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The business people – an extension to your team

# Tax and Budget panel report

January 2011

## Introduction

The Forum of Private Business 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 Panel comprises 98 members who have volunteered to provide feedback to us on training matter and includes training providers as well as business owners who require well-trained staff. Traditionally, we have contacted panel members on an *ad hoc* basis to gather feedback on specific issues, 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

59% of respondents felt that the priority of the tax system was to raise revenue to pay off the UK's national debt; however 33% felt that the tax system should prioritise the regulation of economic behaviour, indicating a preference for long-term reform of the tax system.

48% felt that the VAT rise would create minimal problems for their business as they had already a process in place and were given reasonable warning. 21% felt that it would significantly impact on their business. 9% highlighted the increased advantage that their competitors would have and 6% considered the administrative impact to be a barrier.

41% had changed the way their business operates and 51% of businesses always consider the tax implications of any major decision. Taxation also has an impact on the timing of investment decisions, including employment; however legal implications (73%), the skills needed to bring about change (66%) and cash flow (60%) were considered to be more important than taxation by the majority of respondents.

78% of businesses felt that the taxation system impedes employment due to the complexity of payroll taxes and the repeated increases in National Insurance. 45% considered that the taxation system hindered financial planning and 41% felt it impeded prompt payment.

57% felt that the tax system should be incentivised to allow businesses to employ more people, 38% would like to see a tax system that helped them plan more effectively and 19% wanted to see innovation incentivised.

68% felt that the target for business rates was not fair and equitable, with 63% feeling the same about corporation tax. Respondents were more supportive of the choice of tax base for IR35 (as professional contractors would otherwise have a commercial advantage) and green taxation. IR35, green taxation and tax relief schemes were considered to be the least well designed. Personal taxation for business owners was poorly expressed and the type of taxation that our members found hardest to comply with.

A slight majority 57% would be prepared to support radical tax simplification even if it meant they had to pay more tax if there were greater rewards for business growth. 50% stated they would also support tax simplification under these terms if it reduced tax avoidance by their competitors, although the same number indicated that they would not. 23% would not support tax simplification under any circumstances if it increased the amount of tax their business paid.

Panel members wanted to see fewer people unemployed and felt that the taxation system should reward individuals prepared to work by increasing the number of workers taken out of the tax system as well as creating a system that encourages businesses to employ. Owners would also like to see the rates of taxation for employee and the self employed more closely aligned in any reform of IR35.

Businesses would like to see HMRC use its resources more effectively to be more accessible to businesses seeking advice and also to focus more on tax avoidance by large companies. Such requirements would require additional resources and usage of technology, however the usage of technology needs to be treated sensitively as the lack of flexibility over PAYE returns still rankles with some businesses. Business owners want greater dialogue between accountants and HMRC so that they do not have unexpected tax demands. They would also like to see a continuation of the positive steps made by HMRC since the introduction of the time to pay scheme. For HMRC to meet the targets of our members the tax system has to be radically changed so that owners can police the system themselves.

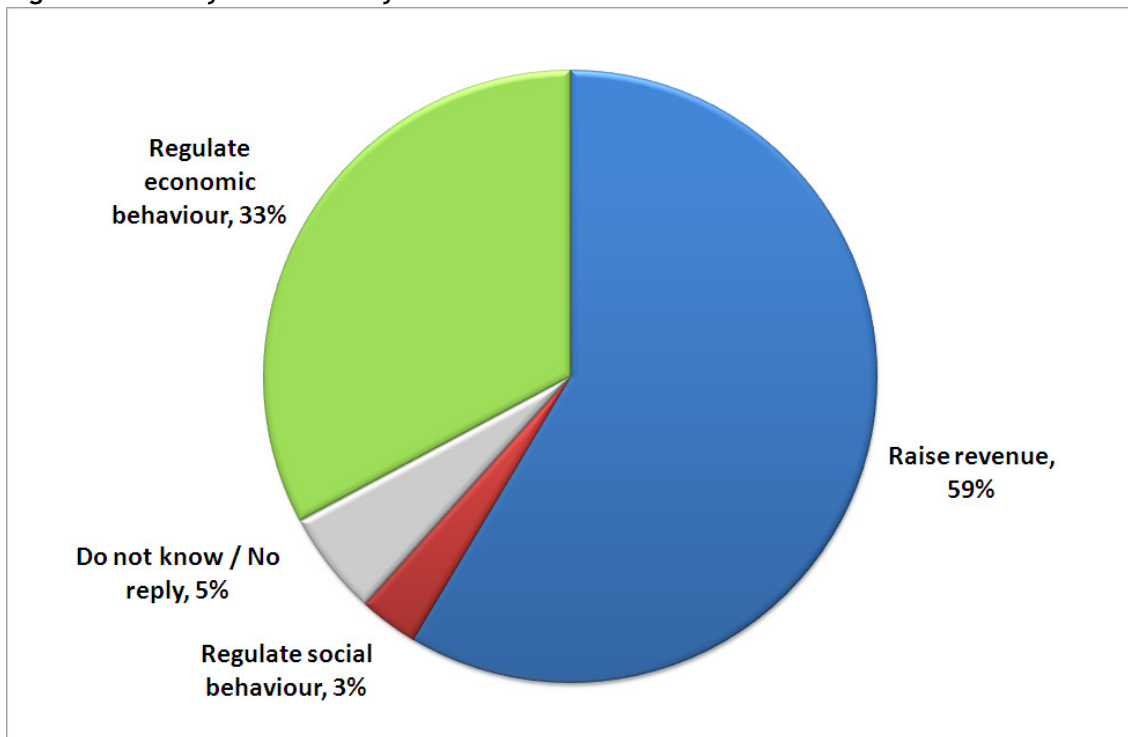
## The Forum’s response to the findings of this research

- The Forum will actively lobby for smaller businesses to ensure that the burden of taxation does not fall disproportionately on them
- We will investigate the possibility of radical overhaul to the taxation system to incentivise employment and investment. This could include abolition of business tax reliefs and allowances if corporation tax was reduced to internationally competitive levels and employment taxes (particularly employers national insurance contributions were significantly reduced or abolished)
- We will support HMRC and our members in pursuing tax avoidance schemes and loopholes such as the abuse of the Low Value Consignment Relief in the channel islands
- We will support good ideas in isolation such as tax relief on training or exemption from employers national insurance contributions for a year for businesses that take on young or unemployed individual with a view to training them internally in a return to traditional apprenticeships, even if this makes the system temporarily more complex.

## Priority for the tax system

Businesses were asked which out of three options they considered to be a priority for the tax system. As Figure 1 shows, the priority for a tax system is controversial and any attempt at tax simplification will be complex due to the diverse priorities of business owners.

Figure 1: Priority for the tax system



Almost 60% felt that the key priority for the tax system was to raise revenue, with short-term considerations in mind. Some business owners felt this was a silly question since the Treasury could not function without revenue and this was needed to support the public sector in regulating social and economic behaviour.

*“The function of a tax system is to raise revenue. The manipulation of that revenue through public expenditure will regulate social and economic behaviour.” Panel member response*

Others took a more immediate approach to answering this question, pointing out the considerable deficit and the need to raise revenue to pay for public sector benefits and repay the national debt. One or two businesses were aware of this, indicating that their answer was dependent on the current financial climate.

*“Necessity to raise revenue exists due to the burdensome ‘benefit’ state and all other major government expenditure. Regulation of economic behaviour comes a close second according to the financial climate at any given time.” Panel member response*

A few businesses took Ockham’s razor to the issue and felt that taxation should be solely focussed on raising revenue pointing out that state attempts to regulate economic and social behaviour over the last 30 years had had limited success. A handful of businesses also felt that economic regulation could and should not be altered by an instrument as blunt as taxation policy on its own.

*“Raise tax fairly. Regulation should be left to other departments.” Panel member response*

1 in 3 businesses felt that the tax system should focus on regulating economic behaviour, evening out the excesses of the financial climate and creating a long-term stable climate in which businesses could flourish.

*“We need a plan for the long term not just a quick fix.” Panel member response*

*“The better the economy is run, with incentives to grow, the more tax revenue will naturally be received.” Panel member response*

A number of business owners felt that the current taxation system created a number of perverse social and economic incentives that impeded economic progress or fair competition. These issues were highlighted by businesses who wanted economic regulation prioritised and those that felt there was a need for taxation to be raised fairly.

A small minority of businesses felt that regulating social behaviour was the key priority for the taxation system. The majority of this small group of businesses dealt directly with social and personal issues although one business also felt that the tax system does not support people in getting off benefits and into self employment or working for a smaller firm.

5% were uncertain, feeling that multiple options were equally valid.

## Impact of the VAT increase

*“Negative and unfair. Indirect taxes are taxes by stealth. All taxes should come from earned income.” Panel member response*

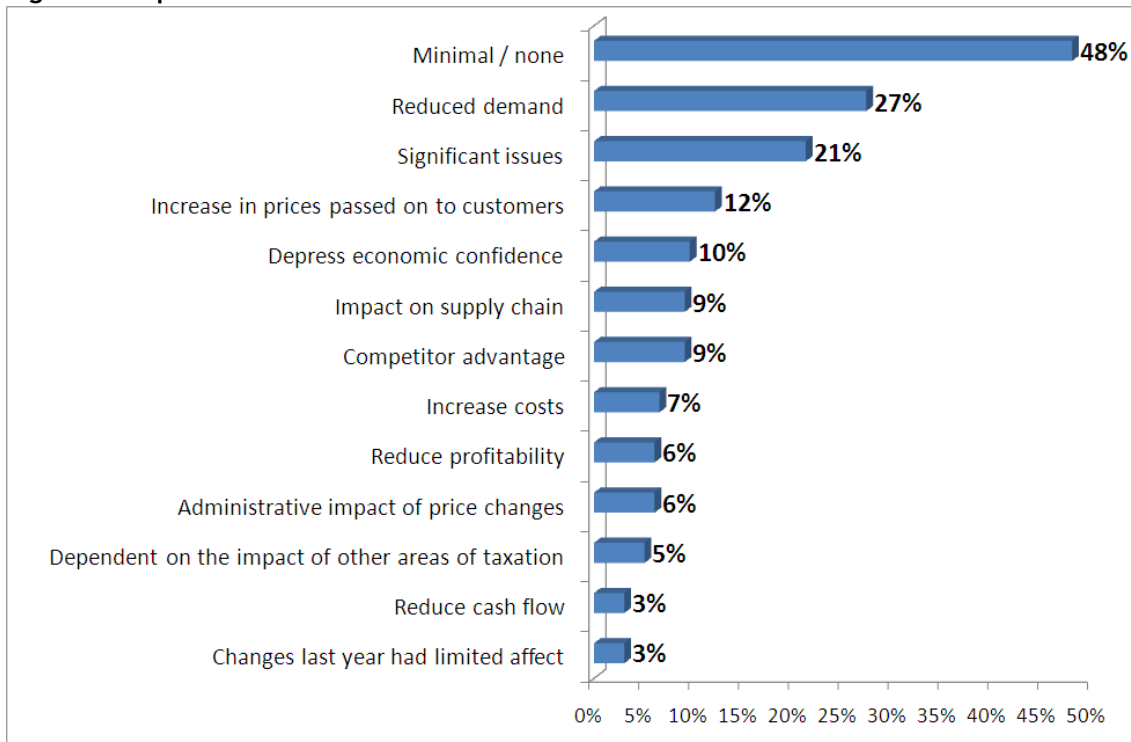
48% of business owners felt that there would be minimal issues from the VAT increase from 17.5% to 20%. These businesses tended to supply other businesses and felt that the only issues may be on their clients who were not VAT registered. 3% of these businesses indicated that the VAT changes last year had no impact on their business whilst one or two other businesses indicated it would only have a cash flow impact in the short term.

*“As a, primarily, business to business company, it will have little effect - a small amount on cash flow, but it is likely to have an effect on our customers sales, indirectly affecting us.” Panel member response*

However 27% indicated that there would be a reduction on demand as a result of this and 21% felt that the increase would significantly impede their business. 12% stated that they would simply raise their prices; many business owners are concerned about demand and the impact of fuel costs on the prices charged by their suppliers.

*“This will materially affect the self assessment clients not registered especially at a time where PAYE has been mismanaged and so they have unexpected tax demands. Other small businesses will find it difficult.”* Panel member response

**Figure 2: Impact of the VAT increase**



6% were concerned about the administrative impact (with time, postal costs and computer systems/invoicing) all mentioned as particular issues.

*“[There will be the] inconvenience of some price changes and possible effects on consumer demand in January & February”.* Panel member response

9% of businesses felt that this would give their competitors an advantage, this was not just businesses who were not VAT registered or provided services for such businesses. Those who produced or sold high ticket items were also affected, as were businesses that competed directly against businesses in the EU (typically hauliers and couriers) or had a lower rate of VAT due to their overall business model.

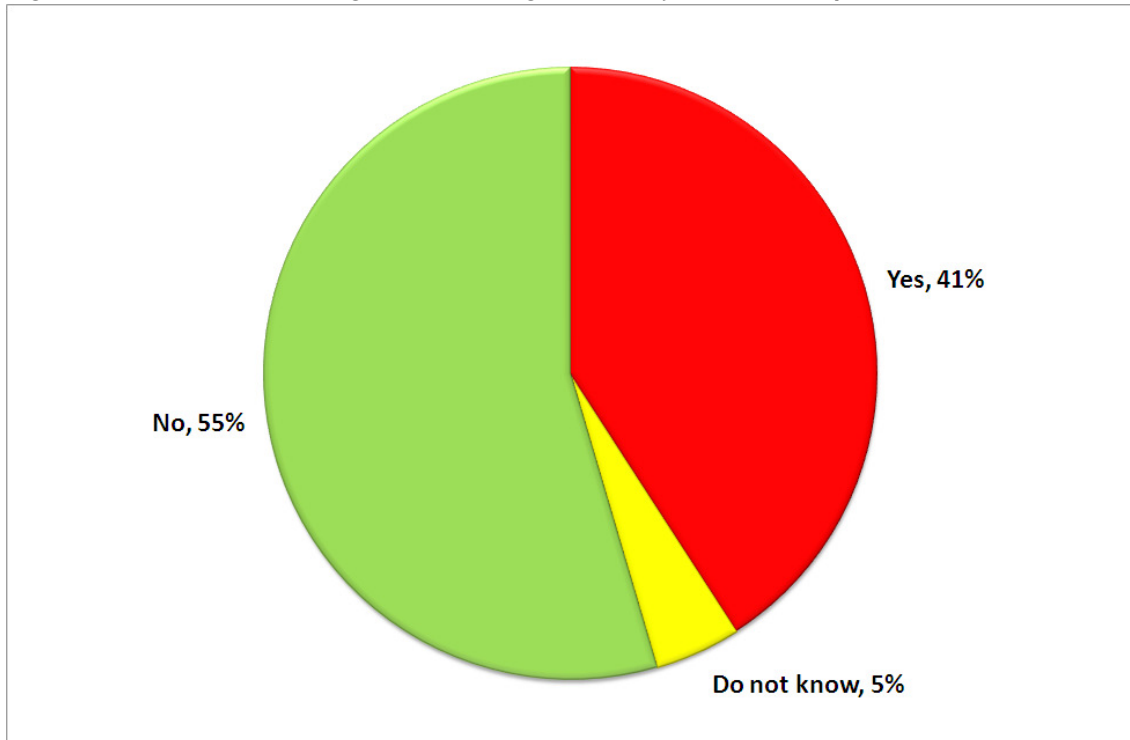
5% were uncertain about the impact. One business owner described it as a ‘gentle pain’ in comparison to other ways the Government could have raised revenue. Another owner felt that it would temporarily impact on consumer demand but would help dampen inflation and minimise interest rate increases.

## Impact of tax on business behaviour

### Past performance

Just over 40% of businesses felt that there had been tax changes that had changed the way their business operated, not always to the benefit of the business.

**Figure 3: Whether tax changes have changed the way a business operates**



*“VAT registration is now more complex & staff are poorly trained, both in company law & business practices. Why can't VAT registration be automatic with a new organisation formed as a Limited (Ltd) company? That way, only sole traders, partnerships etc would need to apply.” Panel member response*

11% indicated that the various VAT changes had had a significant impact on their business behaviour with business owners bringing forward or delaying investment decisions as a result of the changes. For one or two businesses the decision as to whether they should be VAT registered was a major decision in itself. The uncertainty on the VAT rate was the biggest issue for some businesses when it came to planning for 2010/2011 although one business mentioned that VAT avoidance by their competitors was an issue.

10% cited changes to National Insurance Contributions as an impact on their behaviour in the past, dampening demand for employment as it was seen as one of the favourite stealth taxes of the last administration. Some had changed their business model to facilitate use of contractors rather than employing staff as the costs were more predictable.

6% cited the loss of the 10% corporation tax as a major burden as it reduced the war chest that businesses had for surviving the recession and made businesses more dependent on external finance.

*“Uniform Business Rate - the single most unfair tax regime in the UK. Based on notional property values, making no allowance for ability to pay based on revenue. Expensive and is classic taxation without representation”. Panel member response.*

Business rates had a big impact on around 5% of businesses as they limited businesses' expansion plans and in some cases had a detrimental effect on the local business climate as high street outlets became vacant reducing the critical mass of the high street. Business owners also felt that there was no equivalent tax for internet-only retailers, creating a two-tier system.

*“The tax allowance for IT kit which was brought in for 3 years, and then dropped after 2 years with little or no warning.” Panel member response.*

Loss of or changes to tax allowances and tax relief changed the investment behaviour of 7% of panel members; in some cases the increases to capital tax allowances were positive, most notably in the 2009 Budget. However the lack of consistent thresholds was an issue - annual investment allowances are a good example as the level of the allowance has changed three times since its inception in 2007. Inconsistent advice was also an issue as one business had scrapped a project following an HMRC decision that they could not access R&D tax credit for their plans.

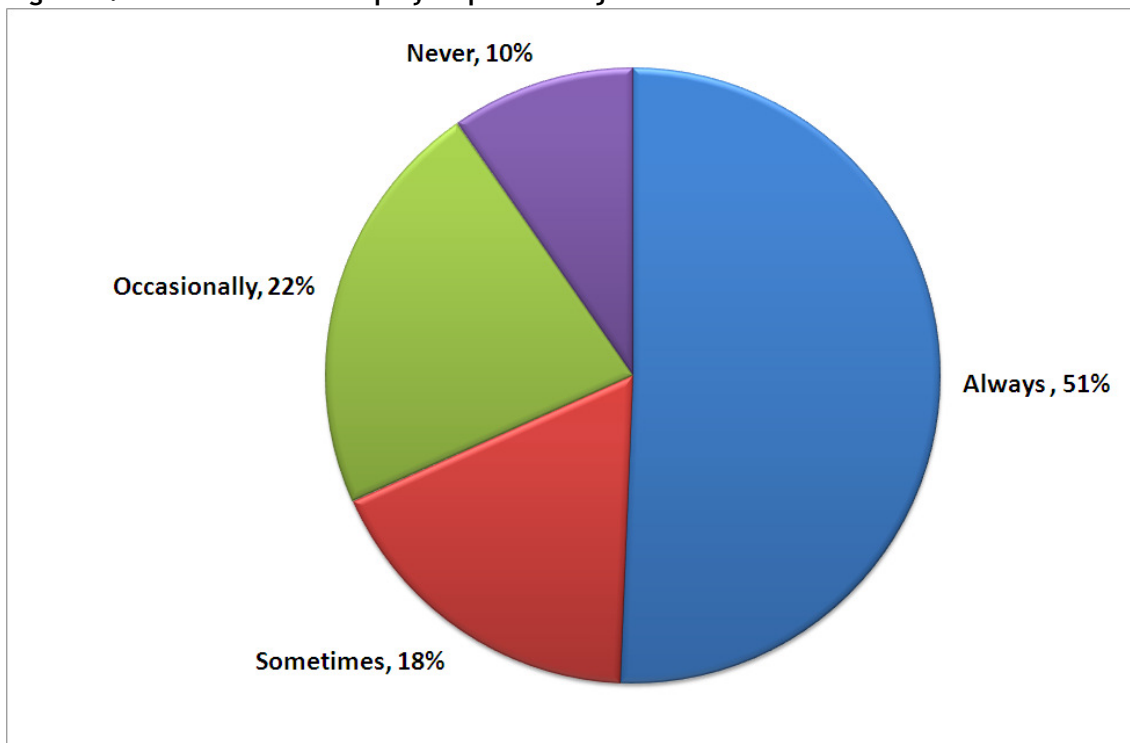
9% of businesses indicated that stealth taxation in general had had an impact on their business, making it harder for them to predict their taxation payments and therefore harder to plan for the future.

Although not a form of taxation itself, a small number of businesses mentioned the computerisation of HMRC as an issue that had changed the way their business operates as it had led to increased administrative requirements and limited the time they could spend developing their business.

### Assessment of taxation on major business decisions

Businesses were asked how frequently they would consider tax implications when making a major business decision.

Figure 4: How often taxation plays a part in major business decisions



51% always considered the tax implications when making a major business decision, with most stating that this was a part of a formal due diligence process.

*“It would be very foolish not to. Once in a while they can have a big impact.”* Panel member response.

In some cases however this is a simple conversation with their accountant or HMRC to check that they were no unforeseen surprises. This caution explains the fact that although 40% had changed the way they operate as a result of past tax changes, almost half of panel members would consider the tax implications of future decisions.

18% sometimes considered the tax implications, although it depended on what the decision was. A similar proportion would occasionally consider the tax implications, particularly if it was directly relevant to the viability of the project.

*“The majority of our decisions cannot be changed easily to take advantage of the tax systems.”* Panel member response.

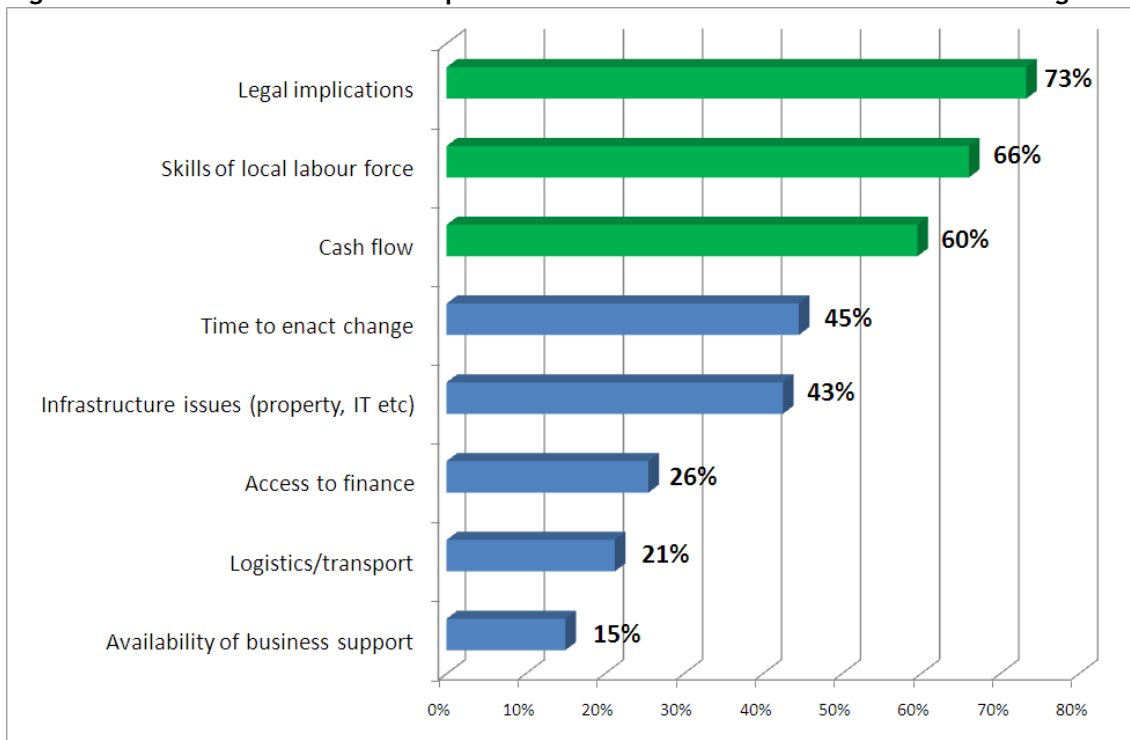
Business owners cited that there was often a change in timing but not in the overall decision, whilst others felt that taxation on profits was so high that it did not really matter as the taxman would still take a similar amount of their turnover.

*“Never made a decision on which tax would have a major impact. You have to pay it regardless, unless you’re a big corporation or a major bank. If you pay more tax it’s because you’ve made more profit.”* Panel member response.

10% of business owners would not consider the taxation implications of a major business decision, in most cases it is because the taxation requirements are likely to be minimal or similar for their competitors. These businesses would, however, still calculate whether the decision was viable and would therefore indirectly consider taxation policy.

Legal implications, the ability of the local labour force to complete the change and cash flow implications were all considered more important than the tax system in the future plans of the business by a majority of panel members.

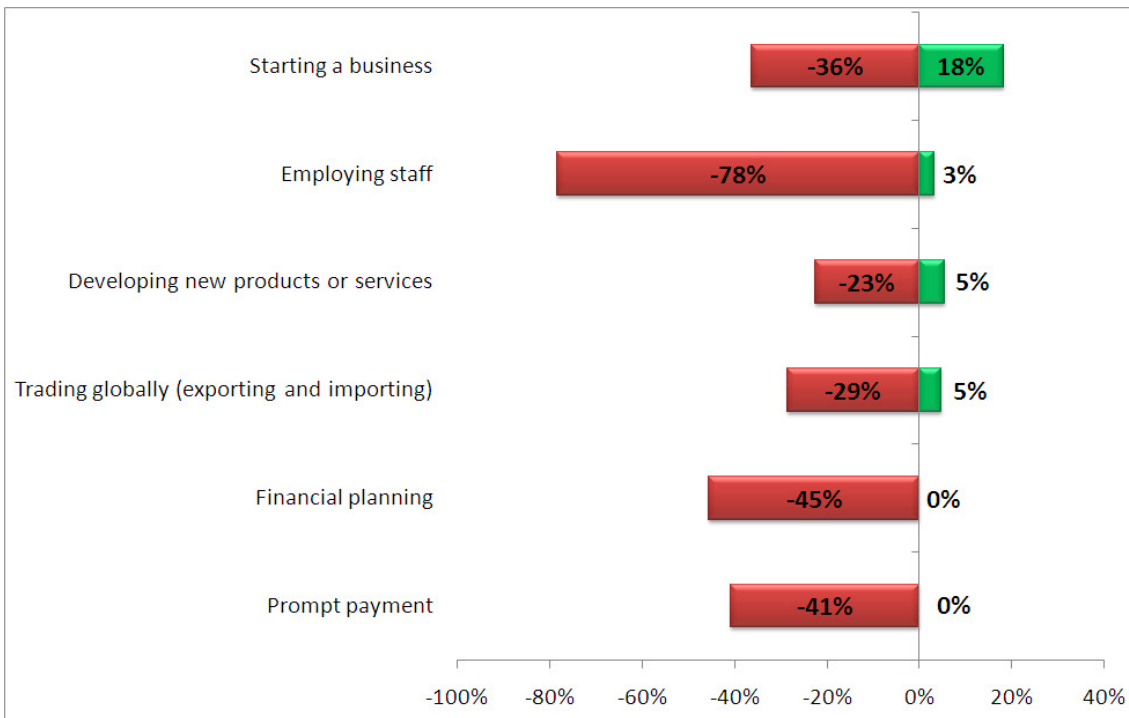
**Figure 5: What factors are more important than taxation in business decision-making?**



## How the taxation system should support business owners

We asked panel members whether the taxation system incentivised or impeded business owners in a number of key stages of the business cycle.

**Figure 6: Whether the taxation system incentivises or impedes business owners**



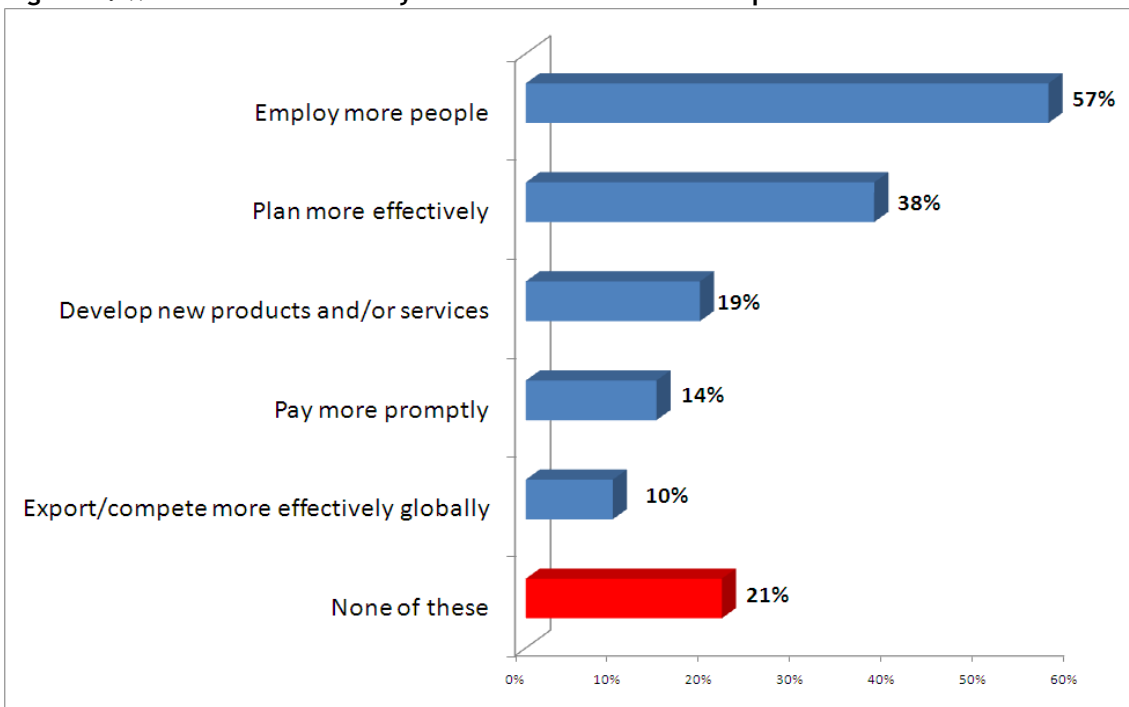
Negative scores (red bar) indicates proportion of respondents viewing the taxation system as an impediment, whilst positive scores (green bar) indicates the proportion believing the system incentivises it.

Starting a business was the most controversial aspect of the taxation system with 36% of business owners feeling that the taxation system impedes starting a business and around half that number feeling that it incentivises new companies. In some cases panel members felt that excessive resources were being placed on start-ups to the detriment of established businesses that had a greater chance of survival.

The taxation system was generally considered neutral in developing new products and services or trading globally.

3% felt that the tax system encourages employing people while 78% believe that the system impedes increasing the workforce. No business felt the current tax system incentivises financial planning or prompt payment.

**Figure 7: Where could the tax system be incentivised to help business owners**



As over three quarters of panel members felt that the current tax system impedes employing staff it is unsurprising that 57% of panel members see this as an area that could be improved.

The most popular incentive mentioned by over a quarter of panel members would be to reduce or abolish employer National Insurance Contributions (NICs). A number of businesses felt that this restricted their ability to grow their business and the current scheme stopped businesses employing and training staff.

*“National Insurance Contributions are quite crippling and are a major monthly cost.” Panel member response.*

Some respondents felt that national insurance should be reduced more generally until employees were productive. One business wanted to see national insurance contributions reduced to incentivise businesses to recruit and train.

*“Cutting the NI rate for new employees, regardless of their age, whilst they are in training (perhaps for the first year). We need to train new fitters but it is a very costly exercise.” Panel member response.*

A number of panel members wanted PAYE simplified and felt that technology had been introduced prematurely. Business owners also felt that the requirements on businesses to calculate Statutory Sick Pay, holiday pay etc was excessive, especially as they could then be penalised for miscalculations.

Owners also felt that businesses were disincentivised from employing people as there was no financial support for SMEs to help them cope with the loss of valued employees who go on maternity or paternity leave.

Businesses also felt that the tax take overall was too high to allow businesses to develop quickly and sustainably, and to employ sufficient people in the short term to make significant inroads into employment. The cost of fuel, employee transport, raw materials and energy were all mentioned. National Minimum Wage was also an issue as businesses could not predict future increases and would like to see the level for each sector based on market forces.

38% would like a taxation system that would help them plan more effectively. Changing allowances as a result of employment law or to increase the revenue from businesses/employees by stealth have become a big issue for our members.

*“We need consistency and simplicity. In the last few years we’ve gone from a logical system to one of the most complex in the world for no apparent reason.” Panel member response.*

Most businesses want minimal changes over the next five years, or a guarantee from parliament not to increase taxation on businesses further so that they can develop their business. A number of businesses wanted greater clarity over business rates in the long term as the current system is having adverse social effects on the high street.

19% would like to see the taxation system allow more innovation, our members mentioned simplification of R&D tax credits and lowering the level for incentives including capital allowances and R&D support would help. Investment would also be stimulated by corporation tax reductions as well as simplified funding support for collaborative research and university support.

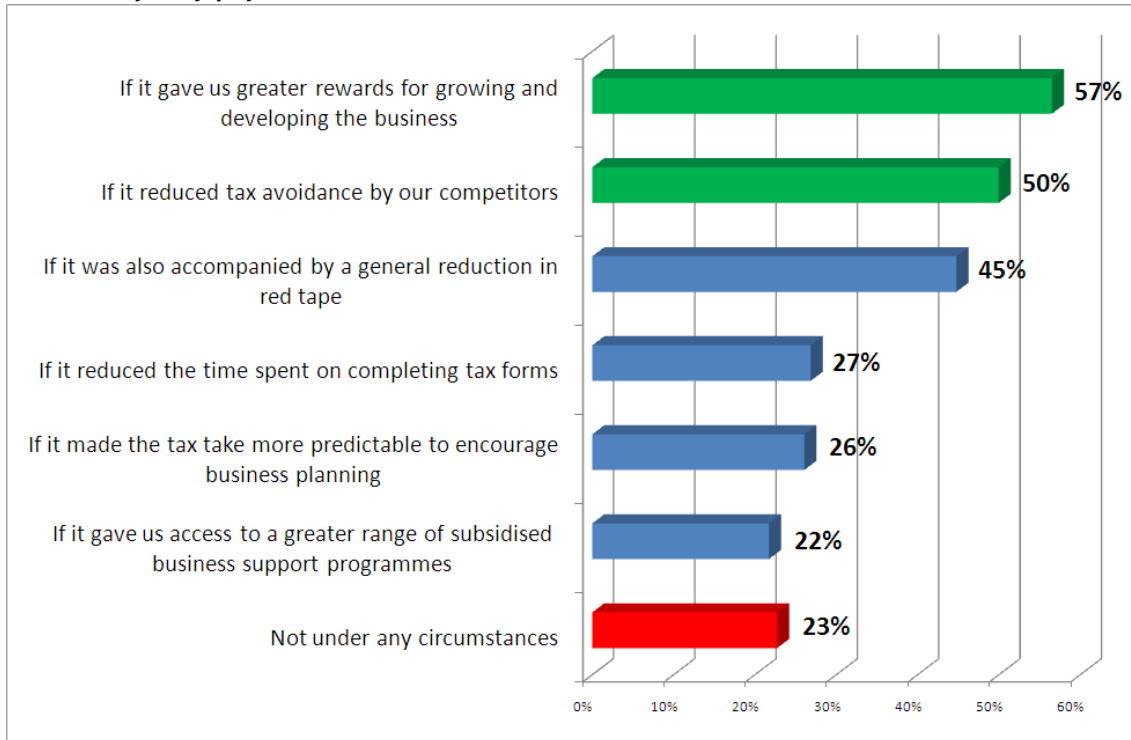
## Tax simplification

Almost a quarter of panel members are not interested in tax simplification if it means increased taxation, arguing that this is what they employ an accountant for.

57% would support an increase in taxation if it led to greater rewards for growing and developing their business and 50% would also support a scheme that levelled the playing field by reducing tax avoidance by their competitors. This does however mean that 43% would not

support an increase in taxation if it led to greater rewards for growing their business and 50% would not support a scheme that reduced levels of tax avoidance.

**Figure 8: Would business owners support radical tax simplification programme even if it meant they may pay more tax**



Finally, we asked panel members where the tax system could be improved based on the following definitions:

- **Choice of tax base:** The target of the taxation is fair and equitable
- **Design of the rules:** The rules have been defined clearly and exemptions are easily understood
- **Expression of the rules:** The rules use language that can be understood and acted upon
- **Administration of the rules:** The time and cost of complying with tax legislation

	Not relevant / Do not know	Choice of tax base	Design of the rules	Expression of the rules	Administration of the rules
National Insurance	9%	55%	42%	26%	53%
PAYE	14%	63%	32%	37%	53%
IR35*	45%	27%	64%	45%	64%
Business Rates	5%	68%	60%	45%	50%
Corporation tax	14%	63%	50%	47%	50%
Capital gains tax	18%	59%	53%	41%	47%
Tax relief on investments	27%	46%	62%	46%	46%
Personal taxation of business owners	9%	58%	53%	55%	66%
Export/Import taxation*	55%	35%	59%	47%	47%
Green taxation	32%	33%	63%	53%	60%

\* Very small base once those who do not feel relevant or did not know were removed

Only around 50% of businesses felt that IR35 or global trading tariffs were relevant to their business.

Business rates were the most contentious business taxation, with 68% feeling that the choice of the tax base was wrong. 63% also felt that the target for corporation tax was not fair and equitable as it penalised businesses that had traded profitably. PAYE was similarly contentious with businesses wanting payroll taxes in general simplified. Owners have also reported the monthly calculations as cumbersome and overly complex.

Our members, who often compete directly with private contractors, feel that there is little wrong with the revenue targeting this sector as this would lead to unfair competition. The design of the rules was, however more complex. Design of tax relief on investments (62%), green taxation (63%) and business rates were also contentious. Green taxation and employment taxation were considered to be the most clearly designed.

A majority of relevant businesses felt that tax regulations on green issues (53%) and personal taxation of business owners (55%). In contrast payroll taxes were most clearly expressed, although this is partly because they are understood by small employers.

Administration of green taxation, IR35 (where relevant) and personal taxation by business owners were the most frequently cited as problematic. Payroll taxation (PAYE and National Insurance) were also seen as an issue by a majority of our members.

## Priorities for reforming the taxation system

### Incentivising businesses that employ and train

*“Employment taxes and business rates are the biggest reasons for not expanding ... how we would like.”* Panel member response.

The most frequently suggested improvement was to make significant cuts to taxes on employment, particularly as respondents were concerned over the implications of pension reforms. Business owners would like to see Employers National Insurance Contributions abolished as few understood why a small firm should have to pay for the risk of recruiting employees. Another option mooted was for National Insurance and PAYE to be combined and simplified. An outright abolition of Employers NICs would be expensive, however removing it for the first year of an individual’s working life as they learn a trade may be more affordable.

One or two businesses also indicated that the Government should consider introducing low VAT rates for labour-intensive industries (hairdressing, hotels and restaurants, renovation and repair of private dwellings, domestic care services and a number of household repair services) arguing that it would help increase employment and encourage businesses to use local skilled labour.

Some respondents would also like to see the taxation rates for the employed and self-employed more closely aligned to allow for more standardised rates of personal taxation. This could be done instead of reforming IR35 in isolation.

### Incentivising people who want to work

Business owners expressed a wish to see employees earning between £15,000 and £20,000 (the level varied) taken out of the tax system completely. These owners argued that financial security and a buoyant jobs market was greater protection for an employee than burdensome employment regulations. Alternatively, business owners also wanted to see tax relief on transport to and from work for low paid workers to allow them to access greater work opportunities.

### Rewarding businesses that grow

A small majority of business owners indicated that they may be prepared to pay more tax if there was greater reward for growing and developing their business. Some businesses wanted a big cut to small firms’/ corporation tax - one respondent wanted to be reduced to “as near zero as possible” to stimulate rapid growth and investment. Other respondents however felt that a fairer tax system would be based on greater taxation of profits and less taxation of employment or business rates.

Some business owners want an increase to personal allowances for proprietors to reward them for the risks that they take in owning the business. One owner felt that effective tax rates for those earning between £100,000 and £112,000 was 60%. Taxes such as Annual Investment Allowances and tax reliefs should be fixed for five years to allow businesses to plan their medium term investment decisions more accurately.

### **Creating fairness on property taxation**

Many businesses questioned the fairness of non domestic rates, arguing that businesses often receive nothing in return. With many non-employers operating out of residential properties this form of taxation further disadvantages small employers. Many owners were surprised about the scale of increases last year and respondents also wanted more transparency in what the rates are used for.

### **More effective use of HMRC**

Business owners would like to see the HMRC do more to support small businesses in terms of providing consistent advice. The overly complex taxation system means that business owners and their tax advisers need clarification from HMRC itself however they often find it difficult to get through. Tax advisers also wanted a closer working relationship with HMRC so that they can anticipate its judgements. A more flexible approach to smaller employers should also be considered for their tax returns and some owners and tax specialists would like to see a temporary return to paper copies of PAYE for some businesses until the HMRC and the businesses can overcome teething problems in the process. However one respondent felt that the computerised system worked extremely well for his business and there is no doubt that technology should be used to a greater extent to help businesses in retaining control of their tax dues and other financial information.

Many of our members felt that HMRC should be focussing on the tax avoidance of larger businesses that pay proportionally less tax than smaller businesses but can afford specialist accountants and legal teams. Low Value Consignment Relief (LVCR) on goods distributed through the Channel Islands is an example of a loophole that is exploited by larger businesses to avoid paying VAT.

A simpler, more predictable taxation system would be a priority in order to allow HMRC to concentrate on these two issues.

### **Allowing small employers to compete on a level playing field**

Businesses wanted the tax system simplified to reduce the tax avoidance by competitors or businesses in related fields. This included slightly perverse judgements such as the application of VAT on some foods and snacks but not others or because of they offer specialist services that lie between zero- and standard-rated VAT. Increasingly business owners feel that there are larger companies with more resources who are not paying their way; this has increased alongside the taxation burden. Some businesses were also concerned that grants and support for businesses were not cost effective and distorted competition.

### **Making taxation more predictable**

Respondents wanted fewer surprises in terms of taxation so that they could accurately predict how much was being paid out. At the moment unforeseen increases to the tax regime can impact disproportionately on smaller employers who have proportionately fewer resources to deal with changes.

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