

TAX SIMPLIFICATION REVIEWS

SIMPLIFYING BUSINESS TAX

1.1 The Government is committed to ensuring the UK provides a world-class environment for business. To help achieve this, Budget 2007 announced improvements which made the tax system fairer, simpler and more efficient by:

- modernising and simplifying both the personal and business tax systems;
- publishing the implementation plan¹ for the 2006 Review of HM Revenue & Customs' (HMRC) Links With Large Business; and
- delivering £300 million of administrative savings to business, helping HMRC towards achieving its administrative burden targets.²

1.2 Building on these and other reforms, **the Government is renewing its commitment by launching a significant programme of tax simplification** – setting out new principles, new reviews and a package of measures - to enhance UK productivity and competitiveness.

Principles of simplification

1.3 The Government commits to three principles of tax simplification, which underpin this new programme:

- simplification will be a priority when designing and reviewing tax policy, alongside sound public finances and fairness;
- the Government will work in partnership with business to identify further opportunities to simplify the tax system; and
- the Government will share its findings on the viability of tax simplifications with business.

Simplification reviews

1.4 The Government today publishes its findings, for discussion with business, on the case for administrative alignment of the income tax and national insurance systems. This autumn the Government will now launch three reviews where HM Treasury and HMRC will work in partnership with business to evaluate how a range of tax policies could be simplified. These initial reviews will cover:

- how to simplify VAT rules and administration in the UK and the EU;
- how anti-avoidance legislation can best meet the aims of simplicity and revenue protection; and
- how to simplify the corporation tax (CT) rules for related companies.

¹ *Making a difference: delivering the review of links with large business*, HM Revenue and Customs, March 2007.

² At Budget 2006, the Chancellor announced targets for HMRC to reduce the administrative burdens imposed on business by the tax system, focusing on forms and returns, and on audits and inspections. Further progress against these targets will be reported at Budget 2008.

OBJECTIVES OF THE REVIEWS

1.5 HM Treasury and HMRC are in regular contact with a wide range of businesses, many of whom have made clear that simplification of the tax system is one of their major priorities. As highlighted above, the Government is committed to simplifying the tax system, within the framework of:

- raising revenue for essential public services and investment in business infrastructure;
- delivering fair outcomes for taxpayers; and
- supporting wider Government objectives such as enterprise, social welfare and the environment.

1.6 The simplification reviews announced today will be wide-ranging but areas where Ministers have already made political or manifesto commitments or policy decisions to protect the public finances from criminal attack and serious non-compliance will be out of their scope.

1.7 The reviews give considerable room for constructive discussion with business on how to simplify these particular areas of tax. Potential priorities for each review have already been identified and are discussed below. Over the autumn, each review will be dedicated to evaluating whether these reflect the concerns and priorities of business, consistent with the framework outlined above. Businesses, their representatives and tax professionals will be invited to comment on these priorities and to suggest other areas for discussion.

1.8 Once priorities have been agreed, HM Treasury and HMRC will set out the remit and estimated timetable for the reviews. **The Government will provide an update on the progress of each review at Budget 2008.**

HOW TO TAKE PART IN THE REVIEWS

1.9 To participate in the reviews, including commenting on the priorities outlined below, respondents are invited either to complete the online questionnaires available at http://www.hm-treasury.gov.uk/pbr_csr/pbr_csr07_index.cfm or to respond by email or post to:

- **VAT:** vat.simplification@hm-treasury.gov.uk; VAT Review Team, HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ
- **Anti-avoidance:** anti-avoidance.simplification@hmrc.gov.uk; Anti-Avoidance Review Team, HMRC, 100 Parliament Street, London, SW1A 2BQ
- **Corporation tax:** relatedcompanies.simplification@hm-treasury.gov.uk Related Companies Review Team, HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

1.10 HM Treasury and HMRC will also be discussing simplification priorities with business through existing forums and especially arranged events. Updates and further details of how the Government is engaging with businesses as part of the review process will also be available at http://www.hm-treasury.gov.uk/pbr_csr/pbr_csr07_index.cfm.

POTENTIAL PRIORITIES FOR THE REVIEWS

1.11 Suggested priorities for each review, how they apply to business, and issues that might be discussed are outlined below. HM Treasury and HMRC would welcome all views, on the importance of these priorities to business by the end of November.

VAT rules and administration

1.12 There are 1.9 million VAT registered organisations in the UK, including businesses of all sizes, activities and trading classes. The VAT system already contains a wide range of schemes and methods - many targeted at smaller businesses – designed to simplify administrative requirements. However, business has told Government that it would like to see further simplification. HM Treasury and HMRC therefore propose the following areas where there may be scope for simplification, mindful of the interaction of UK rules with EU law and processes:

- procedures associated with the election to waive exemption (option to tax);
- Partial Exemption and the Capital Goods Scheme;
- the frequency with which businesses submit returns;
- VAT retail schemes; and
- complexities requiring simplification at EU level.

Option to tax **1.13** The election to waive exemption or 'option to tax' on otherwise VAT exempt supplies of land and non-residential buildings was introduced in 1989 and applies to approximately 75 per cent of all interests in commercial land and buildings. In most cases, having decided to opt to tax, a business is simply required to notify HMRC of this fact. However, there can be additional procedures and requirements in certain cases - for example where a business has made exempt supplies of the land or property prior to making an option.

1.14 HM Treasury and HMRC are already reviewing legislation in this area, but alongside this review would now also like to discuss with business the scope for simplifying the administrative procedures and requirements around opting to tax.

Partial Exemption and the Capital Goods Scheme **1.15** Around 140,000 VAT registered bodies make both taxable and exempt supplies and are therefore 'partly exempt'. Partly exempt businesses are therefore required to carry out a calculation to determine the amount of VAT that they may recover from HMRC. Some 120,000 do so by operating the 'standard method', while the remainder operate bespoke special methods agreed on an individual basis with HMRC.

1.16 Under the Capital Goods Scheme, partly exempt businesses are required to annually adjust the amount of VAT recovered on larger capital items for up to ten years, to ensure that VAT recovery reflects the ongoing use of the item over that period.

1.17 In Budget 2007, changes were made to simplify the process of obtaining HMRC approval for bespoke partial exemption methods. Building on this work, HM Treasury and HMRC would like to discuss with business the scope for simplifying the standard

partial exemption method; the rules and processes around de minimis; and the procedure for calculating and adjusting VAT recovery under the Capital Goods Scheme.

Frequency of returns **1.18** Around 95 per cent of VAT registered businesses, submit and pay their VAT returns quarterly. Others make returns monthly, and some smaller businesses use the Annual Accounting Scheme, which is available to businesses whose annual taxable turnover is not more than £1.35 million. Quarterly returns have been the norm since the inception of VAT, and while there are no strong signs of dissatisfaction, there may be administrative benefits for some businesses in moving to annual returns.

1.19 HM Treasury and HMRC want to explore with business whether there are any obstacles that prevent them from using annual accounting, and whether annual accounting arrangements could be attractive to larger businesses.

VAT retail schemes **1.20** Retail schemes are used by businesses to calculate the VAT due on retail sales. Over 200,000 VAT registered retailers are eligible to use one of the five retail scheme methodologies published by HMRC, while around 200 retailers with a turnover exceeding £100 million are required to agree bespoke retail schemes with HMRC.

1.21 HM Treasury and HMRC wish to consider with business whether, taking into account developments in retail till technology, the existing range of published retail schemes and the design of these schemes is consistent with the objective of simplifying retail accounting; and also whether the requirement that larger retailers agree bespoke schemes provides the right balance between simplification and certainty in tax accounting.

Complexities requiring simplification at EU level **1.22** VAT is an EU-wide tax based on common rules and principles set out in the European agreements signed by successive Governments, and transposed into UK law. The detail of these European VAT agreements impacts upon every VAT registered business in the EU, whether or not they are involved in cross-border trade. Many proposals for simplification would require the unanimous agreement of EU Member States.

1.23 The UK has taken an active role in pursuing simplification at EU level where, for example, the Government has strongly supported reform of the Eighth VAT Directive to modernise and accelerate cross-border refund arrangements. Building on this success, HM Treasury and HMRC wish to extend their existing dialogue with UK business to identify and prioritise further areas for VAT simplification in Europe.

Anti-avoidance legislation

1.24 To maintain sound public finances and fairness, the Government will continue to tackle tax avoidance through legislation and litigation, while ensuring that the competitiveness of the UK is maintained. The priority areas that HM Treasury and HMRC believe will best achieve simplification in anti-avoidance legislation are:

- ensuring new anti-avoidance legislation is clear, effective and well targeted; and
- simplifying areas of existing anti-avoidance legislation.

New anti-avoidance legislation **1.25** To be effective, anti-avoidance legislation needs to counter what are often complex and highly artificial avoidance schemes. Over recent years the Government has developed approaches to make anti-avoidance legislation clearer and better

targeted. The Government believes that modern anti-avoidance approaches can be consistent with moves to simplify the tax system. This Pre-Budget Report and Comprehensive Spending Review includes examples of developing a simplified, streamlined approach in specific areas of anti-avoidance.

1.26 Among the modern approaches to anti-avoidance legislation found in recent Finance Acts are:

- Targeted Anti-Avoidance Rules (TAAR). For example Section 72 of the Finance Act 2007 that seeks to counter schemes to avoid SDLT by the 'seeding' of partnerships; and
- more generic approaches to legislation. For example, Paragraph 1 of Schedule 13, Finance Act 2007 that deals with the sale and repurchase of securities.

1.27 HM Treasury and HMRC want to explore the effectiveness of these newer approaches and agree with business which particular legislative methods minimise business burdens. The review could also look at whether all anti-avoidance provisions should be in primary legislation or use a more flexible combination of primary and secondary legislation, and whether anti-avoidance legislation should be brigaded together in separate parts of the tax code or integrated.

Existing anti-avoidance legislation

1.28 HM Treasury and HMRC would welcome views from business on any particular areas of existing anti-avoidance legislation it thinks could be updated and simplified, whilst ensuring revenue protection. To help focus this review, business is asked to highlight those areas of anti-avoidance legislation that impose the most significant burden. Government will then work with business to see how these areas could be simplified or even removed altogether, without harming revenue protection.

Corporation tax rules for related companies

1.29 There are around two million active companies in the UK, many of which have related companies, either as part of a wider company group, or because of association through common ownership. These relationships may complicate their tax affairs, and simplifying the corporation tax treatment of related companies could help reduce administrative and compliance burdens. HM Treasury and HMRC believe the areas where simplification will be of most significance to UK companies are:

- group aspects of corporation tax on chargeable gains;
- associated company rules for the small companies corporation tax rate;
- Corporation Tax Self Assessment (CTSA) filing and payment arrangements for groups; and
- further reductions in the administrative burden of transfer pricing rules.

Chargeable gains

1.30 The regime for the taxation of corporate gains has a number of longstanding provisions aimed at ensuring tax is only levied on gains realised when an asset is disposed of outside a group. The Government believes there may be scope for simplifying some of these rules as well as aligning the tax outcome more closely to the economic effect for the group.

1.31 HM Treasury and HMRC would specifically welcome views on:

- what should comprise a group for the purposes of corporation tax on chargeable gains;
- the treatment of assets transferred between group companies;
- the offsetting of gains and losses within a group;
- the treatment of companies on joining and leaving a group; and
- whether the taxation of the chargeable gains of a group of companies is fair and accords as far as possible with economic outcome.

Associated company rules

1.32 The associated companies rules have existed for many years and, by and large, still perform the function for which they were adopted: a deterrent against income fragmentation for the purpose of the small companies rate. However when associated company rules were introduced, partnerships were limited in size and the administrative burden of establishing the number of associated companies controlled by business partners was not great. Limits on the size of partnerships have now been lifted and partnerships can be very much larger than was previously the case. The Government believes there may be scope for simplification of the associated company rules as they apply to the small companies rate.

CTSA filing and payment

1.33 Arrangements already exist in certain, currently limited, circumstances for payments and tax information to be provided to HMRC on a group basis, for example group Quarterly Instalment Payments and claims to group relief. There may be scope to review the efficacy of these existing arrangements with business and identify the potential for improving and extending such arrangements to reduce administrative costs for business.

Transfer pricing rules

1.34 Transfer pricing is a key area of concern for businesses. Most of all, business wants greater certainty and speedier resolution of enquiries leading to reduced compliance costs. This is being addressed through the Review of Links with Large Business, and HMRC is introducing a new approach to transfer pricing enquiries. The review will build on this dialogue to discuss whether the burdens caused by transfer pricing in cross-border or domestic situations can be further reduced.

Conclusion

1.35 HM Treasury and HMRC ask business to submit their views, via the emails, postal addresses or questionnaires listed above, to make sure these reviews are properly focused on the simplifications that will make a tangible difference to business.