this and do not seek to challenge the Commons' financial privilege. However it seems to us a waste that the expertise in the Lords plays little part in the Finance Bill process (though the pre-legislative role of the Economic Affairs Committee is noted). Especially in the context of further Lords reform we wonder if it might be time to think innovatively about mechanisms to enable peers to propose and debate amendments to the Finance Bill, especially on its technical aspects, while retaining for the Commons the right to prevail in the event of disagreement between the two Houses.
- 11.8 We would like to see more effective liaison between the Commons Treasury Committee, the Lords Economic Affairs Committee and the Finance Bill public bill committee so that concerns identified by the first two are pressed more by the latter.
- 11.9 **A strategic approach from government.** It is easier for Parliament (primarily through select committees) to engage with tax policy and tax reform when the Government takes a strategic and long-termist approach to tax policy, setting out long-term objectives, using road maps and producing fewer 'rabbits out of hats'.
- 11.10 HMRC resourcing and expertise
- 11.11 As with most government departments, HMRC has been tasked with delivering efficiency savings; but these savings should not come at the expense of customer service and compliance activity. The NAO tax gap report records that HMRC's rate of return on its compliance activity range from 7:1 for individuals, to 44:1 on large businesses. Whilst there will be a point at which returns start to diminish, it begs the questions whether further structural investment is required in these areas. We were pleased therefore to see the announcement in Budget 2020 of investment in additional compliance officers and new technology for HMRC.⁴⁴

⁴⁴ See paragraph 2.254 of the Red Book

- 11.12 Over recent years HMRC staff numbers have reduced significantly, from around 67,500 full time equivalents in June 2011⁴⁵ to just over 58,000 in June 2020.⁴⁶ In 2014-15 – ie. before the additional investment required for Brexit – this number was as low as 56,300. Similarly, prior to Brexit, funding for HMRC seems to have been reduced from around £3.8bn in 2010-11 to £3.4bn in 2014-15. We are concerned at these downward trends, particularly as the tax system continues to become more complicated, and HMRC administers new taxes and activities.
- 11.13 We also remain concerned at the level of tax technical expertise within HMRC. We frequently receive feedback from our members around this issue, and we are concerned that this problem will become more acute with the move to regional centres as experienced HMRC officers will either retire or potentially need to retrain (though it may be that these problems can be ameliorated somewhat with increased flexibility around working from home for some HMRC personnel).
- 11.14 Further, through our day-to-day engagement with HMRC, we see high levels of staff turnover or redeployment within HMRC. This in itself means that experience built up over time within HMRC is often lost, particular when this is coupled with a seeming lack of ‘corporate memory’ within HMRC. This results in issues being repeated or restarted from scratch, or the benefits of previous engagement lost, even though the subject has been on the agenda for a period of time.
- 11.15 We have a similar concern in relation to HM Treasury, where the rate of staff turnover is around 20% per annum.⁴⁷ Clearly Treasury officials are generally very able and in our experience very open and evidence-based when they perceive it as being possible but the issue of secrecy in policy development limits what they feel they can do in supplementing their own experience with that of others outside government or even elsewhere within it.

12 Acknowledgement of submission

- 12.1 We would be grateful if you could acknowledge safe receipt of this evidence, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the inquiry is published.

13 The Chartered Institute of Taxation

- 13.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

⁴⁵ See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/89059/work-mis-june11.csv/preview

⁴⁶ See

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/902826/HMRC_headcount_and_payroll_data_for_June_2020.csv/preview

⁴⁷ See <https://www.instituteforgovernment.org.uk/publication/whitehall-monitor-2020/managing-people>

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

8 September 2020