



Forum of Private Business

Research Report

Tax and Budget Member Panel

January 2010

Introduction

The Forum of Private Business (FPB) is a proactive, not-for-profit organisation, providing comprehensive support, protection and reassurance to small businesses. We add value to businesses through the collective voice for members in local, central and European government, and the provision of tailored solutions that promote business success.

Our Tax and Budget Member Panel comprises approximately 90 members who have volunteered to provide feedback to us on taxation and budget issues. Traditionally, we have contacted panel members on an *ad hoc* basis to gather feedback on specific issues, such as the Pre-Budget Report (PBR); however, we now engage more regularly with the business owners on our Member Panels to better understand and collect evidence of their real life experiences, to more effectively reinforce our policy and campaigns activities.

Note: as figures refer to fewer than 100 businesses, they should be treated as indicative rather than as representative of all small and medium-sized businesses.

Summary of findings

“The tax regime in the UK needs a complete overhaul. Over time, governments have made it more and more complicated and have used many taxes, a lot of which are totally unjustified, to raise money for dubious policies.” *FPB panel member response*

- There was a widespread belief that taxation should be amended to ensure that the UK had a taxation system that will support economic growth and can be understood and policed by business owners.
- The PBR was a microcosm of the issues that business owners were concerned with. There was a tax on employment and little long-term planning to pay off the national debt.
- 43% of businesses on our panel would prioritise fairness as a focus for amendments to the taxation system. 68% felt that the current taxation policy was unfair to smaller business employers. Stealth taxes on employment issues meant that 33% felt that the self-employed had an unfair competitive advantage and 52% felt that larger businesses, which have access to greater resources to cope with administering changes and exploit the taxation system, had an advantage.
- Taxation policy should also be competitive internationally. When only India rivals the UK for the complexity of its taxation system, it means that, as globalisation continues, a major overhaul will be inevitable. Some respondents would like to see a more consistent policing of imports as well.
- Business owners would like to see some transparency and information on the cost effectiveness of policies and where their money was going to. This is particularly relevant to business rates and local spending.
- The overall tax burden was the biggest issue for smaller business employers, with 45% of respondents stating that this was a very serious issue. A majority also felt that the administering of tax changes and ensuring tax compliance were also serious issues.
- Twice as many businesses would prefer a flat rate of 22% for corporation tax regardless of size on the grounds of simplicity compared to the current situation. The majority would, however, like a lower rate for their business, but with a limited – or no – system of allowances for disadvantaged or struggling businesses.
- 73% felt that there should be no incentivisation of certain types of businesses within the taxation system. This was primarily on the basis of simplification of the taxation system. There is a general feeling that this should not be a part of taxation policy.

Our response to the findings of the research

- The FPB is actively lobbying for privately owned small businesses to retain a greater proportion of their profits so that they can invest in their businesses, and drive the UK out of recession and into a sustainable recovery.
- We will continue to lobby for economic responsibility from current and future political leaders to ensure that a recovery is sustainable.
- We will monitor all future taxation regulation on the basis of fairness, competitiveness, efficiency, transparency, stability and certainty.
- We will continue to support the tax simplification process; however, we would like it prioritised and will lobby for a taxation system which is understandable to the layman and so can be policed by businesses in conjunction with Her Majesty's Revenue and Customs (HMRC). This would stop business owners being effectively criminalised if they misunderstand eligibility criteria or miss a little used clause in an area of taxation.
- We will work with the relevant parties to ascertain the feasibility of the suggestions from our panel.

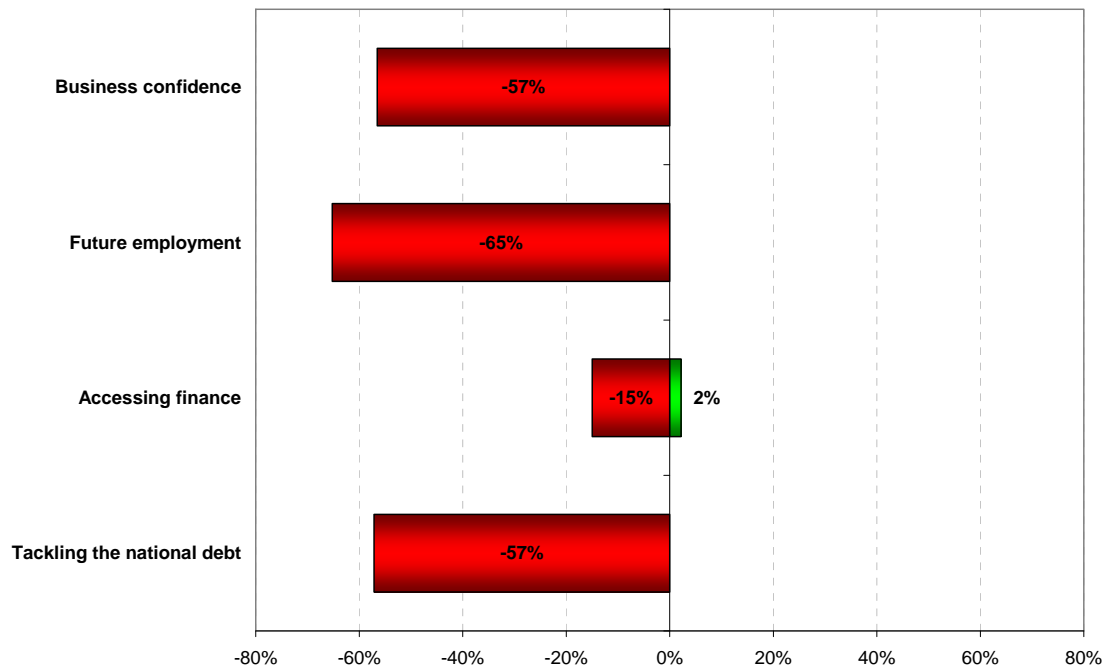
Impact of the budget

Respondents to this survey felt underwhelmed by the measures announced in the PBR. A number reported that the increase to their costs would make 2010 a very difficult year, particularly as the cost of doing business is likely to go up with an increase in business rates as well as the suggestions put forward in the PBR.

"The Pre-Budget Report was a mixed bag of damaging and short-termist proposals. We need to rebuild the UK economy; we need to get rid of our massive fiscal deficit." FPB panel member response

The consensus was that the PBR initiatives will have little or no impact. Many of the positive measures were described as gimmickry and schemes such as the Enterprise Finance Guarantee (that the FPB lobbied hard to have extended) were seen as not being relevant to their business.

Figure 1: Impact of the measures announced in the Pre-Budget Report



Future employment was hit hardest by the feeling that the increase in National Insurance Contributions (NICs) was a statement of intent to increase employment costs rather than reduce them, whilst our own research has indicated that businesses have not seen a corresponding increase in the quality of applicants (in fact, many have seen a decline in attitudes and work ethic). Smaller firms also felt that they were less equipped to deal with these increases than larger corporations and that there was nothing in the PBR for them.

“Nothing is ever done to support and encourage small business. We are lumped in with large businesses and corporations which, for obvious reasons, are much better placed to deal with increased taxation and employee legislation.” FPB panel member response

“The PAYE burden on small and medium-sized businesses is already quite hefty, so this will hurt too. In the current climate, putting prices up is not really an option, so these costs will have to be absorbed, if possible, or running costs cut somehow, which is going to be tough after an already difficult year. That said, I cannot see how we will get out of this mess without all paying a bit more tax. I would like to feel that it is equitable though and it is not just the easy to prey upon businesses that foot the bill.” FPB panel member response

As the respondent indicated above, business owners would have liked to have seen more in the PBR on tackling the nation debt. They would have liked to see that the current government looking beyond the next election; some were even prepared to see more taxation increases to tackle this issue.

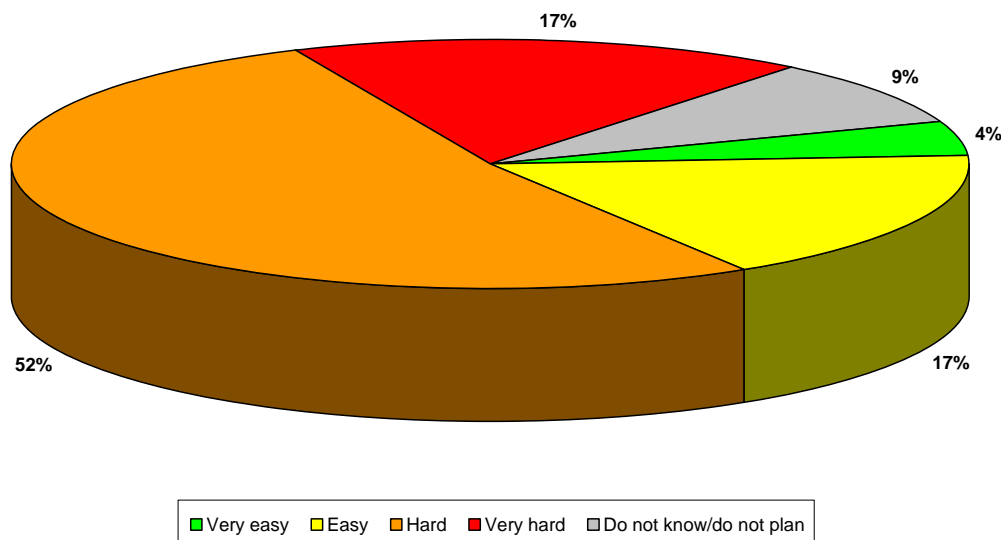
The lack of focus also dented businesses confidence in the Government:

“I am generally concerned at the continued lack of interest in businesses by the Government. The confirmed VAT increase will not encourage new trade and investment, and the increase in National Insurance Contributions (NICs) is another kick in the teeth for the employer. It is already very costly to employ staff and, in an environment when employers are under pressure to maintain or even reduce prices, this is just another cost to impact on the bottom line. It is no surprise that companies are relocating offices overseas.” FPB panel member response

Planning for 2010

87% of respondents expect a second budget in 2010, indicating that the mandate provided by the election will allow the Government at the time the opportunity to significantly revise these priorities. The fact that there is an expectation of a further change to fiscal policy, as well as a likely change on monetary policy due to base rate increases, makes it very difficult for business owners to plan for the next 12 months. In total, around 70% of respondents felt that it would be ‘very hard’ or ‘hard’ to plan for 2010.

Figure 2: Ease of planning for 2010



Those who felt it would be ‘easy’ or ‘very easy’ to plan for 2010 tended to be niche businesses or business owners who felt that they were in control of their own destiny. For one or two export-orientated businesses, the taxations issues were dwarfed by currency volatility. The majority felt that it would be difficult to plan for the year ahead due to the increase in overheads from business rates, VAT, employment taxation and utilities, in particular, when their own market would not stomach further price increases. Some were also concerned a harsher Budget may be needed after the general election, which could lead to further taxation rises to control public debt. Several respondents, whose businesses had a substantial element of public sector work, were concerned about cuts to the public sector.

“The lack of certainty about what is due to happen in 2010 is a big issue when it comes planning. It is hard to plan as no one seems to know quite what is going to happen. Therefore we do not know if people are going to want our services or not.” FPB panel member response

Other issues that make it hard to plan include current and future cash-flow issues, availability of low cost finance and consumer confidence, which are all areas of uncertainty when business owners come to determine their plans for 2010. General business confidence was the biggest factor that respondents felt they could not predict, as these comments illustrate:

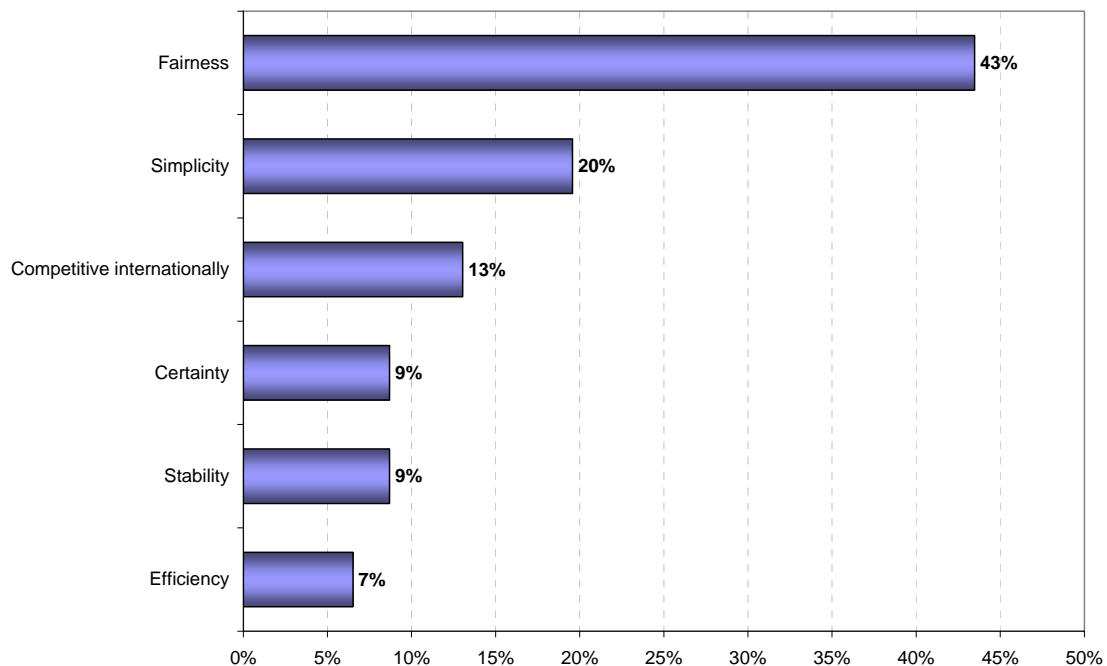
“We are hoping to expand, but it is impossible to really go for it as we might come unstuck. Any tax on employment will have a negative effect on extra staffing and I am sure VAT will rise again.” FPB panel member response

“Delay in expansion will lead to a more widespread deterioration in business confidence.” FPB panel member response

Priorities for the taxation system

Members of the panel were given a range of options as to the one aspect they feel should govern UK taxation policy. 43% chose fairness, with one in five citing simplicity.

Figure 3: The key requirement for a taxation system



Many respondents mentioned that there were other aspects that they would like to see as well, with simplicity and transparency quoted by most business owners.

*“It is overly complicated. The truth is that the right balance of all these factors is what is important; and the UK has got too complex and unfair.”*FPB panel member response

*“Stability is very important to allow for long-term planning. Simplicity is also important to ensure transparency (relates to being seen to be fair) and also impacts on efficiency – the simpler a system is the easier [it is] to be efficient. Efficiency is vital to reduce administrative costs, which in turn will reduce the amount of tax revenue required to cover those costs. I settled on fairness because of the population’s perception of a general ‘unfairness’ within our society in many areas. The perception of ‘unfairness’ gives rise to less compliance, low morale and a generally disgruntled nation.”*FPB panel member response

Business owners in general want a **simple** system that they can understand and police themselves. This is far from the case at the moment, as Tolley’s Yellow Handbook (the definitive rulebook for accountants) now stretches to 10,134 pages, which is more than any one individual can be expected to understand. This in turn means that businesses cannot police their own behaviour.

Many respondents felt that the complexities of the tax system added to business difficulties relating to uncertainty regarding the amount they had to pay, whilst a simple system would reduce the fiddling with the taxation system by legislative bodies to try and plug various tax loopholes. This was often to the detriment of honest business owners and tax payers who then had to reassess what they had to pay.

*“There seems to be hundreds of little hidden ways we are being taxed all over the place. Make the system simple and transparent. It would then cost a lot less to run and administer.”*FPB panel member response

This also has implications on fairness, as larger businesses have more resources to employ in exploiting loopholes and ensuring that they get the benefits that they are entitled to under UK law.

*“Simplicity generally leads to efficiency, which is good. Fairness and stability are good, too. We need a clear, simple system that allows people to plan and an efficient one that helps bring much needed incentives back into the system.”*FPB panel member response

Advocates of a complex taxation policy point out that it allows governments to manipulate fiscal policy to help the country to grow sustainably. The expenses scandal, a lack of robustness in the windfall tax on ‘bankers’ and the continued reliance on stealth taxes such as National Insurance to get revenue means that business owners are cynical about the delivery of an effective fiscal policy.

Being **competitive internationally** was a priority for exporters, in particular, but also for some service industries that now have to compete against larger companies whose cost bases are lower as a proportion of their employees are outside the UK.

*“Two thirds of our business is export and we need to compete with the world, which we are doing with one arm tied behind our back as we are paying for the bloated monopoly of Government to spray our money around on pointless projects and unproductive employees.”*FPB panel member response

Regarding **certainty** and **stability**, which in some cases were interchangeable, business owners wanted certainty so they would not be open to nasty surprises at the year end and can therefore plan more effectively. Respondents that wanted stability felt that this too would allow the confidence to plan for the longer term.

*“The reason I picked ‘stability’ is that it leads to confidence. People need confidence to be able to get on with it, confidence to work, confidence to spend, confidence to invest.”*FPB panel member response

Some felt that lack of stability was particularly a recent phenomenon, with sudden changes in the taxation system meaning that they could not plan for the longer term.

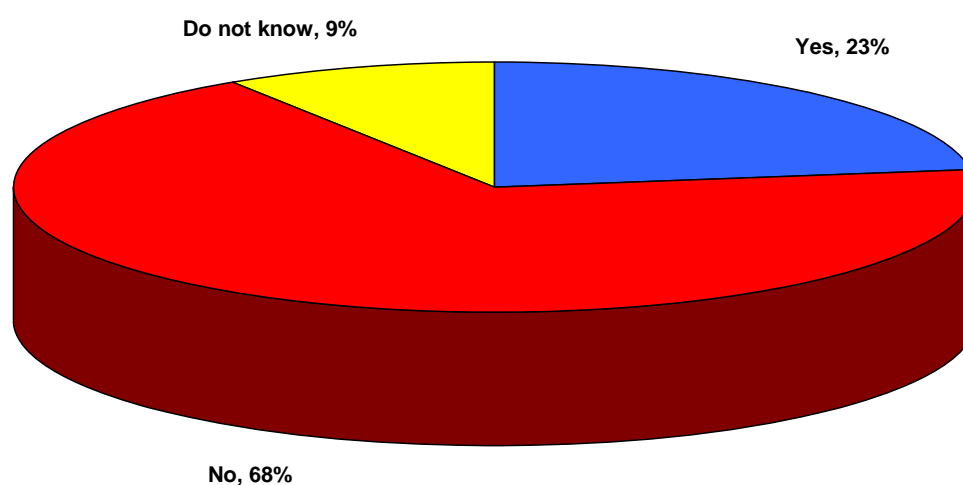
“The worst thing about the present government is their record of introducing allowances then removing them without sufficient notice. For example, the £10,000 nil rate corporation tax band, the

allowance for individuals to have IT equipment for home use, which was announced for three years, then withdrawn with three weeks' notice after two years."FPB panel member response

Efficiency was the least frequently mentioned option; however, it was often cited in conjunction with other aspects as many business owners believe that if the system were fair and simple it would be accountable. Some respondents felt that the current system was wasteful but had other priorities. Efficiency was closely aligned to transparency, as many business owners were concerned that the true wastage of the tax system was not readily available.

However, what business owners want most from a taxation system is fairness. 43% stated that it was the major factor that should be considered in taxation policy and just over two thirds of businesses felt that taxation policy was unfair.

Figure 4: Respondents' views on whether the tax burden is fair for smaller firms



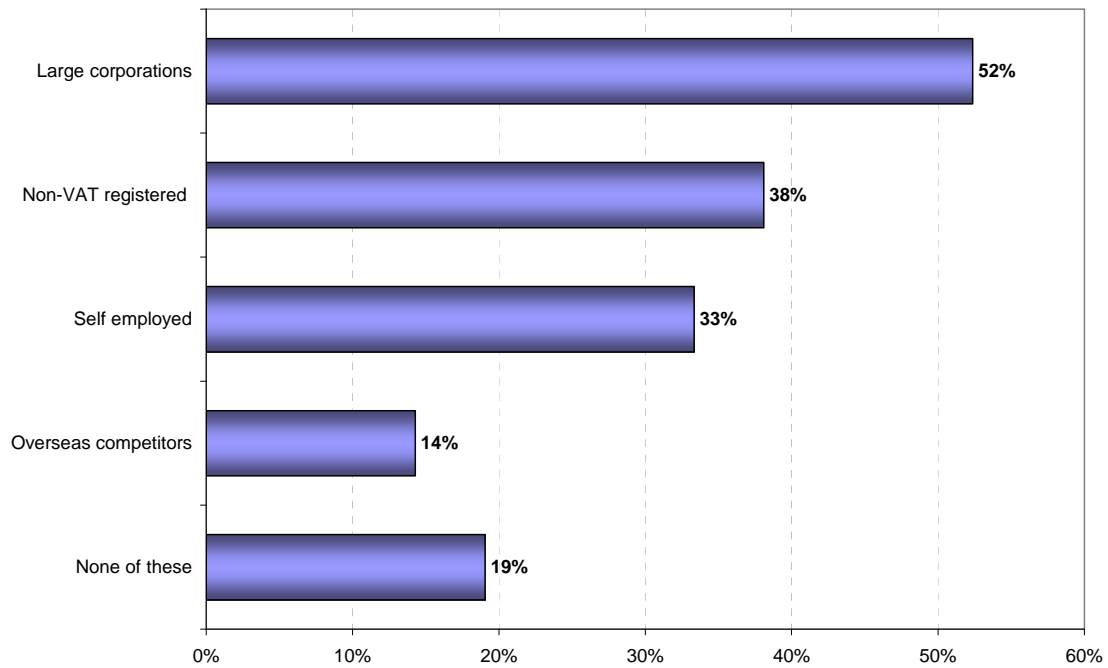
Respondents perceived that the lack of fairness was the major issue, predominantly due to increases over time of stealth taxes on employment which are geared towards larger businesses:

*"Taxes such as employers' NI, sick pay, maternity pay etc have a larger impact on SMEs and are not related to profitability."*FPB panel member response

*"Everything is geared to the large businesses and corporations, but small business is UNFAIRLY lumped in with all this and hence penalised because they are less able to swallow punitive financial and employee legislation. There should be a separate system for small businesses."*FPB panel member response

Around half of the business owners surveyed felt that large corporations had an advantage over them in terms of taxations. The importance of VAT and employment costs through the taxation scheme was felt to be unfair by around a third of respondents.

Figure 5: Who respondents think has a competitive advantage over their business



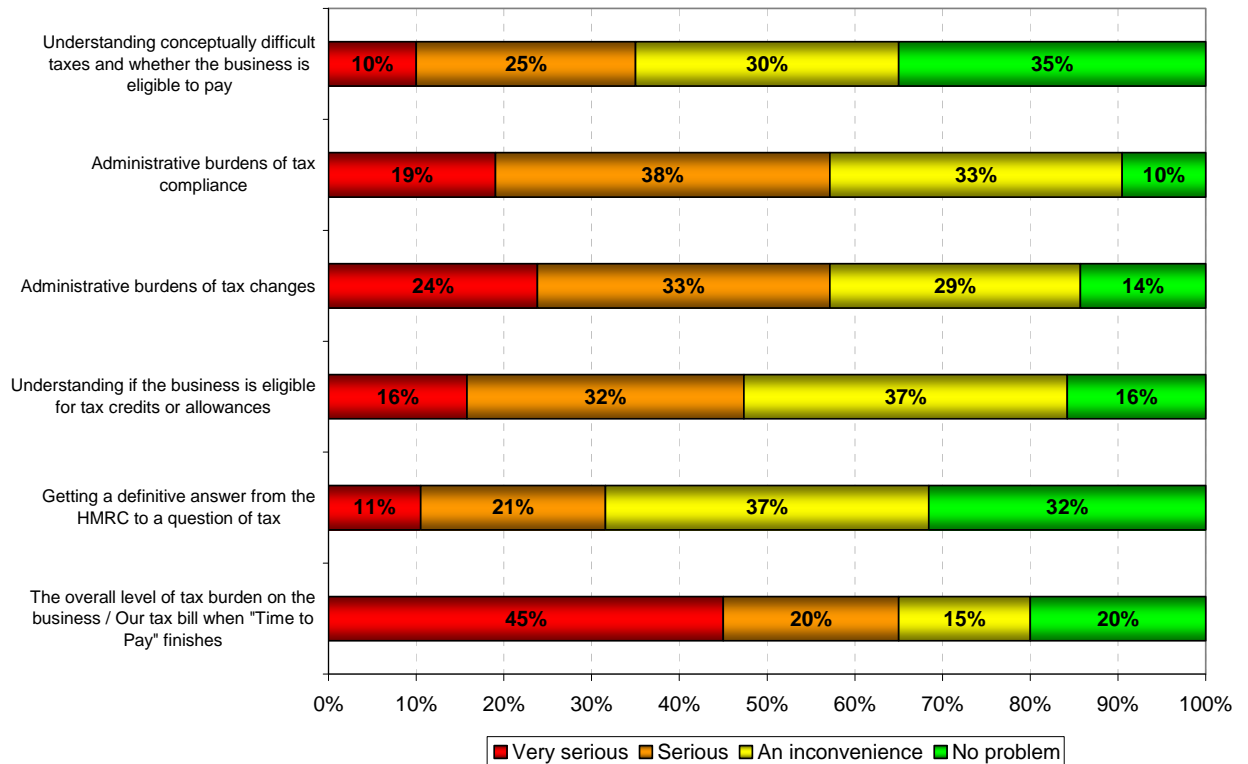
Some smaller business owners also mentioned that the way in which they were asked to pay their taxes was unfair. Smaller businesses, particularly those with fewer than 10 employees face cash-flow issues by paying the amount for corporation tax etc in a lump sum, when larger businesses are allowed to pay in two instalments. Some respondents would like to be offered a range of payment options, such as paying in monthly instalments.

There was a feeling that the taxation burden on businesses in general was unfair, with taxation increases being weighted on businesses rather than individuals. This has been exacerbated by the current economic climate, where businesses have suffered more than consumers.

Business owners also felt that the taxation system was unfair in that they were penalised unfairly for success. Small business owners predominantly earn less than corporate managers, senior civil servants and government ministers, yet effectively pay more tax considering the risk and responsibility (they cannot blame predecessors or other departments for their mistakes) that they shoulder.

Respondents were asked how serious various problems were for their business. The most serious problem was simply the burden of taxation, with 45% stating it was a very serious problem and 20% stating it is a serious one.

Figure 6: Seriousness of potential tax issues



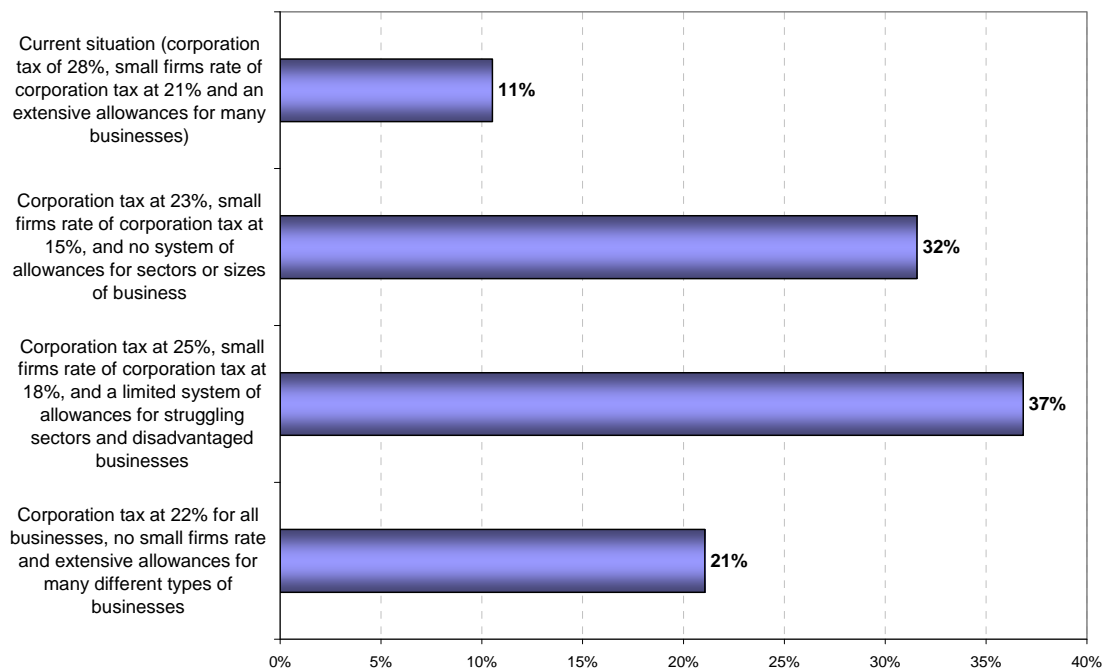
Getting a definitive answer from HMRC was the least likely problem to be rated as serious; however, many respondents left that up to their accountants. Business owners did feel that the information was variable from person to person, but tended to blame the system rather than the institution. For respondents who had been misinformed, though, this was a ‘very serious’ issue.

Over half of respondents felt that administrative problems in compliance and in meeting tax changes were ‘serious’ or ‘very serious’ for their business. A higher proportion of business owners felt that changes to the tax system were ‘very serious’ compared to the overall compliance with taxation. This may be due to the VAT changes on 1 January 2010, but also because much of the overall burden of the tax system is outsourced to accountants.

Corporation tax

Although business owners responded with a measure of self interest when answering this question, just one in ten claimed to be happy with the current system, with these respondents feeling that it is as good as they are going to get. Some respondents, however, feel that this is likely to change to a system with fewer allowances for businesses. In contrast, twice as many respondents would be prepared to have a flat rate of corporation tax, pointing out that this would simplify the taxation system and a profit is still a profit whatever size of company makes it.

Figure 7: Preference for corporation tax



Respondents who would be prepared to give up the flat rate of corporation tax were only prepared to do so if large corporations similarly paid their way (an investigation in 2007 by the National Audit Office on the 700 largest firms in the UK found that 220 paid no corporation tax and 220 paid less than £10 million). The other main advantage would be that it would remove a whole raft of anti-avoidance measures that made it harder to understand and pay.

Some business owners did feel that there should be some balancing of the advantages enjoyed by larger businesses:

“The concept of a level playing field in business is a misconception as large scale business has far too great an advantage in every area; access to finance, utilisation of space, management and cost of staff, application of non-domestic rates etc. There also appears to be far more supervision/inspection by government, VAT inspectors, HMRC etc over the SME than their large competitors, mainly because the SME accounting systems are far more accessible!” FPB panel member response

A number felt that the systems of allowances and eligibility criteria were overly complex already and that this could be limited to help the business owner in understanding a tax that is conceptually difficult anyway.

“Although we only employ seven people at present, our turnover is well over £1m so I don’t think we qualify for a lot of the small business benefits. I might be wrong in this assumption, which just shows how difficult the system is to understand.” FPB panel member response

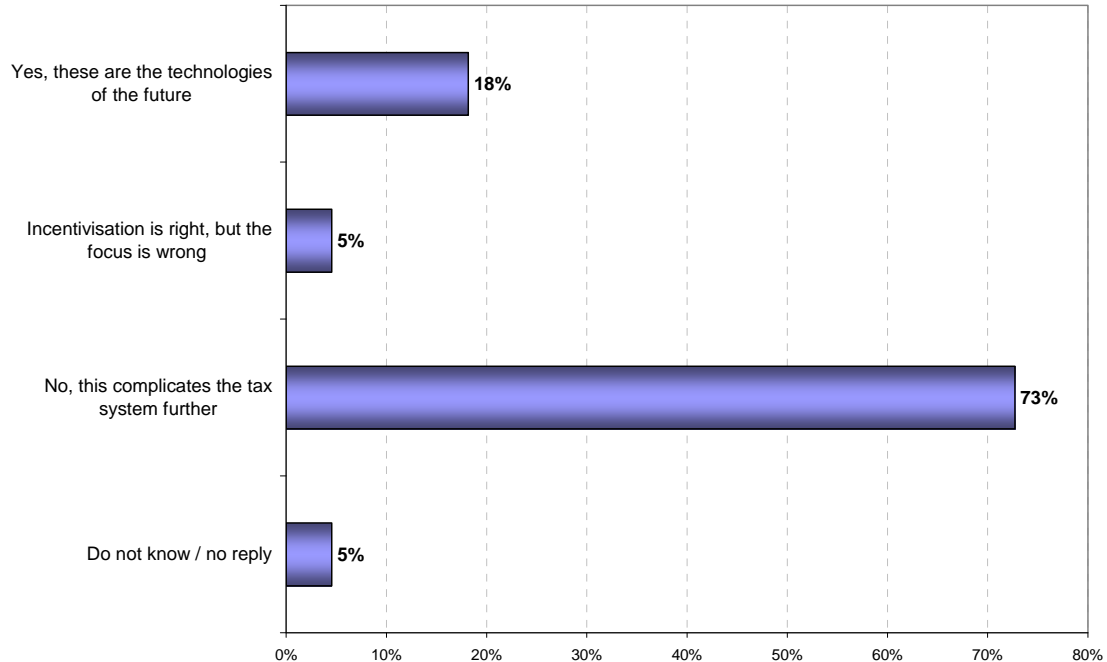
Some respondents felt that the level of taxation was too high for all businesses, irrespective of size, to support owners in developing their business.

“I actually feel that all corporation tax should be 15 or 18% as this is a substantial discount to the income tax rate so will encourage companies to build up reserves and hold profit within the business to provide future security and encourage people to grow their businesses for the long term.” FPB panel member response

Incentivisation of key businesses

Respondents were asked whether businesses believed to be key industries for the future should be incentivised.

Figure 8: Whether taxation should be used to incentivise specific industries such as biotech, digital or low carbon industries



Almost one in five respondents supported the idea of incentivising businesses in key industries, although some did have some provisos, in that they wanted a system that was sufficiently robust and perhaps included sectors such as renew energy.

A small number of people felt that incentivisation as a rule was right, but the focus was wrong. Better targets that were suggested included labour-intensive industries, incentivising businesses to invest in energy efficient vehicles or to export.

Around three quarters of respondents did not feel that these industries should be incentivised, often highlighting the same problems with incentivisation as businesses that would be prepared to see a taxation system used to incentivise these areas, but had some reservations:

"We want technology development, but in the main these are used to avoid tax and many that have had relief do not get off the ground because it is tax relief led not technology led." FPB member response

"We run a business that is not deemed to be in one of the 'sexy' categories, yet we employ people, we generate a profit, we export, so surely we are equally eligible to get some of our hard earned money back? Politicians should not in any way be picking winners of the future; instead, we as a country should be encouraging a broad-based economy." FPB panel member response

Respondents also felt that they should be incentivised outside the taxation scheme (citing the fact that there are already venture capital funds set up for these industries), whilst others believed in a greater acceptance of market forces.

"Incentives for future technologies are not needed. If they are good they will develop without tax incentives, multi-national companies will see to that." FPB panel member response

The majority of businesses in general felt the government should be looking at other priorities mainly related to getting the country out of recession.

Improvements to the taxation system suggested by members

Payroll taxes

Many respondents complained that the system of indirect taxation was difficult to administer, and confusing for the employer and employee. Businesses singled out National Insurance Contributions as an area that could be simplified by abolishing/incorporating it with PAYE/income taxation into a single payroll tax, which would form the majority of taxation revenue. A number of businesses described the current tax credit as a 'nightmare' and felt it would be simpler just to increase the income tax for the lowest paid. This would also alleviate the benefits gap. The administration of other payroll taxation such as maternity leave and calculating sick pay was also problematic. As they are, in effect, collecting tax for the Government, they do not see why it should be so complex.

Property taxes

Respondents mentioned as a problem the lack of fairness in the business rates system following the valuation increases in the autumn, as the cost of being located in an area had no relationship to the benefits they received from local government services. This lack of fairness was not only an issue for retailers, but also for properties that required relatively large buildings to do their work, such as SME manufacturers and some wholesalers. One owner-manager suggested the following tripartite strategy to make civic centres more sustainable and business rates more equitable:

1. Abolish the commercial tax on property ownership, ie non-domestic rates, as it is no longer fit for purpose.
2. Introduce a sales tax, specifically aimed at restoring the sustainability of city centres, ie reduced or nil in core city area and increase in bands as you move outwards.
3. (more a planning issue rather than a taxation one, but again aimed at sustainability of city and town centres) Quantify the existing trading volumes and, where large retailers wish to establish additional locations, oblige them to have to buy up existing floor space so as to fund the reuse of the old, now redundant, property.

Respondents also felt that automatic application of Small Business Rate Relief for those eligible would make business rates a little easier to stomach.

Environmental taxes

Respondents who sit on the FPB's Environmental Member Panel, and some on this panel, felt that the entire taxation policy should be rebased on use of resources. Others were not so sure, citing the fuel price escalation of 2008 and the minimal reduction in vehicle use as evidence that most small businesses are as efficient as they can be. There was also cynicism that the current political elite could be trusted to bring about the necessary changes in a fair and equitable way.

VAT

Business owners felt that VAT was the simplest and most effective way of taxation and a number indicated that they would be prepared to accept an increase of VAT to 20% if other forms of taxation were reduced significantly to make up for this. One or two businesses suggested that some industries in the 0% VAT rate could be reconsidered in the light of the changing costs to consumers. Others suggested that a 5% rate should be introduced on labour intensive industries, particularly those industries still in trouble such as construction.

Taxes on investment

Respondents wanted capital allowances made more business-friendly, either in terms of making them more flexible, treating items under the scheme as a one-off deductible expense at the point of purchase or limiting them to a small number of basic criteria. Currently, the system of allowances is so complex that it is open to manipulation, particularly by larger companies which have greater resources and more to gain by doing so.

One or two respondents would like capital allowances to be abolished completely, but as part of a significant reduction in corporation tax (to 15% or less) others felt that the need for capital allowances would be made unnecessary.

Non-domicile taxation

One or two respondents commented on this as they felt that the amount of money raised from this policy would be less than the amount raised to the economy. One reported that the system was set up after the Napoleonic wars as a way of raising revenue by incentivising people to come to the UK and drive economic growth.

Policing the taxation system

Business owners believe that the issues with HMRC are often due to limited staffing and the pursuit of easy targets (as SME accounts are usually more understandable than larger companies). However, the collateral damage of a big company producing inaccurate accounts, such as Enron did, creates far more damage to the economy. This is likely to be exacerbated by the recent proposals to close 130 HMRC offices. A simpler taxation system would allow greater policing of small businesses by their owners, who have proven themselves to be responsible. It would also give no hiding place for irresponsible businesses that have evaded their taxation responsibilities over the period.

Owners that also take a dividend from the business' profits instead of a salary should be supported rather than treated with suspicion by HMRC as owners minimise the amount taken out of a business in times of trouble and help it to survive.

One business owner would also like a more consistent policy on imports from countries such as the Channels Islands or the US, which have impacted on his business.

More information

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