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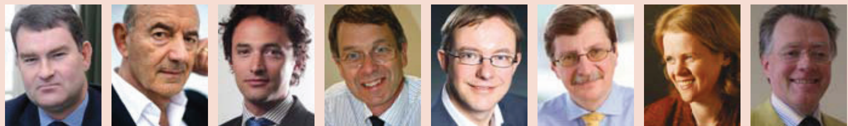
Reflections on 2012

Views on tax that matter



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Reflections on 2012
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Making the tax system simpler, fairer and more efficient

David Gauke MP
Exchequer Secretary to the Treasury

Since taking office in 2010, the government has made it a priority to have a tax system that is simpler, fairer and more efficient. In tax as in other public services, we want to make tax easier for people, by taking advantage of the digital revolution. Part of the government's digital strategy is for HMRC to become digital by default, something on which we've made significant progress.

Our work this year began at Budget 2012, when HMRC published *Making tax easier, quicker and simpler for small business.* This set out changes to the rules to make the tax system easier for small to medium-sized enterprises (SMEs) to understand and outlined how HMRC is going to improve the experience of SMEs when dealing with the tax system. We also announced that 20 million taxpayers will get an online personal tax statement from 2014/15, helping them to better understand their tax affairs.

As a leader in government digital services, HMRC has already embraced many of the opportunities provided by new technology but they believe they can go further. Each year, HMRC have 60 million hits to the website and over 270 million online transactions; they are constantly looking for ways to improve their relationship with businesses and individuals and this year has seen HMRC make further progress, both at Budget and Autumn Statement.

In May we launched the personal tax calculator, an online tool and smartphone app that allows people to work out how much tax they pay and how the government spends it. With more than 250,000 downloads, the tax calculator helps to demystify the tax system, making it more transparent.

And we are going further. This month the chancellor announced that the government will forge ahead with its digital strategy by significantly expanding HMRC's online service aimed at taxpayers. For the first time:

- the UK's 4.6 million SMEs will be able to access everything they need online and from a personalised homepage with secure digital messaging;
- 39 million individual taxpayers in PAYE will be able to let HMRC know of changes to certain information that affects their tax; and
- the 10 million self-assessment tax payers will be able to carry out all their transaction online.

These changes to HMRC's online services will save businesses time and money and give individual taxpayers greater understanding of their tax affairs. Under PAYE Online, taxpayers will be able to update certain information which affects their tax, helping HMRC to accurately calculate their tax code. HMRC's self-assessment online service is already used by 80% of self-assessment tax payers. The Autumn Statement announcement by the government will mean a totally digital experience, completely eliminating 22 million pieces of paper from the system.

Finally, the new service for SMEs, 'tax for my business', will give them access to everything they need to know and do online from their own personalised homepage – they'll be able to register, file and pay online as well as get tailored advice. This follows on from HMRC's 'one click programme' which delivered a tax dashboard for businesses and an online registration service in April 2012. These services will be up and running from the 2014/15 tax year.

HMRC will soon publish a digital strategy providing more information on this work. The digital strategy will contain details of the cross-government initiative, 'assisted digital', which will support users to access digital services and encourage further take up.

The ambitious digital advancements made this year signal a significant change in how taxpayers can interact with their tax affairs. Government is committed to providing individuals and businesses with straightforward, streamlined access to online information and services at times and in ways which are convenient to them – on a scale that has never been done before – and we will continue to forge ahead, making the best use of the advantages technology can offer us.

The GAAR

Graham Aaronson QC
Barrister, Pump Court Tax Chambers

What a difference a year makes.

Just over a year ago the GAAR study report was published. It received a pretty warm welcome by the TUC and, dare I believe it, Richard Murphy of the Tax Justice Network. The CBI was also cautiously happy with it. The doubters were tax professionals who worried about creating uncertainty for tax planners and driving investors abroad.

Well, I took on the GAAR study job because I thought it likely that the combination of coalition politics and years of austerity would move tax avoidance closer to centre stage; and it would be far better to develop a sensible GAAR through a rigorous and non-partisan study than to have one produced hurriedly by HMRC as a response to public anger at tax avoiders. This was the message I gave in the many consultations I held with various professional bodies during the study.

I know it can be very irritating to listen to 'I told you so'. But I did tell you so. So what do we have now, a year later? Thanks to Jimmy Carr, Starbucks and Amazon, tax avoidance is in the very centre of the stage, Joe Public is baying for tax avoiders' blood, Richard Murphy is saying that the GAAR does not go nearly far enough, and tax professionals are praying that the GAAR legislation and the all important guidance notes will hold the sensible line which the study group drew.

To their great credit Treasury ministers and HMRC have not caved in to public pressure, there has been no 'mission creep', and the draft GAAR to be introduced in FB 2013 does hold that line. All the major safeguards are in, the GAAR will target abusive schemes and the centre ground of tax planning remains unaffected.

As for the guidance notes, my job in chairing the interim advisory panel will be to ensure that it too will not cave in to public pressure and that the notes which it must approve will make the GAAR an effective weapon to deter and counteract abusive schemes, while not materially affecting reasonable tax planning.

If I have a message for the coming year, then it is – please wait and see. If I am invited to write an equivalent piece next December, then I hope that I will be able to say again 'I told you so'.

What is wrong with tax policy making?

Paul Johnson
Director, The Institute for Fiscal Studies

2012 has not been a great year for tax policy.
For one thing the debate over tax avoidance has created a great deal of heat without a commensurate amount of light. But the actual making of new policy has certainly not climbed the heights of clarity and coherence.

The March Budget led to the popularising of the marvellous term 'omnishambles', and much of that was about tax policy. The problem wasn't so much that the particular measures proposed were daft. Or rather the daft ones weren't on the whole the ones that led to the omnishambles tag.

Take getting rid of the additional income tax personal allowance for pensioners. It is a perfectly rational and defensible policy. Had the government announced, when it introduced the policy of moving all personal allowances up to £10,000, that it would then get rid of the very small additional advantage that pensioners would have I doubt there would have been that much fuss. Instead it sprang the idea on an unsuspecting world and described it as a 'simplification'.

Or what about the 'pasty tax'? Since our system of VAT requires a line to be drawn somewhere it is not obvious that there is anything wrong with moving hot pasties from one side of the line to the other. If the government had a coherent strategy for extending the VAT base then one could have understood where the pasty tax came from and what its purpose in tax strategy was. Even if this was a genuine attempt at simplification the announcement in fact looked like no more than an opportunistic grab for a bit more revenue.

That is not to say that we haven't also seen some tax policy making which it would be hard to fit into any economically coherent tax strategy.

Economists may be famous for not agreeing on much, but you'd be hard pressed to find many who think that stamp duty land tax is a good idea. It is a tax on transactions which reduces welfare pretty directly by discouraging mutually beneficial trades in the housing market. Yet it was increased to a hefty 7% on properties over £2m. This may not be a group of house purchasers who will gain much public sympathy, but the tax is nevertheless a bad one. A much better reform to housing taxation would be to update the values used in council tax assessments and make payments proportional to house value – as opposed to capped and regressively related to value as at present. But such a change has been ruled out.

Then in the Autumn we got the 'shares for rights' scheme proposing exemption from capital gains tax for employees who give up certain employment rights. Even as issues of tax avoidance were in the headlines the government's fiscal watchdog warned that this could create a new multi million pound avoidance industry.

The list goes on.

So far as tax policy is concerned this has been a year littered with evidence of a lack of any coherent long term strategy for most parts of the tax system. We are left with little idea of the government's long term direction. What does the government expect to go next with pension taxation? I have no idea. What role does it think taxes should play in adjusting behaviour? I don't know. How does it think housing should be taxed in the long run? Not a clue. And as for the taxation of petrol! The continued succession of on, delay, delay, off announcements for indexing fuel duty has descended from soap opera into farce.

This lack of clarity is costly economically. It reduces people's welfare. And it makes planning much more difficult than need be.

Oddly, perhaps one of the better processes – whatever you think of the outcome – was associated with the reduction of the 50p rate of income tax to 45p. For once this was a policy which came with some serious and high quality analysis. There remains a lot of uncertainty over the precise effect of the 50p rate, but nobody could look at the data and ever again believe that taxes don't sometimes have a very big effect on behaviour.

The evidence of massive forestalling might also have led you to believe that no chancellor would ever again announce changes to tax rates for those on over £150,000 with a year's warning to allow maximum tax planning. You would of course have been wrong. By giving a year's warning before reducing the 50p rate Mr Osborne has ensured that the timing of many billions of pounds worth of transactions will again be determined more by changes in the tax regime than by any economic fundamentals.

Tax and *The Times*

Alexi Mostrous
Special correspondent, *The Times*

This year tax has risen to the top of the political agenda.
I confess. This time last year I was not fascinated by tax. Beyond a vague awareness that it was deducted from my *Times* payslip, I knew nothing about it. Little could I have imagined that ten months later I would be conversant in the finer points of employer funded retirement benefit schemes, general anti-abuse rules and unregulated collective investment strategies. I'm still unsure whether this is a good thing.

After writing a series of stories exposing how the wealthy dodge tax, my eyes have been opened. Tax avoidance by individuals is a major problem. In Britain the practice costs the economy, on the most conservative of revenue estimates, £4.5bn a year. Add into the mix corporate tax avoidance and tax at risk rises to more than £30bn. These are staggering figures.

This year has seen tax avoidance rise to the top of the political agenda, partly as a result of stories published by our newspaper.

The Times' undercover investigation exposed providers who shelter billions of pounds for their clients. Hundreds more tax avoidance firms are in business, generating more than 300 new DOTAS schemes a year. As one told us, accurately: 'Between us and the Revenue, it's a game of cat and mouse.'

In June, David Cameron took the unprecedented step of condemning Jimmy Carr, the comedian, after we revealed he was a member of the K2 tax scheme. Interestingly, Mr Cameron refused to condemn Gary Barlow, the Take That singer and Tory supporter, who had also invested millions of pounds in two suspected avoidance schemes.

The Carr story was followed by front-page splashes exposing abuses of film tax relief, Britons claiming tax breaks in Monaco, and a £1bn avoidance scheme called Liberty which attracted

2,000 investors, including BBC presenter Anne Robinson. Responding to the growing political disquiet, the government toughened the rules around disclosure, signed a FATCA-esque agreement with Guernsey, and moved closer towards introducing a GAAR.

Articles on tax provoked a 'marmite' response from our readers. Many commentators on *The Times*' website pointed out, correctly, that avoiding tax is perfectly legal. They said it was up to HMRC, rather than the taxpayer, to change the rules. This argument has strong logical force. But it arguably ignores a societal shift in attitudes towards tax, and in particular towards the relationship between the state and the individual.

From talking to industry professionals and members of the public, my impression is that tax is now viewed by many as an essential component in a civilised society. Perhaps in a time of austerity, the hackneyed old quotation used on every tax avoidance provider's website, that 'every man is entitled if he can to order his affairs so that the tax … is less', holds less authority than it once did. No longer is the taxman regarded as a thief slipping his hand into your pocket.

To earn more than £100,000 a year and opt out of it, however legal your methods, is considered by increasing numbers of people as morally unacceptable. The same can be said for multinationals who charge £5 for a coffee and funnel the profits offshore.

In 2013 it will be fascinating to see how the landscape develops further. Will the GAAR shut down aggressive tax schemes? Or will it prove a toothless tiger, with no real penalties and no possibility of catching anything but the most obviously aggressive 'abuse'?

Will HMRC still cleave to the principle of taxpayer confidentiality? Could the government introduce a limited exception to the rule, allowing some exposure of those entering legal tax avoidance schemes? And what of tax havens such as Jersey and Guernsey?

And are the big banks and the big four accountancy firms really out of the business of aggressive tax avoidance? All these questions will preoccupy me in the New Year.

HMRC customer service

Paul Aplin
Chairman, ICAEW Tax Faculty Technical Committee

I hope that we may look back on 2012 as a year in which something fundamental happened within HMRC, something that changed the department's view on service delivery.

The trigger for the change was the Treasury Select Committee's report in 2011. That report recommended, inter alia, that HMRC should try to see things through the eyes of stakeholders. The professional bodies wrote to HMRC's then chairman, Mike Clasper to suggest that we should meet to take the TSC's ideas forward. Mike agreed. Over the next few months several dozen people from HMRC visited tax practitioners' offices and a number of tax practitioners visited HMRC post processing and call centres. In 2012 HMRC started to act on the information those visits had yielded.

Top of the list of issues was the P35 process. In 2011 it had the feel of something deliberately aimed at catching out employers and at maximising penalties by only telling employers they had failed to file on time after several months' penalties had already accrued. In 2012, because of the visits and the conversations that followed, things were very different. There was better guidance, better timing of the notice to file, an additional reminder letter and a first penalty letter issued after one month rather than four, allowing those who had missed the deadline to cap their penalty at a much lower figure. As a result, far fewer employers faced penalties or multiple penalties.

Another major issue was call centre response times. Detailed discussions took place over the summer and HMRC's new leadership took decisive action. Lin Homer agreed to reallocate £34m of HMRC's budget to call centres, and to redeploy 1,000 staff. She also agreed to publish call waiting times so that the effect of the action could be monitored.

In addition HMRC put in place a better process for dealing with bereavement cases, launched an email pilot and took action to improve post handling.

Central to success was Mike Clasper's willingness to engage and the professional bodies and tax charities willingness to work with HMRC. The dialogue required trust on both sides and as it developed, the degree of openness and candour was – in my experience – unprecedented. The initiative soon began to influence thinking at Board and EXCOM level and attracted some very powerful advocates within HMRC. It quickly gained the total support of HMRC's new top team.

So, in the immortal words of Bart Simpson, are we there yet? No we are not, but we are at last heading in the right direction. We need to ensure that the initiative retains momentum through 2013.

The simple idea at the heart of it was giving people the opportunity to see things through each other's eyes. To keep the momentum we have to do more of that. Personally I think that every member of HMRC's board, of EXCOM and all at director/deputy director level should spend a day with a tax practice, a tax charity or a small business to see service delivery through their eyes.

We must also continue to tackle head on the major problems as well as more routine issues. In 2012 we tackled P35s and call centres. In 2013 the initiative will tackle – amongst other things – debt management and CIS refunds. Another major challenge in 2013 will be RTI and I would urge HMRC to ensure that those who are working on RTI spend time outside Whitehall, with employers (especially small employers), to gain a real and practical understanding of the impact RTI will have.

HMRC's leadership has embraced this taxpayer focused approach and now it needs to embed the culture across the entire department.

Ministers and politicians (of all parties) have a role to play too. HMRC must be properly funded. The Chancellor's remit letter to Lin Homer earlier this year made my heart sink: 'do more with less' is, in my view, a factor at the heart of the problems we have seen since the merger back in 2005. Efficiency savings are one thing, but the department has been asked to do too much with too little for too long. The announcement in the Autumn Statement of extra funding for HMRC was, therefore, very welcome: but funding is needed for better service delivery as well as for tackling evasion and aggressive avoidance. Taxpayers who think they are being listened to and treated fairly are far more likely to be compliant.

So did the joint initiative really achieve anything in 2012? In

my view yes, it most certainly did. Many thousands of employers saw a very real change, but the new commitment to the simple idea of seeing things 'from the outside in' is even more important: it has the potential to be transformational. We have to make sure that this potential is fully realised.

Getting simpler … slowly

John Whiting
Tax Director, The Office of Tax Simplification

A look back at what was achieved in 2012, and a look ahead at what's in store in 2013.

A recent letter to *The Daily Telegraph* enquired, in the wake of the Autumn Statement, 'What are the bureaucrats in the Office of Tax Simplification doing?'. My response, apart from stressing that my (very small) team is very un-bureaucratic, was in terms of what we had achieved, which I suggested was pretty good.

Not that we've produced a simple tax system. Nor will we ever achieve that – we live in complex times, in a complex business environment. All the more reason why we should work towards a simpler tax system and that is what the OTS does: research areas of the tax system and come up with recommendations for improvements. It's then up to Ministers, with advice from HMRC and the Treasury, to decide how to take forward our recommendations.

The OTS has been going for over two years now and 2012 has seen us get into our stride. We have established a sound methodology for our projects: plenty of research and fact-finding among as wide a group (practitioners, businesses, individuals and HMRC staff) as possible; working up and testing ideas by a small staff of civil servants and (mostly volunteer) private sector secondees; lots of support and challenge from our very active consultative committees; reports that identify changes in legislation and administration that will reduce complexity and burdens.

A good deal of our focus has been on small business taxation. The reports we produced in the Spring have all been taken forward:

- HMRC administration: a programme of improvements is in hand, with the Administrative Burdens Advisory Board monitoring progress;
- disincorporation: consultation over a potential new relief, with draft Finance Bill legislation just published; and
- cash basis: our recommendation for cash basis for the smallest businesses is going ahead at a higher level of turnover, together with more use of flat rate allowances.

Our recommendations for improvements to the four tax-advantaged share schemes are moving forward well, again following a constructive consultation. We also had a lot of favourable reaction to our interim pensioners' report, analysing the areas of difficulty older taxpayers face with the tax system. Plus work on moving income tax and NICs closer together continues, stemming from a 2011 OTS report.

So what does 2013 hold? First up will be our final reports on pensioner taxation and unapproved share schemes. Both are coming together well and will have a range of constructive recommendations, large and small, that should make a difference. Publishing in January should mean the Chancellor can give a considered response in the March Budget, although changes are most likely to be from April 2014, after consultation.

Then we will be starting on a new project, on employee expenses and benefits. The terms of reference (ToRs) for this large project are published on our website at www.hm-treasury.gov.uk/ots . Like all of our projects it has revenue-neutral simplification as its aim, though even before the ToRs were published some commentators were saying authoritatively that we were going to abolish this and cut that with a view to raising £x bn for the chancellor. Sorry, but that is neither our remit nor our aim: we are on the lookout for simplifications and I want to test whether the whole system is fit for 21st century working patterns. We'll be seeking input for our project (and indeed people to help us with it) and I will say more about it in a future *Tax Journal* article.

Finally, do keep an eye on our work on complexity. We did some analysis work on the length of the UK's tax code during 2012 and have recently published a paper on a complexity index. A paper on tax thresholds is about to be published. All are available on our website and we really would welcome comments on them. If we can establish the causes of complexity, that should be a significant step towards simplification. Now there's a theme for a New Year's resolution ...

Multinational tax planning

Sara Luder
Partner, Slaughter and May

The issues behind the recent outcry on unacceptable tax planning are far more complicated than have been portrayed in the mainstream media.

The coverage of multinational tax planning this year has been unprecedented, and often frustrating. Common misconceptions include that tax is paid on revenues (rather than profits), corporation tax is paid by reference to where customers are located (rather than where the business is carried on) and transfer pricing is 'tax avoidance'.

Was it right that Starbucks felt the need to offer to pay additional 'voluntary' tax? The Starbucks brand and operating systems distinguishes its business from a local coffee shop. A third party franchisee would have been prepared to pay significant amounts for the use of those assets, and so international tax principles quite properly envisage that the UK subsidiary would pay an arm length's fee for the use of the Starbucks brand. This is a fair allocation of profit to where the value is generated. The most notable fact is that the royalties are not being paid to the US, but that is US, not UK, tax planning.

Earlier in the year the demand was that UK multinationals should pay more UK tax on their worldwide profits, but the territorial principle of tax is that non-UK profits should primarily be taxed in the regime where those profits are generated. A UK headed group will therefore not pay UK tax on its worldwide profits, but transfer pricing should mean that the UK parent will pay UK tax to the extent it can justify

charging foreign affiliates for value that it provides (brands or management services, for example) to the worldwide business. The tax rules for in-bound and out-bound investment need to be consistent.

The allocation of profits amongst taxing jurisdictions can never be wholly within the control of the UK. Transfer pricing is based on international tax principles, backed up by the OECD and a network of bilateral tax treaties signed by the UK with its major trading partners. These tax treaties also preserve the right of businesses to trade *with* the UK (rather than *in* the UK) without being subject to UK tax. In the last decade these rules have been under almost continuous review to ensure they remain relevant for the e-economy, but perhaps the time has come for a more radical reassessment.

The EU angle also makes it very difficult for the UK to take unilateral steps to change the rules. The EU treaties preserve the right of multinationals to set up their European operations in whichever member state they want to, and to sell to customers throughout the EU single market from that location. Should the EU be asking itself whether it is appropriate for member states to seek to attract businesses with attractive tax policies? Would an EU common consolidated tax base help, or simply add another unwelcome layer of complexity, given that the underlying issue would still be one of profit allocation?

It is also the EU that controls how VAT revenues are divided between member states. Is it a correct allocation of tax revenues that currently much of the VAT attributable to supplies of e-books made by Amazon to UK retail customers should benefit Luxembourg, not the UK? Should we be criticising Amazon for taking tax into account when choosing where to locate its operations, or looking more generally at EU VAT policy?

These issues are complicated, and need careful consideration. The current knee-jerk reactions are doing little to provoke an informed debate on international tax policy.

Business record checks

Andrew Gotch
Chairman, CIOT's owner-managed business taxes subcommittee

The new regime on business records checks imposes an impossibly high compliance burden for many businesses.

Business record checks (BRCs) went live at the beginning of November. There was a whimper rather than a bang when it did so, which suggests a lack of understanding in the professional world of what BRCs are and what they are meant to do, despite the late Dame Leslie Strathie citing BRC to the Treasury Select Committee in March 2011 as her sole example of how HMRC would achieve its £7bn CSR anti-evasion target. In reality, there are good grounds for saying that there is plenty for advisers and taxpayers to worry about and that the BRC initiative heralds a renewed attack on the soft target of the small business sector that has been the traditional cannon-fodder of HMRC investigation for many years.

BRCs are not benign and are not educational in inspiration, albeit that taxpayers with 'inadequate' records will certainly be taught a lesson. BRCs are the thin end of HMRC's compliance wedge. There is no random selection, and any taxpayer chosen for a BRC has been selected because they have been identified as a positive compliance risk by HMRC's increasingly sophisticated risk analysis function. So simply receiving notification should ring alarm bells – the taxpayer concerned is on the compliance conveyor belt already, and advisers must act promptly to identify and address potential risk, and to make appropriate disclosure should any be required.

So which taxpayers should be feeling nervous? The telephone questionnaire makes it plain that those in the front line are businesses that deal wholly or partly in cash, and that those particularly at risk are unrepresented cash businesses. The questions (a statistical risk assessment exercise) seek initially to identify whether taxpayers are unfamiliar with all their tax compliance obligations and/or uncomfortable with form-filling. More specific questions then follow, the point of which is to identify how many sales and purchases are in cash, how often records are written up and whether private use is indentified, all questions familiar in an investigative context. The message for all advisers is that clients who deal in cash need to be told that they are under the microscope.

BRCs seek their statutory backing from the intrusive and unappealable compliance checking powers in FA 2008 Sch 36 Pt 2. However, the legislation does not compel the presence of taxpayers, nor does it require records to be at a particular location. Thus, as HMRC agrees, it is perfectly in order for records to be examined at a remote location (an adviser's offices, for example) without the taxpayer being there. It is also agreed by HMRC that it is perfectly in order for an adviser to deal with the initial telephone questionnaire on the behalf of a client, which, given the propensity of clients to give imprecise or inaccurate answers to such questions, is a sensible precaution. HMRC has given an assurance that a taxpayer whose BRC is dealt with in this way will not be automatically selected for a visit.

If a visit takes place, what can advisers and taxpayers expect? What HMRC is seeking to establish is whether the records are 'adequate' – not a word used in the statute and not really descriptive of HMRC's expectations. HMRC does not accept that incomplete records are acceptable in any way at all. HMRC's view is that, following s 12B(3), records of *all* receipts and expenses must be kept. So the hurdle is set, in practice, impossibly high, and particularly so for the small and medium-sized cash businesses that are the focus of the BRC initiative. HMRC seems to be seeking to replace a test of a balance of probabilities with a test of beyond reasonable doubt.

If HMRC decides that records are inadequate, a period of grace will be given to allow a taxpayer to put in place records that may meet HMRC's standards. There will then be a follow-up visit, and if the purported inadequacies have not been addressed by then to HMRC's satisfaction, a penalty will be levied. There is a sliding scale and penalties can run into thousands.

So what should be done if a penalty is levied? The better view is that HMRC's interpretation of s 12B is wrong and that the legislation does not allow for the imposition of in-year penalties for record inadequacies unless records have been deliberately destroyed. It follows that in any case where a penalty is imposed, an appeal should be made and the case progressed to the tribunal without delay.

There is no doubt that every one of the 2.4m small UK businesses with turnover of under £20,000 and which transacts in cash is now seen as a potential compliance risk and suitable for a BRC. Taxpayers in that group, and those who advise them, need to consider the implications of that now.