Finance Bill amendment

Large Corporate

03 May 2013

Bill Dodwell asks whether it is possible to devise
a new, simpler tax system

Clause 4, page 2, line 19, at end add—

‘(4) The Chancellor of the Exchequer shall instruct the Office for Tax Simplification to publish by 31 March 2014 a report setting out proposals for a new, simplified Corporation Tax code, specifically addressing the potential for a simpler tax code to reduce tax avoidance, and the Chancellor shall place a copy of the report in the House of Commons Library.’

All credit to Nigel Mills for raising this question! Personally I doubt that the OTS is the best placed organisation to look at this; I'd suggest a properly resourced Commission which could take evidence from a range of witnesses before coming up with recommendations. However, surely we should think about the question – what might we do?

I'd start with accounting. Clearly, business tax needs to be based on the results of the business. Luca Pacioli wrote about double-entry book-keeping to help merchants understand their business. The issue today is that modern financial accounting has moved away from that defining principle. One of the big reasons for complexity – and tax avoidance – is the adoption of IFRS (and the IFRS-inspired standards added into UK GAAP) as an acceptable method of accounting as a starting point for tax computations. I've not encountered anyone who thinks that the IFRS valuation approach is helpful. Tax law now includes various provisions to remove the unhelpful impact of IFRS. We're about to be faced with even more accounting choice with the planned adoption of new UK GAAP, which differs from IFRS but is related to it. Would it actually be possible to require companies to use a more basic system of accounting, which stripped out the IFRS tweaks? After all, the basic accounting records are unlikely to include them. Some other countries seem to manage with a tax accounting system. Simpler accounting should then result in fewer tax adjustments. We'd also need to ditch the idea of cash accounting, which seems to come with far too many rules and anti-avoidance measures. No one needs two systems.

We should surely have a look at allowances for capital expenditure. Can anyone actually remember how our massively detailed capital allowance system actually works? We have a basic regime of an expenditure pool with an 18% annual allowance, but there are so many items which are treated differently. We can start with the constantly changing annual investment allowance, which seems to be different every year. Add in cars, energy efficient equipment, fixtures, short life assets … it's a mess. The asset boundaries are also a joy, as those who've read the tribunal's decision in JD Wetherspoon can attest. However, it's easier to spot the problem than to diagnose a solution. Changes will involve winners and losers and there needs to be a better explanation than 'neatness' before removing the allowance that makes a difference to the claimant, or to the viability of the category. We can rule out significant changes to the scope of the allowances on grounds of cost and the fact that successive governments have chosen to reduce the value of allowances as part of a strategy to reduce the corporation tax rate. Opting for accounting depreciation seems to open too many benefits for taxpayers, but could be a simpler system.

The next big area is surely that of groups. If we accept that the tax results of a group of companies should be shared – as most countries do – we need to define what qualifies as a group and additionally how to share those tax results. The rules which define this are complicated – in part because companies continue to wish to get economic value for losses by selling them outside the group, while successive governments have sought to limit them. Companies also join and leave groups, so rules are needed to define this. Principles-based drafting could probably make the rules shorter and easier to follow – but we're not going to be able to avoid the complexity caused by the issue. The debate about consolidation compared to single company calculations and elective offset will then resurface. Both have attractions and disadvantages, but neither is simple. I'm sure that companies wouldn't wish to forego the advantages of group treatment for simplicity, though. Ultimately, I can't see a route to simplification here.

Our final big area must be loan relationships and derivatives. The very name brings greater complexity than should surely exist for borrowing money. Getting rid of IFRS would be a good start, as the valuations wouldn't interfere with real life and we could get back to a normal view of hedging. There are still various barriers built into the rules to counter tax avoidance; these would need to be retained. Connected party debt is an obvious one. Depending on where the group rules end up, there may well be continuing planning with debt, so as to access otherwise trapped losses. There may need to be some barriers here.

Ultimately, I lack the imagination to devise a new, simple corporate tax system without significant numbers of winners and losers – and probably an overall switch between taxpayers and the Exchequer, which would require a rate adjustment to keep the tax yield in balance. My suspicion is that the OTS would end up with a similar conclusion; it's a lot easier to stick with the flawed system we've got. Do write to the editor if you've got some brilliant ideas!