



CALL FOR EVIDENCE - TAX AFTER CORONAVIRUS

Issued 7 September 2020

ICAEW are pleased to provide evidence to the Treasury Select Committee on its call for evidence on **Tax after Coronavirus**.

Clearly the economic outturn for the current year is likely to be very different from that originally forecast, with tax receipts below budget and public spending considerably more than predicted. Earlier this year, most commentators would have expected the UK's withdrawal from the EU to be the event most likely to have an economic impact: it remains to be seen what effect this might have in the light of the impact of the Coronavirus pandemic, but taken together the impact on the economy is likely to be significant and likely to continue into 2021 and beyond.

However, the unusual circumstances now facing the UK present an opportunity for more fundamental reform. Changes which might have been deemed too difficult or politically unacceptable might now be contemplated and could be met with broader acceptance than would normally be the case.

Note

In providing this evidence, please note that we have not been able to survey our membership and the comments made in this response should not be taken necessarily as expressions of official ICAEW policy, but are instead based on the empirical evidence gathered from our experienced volunteers.

This response of 7 September 2020 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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For more information, please contact: taxfac@icaew.com

GENERAL

1. The UK faces not only pressure on its finances from the impact of the pandemic this summer, but must consider the ongoing threat of further outbreaks in the future.
2. The speed and efficiency with which the UK population moved to homeworking at the start of the pandemic lockdown period has shown what is possible and that the digital revolution can be moved forward quickly when it is in the interest of business and citizens to do so. While we do not underestimate the difficulties this caused and that there is still considerable uncertainty about what the future will look like, it seems an opportune moment to make changes in tax to support this.
3. There remain areas of the country with inadequate or no access to high speed broadband. Real improvements to tax after coronavirus can only be achieved with the best infrastructure across the UK, which must be a priority
4. We still do not know what effect leaving the EU will have on the economy, but it is certain that easy exchange of information, particularly as goods and services cross borders, can only be achieved using digital tools. Devolution seems likely to be a growing feature of the future tax system, and any changes must avoid adding complexity and minimise divergence.
5. ICAEW supports the digital agenda presented by the Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, in Building a trusted, modern tax administration system, and we are recommending fundamental simplification measures to tax in order to facilitate this move to digital.

THE TAX YEAR

6. The UK requires income tax, capital gains tax, national insurance and Inheritance Tax to be calculated on a fiscal year basis using the period 6 April to 5 April. While the reasons for this unusual time period have entertained students of tax history for many years, dating back as it does to when taxes were collected on Lady Day (25 March), adjusted subsequently to 5 April to account for 11 days of slippage attributed to a 365 $\frac{1}{4}$ day year rather than just 365 days, perhaps the time has come to modernise the tax calendar for personal taxes?
7. In 2002, Ireland changed successfully the end of its tax year from 5 April to 31 December.
8. We suggest that to facilitate a coherent quarterly reporting system for income tax and VAT, the UK should examine moving the tax year end from 5 April to either 31 March or 31 December.

SPECIFIC COMMENTS

Changes causing major long-term pressures on the UK tax system

9. The major long-term pressures on the tax system are caused by the following:

Working practices

10. A single job for life is being replaced by a wide variety of different working practices, such as:
 - Increasing numbers of self-employed workers
 - Frequent job changes
 - Multiple jobs being held simultaneously, each with employee status
 - Individuals being employed and self-employed concurrently
 - More part-time working
 - Job sharing
 - Zero hours contracts
 - Agency working
 - The use of umbrellas

- Working across international borders (it is no longer necessary to live and work in a single country)
11. The shift in working practice away from employment will have a significant impact on the tax base. Employment is taxed more heavily than self-employment so the trend towards self-employment inevitably reduces the tax take. For example:
- Employers' National Insurance does not apply to self-employed workers.
 - Employees pay higher rates of Class 1 NIC than the Class 2 and 4 NIC paid by self-employed workers.
 - Tax from employment is collected in real time through the PAYE system, whereas self-employment is taxed many months later. This was illustrated clearly by the number of newly self-employed people who did not qualify for the COVID self-employed income support scheme.
 - An individual with multiple part-time employments may pay less NIC than a person with a single employment, as will their employers.
 - Employees are allowed far fewer deductions when calculating taxable income than self-employed workers. For example, the rules for claiming travel and subsistence costs and the expenses of working from home are stricter for employees than for the self-employed.
 - Job sharing and part-time working means the work available is spread across more of the population. If both parents work part-time, they each have a £12,500 tax free personal allowance and could both remain basic rate taxpayers, while one full time worker may have been paying higher rates of tax. We observe that the effect of lock-down and enforced home working seems to have increased the desire for more flexible working and also for more parents to share childcare.
12. Regarding employment taxes specifically, the main issues are:
- The distorting effect of employer's National Insurance: there is a cliff-edge;
 - The difference between employment status for tax and employment status for employment law, for which few people can see any rationale;
 - The historical distinction between National Insurance as a weekly tax and Income Tax as an annual one, leading to some people with the same income over the tax year having very different pension entitlements;
 - The sheer complication of the off-payroll legislation;
 - Incentives to adopt behaviours that might be considered undesirable (or which at least should be properly considered), such as effectively forcing people to trade through companies, putting people into umbrella companies, and for umbrella companies to behave unethically;
 - Policy being made without proper consideration of non-tax issues, an example being entitlement to benefits.
13. We note of course that alongside the NIC rate differential there are different entitlements to statutory benefits. The way income is reported and tax is collected contributed to the different way grants could be awarded during the COVID crisis. As some of the economy is naturally contract based, any changes could disadvantage this group.

Increase in self-employment

14. Self-employment tax is collected through the self assessment system using the online tax return. It is much harder for the self-employed to calculate and pay the correct amount of tax than for an employee. Many rely on help from family and friends or use the services of a Chartered Accountant or other agent. Nevertheless many small businesses will try to manage tax on their own and the most recent estimate for the UK tax gap attributable to small business is £13.4bn, over 40% of the total for the year.
- https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/907122/Measuring_tax_gaps_2020_edition.pdf

15. A number of reasons contribute to this, but the complexity of the tax rules will be a significant factor. Employment taxes are much easier to calculate and pay, at least from the worker's perspective.
16. The availability of the cash basis has helped to simplify tax for many small businesses, but anachronisms remaining in the tax system design are a hindrance and non-intuitive.
17. Deciding whether a particular contract is to be taxed as employment or self-employment is not always obvious. Twenty years of IR35 discussions have still not found a clear solution, and as more people move from employment to self employment, there will be more workers finding themselves facing an uncertain tax position.
18. The growth of the gig economy has also introduced an international element. When a contract for perhaps a new website design is put out to tender, self-employed people from across the globe can apply. The tax they pay on their income will then be paid to their home country jurisdiction, while the cost is a tax deduction for the UK engager.
19. The number of employees a company has is relevant to determining the size of a company. For example, research and development expenditure reliefs are different for SMEs, and the new off-payroll working rules beginning in April 2021, do not apply to small company engagers.

Demographics

20. Many people continue to work beyond the State pension age, many will be claiming their pension at the same time as continuing to receive a salary from employment or income from self-employment. Also, having multiple jobs in a lifetime will mean that many workers will have paid into several unconnected pension schemes. This adds to the tax complexity of managing finances in retirement. Each pension other than the State pension will be paid out of a different fund, each with its own tax code under a different PAYE scheme.
21. It is not possible to pay the State pension under deduction of PAYE. This results in many taxpayers who continue to work or who have other taxable income, under or over paying tax which needs to be corrected after the end of the tax year, adding further to the complexity and inefficiency of the tax system.
22. People who continue to work past the State pension age do not need to pay NIC on that income, although employers do have to continue to pay employers' NIC regardless of age. Of course businesses do not have to pay NIC for self-employed workers above the State pension age, although of course the worker's status is dependent on the nature of work and the contract. Using older self-employed workers rather than older employees if the nature of the work permits is a cheaper option.

Environment

23. Working from home has become the norm for millions more workers during COVID-19 and the crisis has accelerated acceptance of new working patterns. Clearly the travel restrictions will have had a positive impact on the environment, as will the decrease in heat and light normally used for office space.
24. From a tax perspective, there will be less fuel duty collected although we cannot quantify this. As people work from home, city sandwich and coffee bars were closed and over five months, many workers have noted how much they have saved. We do not know whether previous spending levels will return. Meanwhile, business tax receipts, including VAT, are reduced.
25. Increased use of Zoom, Lifesize, Microsoft Teams etc has meant less travel so again less tax will be collected as a result. We do not expect this to be a permanent reduction, but clearly some of this behavioural change will remain.
26. More working from home will reduce the need for permanent single use office space, while increase the need for hot desk and office sharing spaces. An overall reduction in office space and associated city centre facilities will result in a reduction in tax collected from business rates.

Familiarity with new technology

27. Most businesses use IT in one form or another, but the pandemic has accelerated the need to rely on technology to work with colleagues. 'Business as normal' has adopted new technology which should have a beneficial effect on the government's plans as set out in Building a trusted, modern tax administration system.
<https://www.gov.uk/government/publications/tax-administration-strategy/building-a-trusted-modern-tax-administration-system>

Erosion of the UK tax base

28. Unless there is an agreement by all countries under the auspices of the OECD BEPS project, it seems inevitable that the UK's tax base will continue to be eroded as a result of globalisation and technological change.
29. As even more people buy online, the way online businesses are taxed needs to be properly aligned with the economic reality of where their profits are generated, but this cannot be achieved in a sustainable way without international agreement.
30. The coronavirus pandemic seems likely to have increased the move to digital transactions rather than purchases being made on the high street.

Infrastructure

31. Good infrastructure, both digital and also through good road and rail links, is essential if the UK is to remain competitive in the future.
32. Perhaps one of the biggest challenges for businesses during the past five months has been to remain connected. Connections internally so that teams remain safe, engaged and productive; connections with suppliers to be sure that supply chains are secure; connections with customers who know when to expect services and deliveries. Historically these have relied on good transport links, but increasingly they will rely on technology. Even within city centres, broadband speeds remain low and many areas of the country remain without any form of Wi-Fi at all.
33. It is clear that without a viable vaccine, the virus will continue to interrupt our lives and business activities, so we need to recognise its presence in some form or other for the foreseeable future and plan around it: we either adapt or risk economic decline.
34. Even if you adopt the most dystopian view of the future, technology seems key to being able to operate most businesses. Investment now is therefore essential to secure tax receipts going forward. Tax incentives to encourage innovation in technology must be prioritised.

Is tax reform the solution, and if so, when?

35. The tax system will continue to charge and collect taxes in the changing environment we have described above. However, the amount of tax and the efficiency of the existing collection mechanisms are a different matter.
36. If we are ever going to make fundamental changes to our tax system, it has to be now while we have recent experience of how in a crisis we can make policy changes quickly.
37. Reform should be undertaken within the context of the underlying framework of the government's Building a trusted, modern tax administration system paper. This paper places real-time information at the core of an effective and modern tax system, but this means simplification of income tax, and also of VAT, need to be addressed as priorities. Simplification of tax is an essential prerequisite for businesses to move to a more digital system.
38. Some of the big questions which should form the basis of separate projects might be:
- Should the tax year end be moved to 31 March or even 31 December? Does 5th April really have a place in our digital future? If unincorporated businesses are to report on both VAT and income tax quarterly at the same time, the quarters need to be properly aligned with the calendar. A 6th April to 5th April tax year will hinder this.

- How can VAT be simplified after 31 December 2020? Should we abolish the VAT exemption and make greater use of rates?
 - Should and could we reduce the tax and legal differences between different forms of work? If the tax and state benefit entitlements can be aligned for all types of work, then the remaining drivers for work engagements could be identified and considered separately.
 - Tax rates are still a major reason for motivating incorporation. Should we consider once again how to level the playing field between different structures?
 - Do the reasons for taxing personal earned, unearned income and capital gains at different rates still support the government's policy objectives?
 - How can we ensure that there is a fair and equitable tax system between online purchases made by the UK public and those made on the High Street? To this end, ICAEW will be responding to HM Treasury to encourage deeper reform of business rates. <https://www.gov.uk/government/publications/business-rates-review-terms-of-reference/hm-treasury-fundamental-review-of-business-rates-terms-of-reference>
39. The Office of Tax Simplification has a considerable back catalogue of recommendations and ideas for simplification which should form the starting point for future discussions.

Tax rates

40. Tax reform must be taken slowly and with a road map in mind. Tax rates are an integral part of the tax system and are an easy headline, but are only part of the picture.
41. We would strongly recommend that the UK should not chase tax rate changes without further considering the income and profits on which that tax rate is applied.

Tax reliefs

42. Clearly tax reliefs have an important role in rebuilding the economy and promoting economic growth and efficiency. Historically, reliefs have been used successfully to encourage innovation and entrepreneurship. We understand the UK is anticipating record numbers of start-ups and our perception is the current regime of tax reliefs works well. We suggest better feedback would be helpful for government to review whether reliefs meet their behavioural intent.
43. Sunset clause provisions should be considered as these would focus the benefit of new reliefs and it would be easier to tell if they achieve their objectives.

Windfall taxes

44. We suggest that windfall taxes in the post coronavirus world should be approached with caution. A compelling case would need to be made.

Tax reform

45. The best way to tackle tax reform is through consultation and clear road maps. Implementation of major reform will undoubtedly take time and may extend beyond one parliament.
46. The ongoing crisis is having a major effect on the UK economy and public finances, and the recovery will take time. We can expect ongoing debt levels to be significantly higher than they were previously and the tax base must be strong and sustainable.
47. However, now is the time to make plans to modernise the tax system. This will need considerable investment in HMRC to support implementation, and its IT systems in particular, noting the need to also make provision for the digitally excluded
48. ICAEW sees this an opportunity for the UK to make a positive investment in the next generation, who will be paying the cost of the current crisis for many years to come.