

Office of  
Tax Simplification

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## **Simplification of the corporation tax computation**

July 2017



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Tax Simplification

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**Simplification of the corporation tax  
computation**

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to section 186(4)(b) of Finance Act  
2016

July 2017



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# Foreword

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Corporation tax has been a subject of considerable interest and study in recent years. In a 21<sup>st</sup> century world where location is much less important, and internet and remote selling the norm, there has been a major effort to modernise this tax. Some even ask whether corporation tax should be abolished as no longer being relevant – but that is a question for government rather than the Office of Tax Simplification (OTS).

However, despite all this attention, there has been little focus on making the tax operate more simply, to the potential benefit of the vast majority of companies. So in this report the OTS is addressing what can be done to simplify the current arrangements, from the perspective of smaller companies and of larger companies as well. This is especially timely in the context of HMRC's Making Tax Digital proposals.

Evidence-gathering has as usual taken the OTS far and wide. Some say the tax is relatively easy – but others stress a variety of complexities. Probing this apparent contradiction leads to the fact that a company's corporation tax figures often fall easily out of the accounts (which a company has to prepare anyway). But when they do not and adjustments are needed to those accounting figures, this starts to add to burdens – and often the analyses required can be extensive (for example with capital allowances or testing for UK:UK transfer pricing).

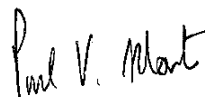
The conclusion the OTS has been drawn to is that for all but the very largest companies, and particularly for smaller ones, the simplest solution is surely that tax should follow the accounts, without adjustments being required.

The recommendations in this report are a mix of short and long term, technical and administrative, with those most relevant for smaller companies being separated from those for the large. Some aim to promote debate (we welcome input); some are worthy of more work (we point the direction that work needs to take); some are ready to take forward now. All will make a difference; the aim is to develop a framework to improve the way the tax operates and so make it simpler, easier for all companies to operate, and help ensure the UK has a 21<sup>st</sup> century system for 21<sup>st</sup> century business.

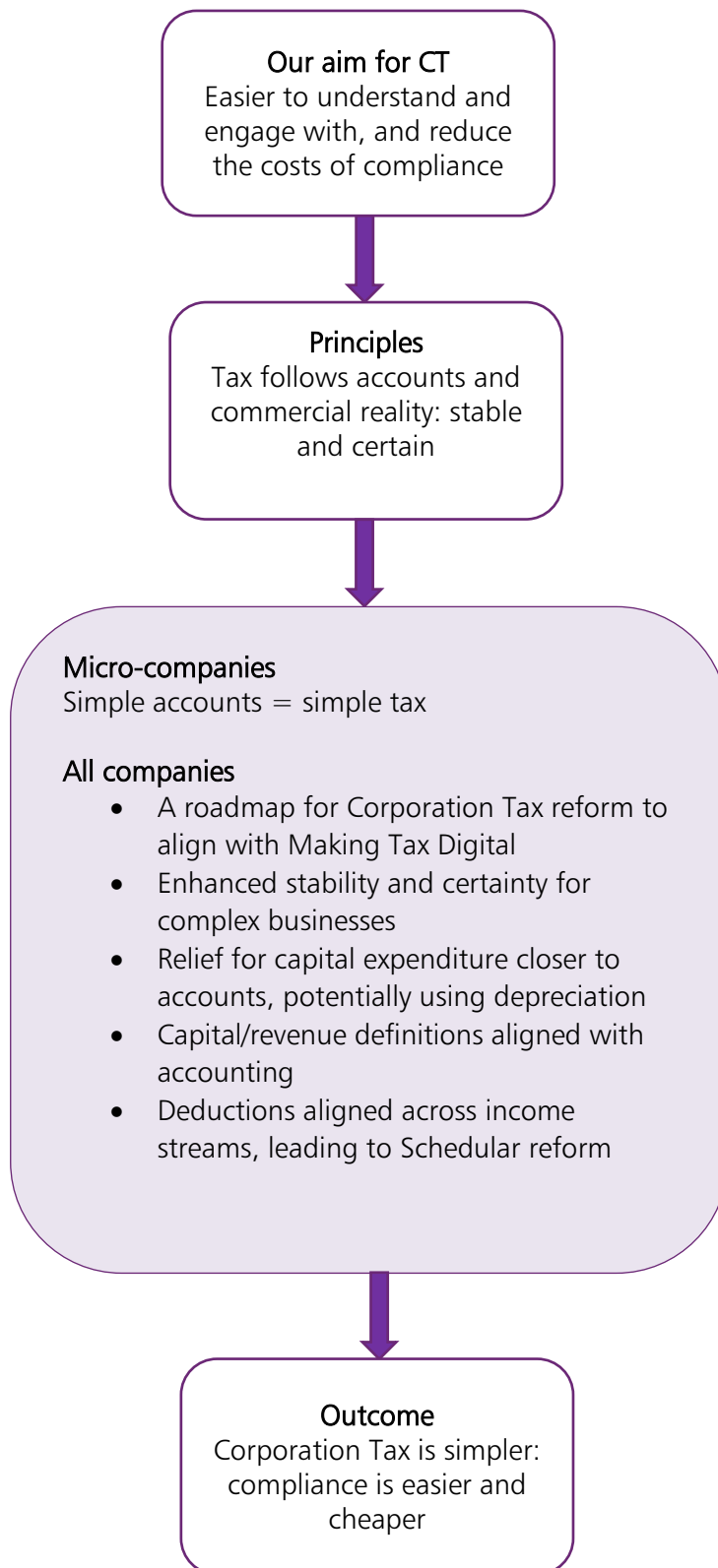
The OTS has been fortunate to have a very able team who have all put a great deal into this review, led by John Whiting who was the OTS Tax Director until this last March. Most are from the private sector and part time. The work has been project-managed by Angela Brown, with a core team of Randeep Sidhu, Chris Burns, Daphna Jowell and Andy Richens. Marian Drew, Zoe Judd, John Hampton and Olimpia Wojtyczko have also made major contributions, overseen by OTS Head of Office David Halsey. We would like to extend our grateful thanks to them and to our HMT and HMRC colleagues, our Consultative Committee members and all those who have so willingly given ideas and input.



Angela Knight CBE Chair



Paul Morton Tax Director





# Executive summary

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In the Spring Budget 2017, the Chancellor said “The tax system needs to ... be competitive, to support economic growth and maintain the UK as one of the best places in the world to set up and grow a business”.<sup>1</sup>

This report fits squarely with that agenda and takes a bold look at:

- Simpler tax for smaller companies
- Aligning the tax rules more closely with accounting rules
- Simplifying tax relief for capital investment
- Issues affecting the largest companies

The report deals with Corporation Tax (CT) and therefore with companies, but many of our ideas could be considered for unincorporated business taxation as well. Making Tax Digital (MTD) provides a real impetus to design a much simpler tax system, especially for the smallest companies, to reduce their administrative burden alongside more frequent reporting to HMRC.

**In the 2014 report on the Competitiveness of the tax system, the OTS outlined an important principle.<sup>2</sup>**

CT should be a tax on business profits arrived at after deducting all legitimate business expenses, the profits being those disclosed by the business accounts. There should be a minimum number of adjustments and these should be in accordance with a clear and well understood policy.

*OTS report on improving the competitiveness of the UK tax system – Chapter 3 on Corporation Tax*

Only significant reform to the rules will make a real difference to the time taken on corporation tax administration. These reforms need to be both technical and administrative. While the report is clear that we are setting out a range of practical recommendations that will simplify the corporation tax system, we recognise further feasibility work will be necessary before some of these recommendations can be implemented.

## Developing the report – a conversation that business wanted to have

This report is based on work carried out by the OTS from June 2016 to March 2017. It includes feedback from one-to-one meetings and round table discussions, and written submissions from representative bodies and companies. We have also talked to a wide range of HMRC and HM Treasury (HMT) policy teams and explored the available data. We found real interest and

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<sup>1</sup> <https://www.gov.uk/government/publications/spring-budget-2017-documents/spring-budget-2017> at 1.3 ‘A fair and sustainable tax system’

<sup>2</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/362302/competitiveness\\_review\\_final\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/362302/competitiveness_review_final_report.pdf)

enthusiasm from business contacts about the review and the possibilities for streamlining the corporation tax processes. Understandably, they are keen to see administrative burdens reduce.

The report is based on the views heard during this period and our researches into tax legislation and administrative processes. It also draws on the extensive knowledge of the OTS staff, who collectively have many years' experience in government and business, and the guidance of our Consultative Committee members. We have focussed on the areas that were consistently raised as the most difficult to administer, either because of technical complexity or the forms and procedures required. Our goal has been to develop ideas to simplify the system and we make our own judgements on what will make real differences.

The recommendations are discussed below under the four broad headings set out at the start of this executive summary. At the end we provide a full list of our recommendations, split into

- the 7 ideas we think are most important and will make the greatest difference
- 25 additional ideas we think will also make an important contribution

We have indicated the broad timescale for all these recommendations and have also noted those that we think will help smooth the way for Making Tax Digital for companies.

One immediate issue is the prioritisation of our recommendations. We are very conscious that our full list of recommendations constitutes an extensive work programme and so one of our overriding proposals is that we should work with HMRC and HMT to develop a priority order. In a similar vein, many of the proposals will need significant work to determine the tax costs involved. However, we believe that the OTS has done enough work on this aspect to be confident that the recommendations are valid and some broad indications are given in the body of the report. It would, though, be premature to try to develop definitive costs at this stage.

**Importantly, this report highlights that for any or all changes to corporation tax, a CT Roadmap should be developed to sit alongside the Business Tax Roadmap.**

### **The starting point is that tax should follow the accounts**

The company's accounts<sup>3</sup> reflect the commercial reality of its business operations. Accounts, especially for larger companies, are compiled under an extensive set of well understood accounting rules: it is logical for tax charges to be based as far as possible on these accounts, with the minimum of adjustments. In practice accounts are the basis of the tax charge so this report looks at the extent to which the calculations and decisions for tax differ from accounting, introducing complexity and administrative burdens.

We recognise that this principle of 'follow the accounts' will raise concerns among some who have said that accounting standards are in practice flexible in some areas, or that they change too frequently, or simply that they can be uncommercial. But we think the principle of following the accounts is important as it offers (especially for small companies) the prospect of simpler procedures though there will be issues to research in taking the principle forward. We would also note that public opinion is a factor pointing towards accounts and tax being close together.

We heard a range of views from business on the time and cost of tax compliance, and where this felt disproportionate to the tax outcome. HMRC measures the administrative burden for

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<sup>3</sup> Prepared according to international and UK accounting standards ('GAAP'), in accordance with company law.

business using its Standard Cost Model (SCM)<sup>4</sup>. The HMRC SCM model is not currently published and we heard a desire from stakeholders for more information on how HMRC uses the model to cost administrative burdens and savings.<sup>5 6</sup>

## For the smallest companies

The OTS wants to see a much simpler tax system for the UK's micro companies<sup>7</sup>, in recognition of their simpler accounting requirements...

Our aim for all companies is to improve the corporation tax system so it is easy to understand and engage with, and smaller companies have the confidence to do their own tax return or 'self-serve' if they so choose. To help achieve this, the OTS proposes that:

- micro-companies opting to use simpler accounting principles (FRS105) should be taxed on their accounting profit
- for micro-companies outside FRS105, the tax calculation should be simplified to require only a minimum number of essential adjustments to accounting profit. This could be extended to more companies over time
- in the future, optional cash accounting could be introduced for companies with a turnover under £150,000, to mirror the successful system for 1.1 million unincorporated businesses<sup>8</sup>

The principle here is 'do it once': if small companies have to prepare accounts, the work that they put in should suffice to deal with their tax computation with only minimal additional input.

...and on Making Tax Digital (MTD), especially for small companies, we suggest that:

- as a principle no additional information needs to be provided beyond that already required by generally accepted accounting practice (GAAP) and company law, without clear justification, and that this information is reported digitally to government through a single account
- MTD and iXBRL reporting should be integrated into a single process (assuming iXBRL is still necessary), to avoid creating an additional burden

Some of the technical recommendations we include under the heading of 'For the largest companies' would also apply to some small or medium companies, and facilitate MTD.

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<sup>4</sup> HMRC point out that the SCM is an internationally recognised model, originally developed by KPMG, and that they seek input from businesses and their representative to ensure all costs and impacts are measured.

<sup>5</sup>

[http://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/taxation/gen\\_info/economic\\_analysis/tax\\_papers/taxation\\_paper\\_40.pdf](http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/economic_analysis/tax_papers/taxation_paper_40.pdf).

<sup>6</sup> Throughout this report, as in all OTS reports, we regularly refer to the admin costs and burdens that the tax system creates for taxpayers and indeed HMRC. In some cases we observe that these seem disproportionate, modest or similar. Such comments are based on what we have heard and found in our research and are not intended to imply they are based on figures arrived at under HMRC's SCM methodology unless otherwise indicated.

<sup>7</sup> S384A CA 2006: a micro-entity is defined as two or more of the following: turnover <= £632,000; balance sheet <= £316,000; 0-10 employees.

<sup>8</sup> However, this would not currently represent an overall simplification unless there is a change in company law and, currently, EU accounting Directives governing financial reporting requirements as companies would still have to prepare full GAAP accounts. If cash accounting becomes possible – and we would stress that we only see it as a system suitable for small, simple companies – then the goal would be that the 'cash profit' becomes the basis for the tax charge as well as being all that is needed for accounting purposes.

We recognise that, however beneficial this may be, stripping away tax complexity for small companies will necessarily create a different system and a boundary with larger and more complex companies.

Consideration would need to be given to this and the impact of creating further tax disparities with unincorporated businesses.<sup>9</sup> In addition, the needs of fast-growing companies will also need to be considered. This report highlights these and other issues that will need to be addressed, and sets out an indicative timetable.

### **For all companies: Aligning corporation tax more closely with the accounts**

During the project, the OTS heard many suggestions for simplifying specific parts of the corporation tax legislation, and these are covered in more detail in this report. Three ideas stood out as delivering a reduction in administrative burden to business; all bring the accounts and tax figures closer together:

- using the accounting definition of capital expenditure (essentially creating an asset) for tax purposes

This would mean that valid business expenses taken to the profit and loss account would be deductible for tax purposes, saving significant amounts of time on identifying small tax adjustments (for example, capital elements of legal and professional fees). Importantly this would encourage enterprise by giving wider relief for abortive costs incurred by companies in attempting new ventures.

- bringing the definitions of trading and property deductions and management expenses together to remove the complication of having two sets of very similar rules

In time, this first step should lead to considering extending relief to all business expenditure of an income nature, to more closely align tax with the accounts and commercial reality.

- for companies with different sources of income, bringing these together into one business profit or loss for tax purposes, with losses fully pooled

This can be termed 'schedular reform' and would build on bringing the expenses rules together. It means abolishing the schedular system for income – so avoiding the need for analyses for tax purposes that do not reflect commercial reality. This would not mean eliminating the divide between trading income and capital gains: capital gains (and losses) would continue to be dealt with separately from income gains.

We accept that these three reforms would come with exchequer costs, which need to be thoroughly explored. We think such costs would be modest and the simplification dividend significant. Accordingly, the OTS recommends that these reforms should be taken forward, to better align the tax system with the accounts and modern commercial reality. Ideally these, as with other recommendations, should be built into a CT roadmap, perhaps over a five year period, to allow proper consideration of the inherently complex legislation, whilst guarding against unintended consequences.

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<sup>9</sup> <https://www.gov.uk/government/speeches/autumn-statement-2016-philip-hammonds-speech> "the government will consider how we can ensure that the taxation of different ways of working is fair between different individuals, and sustains the tax-base as the economy undergoes rapid change."

## For all companies: Capital investment

Companies don't get tax relief for the depreciation of their assets; instead they may get capital allowances (CAs). The OTS heard that the rules on how assets are recognised and categorised for CAs are complex and burdensome.

The commercial reality of a company's business is reflected in its accounts, which includes all assets owned by the business. At present not all of these qualify for CAs, and the rate of relief doesn't align with the rate of depreciation in the accounts. We heard from many companies that useful simplification can only be achieved if the tax rules in this area to a greater extent 'follow the accounts'.

This report sets out possible routes to simplification, outlines the issues these changes might create and how these could be tackled. Many have said that the 'follow the accounts' principle should mean depreciation simply becomes tax deductible. But this simple idea conceals a lot of complexities (for example transitional arrangements) and concerns (for example costs and sectoral impacts). Nonetheless, we think this route offers the best scope for significant simplification and so our key recommendation here is to explore in more detail replacing CAs with a tax deduction for accounts depreciation. This would align tax with the accounts, and remove the need for separate calculations.

Such a reform implies extending the range of assets which would receive tax relief and would, of course, have exchequer and sectoral effects which need to be explored in detail. However, the reducing CT rate means that the impacts will not be anything like they once might have been; and extending qualifying assets to include relief for depreciating structures may will mitigate the impacts for businesses. The key will be to develop proper costings. Other factors to consider include departing from accounting depreciation in certain circumstances (primarily revaluations); transitional arrangements; and ways in which it would be feasible to make the overall change revenue-neutral.

Another route would be to retain the existing CA structure but extend relief to more of the assets reflected in a company's accounts. However companies would still need to analyse assets into tax categories (for example, separating the cost of plant and machinery from the cost of the building) where much of the complexity currently arises. This route would also come with sectoral effects and a cost to the exchequer and would generally not offer the simplification possibilities of our preferred route.

Overall, we recommend that the OTS does further work to explore simplifying CAs along the first of these routes: to explore in more detail replacing CAs with a tax deduction for accounts depreciation. We recognise that it would be necessary to explore the potential impact of such a change on unincorporated businesses as well.

**In recommending this way forward, the OTS recognises two important points. The first is that any such change is structural and significant and needs extensive exploration. The second is that for some investment and particularly long term infrastructure, the decision to invest has been made with regard to the existing allowances regime: hence our stress that transitional arrangements are one of the major aspects to explore.**

## For the largest companies

**The need for stability and certainty stands out above everything else:** These issues were raised consistently by companies we spoke to and have recently also been identified in a joint IMF/OECD report into tax certainty.<sup>10</sup> Addressing these issues is critical to enhancing the UK's attractiveness as a place for investment and as a location for businesses.

To ensure that companies can have a reasonable expectation of the future stability and direction of the corporation tax regime, and reasonable certainty of and confidence in HMRC's approach, we believe that two main measures could be adopted to provide a more stable and certain environment and so increase businesses' confidence in the tax system:

- Earlier, more open, consultation as part of a coherent 5 year CT roadmap, alongside the Business Tax Roadmap<sup>11</sup>, and a commitment to sufficient lead times for changes
- The role of the Customer Relationship Manager (CRM), as set out in HMRC's Large Business Strategy and the Framework for Cooperative Compliance, be consistently communicated and embedded, recognising roles in both risk management and in helping businesses with achieving certainty.<sup>12 13 14</sup>

In addition, a number of simplifications are recommended for some of the more complex technical areas of the corporation tax code which impact particularly on large companies. These would reduce their compliance burden without materially affecting the tax payable by them or increasing HMRC's risk. They include UK:UK transfer pricing, intangibles and anti-avoidance legislation generally.

Also recommended is the consideration of reforms to reduce the administrative burden, including aggregated group returns, digitised group relief and group payment arrangements. Aggregated returns, possibly on an optional basis, could pave the way for consolidated returns for groups.

## Conclusions

The reforms recommended in this report are not 'quick wins'. But some can be taken forward relatively quickly; many of these need to be considered in the light of the moves towards Making Tax Digital, which is on the horizon for companies.

The OTS is clear that its proposals for a simpler system for small companies should be considered separately from its proposal for the larger companies; they represent a clear programme of work with significant potential to help with the introduction of Making Tax Digital. Meanwhile, some of our recommendations for the large company sector are more directional in nature.

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<sup>10</sup> <http://www.oecd.org/ctp/oecd-secretary-general-tax-report-g20-finance-ministers-march-2017.pdf>

<sup>11</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/509249/business\\_tax\\_road\\_map\\_final\\_2.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/509249/business_tax_road_map_final_2.pdf)

<sup>12</sup> <https://www.gov.uk/guidance/large-business-strategy>

<sup>13</sup> <https://www.gov.uk/government/consultations/improving-large-business-tax-compliance>

<sup>14</sup> See also the consultation announced at the Spring Budget <https://www.gov.uk/government/publications/spring-budget-2017-documents/spring-budget-2017> at 4.9 Tax Administration

Overall, the report points the way towards a significant revamp of the UK’s corporation tax system; a revamp that is needed if corporation tax is to fit properly with the UK’s aspirations and the needs of 21<sup>st</sup> century business. The report recognises that more work will need to be done in areas such as costings, impacts and transitions, but sees the potential gains as significant.

**OTS path to CT simplification**

We present this summary of our recommendations in two tables:

- the 7 ideas we think are most important and will make the greatest difference
- 25 additional ideas we think will also make an important contribution

The comments below are necessarily brief. Each of the five chapters in the full report discusses the issues and shows how we arrived at the recommendation. At the end of each chapter is a summary of the recommendations for that chapter, which link to these two tables.

**Table ES1: This table sets out recommendations that, together, would create a much simpler CT system for companies and bring tax much closer to the accounts and commercial reality. Further feasibility work will be necessary before some of these can be implemented.**

CT simplification	Taking them forward: some major issues	Short term	Medium term - link to MTD	Longer term
1 Build a 5 year CT Roadmap, alongside the Business Tax Roadmap, to include a commitment on earlier and more open consultation		✓		
2 For the smallest companies: simple accounts = simple tax: <ul style="list-style-type: none"> <li>• FRS 105 adopters, tax to follow accounts; otherwise</li> <li>• a minimum number of essential tax adjustments to accounting profit</li> </ul>	Disparity with unincorporated businesses to be fully understood		✓	
3 Capital / revenue tax definitions aligned with accounting definitions			✓	
4 Align definitions between management expenses and trading deductions	Costings & analysis		✓	
5 Develop a roadmap for, and take steps towards, replacing the schedular system with a whole business approach	Costings & analysis, loss relief issues			✓
6 OTS to explore use of accounting depreciation instead of capital allowances	Costings & sectoral analysis, transitional issues			✓
7 For the largest companies: embed the CRM role in line with HMRC’s published strategy, to provide greater certainty in a complex system	Align with work already underway in HMRC	✓		

**Table ES2: This table is a list of all the additional recommendations in our report, and a proposed time frame. We suggest that HMRC, HMT and OTS work together to agree how these recommendations should be addressed, including prioritisation. As part of this, we indicate with an asterisk those recommendations which are particularly relevant to MTD.**

<b>Recommendation</b>	<b>Time frame</b>
Simplifying CT for smaller companies	
1 Review the asset limit for disincorporation relief.	Short
2* Explore cash accounting for the very smallest companies, to align with the scheme for unincorporated businesses (recognising that company law and, currently, EU accounting directives would need to change).	Long
3 Update HMRC guidance to confirm that abridged accounts prepared by 'small' companies for Companies House and their members constitute statutory accounts and are those required by HMRC.	Short
Aligning CT more closely with the accounts (including schedular reform)	
4* We suggest as a principle that no additional information need be provided beyond that required by company law, without clear justification, and that this information is reported digitally to government through a single route.	Medium
5* Consider abolishing the requirement to submit a separate CT computation.	Medium
6* HMRC to either integrate or remove iXBRL reporting as part of MTD.	Medium
7 Extend scope of relief to all business income expenditure.	Long
Aligning CT more closely with the accounts: capital expenditure	
8 Changes to the CA regime should be accompanied with clear statements of the policy objectives.	Short
9* Introduce a small capital exemption to allow 100% deduction for capital expenditure worth less than £1,000 per item.	Short
10* Develop a proposal to provide specific guidance, by way of a list, of all assets qualifying for capital allowances, as a single point of reference.	Medium
11 Improve current non-statutory clearance process in regards to the capital allowance regime.	Short
12 Review the effectiveness and compliance process for making s198 CAA 2001 elections.	Short
13 Review the effectiveness and compliance process for making an Enhanced Capital Allowances (ECA) claim.	Short
Areas specific to large and complex companies	
14 UK:UK transfer pricing – explore whether the scope can be limited to instances where there is an actual tax difference arising.	Medium
15 Dormant companies and transfer pricing generally – explore whether the existing exemption for pre-2004 dormant companies can be extended to all dormant companies.	Medium
16 Deferred remuneration - consider adjusting the time limit to harmonise with accounts; as part of this also whether this legislation is still needed given the changes in accounting rules.	Medium
17 Pensions - undertake a review of the application of the 'paid' basis of deduction to the various types of expenses associated with pension schemes, with a view to clarifying the rules.	Medium



18	Share based payments - consider whether the existing rules for mobile, international employees are unnecessarily complex.	Medium
19	Intangibles - consider whether the current three-tier regime for goodwill is necessary and whether new expenditure on pre 2002 goodwill could be brought into the income-based regime.	Medium
20	Group relief arrangements – consider relaxing the current rule that denies access to group relief for a company which does not in fact leave the group but in respect of which there are ‘arrangements’ during the relevant accounting period.	Medium
21	Surplus ACT - quantify the number of companies with, and the amount of, unrelieved surplus ACT, with a view to providing the remaining relief in a less complex way.	Medium
22	Review of anti-avoidance legislation to consider consistent de minimis limits and motive tests, testing the compliance burden and removing duplication.	Medium
23*	Aggregated returns – consider the introduction of voluntary aggregated returns, giving HMRC the powers to refuse admission of an entity to such an arrangement.	Medium
24	Materiality – consider introduction of de minimis levels.	Short
25*	Group relief and tax payments - existing arrangements to be reviewed in the light of MTD for companies with a view to digitising and simplifying.	Medium

# Explanatory note

## Definitions

Generally in this report we use these EU definitions:

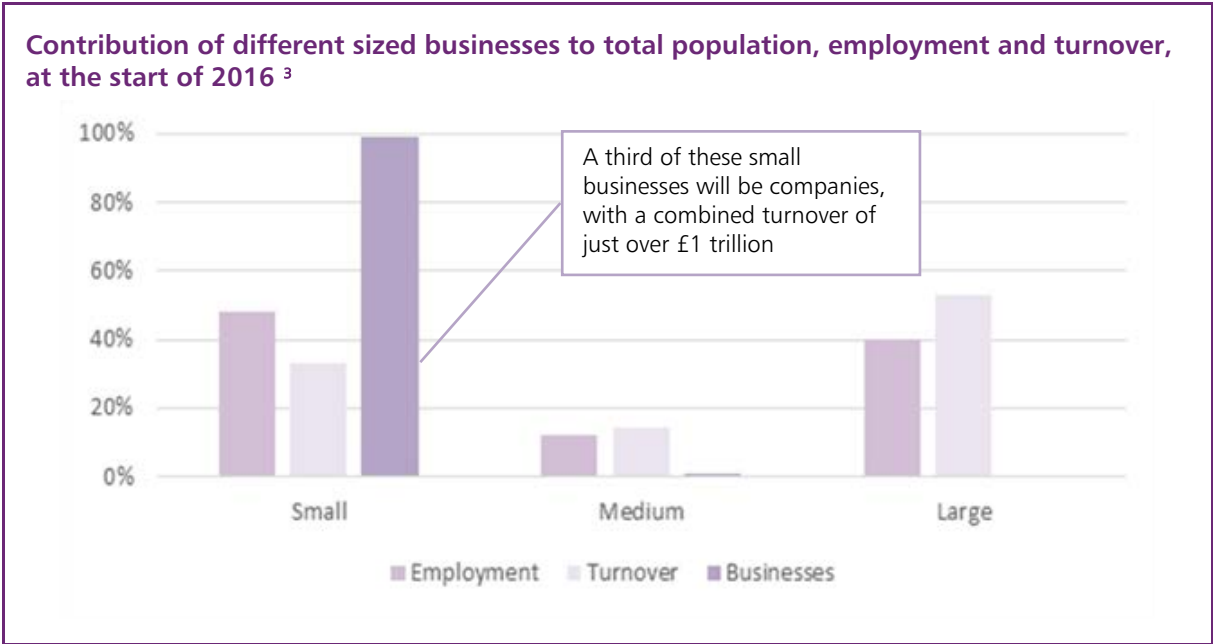
Company category	Staff headcount	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50m		≤ € 43m
Small	< 50	≤ € 10m		≤ € 10m
Micro	< 10	≤ € 2m		≤ € 2m

However, our recommendations for micro-entities in Chapter 1 align with the definitions in UK company law<sup>1</sup>, if the company meets any two or more of the following:

- Turnover                                   £632,000 or less
- Balance sheet                           £316,000 or less on its balance sheet
- Number of employees               10 employees or less

## The business landscape in 2016

There were 5.5 million UK private sector businesses in 2016; 1.75 million are companies, of which 1.5 million have under 10 employees and a further 0.17 million have under 50 employees.<sup>2</sup>



<sup>1</sup> S384A Companies Act 2006  
<sup>2</sup> <https://www.gov.uk/government/statistics/business-population-estimates-2016> [Table 3, by number of employees]  
<sup>3</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/559219/bpe\\_2016\\_statistical\\_release.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/559219/bpe_2016_statistical_release.pdf) [Figure 1]

# Simplifying CT for smaller companies

## 1

### What have we heard about the CT computation for small companies?

1.1 In our 2014 Competitiveness Review<sup>1</sup> we summarised business views on the CT computation:

“CT should be a tax on business profits arrived at after deducting all legitimate business expenses, the profits being those disclosed by the business accounts. There should be a minimum number of adjustments and these should be in accordance with a clear and well understood policy.”

1.2 This view hasn't changed, and we have heard a strong message from business that the tax system should be:

- transparent: clear and well understood policies
- fair: even handed between small businesses, and with large business; tax outcomes should be fair between different ways of working
- easy to do: the business can choose to self-serve end to end tax compliance, or choose to employ an agent to do this for them

1.3 We have worked closely with the Administrative Burdens Advisory Board<sup>2</sup>, who have a commitment to 'make a noticeable difference' for small business; removing unnecessary burdens on them; and simplifying the tax system.<sup>3</sup>

### Our aim: a simpler system for small companies

1.4 For the smallest companies we think the government's ambition should be to create a tax system that is simple enough for the business owner to understand and engage with, and that allows them the choice to self-serve.<sup>4</sup> With such transparency comes a greater perception that the tax system is even handed between businesses of all sizes.

<sup>1</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/362302/competitiveness\\_review\\_final\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/362302/competitiveness_review_final_report.pdf) page 27

<sup>2</sup> <https://www.gov.uk/government/groups/administrative-burden-advisory-board>

<sup>3</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/546228/Administrative\\_Burdens\\_Advisory\\_Board\\_Annual\\_Report\\_2016.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/546228/Administrative_Burdens_Advisory_Board_Annual_Report_2016.pdf)

<sup>4</sup> At the moment most small companies have no choice but to employ a tax professional to service their tax compliance.

### Box 1.A: A view from a small business proprietor

"I find it all really confusing, my brain just gets scrambled and I have to send it all to someone else to do because I wouldn't know what to do...I wouldn't have the patience to do my own tax return, or the time.." <sup>5</sup>

1.5 However, the OTS noted in its Competitiveness Review that the UK is only going to make a real difference to the time taken on CT administration by making some significant reforms to the rules for the computation.

1.6 This chapter is about simplifying CT for small companies, in particular the UK's estimated 1 million micro-companies which meet the definition in UK company law, as set out in the Executive Summary on page 14. In time we think these proposals could be extended to a larger proportion of the small company population.<sup>6</sup>

### Box 1.B: Positioning a review of CT in an evolving economy

The business landscape is evolving in response to new markets and ways of working. We recognise that simplifying the CT computation for small companies in isolation could increase the tax disparities with other small enterprise structures, and create unintended incentives.<sup>7</sup> Although we are primarily considering corporate structures in this review, some of our ideas could and should equally apply to unincorporated businesses. Further consideration would need to be given to the impact of our recommendations on unincorporated businesses.

## Options for a simpler system

1.7 With some exceptions, CT is a 'one size fits all' regime regardless of business complexity. While the majority of small companies need only engage with a handful of tax adjustments, the company or its agent must consider and discard a wide range of adjustments to find the few that are relevant.

1.8 Removing all but the most necessary adjustments, whether they are taxing or relieving, and making the remainder simple to apply and with clarity about the policy behind them, would remove the perception that CT is overly complex ("a dark art") and give businesses the confidence and ability to 'self-serve' (do their own compliance) if they choose. While it could be argued that software could disguise some of this complexity, this wouldn't make tax any easier to understand. To a certain extent the CATO software<sup>8</sup> already provides helpful gateways that mask this complexity, but this is still quite time consuming (see *Annex F*).

1.9 Our starting point is the accounting profit. A number of accounting changes have recently been introduced for small company reporting, with the Financial Reporting Council having

<sup>5</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/444770/HMRC\\_ResearchReport377-small-business-and-choice.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/444770/HMRC_ResearchReport377-small-business-and-choice.pdf) page 10 (Ltd Co £30,000, using an agent)

<sup>6</sup> <https://www.gov.uk/government/statistics/business-population-estimates-2016> [Table 3, by number of employees]

<sup>7</sup> <https://www.gov.uk/government/speeches/autumn-statement-2016-philip-hammonds-speech> "the government will consider how we can ensure that the taxation of different ways of working is fair between different individuals, and sustains the tax-base as the economy undergoes rapid change."

<sup>8</sup> Company tax return and company accounts filing service Company Accounts and Tax Online (CATO). The system is no longer available for agents – further detail at paragraph 1.32 below.

withdrawn the Financial Reporting Standard for Smaller Entities and replacing it with two new standards, FRS105 and FRS102 section 1A, for accounting periods commencing on or after 1 January 2016.

**1.10** We set out two options below, as a route to simplification:

## Option A: for companies with the simplest affairs, which are less likely to grow beyond micro

FRS105 is the new accounting standard for micro entities, adapted from FRS102 to reflect the simpler nature of micros, and brings in reduced reporting and decision making. FRS105 is optional, and is most likely to be chosen by those with less ambition to grow, with few fixed assets or need for investment funds. Those companies wanting to self-serve are likely to opt for this standard. We propose **the accounting profit under FRS105<sup>9</sup>, representing a true and fair view of the profits of the company, be used as the profits chargeable to CT, with no adjustments necessary by the company.**

### Potential benefits

Companies that choose simpler accounting would by default also be choosing simpler tax, and this would remove a significant burden for micro companies. FRS105 provides rigour and consistency across all companies. Available software means that companies could prepare their own accounts, which together with MTD compliant software, could enable end-to-end self-service. Greater simplicity and transparency would increase compliance and perception of fairness.

### Issues that would need resolving

Introducing choices based on tax outcome would be an increase in complexity, and the removal of reliefs may make this less attractive. Companies not wanting to adopt both a simple accounting and tax approach, would not choose this standard.<sup>10</sup> It's too early to say how many companies are choosing FRS105, although early indications are that many agents will continue to use FRS102.

Fast growing businesses which would quickly outgrow the simplified standard would not opt in. This option is purely intended for those companies wanting access to a simpler accounting and tax regime, which would want to self-serve, and for which the tax computation currently has no material impact on accounting profit. Fast growing companies moving to a different accounting treatment may encounter change of basis tax issues.

There would be boundary issues for a business that grows. Some have expressed concern that the removal of the administrative burden will take away the disincentive for incorporation.

### Further work

We recognise this proposal would produce winners and losers when compared to the current tax regime. Further analysis would need to be done to understand the impact of removing the tax computation, across business sectors, but initial views from representative bodies are that the impact would primarily be timing differences on reliefs, in particular the loss of the annual investment allowance (AIA). Further analysis would also be needed on whether removal of the tax computation would have a material exchequer effect, weighed against the benefits to business and improved compliance. The government is aware of the disparity between unincorporated and incorporated business, and the impact of this option on the incentive to incorporate would need to be explored.

<sup>9</sup> FRS105 can produce a different profit figure, and therefore resulting tax, than that under FRS102 in view of differences in accounting requirements, but we have not heard that this is a factor in choosing which standard to apply.

<sup>10</sup> We acknowledge introducing an element of choice increases complexity as agents would be obliged to determine the most favourable tax outcome. Further, the linking of tax simplification with a simplified accounting standard would impose a different tax system on those companies. These will need exploring further as the options are developed.

## Option B: for micros with less simple affairs, who do not opt for FRS105 and therefore use FRS102

For micros not opting into FRS105 (and all companies within the 'small' definition<sup>11</sup>) the original version of accounting standard FRS102 has been updated and includes a new section 1A offering a reduced disclosure regime. **We suggest that micros using FRS102 have only a limited number of essential adjustments from accounting to taxable profits, each backed by a clear and well understood policy.**

### Potential benefits

These companies will have more complex affairs and are likely to be represented by professional agents who will use FRS102 accruals<sup>12</sup> and fair value accounting. However, a simple tax computation would provide the certainty that these are the only adjustments they need to consider, while preserving the ability of the government to choose key taxing and relieving provisions. On the grounds that a simpler system is more transparent, it would sharpen the focus on why these particular adjustments matter to business or the exchequer and on how the tax system both helps business and is fair.

### Issues that would need resolving

The option creates a clear boundary for micro businesses, that would need to be policed, and may create complexity for businesses that grow quickly or that operate globally. The latter may want the facility to opt out of the simpler system altogether, to avoid the boundary issues, however, and introducing an element of choice increases complexity as agents would be obliged to determine the most favourable tax outcome.

Some said the tax adjustments selected are likely to be the only ones encountered already by the small company, therefore reduction in the administrative burden may be limited.

Again, any improvement to CT for small companies could encourage incorporation, and aligning with the income tax computation will need consideration.

### Further work

Further analysis would need to be done to establish the adjustments that really matter, the impact across business sectors, and to assess and test that the rules in each case are fit for purpose and meet our principle (easy to understand and engage with).

1.11 The proposals above apply to income profits and losses. Capital gains and capital losses would continue to be dealt with separately.

1.12 **As an alternative, there is an opportunity to design a series of small business specific gateways within HMRC's Making Tax Digital (MTD) plans that would disguise complexity.** This avoids legislative change and boundary issues, which may ease reporting. However it wouldn't remove the perception of complexity, and would still require a tax professional to ensure 'the right boxes have been ticked'; the tax computation would still be an additional reporting requirement.

<sup>11</sup> To be eligible as 'small' for the purposes of FRS 105, a company must meet two of the following three requirements in two consecutive years (unless newly incorporated when it must meet the two requirements in the first year):

- Turnover not more than £10.2 million,
- Balance sheet total not more than £5.1 million, and
- Average number of employees no more than 50.

<sup>12</sup> Accruals accounting also applies to FRS105

## Boundary issues

**1.13** The above two solutions could be implemented together, or as alternatives. We are conscious that these proposals open boundary issues with larger companies and unincorporated businesses. An advantage of MTD for business is that richer data may enable a case to be built to extend simpler tax to an increasing proportion of small companies, and unincorporated businesses of similar size, until only those businesses with complex affairs are exposed to all the complexities of the CT regime. The Industrial Strategy<sup>13</sup> published in January set out the government's priorities to support businesses to start and grow, and to create the right conditions for companies to invest for the long term. A simpler system for most companies would need to ensure that fast growing entrepreneurial businesses could be identified and managed carefully across the boundary towards the complex rules necessary for a large business.

**1.14** While it is a fine ambition to leave only the largest, most complex businesses exposed to all the complexities of the CT regime we recognise that this will take time. In the short term, we have made a number of recommendations to simplify some of the more complex areas of CT, for example the anti-avoidance legislation. We have discussed these areas in detail in Chapter 5 'Areas specific to large and complex companies', because they impact most frequently on such companies. But those recommendations are of equal validity to smaller companies (who represent the vast majority of the corporate population) and would provide a further route to simplification for all companies.

## Which are the essential tax adjustments and reliefs for micro companies?

**1.15** Annex D contains a list of the adjustments and reliefs that the majority of small companies currently engage with, and that are reflected in CATO software. It is not definitive or exhaustive.

**1.16** Our guiding principle is the desire of businesses that these adjustments should be based on a clear and well understood policy, and that they demonstrably achieve a worthwhile purpose for either the exchequer, the business or both. As part of a discussion on limiting the number of adjustments necessary to achieve the appropriate tax outcome for small and micro business, we recommend that further analysis is done to assess and test that the rules in each case are fit for purpose and meet our principle.

**1.17** We recognise that some of these adjustments also apply to Income Tax computations, and the interaction would need careful consideration to avoid creating tax-driven incentives to incorporate (or indeed not incorporate). We think that all small businesses (incorporated and unincorporated) should find tax easy to understand and engage with.

**1.18** In some cases a de minimis limit or a cap on certain adjustments may help manage compliance risks, but this may not reduce the current additional burden. Accordingly, we think the aim of the analysis we refer to above should be to develop the key five or six adjustments (for example: depreciation/capital allowances; entertaining; penalties / fines; non-business expenditure) which would be all that a small business should have to consider.

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<sup>13</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/586626/building-our-industrial-strategy-green-paper.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/586626/building-our-industrial-strategy-green-paper.pdf)



## Disincorporation relief

**1.19** Although technically not an adjustment, the subject of a relief on disincorporation<sup>14</sup>, i.e. transferring the business from the company to the shareholder(s), introduced in Finance Act 2013 for a period of 5 years, continues to be raised at our stakeholder meetings. The introduction of the new dividend tax charge has increased the number of companies where the additional administrative burden of operating through a company now outweighs any taxation advantages, and there remains a wish for these companies to disincorporate. But we continue to hear that restricting relief to companies having goodwill and land with total value not exceeding £100,000 disqualifies almost all companies from accessing the relief.<sup>15</sup>

**1.20** We understand that the relief will be reviewed in anticipation of its time expiry. **We recommend as part of this work that that the asset limit be reviewed and if necessary, the relief be extended for a further period or made permanent to enable relevant companies to claim before the measure expires.**

## Cash Basis

**1.21** We have explored applying a cash basis to the smallest single director companies, using the same parameters as unincorporated businesses, as this could enable the very smallest companies to self-serve both tax and accounts through MTD.

**1.22** The 2012 OTS Small Business Review<sup>16</sup> found a good level of support from stakeholders for the use of receipts and payments accounting, the 'cash basis', for the smallest unincorporated businesses. The view was that for the considerable number of these businesses with few or no capital assets and no stock, the additional work necessary to produce accruals accounts under 'GAAP' was not justified since the 'cash basis' results would not have been materially different.

**1.23** The Finance Act 2013 introduced an election for the cash basis for unincorporated trading businesses with a turnover up to the VAT threshold<sup>17</sup>. Since the option was introduced, over 1.1 million businesses have opted for the scheme<sup>18</sup>. The HMRC response documents on MTD have proposed extending the scope of the cash basis, to include unincorporated property businesses (which was the original OTS intention), and to unincorporated businesses with a higher turnover up to £150,000 per year.

**1.24** The Small Business Final Report was based on unincorporated businesses, but suggested that cash basis for companies could be explored, building on the experience of unincorporated business and developments in accounting rules for small businesses. We have therefore raised the subject with our stakeholders over the course of the current review and, again, there has been a level of agreement that this would represent a simplification for tax purposes for the smallest companies with very simple affairs. We recognise that certain financial information is needed in order to protect the shareholders, members and third parties where the entity has

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<sup>14</sup> Originally recommended in the OTS Small Business Final Report:  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/199181/03\\_ots\\_small\\_business\\_tax\\_review\\_disincorporation\\_280212.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/199181/03_ots_small_business_tax_review_disincorporation_280212.pdf)

<sup>15</sup> At the time of the OTS Small Company review, February 2016, HMRC informed us fewer than 50 companies had claimed the relief.

<sup>16</sup> Final report published February 2012  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/199180/02\\_ots\\_small\\_business\\_tax\\_review\\_simpler\\_income\\_tax\\_280212.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/199180/02_ots_small_business_tax_review_simpler_income_tax_280212.pdf)

<sup>17</sup> Twice the VAT threshold for Universal Credit claimants

<sup>18</sup> HMRC figures

limited liability,<sup>19</sup> and that cash basis does not necessarily provide for this. However, where the shareholder, owner and manager are the same person, and the accounts are not necessarily used by third parties (for example, banks), this is not so relevant.

**1.25** The distinction from unincorporated business is the need for all limited companies to prepare accruals accounts for financial reporting purposes, including under company law, as currently required by the EU Accounting Directive<sup>20</sup>. Providing the cash basis for tax reporting purposes only, leaving accruals accounting in place for financial reporting would not reduce the administrative burden, indeed it would increase it.

**1.26** EU law includes various Member State options for exemptions for micro-undertakings, but at present this does not extend to cash accounting, as the law specifically requires accruals accounting (subject to materiality). **A move to adopt cash accounting would therefore require a change in company law and potentially would have to be reported to the EU Commission for consideration.**<sup>21</sup>

**1.27** Clearly, with the UK's planned exit from the EU, the EU Accounting Directive may cease to apply in the UK, depending on the UK's exit arrangements. So it is possible that in due course the UK could take unilateral action to introduce a cash basis for the smallest companies.

**1.28** A cash accounting option would be mutually exclusive from the FRS105 and FRS102 options above, and we would also suggest a review of the tax computation to understand the overall impact it has on these very small businesses, and whether there is merit in either removing the computation altogether or retaining only those adjustments that make a material difference. Finally, extending the scheme to companies would perhaps reduce an administrative barrier to incorporation, and this would need to be considered. **In summary, we recommend exploring cash accounting for the very smallest companies, to align with the scheme for unincorporated businesses (recognising that company law and, currently, EU accounting directives would need to change).**

## 'Tell us once': aligning reporting requirements

**1.29** Ideally, small companies should have to keep records, prepare and then file only one set of financial accounts, and this would suit all users of those accounts (including shareholders, Companies House and HMRC).

**1.30** However, across the OTS business reviews<sup>22</sup>, we have repeatedly heard that businesses prepare and use their accounts for a number of purposes, of which tax reporting is only one. But for the smallest companies, which do not need to use their accounts to support borrowing, the main driver for accounts analysis and additional data preparation can be HMRC.

**1.31** At present, GAAP accounts follow company law in relation to record keeping and preparation of accounts. Company law requires sufficient records to be able to state with reasonable accuracy and at any time the financial position of the company. The company must file a balance sheet, but small companies may prepare abridged accounts (with a profit and loss account beginning at gross profit) which now also forms the full statutory accounts for the

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<sup>19</sup> Para 3. pre-amble EU Accounting Directive 2013/34/EU

<sup>20</sup> EU Accounting Directive 2013/34/EU

<sup>21</sup> EU Accounting Directive, Chapter 9, Article 36 (9) contains a provision for the Commission to report back to the European Parliament by 20 July 2018 on the situation for micro entities taking into account, in particular at national level, the number of undertakings covered by the size criteria and the reduction of administrative burdens resulting from the exemptions from the publication requirement. This could include a report from the UK on the benefits that cash accounting could bring for our smallest companies

<sup>22</sup> <https://www.gov.uk/government/publications?departments%5B%5D=office-of-tax-simplification>

shareholders. These abridged accounts may be filleted so that only the balance sheet and balance sheet notes are filed at Companies House. There is no requirement for a micro-entity to prepare a directors' report under FRS105.

**1.32** In order to compare reporting requirements to Companies House with those to HMRC, we completed a case study example using the free 'Company Accounts and Tax Online' (CATO) facility under the joint Companies House/HMRC portal<sup>23</sup>. It was immediately explained that a shortened balance sheet only needs submitting to Companies House, while profit and loss account, notes, shortened balance sheet, directors' report, CT computation and CT600 return were necessary for HMRC. A full comparison of the requirements of Companies House v HMRC, together with a step by step account of our CATO experience, is set out in Annex F.

**1.33** Because of the different reporting requirements, it is necessary to run through the reporting loop twice, firstly for Companies House, and then again but in more detail for HMRC. Aligning filing requirements, our recommendation below, would enable just one loop to be completed.

**1.34** As an observation, we note that the legislation governing record keeping differs between Companies Act and HMRC, and we question whether that is necessary and whether it places an additional burden on smaller companies. Accounts prepared to comply with the Companies Act should be sufficient for all users of those accounts.

**1.35** The table at Annex F sets out the form of accounts required under accounting standards FRS102 section 1A and FRS105, in particular the abridged accounts which now form the full accounts where agreed by all members, and compares these with the additional information set out under current HMRC guidance. Given that paragraph 11 of Schedule 18 to FA 1998 sets out that the accounts to be submitted are those required under the Companies Act, **we recommend that HMRC guidance be updated to confirm that where 'abridged' accounts are completed by small companies for their members and Companies House, these form full statutory accounts and will satisfy HMRC reporting requirements under this paragraph of FA 1998.** Currently the guidance still refers to 'abbreviated' accounts which did not meet those requirements and which have been replaced. This would represent an administrative burden saving for small companies.

## Summary and options

**1.36** The perception of fairness is a critical component of a modern tax system. For the smallest businesses a simple system is one that can be easily understood by the business owner. A simple set of rules for both tax calculation and reporting will help raise the perception that tax compliance is fair and even handed for small businesses.

**1.37** We recommend building on recommendations in the OTS Small Company report<sup>24</sup> and considering a simpler CT system for smaller companies, which will help to reduce their administrative burden. This distinguishes them from larger businesses where there is a need to retain legislative complexity to deal with their complex transactions.

**1.38** Our options are summarised below, with the caution that further work would be needed in each case to understand the total impact to business and the exchequer, and to avoid increasing the disparity with unincorporated businesses. **We think the main recommendation, with the potential to make the most difference to small businesses, is to base the tax charge on the FRS105 profit or the FRS102 profit (with a small number of defined adjustments).**

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<sup>23</sup> The previous Adobe version was used to file 325,000 returns, approximately 15% of the total. 58% of these were filed by Agents, which is no longer permitted under the latest version (HMRC 2015 figures).

<sup>24</sup><https://www.gov.uk/government/publications/small-company-taxation-review>

**Table 1.A: Summary of the recommendations:**

These options could potentially apply to all small businesses; part of taking them forward will be to consider the balance with wider issues of fairness between different forms of working and wider fiscal and compliance issues.

	<b>Simpler tax for the smallest companies: Recommendations</b>	<b>Short term</b>	<b>Medium term, link to MTD</b>	<b>Longer term</b>
1	Micro-entities <sup>25</sup> which have opted into the new simplified accounting standard, FRS105, would automatically be subject to CT simply on their accounting profit. This will remove the need to make all adjustments to accounting profit and remove a significant burden for these companies.		✓	
2	For Micro entities which do not opt for the accounting standard FRS105, and follow the default accounting standard FRS102 (whether or not they take up section 1A), we recommend that adjustments to accounting profit be limited to a small number of the essential ones; to be extended to a wider pool of small companies over time.		✓	
3	Disincorporation relief is being reviewed; as part of this work we recommend that the asset limit for the relief be reviewed and that the relief be extended for a further period or indefinitely.	✓		
4	We note that cash accounting basis for unincorporated businesses has been very successful, with 1.1 million <sup>26</sup> businesses opting to use this simpler system. We recommend exploring mirroring this system for the very smallest companies (recognising that in order to reduce the administrative burden this would require a change in company law and currently EU directives). We further suggest that the necessity of a tax computation for these smallest companies is explored.			✓
5	We recommend that HMRC guidance be updated to confirm that where 'abridged' accounts are completed under FRS 102 section 1A or FRS 105 by small companies for their members and Companies House, these form full statutory accounts and will satisfy HMRC reporting requirements.	✓		

<sup>25</sup> As defined on page 14

<sup>26</sup> HMRC figures

# Aligning CT more closely with the accounts

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**2.1** All companies must prepare accounts in accordance with Companies Act requirements, reflecting generally accepted accounting practice. Accounts prepared in this way are designed to report the financial performance of a company in a consistent way.

**2.2** In this report we work on the basis that the financial results of a company's business operations, which are reflected in its accounts, are the appropriate starting point for calculating trading profit or loss for CT purposes. Those results encompass all the income streams of a company and all the resources used in the business. To the extent that the current calculations for CT deviate from accounts, complexity is introduced.

**2.3** In saying this, we are well aware that accounting standards are not a cast-iron, rigid set of rules. Judgement remains important in some areas such as rates of depreciation. It can be argued that accounting standards do not always seem to reflect commercial reality; in addition they can change too frequently.

**2.4** We accept these are considerations but they should not detract from the principle that following the accounts for tax purposes has to be simpler than applying another set of rules. In effect we are saying 'do it once'.

**2.5** In applying this principle we recognise that there will be areas, particularly for the largest and most complex companies, where following the accounts does not seem to be the best basis for taxation (fair value accounting has been cited to us as an example) and these will warrant further consideration. At the same time, we note public opinion seems to expect companies' tax charges to be based on their accounting results – so if there are to be differences these need to be defined and evidenced.

**2.6** We have considered areas where reporting and administration is unnecessarily burdensome, with Making Tax Digital in mind, and technical areas where tax decisions differ from accounting decisions. The recommendations set out below would bring benefits to companies of all sizes.

## Making tax digital (MTD)

**2.7** HMRC has published its plans for MTD, aiming to move to more regular reporting/updating and through digital channels. While we welcome a move to digital engagement, the OTS recognises that there have been concerns from businesses that overall administration burdens may increase. We await consultations on MTD for companies, and the outcome of the 2017 pilot, to be able to understand and comment on the design of MTD for companies. A number of our recommendations in this report will facilitate MTD for companies.

**2.8** MTD presents a real impetus to design in a much simpler tax calculation, in particular for small business, something which we first recommended in 2014.<sup>1</sup> This should reduce the administrative burden overall, while balancing more frequent accounts reporting and making the quarterly updates required under MTD simpler.

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<sup>1</sup> OTS Competitiveness Review  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/362302/competitiveness\\_review\\_final\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/362302/competitiveness_review_final_report.pdf)

**2.9** We suggest as a principle that no additional information need be provided beyond that already required by company law, without clear justification, and that this information is reported digitally to government through a single route. The richer data provided by MTD across all businesses will allow sharper compliance tools and in future HMRC can be clearer what information is essential to ensure compliance.

## A standardised computation for companies

**2.10** As part of the design for digital reporting, consideration should be given to abolishing the general requirement for companies to submit a separate tax computation as a supplement to their CT return, thus bringing CT into line with Income Tax, where all tax data is included on the statutory Return itself.<sup>2</sup> This would enable all tax data to be submitted in a standardised format and would seem to be consistent with the ambition for MTD.

**2.11** Concerns have been expressed by some companies that a prescribed computation would reduce the ability of companies to disclose, and thus would erode their protection from future 'discovery' by HMRC. However, this could be dealt with, as with Income Tax, by the provision of sufficient 'white space' on the statutory (MTD) return to enable any necessary disclosures to be made, and a facility to enable additional explanatory documents (which could take the form of a computation for those companies that still wished to do so – probably larger ones) to be enclosed with the return.<sup>3</sup>

**2.12** A revision of the disclosure and discovery provisions, to give businesses confidence that HMRC's discovery powers are fair to all parties, would also be welcomed. The objective would be to draw back a little from the position developed by recent Tribunal decisions, whereby it is perceived that HMRC can make a 'discovery' in a very wide range of circumstances, almost regardless of the quality of previous disclosure. This is a wider subject than just CT but we think it is something that will have to be reviewed in the light of the increased digitisation of tax compliance. It is an issue the OTS may well return to.

## Will iXBRL still be needed?

**2.13** Companies are required to 'tag' certain specified data in their CT computations, using iXBRL taxonomy. This requirement was introduced several years ago to provide HMRC with a better way of collating and analysing data as a means of risk assessment. The amount of data required to be tagged has increased in recent years and now covers all items in the accounts and computations. Commercially available software used to prepare the accounts and tax computation has been developed to tag data automatically.

**2.14** However, we have consistently heard that some tagging still has to be undertaken manually to deal with non-standard presentation of data, for example in relation to consolidated group accounts and information provided in free-form format on tax computations, and that this is a time-consuming exercise. Small companies often prepare accounts using generic software rather than dedicated accounting software which (at a cost) would have a tagging facility. More widely, many question the utility of the tagged data to HMRC, especially as some agents report that full tagging does not seem to be required by HMRC. The point is that iXBRL is not an automatic no-cost exercise.<sup>4</sup>

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<sup>2</sup> Currently SA 100 for individuals, SA 800 for partnerships

<sup>3</sup> We recognise that excessive use of white space could counter the effectiveness of MTD but we think it is important to have a system that allows companies to use formats and systems that work for them, provided of course that HMRC receive the necessary data.

<sup>4</sup> One adviser commented in relation to many of his clients or those of colleagues: '...they send their accounts off to India to be tagged (the normal approach). The latter costs between £100 and £350 per set of accounts, plus the time uploading it and checking what has been done and sending it to the tax advisers for adding to the computations...'

**2.15** The introduction of digital reporting for companies will generate another means of reporting data in a standardised format, potentially dispensing with the need for iXBRL at all. If iXBRL is to be continued, with its ongoing cost to business, HMRC needs to be clear on the value this will add and, where possible, look to complete iXBRL tagging using MTD data, or integrate iXBRL with MTD, without the need for additional reporting.

**2.16** Accordingly, we recommend that the continuance of iXBRL as a separate requirement should be reviewed in the light of MTD, with the aim of combining reporting into a single set of requirements.

## Three technical areas that could be simplified

**2.17** In November 2016 we published a list of the tax adjustments common to most companies, which illustrates the degree of complexity that has arisen for businesses.<sup>5</sup> We have not carried out a detailed analysis of the burden and value of all of these in the course of this work, and would encourage HMRC to routinely review reliefs and adjustments to test their usage and value, especially as data becomes more readily available across all businesses through MTD.

**2.18** We focus below on three key technical areas that businesses of all sizes cite as unnecessarily burdensome, and that could be addressed in the medium term or in conjunction with MTD. There are a range of other technical simplifications that we think would be helpful; as they are mainly relevant to large and complex companies, we discuss them in Chapter 5 though we would stress that some of those would benefit many small/medium companies as well.

### Distinction between capital and revenue

**2.19** Since the introduction of income tax, deductions of a capital nature in computing profits have been disallowed. In those early (19<sup>th</sup> century) days, rules around accounting were simply not established and so the law specifically disallowed capital expenditure in arriving at taxable profits. However, recognised accounting standards are now well established and both income tax and CT legislation<sup>6</sup> generally requires taxable profits to be calculated in accordance with them, unless the cash basis applies, subject to tax adjustments authorised by law.

**2.20** Furthermore, the Financial Reporting Council and other Recognised Supervisory Bodies (including the main accounting Chartered Institutes) now have statutory responsibility to monitor audit standards and thus compliance with GAAP.<sup>7</sup> In addition, for example, the Institute of Chartered Accountants in England & Wales (ICAEW) carries out wider regulatory and supervisory overview of members in practice in relation to, inter alia, technical standards.<sup>8</sup>

**2.21** There remains a subtle distinction between an accounting perspective on whether expenditure should be charged to profit & loss account or recognised as an asset on the balance sheet, and the tax perspective on whether an expense is capital in nature.

**2.22** The accounting definition is of an asset whose “future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably” insofar as “the economic benefits will flow to the entity beyond the current reporting period”.<sup>9</sup> From a tax perspective however, the definition of capital expenditure still essentially relies on case law that has

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<sup>5</sup>[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/569329/Adjustments\\_from\\_accounts\\_to\\_tax\\_-\\_supplementary\\_discussion\\_paper\\_.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/569329/Adjustments_from_accounts_to_tax_-_supplementary_discussion_paper_.pdf)

<sup>6</sup> Section 25 ITTOIA 2005 and section 46 CTA 2009

<sup>7</sup> <https://www.frc.org.uk/Our-Work/Enforcement/Enforcement.aspx>

<sup>8</sup> [www.icaew.com/en/technical/practice-resources/practice-regulation](http://www.icaew.com/en/technical/practice-resources/practice-regulation)

<sup>9</sup> FRS 102 paragraph 2.37

described it as "... an expenditure...made, not only once for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade."<sup>10</sup>

**2.23** We recommend that this subtle distinction generally be resolved in favour of the accounting perspective, so that the accounting split of capital and revenue could be accepted for tax purposes. This potentially saves large amounts of largely unproductive time in identifying and disallowing capital expenditure charged to profit & loss account and then - very often - claiming capital allowances on it (potentially at 100% thanks to the Annual Investment Allowance). In addition, with the recent removal of renewals allowances and with revenue in capital / deferred revenue expenditure being allowed only as it is debited to the profit & loss account, such a measure would enable debates around capital v revenue largely to disappear, while preserving the distinction where needed, for example to handle specific areas such as goodwill amortisation.

**2.24** As an illustration of how the compliance burden could be reduced by this simple measure, one large business explained to us "To give an indication of the type of compliance burden placed on companies to get comfortable under self-assessment, [we] have historically had one individual dedicate about 3 months of their time each year reviewing profit and loss account codes to identify capital costs in revenue. This does not include the time spent by other colleagues around the business answering questions about what certain items identified and queried relate to."

**2.25** In this context, it would be valuable to consider the treatment of abortive capital expenditure, which is charged to the profit and loss account - there being no balance sheet asset to value. The long-standing position is that such expenditure is disallowed as being capital despite it also not being eligible for relief under the chargeable gains rules.<sup>11</sup> One approach would be for such items charged to the profit & loss account to be allowed as genuine business expenses (which in the vast majority of cases it would be).

**2.26** The other approach, which would not follow the accounts or be quite as simple, but would respond in part to a point frequently made to us about such 'tax nothings', would be to allow such abortive capital expenditure as a free-standing capital loss.

**2.27** Both these routes for abortive capital expenditure would involve some exchequer cost, which would need to be evaluated in the ordinary way.

**2.28** We recommend that the capital/revenue distinction reflected in the accounts be followed for tax, other than where specific rules are needed to provide otherwise, and that consideration be given to giving relief for abortive capital expenditure, preferably as revenue deduction on the basis that it is expenditure for valid business purposes.

## **Aligning trading and property deductions with management expenses**

**2.29** At present, deductions relating to trades, property businesses and the management expenses of investment companies follow similar but not identical rules leading to slightly different outcomes. This complexity adds to administrative burdens and is irrelevant commercially. Structural reform in this area, to include amalgamating these and other categories of income, would be desirable (see Chapter 3).

**2.30** The first stage however, which we consider worthwhile in its own right, is to make technical changes to align the definitions of trading and property deductions and management

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<sup>10</sup> British Insulated and Helsby Cable Ltd v Atherton [1926] AC 205

<sup>11</sup> ECC Quarries Ltd v Watkis [1975] 51TC153



expenses. This, we think, can be done in such a way as to make only a marginal difference to the present outcome but would produce a more logical result.

**2.31** Aligning the trading and property deductions rules would be fairly straightforward, as most of the rules are the same or can only apply in one context (such as rules about lease premiums).

**2.32** Aligning the trading rules with those for management expenses would be more involved as they are rooted in two different conceptions of the activities in view.

**2.33** In 2004, HMRC published draft legislation<sup>12</sup> as part of a consultation<sup>13</sup> aimed at moving towards schedular reform. It did not extend as far as management expenses but the way it was proposed to extend the rules now in section 53 and 54 CTA 2009 (disallowances for capital expenditure and non-wholly & exclusively expenses) across the piece provides a useful starting point.

**2.34** The proposal was, in effect, as follows:

“In calculating business operating profits, no deduction is allowed for

- expenses not incurred wholly and exclusively for the purposes of that business, or
- losses not connected with or arising out of that business
- items of a capital nature”

**2.35** In the 2004 work, ‘business’ was to have been defined residually, to cover everything the company did that was not specifically excluded. While such an approach would be needed to secure schedular reform, it is not needed simply to align the expenses rules while preserving the difference between trades, property and investment businesses.

**2.36** The key management expenses rules, in section 1219 CTA 2009, are that they must

- be in respect of the making of investments as part of the company’s investment business
- not be of a capital nature, and
- not relate to investments held for an ‘unallowable purpose’, which means
  - held for a non-business or non-commercial purpose, or
  - held for activities for which the company is not within the charge to CT

**2.37** The rule about capital items is the same as that for trades, but the other two rules are specific to a business of making or holding of investments. Applying a common set of rules will therefore involve reframing them in more general terms.

**2.38** In terms of the unallowable purpose tests:

- “non-business or non-commercial purpose” and “not connected with or arising out of the business”, are not quite the same, but could be aggregated into something

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<sup>12</sup> See HMRC’s Corporation Tax Reform Technical Note of December 2004 at [http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/pbr2004/sup\\_ct-reform-tech-note.pdf](http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/pbr2004/sup_ct-reform-tech-note.pdf), and the later Summary of responses to that note of December 2005 at <http://webarchive.nationalarchives.gov.uk/20091222074811/http://www.hmrc.gov.uk/consultations/summary-ctreform.pdf>.

like “an expense or loss is not allowable if it is not connected with, or does not arise out of, the business, or does not have a business or commercial purpose”

- and it would appear feasible to apply a rule across the piece that “an expense is not allowable to the extent that it relates to a business, or an investment held for the purpose of a business, outside the charge to corporation tax”

**2.39** Putting all this together would result in the following basic formulation:

“In calculating business expenses, no deduction is allowed for:

- items of a capital nature,
- expenses not incurred wholly and exclusively for the purposes of that business,
- expenses or losses not connected with, or arising out of, the business, or without a business or commercial purpose
- an expense relating to a business, or to an investment held for the purpose of a business, outside the charge to Corporation Tax”<sup>14</sup>

**2.40** This approach to merging the basic rules, preserves the separate identities of trades, property businesses and investment businesses, and aims to avoid any material change in the scope of allowable deductions or therefore to the exchequer, the simplicity gain principally arising from only having one, rather than two subtly different, sets of rules for companies, advisers and HMRC to grapple with.

**2.41** We consider that this would in itself be a really good step forward in terms of simplicity, alongside a rule to ensure that the business as a whole was carried on commercially.

**2.42** We recommend the definitions of trading and property deductions and management expenses be brought together, as a valuable step in on its own and to signal a positive direction of travel.

## **Extending business deductions to embrace all expenditure of an income nature**

**2.43** If the step described above, aligning the existing rules about trading, property and management expenses is taken, the next step, discussed here, would be to end the longstanding anomaly of some entirely genuine business expenses of an income nature not qualifying for relief at all because of the specific terms of the management expenses rules.

**2.44** Even if our proposals above, about generally accepting the accounts approach to capital/revenue and aligning the trading, property and management expenses definitions, are adopted, there will remain some genuine business expenditure of an income nature which would remain unrelieved, above and beyond those where there is a clear policy rationale for disallowance (for example in relation to fines and penalties).

**2.45** In particular this concerns expenditure relating to running group operations or shareholder-related costs (sometimes termed ‘stewardship’ activities), in so far as they are not presently allowable and relate to other companies within the charge to CT (i.e. subject to appropriate transfer pricing protections). Allowing such expenditure would remove an historic barrier to relief for legitimate business expenditure, derived from the management expenses rules, and more fully align the tax system with commercial reality.

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<sup>14</sup> There would need to be provision for apportionment.

2.46 However, this would involve some exchequer cost, which would need to be evaluated in the ordinary way.

2.47 We recommend the government also consider extending the potential scope of relief to all business income expenditure as part of a wider reform, to more closely align tax with the accounts and commercial reality.

**Table 2.A: Summary of recommendations**

<b>Aligning corporation tax with the accounts: Recommendations</b>		<b>Short term</b>	<b>Medium term, link to MTD</b>	<b>Longer term</b>
1	No additional information needed beyond that already required by company law, without clear justification, and for this information to be reported digitally to government through a single route.		✓	
2	Consider abolishing the requirement for companies to submit a separate corporation tax computation.		✓	
3	Review iXBRL reporting and either integrate it with MTD or remove it as part of the move to MTD		✓	
4	<b>Tax to follow accounts for capital / revenue distinction to reduce the burden of having to analyse capital expenditure for tax purposes. Also consider allowing abortive capital expenditure.</b>		✓	
5	<b>Aligning definitions of trading and property deductions, and management expenses and trading expenses would be a valuable step towards simplicity of the tax regime</b>		✓	
6	Extend the potential scope of relief to all business income expenditure to more closely align tax with the accounts and commercial reality			✓



# Aligning CT more closely with the accounts:

## 3 schedular reform

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### Why reform the schedular system?

**3.1** If the UK were designing a company tax system, starting with the proverbial blank sheet of paper, would it create a schedular system - under which different types of income are calculated separately and subject to different rules for tax purposes? No-one we met thought so.

**3.2** Reforming this feature of the tax was one of the key areas flagged up for us to review: to examine the categories or sources of income, and how well they fit the modern context. In particular we were asked to look at the potential for combining at least some of these categories, while maintaining a separation between capital and revenue.

**3.3** This work picks up one of the recommendations in our Competitiveness Review<sup>1</sup>. That drew attention to the historic nature of the schedular system<sup>2</sup>, which is anachronistic rather than fitting the commercial reality of a business generally seeing everything it does as part of a whole.

**3.4** At present, income and expenses in categories such as trades, property, investments, non-trade loan relationships and management expenses need to be considered separately. This involves keeping underlying records in a way which facilitates this, whether or not there is any other reason to do so, or undertaking extensive analysis purely for tax purposes. This affects a wide range of businesses, small and large, that diversify in some way<sup>3</sup> and who have to allocate overhead expenditure between different parts of the overall business for tax purposes despite them all falling within the same set of accounts. That adds to burdens, and is unnecessary commercially.

**3.5** As our work on other countries' systems shows (see Annex E) many other countries do not have a schedular system. Those which do have one generally use it to do something significant – such as the Republic of Ireland and Canada applying different tax rates to different types of income (as distinct from gains) received by companies, something which the UK has never generally done (one exception is the oil ring fence).

**3.6** The chart below shows the proportion of CT returns disclosing particular income streams of different sizes of companies<sup>4</sup>. The chart does not show which companies have more than one type of income stream, or convey the number of companies with more than one trade. The predominance of taxable trades and the relative infrequency of management expenses,

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<sup>1</sup> <https://www.gov.uk/government/publications/competitiveness-of-uk-tax-administration-review>: 8 December 2014: Pages 8 and 35-36

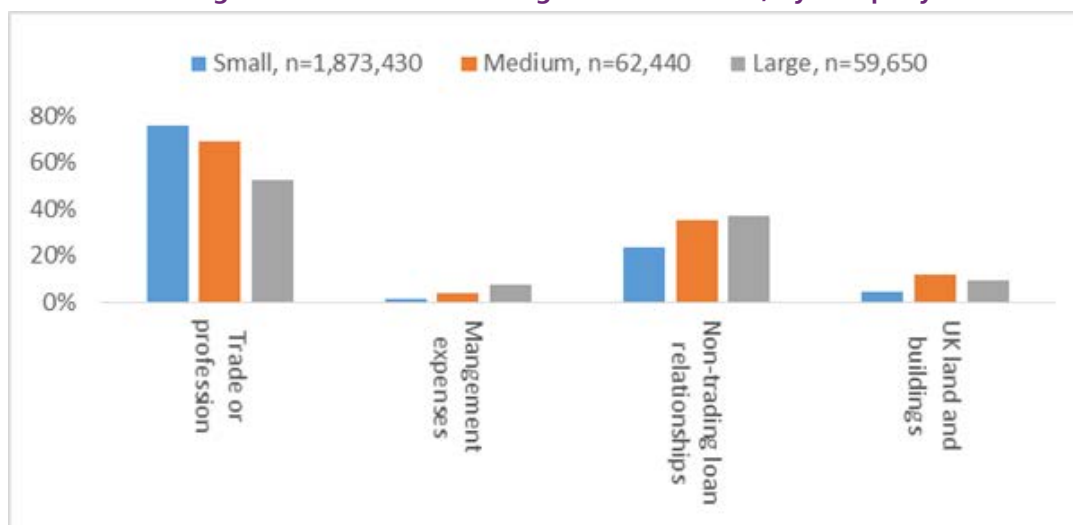
<sup>2</sup> It dates back to the re-introduction of income tax in 1803, following its initial introduction in 1799, and was originally designed to provide a taxpayer with the comfort that no one person in the tax authority would know the totality of the individual's tax affairs.

<sup>3</sup> Farmers who diversify into property letting would be one example but the business conglomerate with multiple activities is often affected – it is not the case that different activities are always put into different companies in a group.

<sup>4</sup> Size bands follow [http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index\\_en.htm](http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm). A group structure database was used as a proxy to assign companies to groups, which is required for applying the EU definition of a SME. This takes information from HMRC compliance databases and FAME.

especially amongst small companies, is clear, suggesting that there is limited value added by maintaining these different rules.

**Chart 3.A: Percentage of CT returns disclosing income streams, by company size**



Source: HMRC data on companies completing CT600 forms for 2013-14: - "Trade or profession" above based on Box 1 "Total turnover from trade or profession"; "Management expenses" based on Box 24 "Management expenses under S75 ICTA 1988"; "Non-trading loan relationships" based on Box 6 "Bank, building society or other interest, and profits and gains from non-trading loan relationships"; "UK land and buildings" based on Box 11 "Income from UK land and buildings".

**3.7** A key benefit of reform would be to transform the income categorisation process for the great majority of businesses, so that a common tax calculation process can operate across the piece – and be built into the way MTD works.

### Previous work on schedular reform

**3.8** Reform in this area has been considered before, in particular in 2005<sup>5</sup>. HMRC's December 2004 technical note recorded that previous consultations had shown strong support for reform. The key proposal put forward at that time (supported by detailed draft legislation) was the creation of a new 'operating business' source encompassing trading and letting income together with some miscellaneous income (then chargeable under Case VI of Schedule D), operating under a common set of basic computational rules. The new 'operating business' was to be defined on a residual basis – to include everything not catered for elsewhere.

**3.9** This approach, as well as keeping capital gains separate, did not include non-trading loan relationships or management expenses in the new 'operating business'. So this would have involved a 'much more limited'<sup>6</sup> exchequer effect than full pooling. However, the Response Document, in December 2005, reported a strong view that it would be better not to proceed in this way if it were not possible to achieve full reform; the change needed to be essentially all-embracing if the benefits were to be worth the transitional disruption.

**3.10** The exchequer effect referred to arises mainly because schedular reform implies pooling losses - as well as profits - from any merged categories or sources of income. Indeed, the main

<sup>5</sup> See HMRC's Corporation Tax Reform Technical Note of December 2004 at [http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/pbr2004/sup\\_ct-reform-tech-note.pdf](http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/pbr2004/sup_ct-reform-tech-note.pdf), and the later Summary of responses to that note of December 2005 at <http://webarchive.nationalarchives.gov.uk/20091222074811/http://www.hmrc.gov.uk/consultations/summary-ctreform.pdf>.

<sup>6</sup> See para 2.14 of HMRC's December 2004 Technical Note

practical effect of the schedular system at present is to enable, or to support, different rules about the relief of different types of losses.

**3.11** It has also been observed that the schedular system provides a mechanism which policy-makers can use to differentiate the tax treatment of different streams of business or commercial activity. From a simplification perspective it is not obvious that this is desirable; nor is it something that has been used a great deal (apart from loss streaming) in the corporate field.<sup>7</sup>

### **Now is the right time to develop a roadmap for reform**

**3.12** The currently proposed loss relief changes<sup>8</sup> will take a significant step towards pooling post-2017 CT losses. For the ever-increasing number of companies without pre-2017 losses, all the main categories of carried forward losses will be available to set against total profits (subject to the general loss restrictions) which will generally give the same result as pooling (even though the revenue protection rules depend on them being tracked separately). More widely, the remaining pre-2017 losses will, unless effectively stranded forever, work their way through the system over the coming years.

**3.13** Accordingly, given these proposed loss relief changes and lower CT rates (which reduce the significance of such differences as there are between the tax rules applying to different types of income), now is a fruitful time in which to re-examine this area. It would also fit naturally with the opportunity to improve things in conjunction with the development of MTD for companies.

**3.14** A roadmap towards schedular reform, alongside the planned reductions in the rate of CT, would send a clear message of intent about the UK's will to modernise its tax system – moving away from a 19<sup>th</sup> century construct to better align with modern commercial reality.

**3.15** We recommend the government develop a roadmap for, and take steps towards, structural reform of the Schedular system, to better align the tax system with the accounts and modern commercial reality, taking the initial analysis presented here into account.

**3.16** Laying the foundation for schedular reform, as well as involving consideration of the effect on the exchequer and administrative burdens, will require a range of technical and practical issues to be worked through. This is an inevitable part of a structural simplification of this kind, given the need to avoid unintended consequences arising from disturbing the 200-year old roots of the schedular system. It is encouraging that in December 2004 HMRC not only considered something comparable (if on a smaller canvass) to be feasible but got as far as consulting on draft legislation.

**3.17** This report aims to give a sufficient indication of what would be involved to show that such reform is feasible. In that context, the following areas seem sufficiently important, either for particular industries or in terms of exchequer protection, to call for initial analysis.

### **Main stages of reform for small and large companies**

**3.18** For micro and small companies, it is inherent in our proposals (see Chapter 2) on:

- following FRS105 accounts, or
- adopting an approach based on FRS102 accounts with a small number of adjustments

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<sup>7</sup> A non-corporate illustration of differing treatments facilitated by the schedular system might be the investment income surcharge which operated for some years until abolished in the 1980s.

<sup>8</sup>See Schedule 9 to the Finance (No 2) Bill as introduced on 20/3/2017:  
<http://services.parliament.uk/bills/2016-17/financeno2/documents.html>

that the schedular system effectively be disregarded (subject to considering the position of capital gains). This would also fit well with MTD developments.

**3.19** For all other companies schedular reform would reduce the administrative burden resulting from needing to split out income and expenditure into different categories only then to add it together again. While this may often be little more than a matter of treating interest income separately, it also affects businesses needing to allocate expenses between income streams in a range of circumstances. One would accordingly expect such a reform to assist the transition to MTD, in particular where incidental amounts of income arise from secondary activities – which seems likely to become more common rather than less.

**3.20** For medium sized or large companies the idea, ultimately, would be to see everything a company did as part of an overall ‘business profit or loss’, apart from specific items such as capital gains and losses (charged separately) or dividends (exempt). This could align well with MTD; illustrated by the fact that it would reduce 33 boxes to 18 boxes on the key part of the existing return form.

**3.21** But it does not all need to happen at once:

- The first stage would be to align the statutory definitions of allowable deductions and expenses – in particular the different definitions of trading and property deductions and management expenses, and to remove remaining ‘tax nothings’ (as discussed in the previous chapter).
- The second stage, discussed here, would go further: bringing all the different income categories together into one business profit or loss for tax purposes, with losses fully pooled.

**3.22** This could mean losses which would otherwise be lost (in particular from trades which cease) would be relieved against continuing sources of income, with potentially significant exchequer effects in particular cases even taking the proposed loss relief changes into account. We set out below some measures that could be taken to address these potential effects, guarding against abuse, and weigh up the balance between the potential complexity involved for those affected against the bigger picture, and the practical transitional impacts involved.

**3.23** It would also be necessary to review the considerable number of references in tax legislation to terms such as trade or investment company to guard against unintended consequences. We offer an initial exploration of what would be involved here.

## **Amalgamating the income and expenses categories**

**3.24** Amalgamating the various ‘income’ nature items presently appearing separately in CT computations into one overall profit or loss would embrace trading and property income, non-trading loan relationships, miscellaneous income, management expenses, and charges on income.

**3.25** It would not just be about aggregating these items, having worked each of them out separately (possibly under different rules) and then entering a single aggregate figure in a single box. That, after all, would not alter the substantive work needed.

**3.26** It would, rather, be to stop thinking in terms of those different categories separately but thinking in terms of a single overall business category. So it would be a pre-requisite that there were common rules about what is taxable when and what deductions are allowed, building on the proposals to align the deduction and expenses definitions discussed in the previous chapter.



**3.27** For the purposes of this report, we describe this new overall category as 'business profit or loss'.<sup>9</sup> We would envisage it being defined residually, mirroring the approach in the December 2004 draft<sup>10</sup>, but going further - to include everything the company does unless it is taxable separately (for example capital gains), is exempt (for example UK dividends) or is not relievable (for example dividends paid). This should remove any need to debate what counts as a 'business', subject to the usual rule about it being carried on commercially.

**3.28** This would not, however, affect the detail of particular regimes such as loan relationships – it is just that the amounts of taxable credits or relievable debits resulting, whether trade or non-trade, would form part of the business profit or loss, just as trading loan relationship credits or debits presently form part of the trading profit or loss.

**3.29** Any overall 'business loss' would be carried forward against future business profits, mirroring the way trading losses are currently carried forward against future trading profits.

**3.30** Such a change would take place in relation to accounting periods starting on or after a particular transitional date. Any 'post 2017' losses or expenses (arising from periods after the loss restriction changes come into effect but before that transitional date) which remained unused would be merged and carried forward against the future income profits of that business. The 50% loss restriction rule would operate for the future in relation to the business as a whole.

**3.31** Pre-2017 losses would continue to be streamed, as now. Companies with pre-2017 losses would need to carry out more detailed calculations for future periods - essentially mirroring the calculation they presently do, to enable the rules to be operated until those pre-2017 losses are used up, or the company no longer wishes to preserve them for possible future use.

### **Practical issues: What CT returns could look like for most companies**

**3.32** We offer below an illustrative description of how the CT return might look if the categories were combined, developed by reference to the boxes appearing on the latest version of the CT600.<sup>11</sup> It is recognised, of course, that this landscape is likely to change with MTD.

**3.33** Schedular reform would make many of the present boxes (concerned with different types of income and the way losses are handled) otiose. The present 'income' section of the return could be halved in length from 12 boxes to 6, namely:

- business profits
- business losses brought forward
- net business profits
- non-exempt dividends from non-UK companies
- income from which tax deducted
- tonnage tax profits

**3.34** Overall, across the income, chargeable gains, profits before deductions and reliefs and deductions and reliefs sections of the CT600, there would be a great reduction - from 33 boxes to 18 boxes.

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<sup>9</sup> In the December 2004 draft legislation the term for the more limited pot - not including non-trade loan relationships or management expenses - was termed 'business operating profit'.

<sup>10</sup>As provided for by the then proposed new section 18A of ICTA 1988

<sup>11</sup> <https://www.gov.uk/government/publications/corporation-tax-company-tax-return-ct600-2015-version-3>

**3.35** Initial analysis from HMRC is that, if applicable across the entire CT population, this would save businesses around £6 million a year in terms of ‘form filling’. We note a small number of companies may not benefit from this saving (at least not immediately) and the avoidance rules discussed below may reduce the saving below this figure.

**3.36** In addition, there would be further benefits to businesses, above and beyond the £6 million, in relation to their record keeping obligations; a point all the more pertinent in the context of MTD.

### **Practical issues: record keeping etc.**

**3.37** Schedular reform, would significantly reduce the number of categories of income and expenditure for which records need to be kept for most companies, but would not entirely remove that need for everyone. In particular, there would be a need for old style records to be maintained, at least to some extent, by those

- with pre-2017 losses
- with losses that might still need to be streamed
- needing to take account of any post-2017 loss restriction rules (such as those canvassed in the technical section below) that work by reference to trades etc.
- claiming double tax credit relief (and thus needing to measure the related income)
- those concerned with specialist areas such as Controlled Foreign Companies (CFCs) (to the extent that these operate by reference to existing categories of income)

**3.38** It is clearly to be hoped that schedular reform would help reduce the extent of the record keeping and information required to support MTD quarterly updates. It would also make the integration of iXBRL and MTD easier.

### **Technical issues to consider**

#### **Source doctrine**

**3.39** Defining ‘business profit’ residually, to include everything the company does, offers the opportunity to go beyond the source doctrine, either by regarding the company’s business - taken as a whole - as the source, or by no longer relying on the idea at all.

**3.40** For example, there would appear to be simplification opportunities available in various areas, such as

- pre-trading expenditure (section 61 CTA 2009) simply being part of the business profit/loss even if trading or other business has not started yet, on the basis that if the company is preparing to conduct a trade then that counts as business activity
- removing the post-cessation receipts (and related deductions) rules (section 188-201 CTA 2009) on the same basis
- removing the special rules about released debts (section 94 CTA 2009) and streamlining the rules about reverse premiums (sections 96-100 CTA 2009 ) or about the income of investment company from a source not charged to tax (section 1222 CTA 2009), because these would, on this approach, be taxable anyway
- making it clear (if need be) that revenue expenditure incurred while a company is in liquidation (and associated with its previous business) is allowable

## Losses

**3.41** One focus is the need to ensure, while freeing-up the use of losses, that reform does not have consequences, or offer avoidance opportunities, involving an unexpected cost to the exchequer.

**3.42 First**, one would presumably retain the loss buying and related rules in Parts 14-14B CTA 2010, streamlined to reflect the reduced number of categories of losses needing consideration. (One consequence may be that these are easier to monitor/apply.)

**3.43 Secondly**, there would need to be something comparable to the present rules about losses ceasing to be available for carry forward, for example when a trade ceases (section 45(4)(a) CTA 2010). The starting point would be a rule ensuring that a business loss carried forward ceased to be available when the business (taken as a whole) ceases.

**3.44** A further rule could also be needed if merging previously separate streams of losses was likely to involve a material exchequer cost. Such a rule could be limited in application either to what would previously have been trade losses carried forward in excess of a substantial figure or to any losses which would otherwise be carried forward and which relate to discontinued operations<sup>12</sup>. It would however run counter to the idea of schedular reform if companies had to maintain old-style calculations against the mere possibility of needing them.

**3.45** One would also have to address the risk of a loss-making trading company about to cease trading becoming the natural home for a new trade or other activity, in order to preserve the losses. Such a rule could be based on the idea of a major change in the variety or nature of the activities carried on by a company or on the idea of discontinued operations.

**3.46 Thirdly**, loss streaming rules need to be considered (e.g. Part 22 CTA 2010). A number of observations were made to us that it would be desirable, as part of schedular reform, to do away with, or at least limit, the operation of these rules in situations where an overarching business is continuing. Equally this would have an exchequer cost and there would be a need to guard against abuse. Any rule aimed at this might also could be framed by reference to changes in the nature of the business or discontinued operations.

**3.47** Ultimately, one (less attractive) option would be for companies with sufficiently large losses to be required, at least initially, to distinguish between losses from different sources as they always have. This would at least enable the system to be rationalised for the great majority of companies, and for all small companies.

## Consequential changes to consider

**3.48** Combining trading, property and management expenses categories into a single 'business profit' category would involve consequential changes, either to preserve the status quo or to adapt existing provisions to this new approach.

**3.49** Generally, one would need to consider any rule which specifically refers to the existence of a trade or a property business or an investment company. This need not involve a substantive change (as one could still refer to whether or not there was a trade, even if that concept was no longer the bedrock of the computation) but the reform will have more benefit if the range of occasions where such distinctions are needed can be reduced.

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<sup>12</sup> Defined in FRS 102 as "A component of an entity that has been disposed of and: (a) represented a separate major line of business or geographical area of operations; (b) was part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or (c) was a subsidiary acquired exclusively with a view to resale".

**3.50** A number of specific provisions, including those that have specifically been drawn to our attention are referred to here, but we do not claim that this list is exhaustive

- movements of properties from capital/investment status to trading stock
- differences between taxation of different sorts of property (e.g. Furnished Holiday Lettings), which one would aim to remove in the corporate sector
- substantial shareholding exemption
- R&D: the SME scheme rule in s1055 CTA 2009 is based on trading
- RDEC has rules referring to trading (e.g. s104J CTA 2009)
- section 9A CTA 2010 (designated currencies)
- the position of life insurance (I-E) business (Parts 2 and 3 FA 2012)
- the risk of unintended implications for the investment funds industry (SI 2014/685)

**3.51** Consideration of other regimes connected to or impacting on CT (such as diverted profits tax or the bank levy) would be needed; we have not attempted that as part of this work.

**Capital gains**

**3.52** We have not focused on simplifications in the capital gains arena as part of this work on Schedular reform and the treatment of income. But the following suggestions have been made:

- removing the 2002 cut-off in the intangible regime (as noted in Large business chapter)
- abolishing indexation relief (which we have not considered in any detail)

**3.53** We think that once schedular reform is committed to and a direction set, then there should be a review of the capital gains that are really taxed on companies. There is an argument that reliefs such as Substantial shareholdings and Rollover, plus of course loss relief, eliminate most of the tax on most gains made by companies. Would it be possible – and thus simpler – to define which (few) capital transactions should be subject to tax, instead of having all capital transactions subject to tax and then relieved? But this would need to be the subject of a proper review, potentially by the OTS.

**Summary recommendations**

**Table 3.A: Recommended path to schedular reform**

	<b>Schedular reform: Recommendation</b>	<b>Short term</b>	<b>Medium term, link with MTD</b>	<b>Longer term</b>
1	The government develop a roadmap for, and take steps towards, structural reform of the schedular system, to better align the tax system with the accounts and modern commercial reality.			✓

# Aligning CT more closely with accounts: capital expenditure

## 4

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### Introduction and background

**4.1** The adjustment replacing the charge for depreciation with capital allowances (CAs) is a feature of almost every company's CT computation. In 2014-15 1.4 million companies submitted CT returns and 1 million of these included CA claims<sup>1</sup>.

**4.2** Depreciation is not a permitted deduction following the long established distinction between 'capital' and 'revenue' expenses and the view taken that depreciation is a type of capital cost<sup>2</sup>. For many years, for different classes of assets and at a variety of rates, relief for some capital expenditure on assets has been provided by the ever changing landscape of CAs. It takes about 500 pages of primary legislation<sup>3</sup> to set out the CA regime, clarified in numerous tribunal and court cases.

**4.3** There are a number of ways of viewing CAs:

- **relief for the cost of an asset to a business**

Under GAAP the costs of assets are written off over the useful life of the asset ('GAAP depreciation') – and to the extent that CAs reflect such depreciation they can be regarded as simply a normal business cost, in the same way as, for example, utility costs.

- **an incentive to invest**

To the extent that CAs either give relief faster than GAAP depreciation would do, or provide a cash tax credit, they may be an incentive to invest.

- **an indeterminate combination of these**

**4.4** In our interim report, we raised two questions about the current CAs regime:

- 1 whether the current regime continues to relieve capital expenditure and support capital investment in a way which recognises the commercial reality under which business make decisions and prepare accounts
- 2 whether this can be achieved more simply

**4.5** We heard concerns about complexity in the CA regime reflected across four themes:

- frequency of change (stability)
- scope (which assets qualify for CAs, and which don't)
- boundaries (the distinctions between assets of different classes that do qualify)

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<sup>1</sup> HMRC Table 11.3

<sup>2</sup> Now expressed in CTA 2009 s53 "In calculating the profits of a trade, no deduction is allowed for items of a capital nature"

<sup>3</sup> Based on Tolley's Yellow Handbook 2016-17

- writing off rates

**4.6** In some cases, these concerns led to the view that the overall policy intention of the regime isn't always clear. More generally, that the judgements which must be made on scope and boundaries cannot always be solved simply with software, and can require specialist opinion.

**4.7** Uncertainty arises from frequent changes to scope; businesses we spoke to felt that there is a disproportionate administrative burden in adhering to the boundaries when claims are made, as compared to the value of the tax relief. Reducing this burden, and thus creating a simpler system, can only be achieved if these areas are addressed.

**4.8** Businesses are sometimes unclear as to the broader intention of the CAs regime as the rules do not reflect their commercial reality. That makes the rules appear abstract, and difficult to understand and implement. Nor is it clear to what extent they are meant to encourage, rather than merely take account of, capital investment, especially as the CT rate reduces.

**4.9** It is important to recognise that taxpayers have differing perspectives on the CA regime. The Annual Investment Allowance (AIA) already gives smaller companies a fairly simple regime, and is easy to understand. (Though of course it will not always cover all their capital expenditure, as it is an allowance only for plant and machinery.) Those companies with substantial capital expenditure, for example utility companies or large retailers, have procedures and processes which enable them to address the complexity of CAs (although this may be regarded as an unproductive activity).

**4.10** Any further work in this area would need to consider the impact of changes to the CAs regime on taxpayers varying in size, trade and whether incorporated or unincorporated.

**4.11** We should make it clear that as this review is concerned with the corporation tax computation, we have focussed on simplifying CAs in that context. It is beyond the scope of the current review to consider wider policy questions such as the replacement of CAs with (for example) cash deductions for capital spend balanced by a disallowance of related interest costs, though we note such ideas.<sup>4</sup>

## Importance of stability

**4.12** Taxpayers have told us that investment decisions are more easily made in a stable CA regime. One taxpayer commented to us that CAs are so complex and volatile they try and avoid them altogether by leasing instead of buying. In the charts which follow we illustrate some of the issues around consistency which taxpayers have faced in recent years<sup>5</sup>.

**4.13** Chart 4.A below shows the frequency of major changes to the scope and rates of CAs which an investor has to take account of as part of the political risk associated with investment decisions.

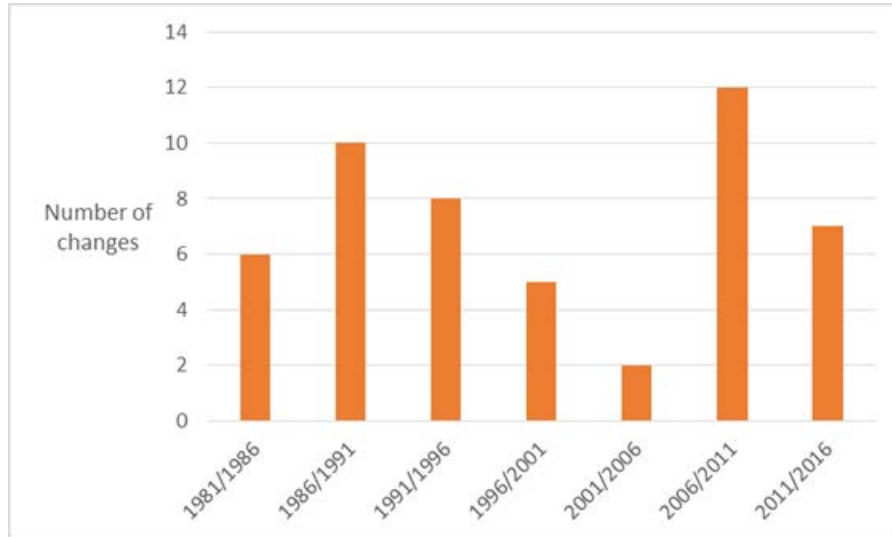
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<sup>4</sup> Of course the Annual Investment Allowance is a cash basis for many companies' capital investment, without an interest restriction, and is a system that offers clear simplification benefits as the OTS has noted in previous reports.

<sup>5</sup> The major impact of change in creating tax complexity is discussed in the OTS document "Principles of avoiding complexity"

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/435704/Principles\\_of\\_avoiding\\_complexity\\_June\\_2015.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/435704/Principles_of_avoiding_complexity_June_2015.pdf)

**Chart 4.A: Capital allowances – Number of major changes to the scope or rate of allowance from April 1981 to March 2016 in 5 year periods**



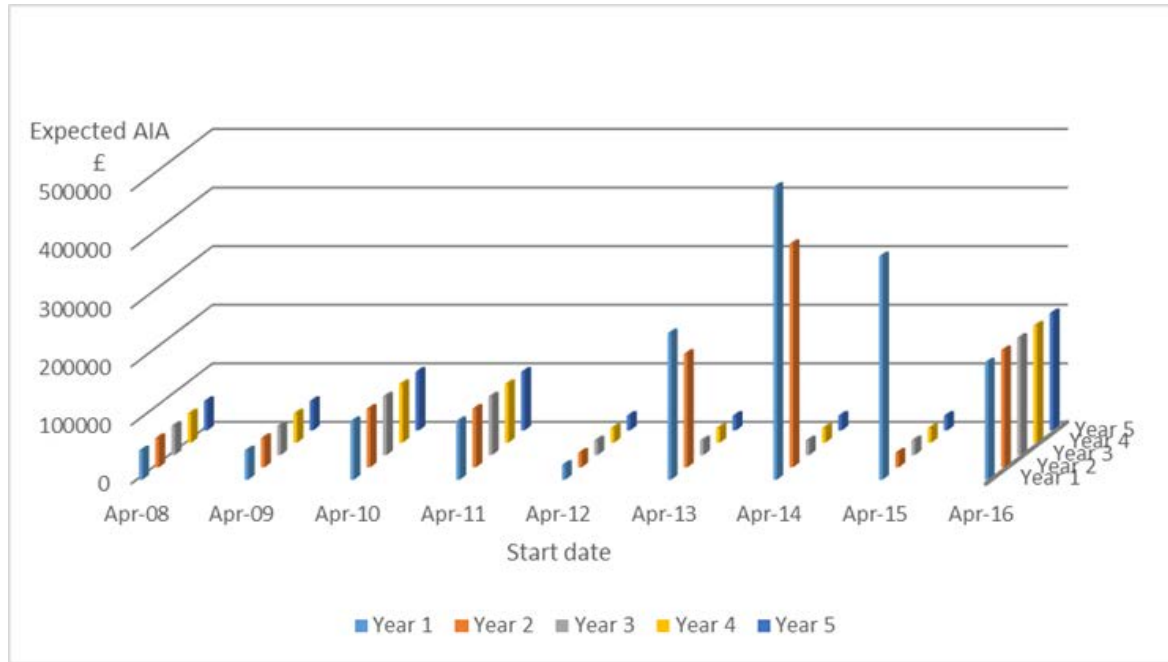
Source: HMRC Table A.5 Corporate Tax<sup>6</sup>

**4.14** Some of the difficulties with CAs for smaller businesses were addressed by the introduction of the AIA. This enables qualifying capital expenditure within an annual limit to be written off against taxable profits in the year the expenditure is incurred. It therefore combines features of an incentive (faster write-off than depreciation) and simplicity (no need to track a CA pool from one year to another). However, the simplicity is compromised by the continuing requirement to establish what qualifies; and the incentive is compromised by changes to the annual limit. These problems are illustrated in the following charts.

**4.15** The chart below shows how the monetary limit at the outset of each tax year has varied. At some dates (for example, April 2011) the AIA has been expected to be constant for the next 5 years, at others (for example April 2014) it has been expected to change radically. Investment decisions are difficult in such a volatile environment.

<sup>6</sup> <https://www.gov.uk/government/statistics/corporate-tax-rates-of-capital-allowance>

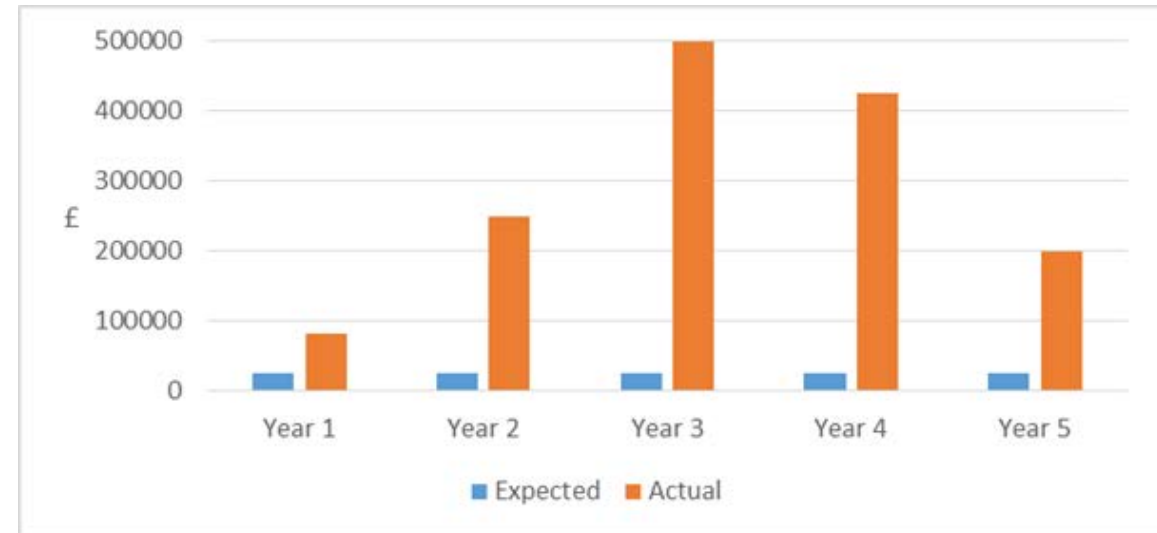
**Chart 4.B: Investment planning – Expected AIA at the start of a 5 year investment period**



Source: OTS

4.16 The position is even more difficult for taxpayers when the expected AIA (shown in the chart above) is compared with the actual AIA. The chart below shows the AIA which a taxpayer planning a 5 year investment in April 2012 would have expected, compared with the ACA which actually materialised in those 5 years.

**Chart 4.C: 5 year investment planning at April 2012 – Expected vs actual AIA**

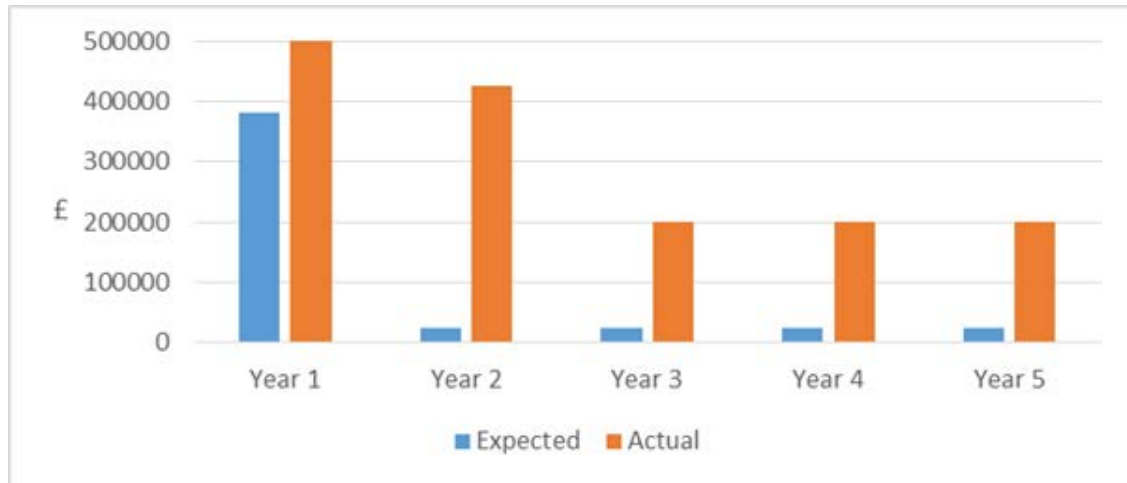


Source: OTS

4.17 The difficulties that these changes cause have been recognised in the government’s commitment to an AIA of £200,000 for the remainder of this Parliament. The impact of this is shown in the next chart.



**Chart 4.D: 5 year investment planning at April 2015 – Expected vs actual AIA (assuming constant to end of current Parliament)**



Source: OTS

**4.18** With a stable annual limit, the AIA in some ways provides a good standard of simplification against which potential changes to the CA regime should be gauged: 99% of companies in CT are able to relieve their qualifying capital expenditure in full in the year it is bought.<sup>7</sup> We welcome the commitment to a specific value for the AIA for a period of time.

**4.19** We are conscious that in making suggestions for further change we are arguably adding to the problems that taxpayers face, particularly where transitional arrangements may be required (see, for example, the discussion below on the use of accounts depreciation). Any further change must have a clear long term benefit to the delivery of a simpler CT regime.

### **Complexity caused by impact of scope, boundaries and different writing off rates**

**4.20** The current CA regime requires taxpayers to allocate capital expenditure into qualifying and non-qualifying assets, and then the qualifying assets into different categories. This creates boundaries. As each category is written off for tax at a different rates, varying from nil to 100% per annum, the categorisation has a significant impact on the post-tax cost of the investment because of the cash-flow consequences for assets relieved at different rates.

**4.21** The table below assumes a company is considering a capital investment of £10 million in addition to investments which have used up the AIA. It shows the net present value (NPV), using a discount rate of 5%, of the CAs with seven different assumptions (A to G) about the tax nature of the asset. The 24% CT rate illustrated below was the rate applying in 2012 when the current rates of writing down allowances were introduced.

<sup>7</sup> HMRC response to OTS request.

**Table 4.A: Net present value of capital allowances on expenditure of £10 million**

	Tax nature of asset			CT rate	
				17%	24%
	Non qualifying	Plant & machinery WDA 18%	Integral features & long life assets WDA 8%	£m	£m
<b>Scenario</b>					
A	0%	100%	0%	1.4	2.0
B	0%	75%	25%	1.3	1.9
C	0%	50%	50%	1.2	1.8
D	0%	25%	75%	1.2	1.7
E	0%	0%	100%	1.1	1.6
F	25%	50%	25%	1.0	1.4
G	25%	25%	50%	0.9	1.3

**4.22** Taxpayers have told us that the attribution of capital expenditure to the correct tax category is the most complex aspect of the regime. The table above illustrates the reason for this complexity, namely, the significant impact on the value of relief available depending on the categorisation of an asset in terms of whether the asset is qualifying (the ‘scope’ issue) and which write down pool the asset should go in (the ‘border issues’).

## A way forward

**4.23** This chapter sets out various issues with the current regime highlighted by the businesses and advisers we have met to better inform the debate on how the current regime can be simplified. We have considered a number of options which could improve the current regime and others which move away from the current regime. These options revolve around the four themes we set out in paragraph 4.5, namely, stability, scope, boundaries and rates, shown in the table below.

**Table 4.B: Summary of views heard and options considered**

Issue – what we heard	Themes of complexity	Options to address these concerns
Unclear and changing policy objectives	Stability	Provide clear signposts on the purpose of relief for capital expenditure (para 4.28f)
CA regime does not reflect commercial reality	Boundaries, writing off rates	Replace CAs with accounts depreciation (para 4.34f)
CA regime does not reflect commercial reality	Scope	If CA regime retained, extend scope to all assets used by the business (para 4.51f)
Taxpayer resources wasted on classifying low value assets	Boundaries	Small capital override (para 4.74f)
Uncertainty on classification deters investment and causes taxpayers to waste resources	Stability, boundaries	Specific HMRC guidance (para 4.88f) Binding rulings from HMRC (para 4.100f)
Taxpayer resources wasted on classifying assets	Boundaries	Reduce number of CA pools – not recommended (para 4.113f)

Elections on asset disposal (s198) not well understood, cause significant compliance problems for vendor and purchaser and deny purchaser of future relief	Stability, writing off rates	Review less onerous mechanism (para 4.119f)
The Enhanced Capital Allowance (ECA) schemes generate significant compliance problems	Boundaries, stability	List of qualifying assets to be kept up to date; claim processes streamlined (para 4.125f)

**4.24** We have identified the main advantages and possible disadvantages of each of the options listed above and what further work needs to be done, particularly to explore who the likely gainers and losers would be. This will help form the agenda for further discussions on the future of giving relief for capital expenditure, once all stakeholders are clear on the policy objective.

**4.25** Some of the options we explore below are radical departures from the current CA regime and would require considerably more review. We are not convinced that significant simplification can be achieved in any other way, but we are also not fully convinced at present that the simplification gains overwhelmingly outweigh the transitional impacts. If a full review shows they are an attractive means of simplification, there would need to be a long lead time to introduction.

**4.26** Some of the changes have been contemplated in the past. One reason for revisiting them is the fall in rates of CT, which reduces the value to the taxpayer of the reliefs. The reducing value of the reliefs generally also make the administrative burden involved offset a greater proportion of the relief. This can be seen by comparing the columns headed 17% and 24% in Table 4.A above.

**4.27** The OTS recommends that a standalone, detailed review is undertaken to follow up on the work done as part of this report to examine how the CAs regime can be improved. Issues to be covered in such a project are listed against each recommendation below. The aim would include developing a framework for reform.

## Clarity on policy objective of capital allowance

<b>Issue</b>	Unclear and changing policy objectives
<b>Theme</b>	Stability
<b>Suggestion</b>	Provide clear signposts on the purpose of relief for capital expenditure

**4.28** It's clear that CAs can play a vital role in the decision making process for businesses which are planning to make capital investment. This is particularly important for large business where the relief is sizable enough to have a significant impact on the financing of projects (and HMT and HMRC entirely recognise this), although we appreciate many businesses may take a pre-tax approach to investment decisions.

**4.29** However, there is uncertainty amongst businesses about the relative priority, in terms of policy objectives, between the CAs regime incentivising capital expenditure or simply providing

appropriate relief for a business expense (for example, depreciation), or indeed, an indeterminate combination of the two.<sup>8</sup>

**4.30** What is the real link between the CAs policy objective and tax simplification? CAs have a role in defining the tax base and should be designed with that in mind and made as simple as possible. A transparent tax system with clear policy objectives is easier for taxpayers to engage and comply with.

**4.31** We think that the regime should be viewed as giving tax relief for a business expense (expressed in accounts as depreciation, but at present only some depreciation), and not the primary lever to influence capital investment. In our view, the latter would ideally be done outside of the CAs regime in order to avoid mixed messages from changes of policy objectives, which also create uncertainty.

**4.32** However, while we think that CAs are primarily a tax relief for a business expense, we don't believe the regime in its current form does this particularly well. From the feedback and examples we have explored, there are various reasons for this.

- 1 The changes to the boundaries (see below) have led to uncertainty and add to the burden involved in making a claim which is already perceived to be disproportionate. Although amending rules or interpretation are inevitable, we have heard that these changes usually result in a move away from the accounting treatment and the commercial rationale for the capital expenditure incurred. This leads to too many 'tax nothings' or lengthy enquiries.
- 2 The nature of the current system means some industries and sectors of the economy benefit more than others which raises the question of fairness.

**4.33** We recommend that changes to the CA regime, whether deriving from the suggestions which follow or others, should be accompanied with clear statements of the policy objectives. They should run with the grain of commercial reality and not against it. The aim of this recommendation is to improve understanding of the system, which contributes to a simpler system – or perception that the system is simpler.

## Replacing CAs with accounts depreciation

<b>Issue</b>	CA regime does not reflect commercial reality
<b>Theme</b>	Boundaries, writing off rates
<b>Suggestion</b>	Replace CAs with accounts depreciation

**4.34** Replacing CAs with a deduction for depreciation charged in the accounts is not a new concept. It was one of the recommendations of the OTS's UK Competitiveness review (2014) and further back was proposed by the government in 2002<sup>9</sup>. It has been frequently raised with us as an obvious route to simplification.

**4.35** The premise is that a) depreciation is a better representation than CAs of the underlying economic costs of an asset and b) use of depreciation avoids the need to maintain two fixed asset registers – one for accounts and the other for tax.

<sup>8</sup> In part the different perspectives may be due to the long history of CAs, when different emphases have been placed on different aspects of the regime.

<sup>9</sup> HM Treasury, Reform of Corporation Tax A consultation document, [http://webarchive.nationalarchives.gov.uk/20061209025025/http://hmrc.gov.uk/consult\\_new/taxreform\\_final.pdf](http://webarchive.nationalarchives.gov.uk/20061209025025/http://hmrc.gov.uk/consult_new/taxreform_final.pdf)

**4.36** A move to accounts depreciation could take two possible shapes:

- 1 keeping the current boundaries of what qualifies for relief, but taking a deduction for depreciation as per the accounts, or
- 2 deducting accounts depreciation in full without restrictions or boundaries.

**4.37** From the meetings and written responses we have received, a point that is frequently made is that a move to accounts depreciation while keeping the existing CAs boundaries (e.g. whether an asset is qualifying or not) would not be a real simplification as it would replace one complicated system with another.

**4.38** This suggests that, to obtain real simplification benefits, a move to accounts depreciation should be without the current complex rules which establish tax asset boundaries. The use of accounts depreciation would then remove the necessity to carry out additional analysis that allocates capital expenditure in the context of the CA regime and avoid circumstances which lead to 'tax nothings'. This should be looked at as part of the further work into this proposal (see below).

**4.39** Under GAAP, fixed assets may be revalued and depreciated. Depreciation deductible for tax purposes would clearly need to be confined to depreciation on the historic cost, and would not include depreciation on the revaluation uplift. Also the allowable depreciation would have to be restricted to that on the original cost to a group – to control passing assets around a group at increasing values.

**4.40** It is worth noting that from our international comparisons review (see Annex E), only the French and Dutch tax systems allow the tax treatment of capital expenditure to follow the accounts, but neither has a 'pure' accounts depreciation regime. Both tax systems either have incentives to encourage a particular behaviour which overrides the depreciation figure from the accounts or require adjustments to be made to the depreciation figure. The difficulty of finding an overseas tax system that allows tax treatment to mirror accounts depreciation without any adjustments demonstrates the challenge in achieving such a system.<sup>10</sup>

### Issues that would need resolving

**4.41** One immediate issue is whether existing accelerated or enhanced allowances would be retained and override accounts depreciation. Examples of this are the AIA, the Enhanced Capital Allowances regime (ECA) and relief for R&D expenditure. These illustrate some of the difficult trade-offs in the CA regime as it relates to simplification: for the 99% of companies in CT who would be covered by the AIA, this allowance provides an obvious and existing simplification by removing the need to track a capital allowance pool, though the classification of assets is still necessary and not all of a company's capital expenditure would qualify.

**4.42** A major problem with a move to accounts depreciation is the transition: a straight flip from one regime to the other would mean that, for the existing stock of assets:

- some would receive double allowances (where the current accounts net book value is higher than the current tax written down value)
- going forward, allowances, in the form of depreciation, would be given for assets which did not qualify for an allowance when originally purchased.

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<sup>10</sup> We did try and find out why the countries that have systems close to allowing accounts depreciation do not go the whole way and simply allow depreciation. We were often told it came back to the desire to use the tax system to influence certain behaviours which resulted in variants from 'simple' depreciation.

**4.43** Avoiding these issues would require transition mechanisms, for example running the old and new regimes in parallel for a period of time.

**4.44** An objection to the notion of using accounts depreciation is that taxpayers would manipulate their accounts to achieve a tax advantage. In other words they would depreciate assets more quickly in order to get tax relief faster. One control here is that accounts depreciation has to comply with accounting standards. Larger companies which are subject to an external audit, and which are more aware of the importance of corporate responsibility, are unlikely to manipulate their accounts<sup>11</sup>. Other stakeholders (for example shareholders, and employees in receipt of accounts based remuneration) will also have their own different interests in disclosed profits.<sup>12</sup>

**4.45** For smaller businesses the AIA would neutralise the issue. Of course an accounts-based tax depreciation regime has applied since 2002 for intangibles and we suggest that this regime is reviewed to establish if anything valuable can be learned about the way corporate taxpayers behave on the introduction of an accounts based relief.

**4.46** Turning to the potential cost to the exchequer of substituting CAs with depreciation, there are significant challenges in attempting to quantify the impact of moving to accounts depreciation. At a very high level, Office for National Statistics data on the 'consumption of assets'<sup>13</sup> perhaps provides an adequate proxy for depreciation, as this should be reflected in company accounts over time. Whether this is the case requires an extensive review of company accounts. We set out below some matters which should be included in a further review of the potential for replacing capital allowances with accounts depreciation. It is important to note that the depreciation in this scenario includes depreciation on assets which at present do not qualify for relief so the exchequer cost could be considerable.

**4.47** The potential cost of a change to depreciation is not just to the exchequer. We have heard from some businesses that they think they would lose considerably; that at present the CAs system still represents usefully accelerated allowances compared with depreciation. We fully acknowledge this as an issue and it is something that we would want to probe in our proposed follow-up work. However, we would note that there would be the potential for allowances of more buildings/structural expenditure to balance any loss on 'core' plant and machinery allowances. We also note that a change to depreciation cannot disadvantage significantly both the exchequer and major capital investors!

**4.48** A regime based on depreciation potentially retains some flexibility for policy makers. For example, revenue neutrality could be achieved by applying an overall discount to the deductible depreciation, or relief could be enhanced by applying an overall uplift to the deductible depreciation. These notions of course immediately compromise the basic simplicity of tax depreciation but could be a route to managing any exchequer cost initially.

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<sup>11</sup> Arguably any manipulation would be to try and increase profits – and so reduce depreciation – rather than trying to increase depreciation which would reduce profits.

<sup>12</sup> We should note that it would be possible for the tax system to lay down acceptable depreciation rates (or ranges of depreciations rates) – so that if companies used rates within the acceptable range, no adjustment would be necessary. On the other hand, they could use rates outside the statutory range, in which case adjustments would be needed to get to tax allowances. Such a system was at one stage in use in the USA. We have not pursued it as it would interfere with accounting standards which we are aiming to use as a general basis for tax purposes.

<sup>13</sup> [http://webarchive.nationalarchives.gov.uk/20160105160709/http://www.ons.gov.uk/ons/dcp171778\\_385118.pdf](http://webarchive.nationalarchives.gov.uk/20160105160709/http://www.ons.gov.uk/ons/dcp171778_385118.pdf) The consumption of fixed capital is described by the ONS as "the decline in the value, or depreciation, of fixed assets in the economy over a time period. The decline in value can be due to wear and tear, assets no longer being used, or normal accidental damage. It can also be described as the quantity (or value) of the capital stocks which is used up in that period."

## Further work

**4.49** In order to develop this suggestion further, we recommend that the OTS continues to work to explore fully the potential impact of replacing CAs with accounts depreciation addressing the following:

- 1 What would be the impact on the exchequer?
- 2 What would be the impact on different industries/sectors?
- 3 Would there be noticeable national or regional impacts?
- 4 How would the impact vary between companies of different sizes?
- 5 What would be the impact on unincorporated taxpayers?
- 6 Is accounts depreciation a flexible concept? Does the role of judgment and the potential for changes in accounting standards introduce unacceptable risk?
- 7 How would accounting revaluations and impairments be dealt with?
- 8 What transition mechanisms would be needed?
- 9 How can the AIA be best accommodated into the system?
- 10 What might be the impacts on the international competitiveness of the UK?

**4.50** If replacing CAs with accounts depreciation is not feasible, the alternative route to a simpler regime which better reflects business reality is to extend the scope of CAs or remove some of the existing boundaries.

## Extending the scope of capital allowances

<b>Issue</b>	CA regime does not reflect commercial reality
<b>Theme</b>	Scope
<b>Suggestion</b>	If CA regime retained, extend scope to all assets used by the business

**4.51** A core feature of the CA regime is that allowances are not available for all assets used in a business activity and as a consequence the CT calculation does not reflect the commercial reality of a business, which is set out in the accounts. Our approach in this report is underpinned by the idea that the closer the CT return is to the accounts, the simpler it will be. For this reason the scope of the CA regime is fundamentally linked to the ideal of simplification.

**4.52** Qualifying assets must meet criteria set out in legislation and voluminous case law. Those not well versed in the esoteric tax distinctions may be bemused by the assets which are acceptable (for example, a five a side football pitch consisting of a sand-filled synthetic grass carpet on a stone pitch base<sup>14</sup>) and those which are not (for example, a racecourse all-weather racetrack<sup>15</sup>). We heard that for investment projects, specialist advisers are usually employed to make the distinctions between qualifying and non-qualifying spend. In some cases, if companies did not seek specialist advice during the build, the cost of reworking accounting decisions to reclassify the assets outweighed the tax outcome so they did not engage with the relief at all.

<sup>14</sup>Anchor International Limited v IRC TCL3751

<sup>15</sup>Shove v Lingfield Park 1991 Limited TCL3725, TCR15/04

**4.53** Legislation as to which assets qualify can change with little notice. The most significant contraction in assets qualifying for CAs in recent years was the abolition of relief (IBAs, hotels and ABAs) for industrial/agricultural buildings and structures announced in 2007, which affected a wide range of assets, from cowsheds to cooling towers, and left the UK with a CA regime which impairs the competitive impact of the UK's low CT rate<sup>16</sup>.

**4.54** In terms of the current competitiveness of the UK tax system, Singapore was the only jurisdiction not to give relief for buildings, out of the 8 we have looked at as part of this review<sup>17</sup>.

**4.55** Not surprisingly, all of the businesses and advisers we spoke with were in favour of some kind of relief for buildings (from now on we use this to include structures)<sup>18</sup> since as far as they are concerned, depreciation of these assets used in a trade is a genuine business expense. Against this, we must acknowledge that there is an argument that the assets potentially brought into scope (see below) are not ones requiring an investment incentive, and so the cost of the new relief would be a 'dead weight' cost to the exchequer. This is a good illustration of the confusion about the role of CAs as a reflection of real costs, or as an incentive.

## Advantages

**4.56** An introduction of relief for buildings will go a long way in aligning the CAs regimes with the commercial reality of many businesses. Of course, the size and type of building differs considerably from sector to sector and the rate of tax relief would not necessarily align with the rate of depreciation that may be reported in the accounts.

**4.57** From our discussions, relief for buildings would greatly reduce the administrative burden caused by the abolition of IBAs, as it would eliminate the current 'cliff edge' boundary issue of relief/no relief.

**4.58** Businesses would have more certainty if relief is available for all assets used in the business (even if the relief is at a slower rate) without having to spend significant amount of resources to understand whether an asset is plant or building and which pool it should join (i.e. boundaries). We were told historically some taxpayers constructing buildings used for an IBA qualifying purposes didn't bother carrying out a detailed review of available capital allowances, on the basis that IBA would be available.

**4.59** Of course, there is an advantage of claiming plant and machinery allowances because of the higher write down rate, but we heard that businesses saw this as essentially a timing benefit. It is worth noting that this benefit has been eroded with the decreasing CT rate.

**4.60** Following the abolition of IBAs, businesses have been forced to interact with the full CAs regime as there is now an absolute cost. We heard this has led to greater uncertainty (caused by boundaries), resulting in increased administrative burden and professional costs relating to making a claim. We have heard from companies of the border disputes caused by the segregation of assets into qualifying and non-qualifying following the abolition of IBAs and the many years it can take to reach agreement on classification with HMRC.

**4.61** Relief for buildings would therefore provide a simplification benefit for a vast number of businesses in allowing relief (albeit at a slower rate) without needing to carry our extensive

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<sup>16</sup>

[http://www.sbs.ox.ac.uk/sites/default/files/Business\\_Taxation/Docs/Publications/Policy\\_Papers/g20-corporation-tax-ranking-2016\\_0.pdf](http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Policy_Papers/g20-corporation-tax-ranking-2016_0.pdf)

<sup>17</sup> The scope of buildings relief varies among the jurisdictions we have looked at as part of this review

<sup>18</sup> But for the avoidance of doubt we would emphasise that we do not include the cost of land in this discussion of allowing the depreciation of the cost of buildings.



analysis to consider the boundaries mentioned above and so ultimately providing more certainty for taxpayers over their tax affairs.

**Box 4.A: A case study on the complexity of the capital allowances system**

A company described the nature of the current compliance burden:

- we have multiple building projects each year, ranging from maintenance to new build
- quantity surveyors or capital allowances experts are essential and costly
- ECAs are particularly onerous to manage and usually require the appointment of a specialist to a particular project. So we believe we significantly under claim
- technology has significantly reduced the cost of compliance. While 4 in-house FTEs were needed to deliver the CA claim 20 years ago this may reduce to 0.5 with further automation

However automation carries its own cost: in addition to the accounts fixed asset register we have to maintain a tax database which cost almost £0.5 million together with an annual licence over £50,000 pa.

**4.62** We believe that the introduction of relief for buildings needs to be seriously considered in the context of the competitiveness of the UK’s tax system, with the potential of putting UK PLC on equal footing as other G20 countries.

**Issues that would need resolving**

**4.63** Although the types of asset which could be covered by an extension of relief is wide (see table below) it is important to acknowledge that some buildings and structures would continue to be excluded as they are not related to commercial activity, and so the perennial complexity issue of borders would not vanish completely.

**4.64** Another simplification concern may be that extension of relief comes trammelled with anti-avoidance rules to discourage abuse of the relief. A low rate of relief and the high entry cost of construction of the relevant assets should mitigate this risk.

**4.65** The list below uses ONS categorisations for construction to give an idea of the range of assets which could be in scope of an extension to CAs, and also an indication of how much wider this would be than the regime which existed up to 2008.

**Table 4.C: Assets potentially included in an extension to CAs**

ONS construction category	Buildings and structures within expanded scope of CAs: at present only plant and machinery qualifies	Up to 2008: buildings and structures within scope of IBAs <sup>19</sup>
Housing	X	X
Infrastructure: Water, Sewerage, Electricity, Roads, Railways, Harbours, Other – gas, communications and air	✓	✓

<sup>19</sup> Also Agricultural Buildings Allowances, Hotels Allowances.

Other industrial and commercial		
Factories	✓	✓
Warehouses	✓	✓
Oil, Steel, Coal	✓	✓
Schools & Colleges	✓	X
Universities	✓	X
Health	✓	X
Offices	✓	X
Entertainment	✓	X
Garages	✓	✓
Shops	✓	X
Agriculture	✓	✓

**4.66** The present structure of CAs has a forecast total cost to the exchequer of £22.2 billion<sup>20</sup> for 2016-17. Extending the scope of capital allowances, without reducing the rates of allowance for any of the assets which already qualify, would increase the overall cost to the exchequer of the relief. The starting point for an analysis of the potential cost is the expenditure on commercial buildings, in 2015 this was almost £27 billion<sup>21</sup>. Some of this already attracts CAs, and there are number of factors (including those set out below) which mean that this figure does not directly or readily translate into the potential cost of extending CAs.

**4.67** Clearly any extension of relief could only apply to new assets, so the increased cost to the exchequer would rise gradually over time as the stock of qualifying assets builds up. The cost would also be mitigated because a significant proportion of the relevant assets are owned by entities which do not pay tax, for example pension funds, charities and REITs.

**4.68** The costs would be less if the relief was restricted to assets which are depreciated in the taxpayer's accounts. A very significant portion of commercial property is owned by investors<sup>22</sup> for whom the property is not a depreciating asset (and who will value the asset at fair value in their accounts). On the other hand if these investors could claim the allowance (just as property investors could claim IBAs), it might be considered an encouragement to invest<sup>23</sup> and there is also an argument that the CA regime should not distinguish between different ownership structures. Such considerations are beyond our remit of simplification, though we note them as issues that would need to be considered if the idea is taken forward.

**4.69** Another approach to manage the cost would be to distinguish types of building and different activities.

<sup>20</sup> HMRC Estimated cost of the principal tax reliefs  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/579720/Dec\\_16\\_Main\\_Reliefs\\_Final.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/579720/Dec_16_Main_Reliefs_Final.pdf)

<sup>21</sup> <https://www.ons.gov.uk/businessindustryandtrade/constructionindustry/datasets/constructionstatisticsannualtables>

<sup>22</sup> 55% according to Investment Property Forum - Size and structure of the UK Property Market  
[http://www.ipf.org.uk/resourceLibrary/the-size---structure-of-the-uk-property-market---end-2015-update-\(July-2016\).html](http://www.ipf.org.uk/resourceLibrary/the-size---structure-of-the-uk-property-market---end-2015-update-(July-2016).html)

<sup>23</sup> With appropriate mechanisms to clawback relief on a disposal.

4.70 Of course any restriction introduces new boundaries and is not helpful for simplification. State Aid considerations at present preclude any approach which confines a buildings allowance to particular industries or assets.

### Further work towards simplification

4.71 If our further work on accounts depreciation concludes that it is not a viable alternative to the CA regime, the OTS could explore further the potential impact of extending the scope of CAs, addressing the following:

- 1 What would be the impact on the exchequer?
- 2 Should relief be restricted to depreciating assets?
- 3 Should certain types of buildings or structures be excluded?
- 4 What are the likely problems with definitions and borders? Can these be addressed with de minimis rules?
- 5 What would be the impact on different industries?
- 6 Would there be noticeable national or regional impacts?
- 7 How would the impact vary between companies of different sizes?

### Further recommendations

4.72 We appreciate the two options discussed in detail above, namely, a move to accounts depreciation and widening the regime’s current scope, constitute significant changes to the current regime and require more detailed analysis.

4.73 Although we believe further work should be done in regards to these options, we outline a number of other options below, along with recommendations, which can be implemented in the short or medium term. We believe these can improve the current regime significantly in terms of reducing the administrative burden on businesses and provide more certainty.

### Introduce a small capital de minimis

<b>Issue</b>	Taxpayer resources wasted on classifying low value assets
<b>Theme</b>	Boundaries
<b>Suggestion</b>	Small capital override

4.74 In Chapter 2, we recommend removing the capital / revenue divide, so that the accounting profits could be accepted for tax purposes with amounts written off in the accounts being accepted as tax-deductible. This would be a clear simplification.

4.75 As an alternative (and potentially in addition) we recommend the introduction of a 100% deduction for capital items costing less than £1,000<sup>24</sup> in the year the expenditure is incurred.

4.76 This measure would remove the need for businesses to spend time and resources identifying small items of expenditure and tracking these in future years. From the discussions we have had so far, we believe there is scope to significantly reduce the administrative burden on business as a result. Another advantage of this measure would be that businesses can make

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<sup>24</sup> The de-minimis of £1,000 seems appropriate, matching the current £1,000 small pool allowance. The small pool allowance allows 100% write-off of the special or main rate pools valued less than £1,000.

better use of their time and resources, concentrating on larger items of expenditure which would have a material impact on their tax liabilities.

**4.77** During our consultation meetings, it was suggested that this pragmatic approach was sometimes already taken in practice.

**4.78** On the small business scale, this measure would significantly reduce the administrative burden of having to identify small capital expenditure items. Although capital expenditure by small businesses is likely to be covered by the AIA in any case, this measure would remove the need to analyse whether expenditure was qualifying or not.

**4.79** This advantage has become more relevant following the abolition of the renewals allowance (as of 6 April 2016), which the OTS thinks could increase the administrative burden on businesses in terms of analysing and tracking items year on year, as required under the capital allowances regime. As pointed out above, a small capital expenditure exemption should significantly reduce the amount of work involved.

**4.80** As such, we believe there is a strong case for this measure from a simplification point of view and **we recommend that the idea of a £1000 de minimis is taken forward**. It is important to highlight that this measure would have an exchequer cost because, effectively, 100% relief is being given in the current year, which may otherwise have been written down over a number years or not be available at all. However, given the fact the main CT rate is coming down to 17% and that this measure would only be conforming to what already is often done in practice, we do not expect this to have a large cost.

**4.81** It is necessary to consider whether such an exemption could lead to changes in behaviour, to arrange expenditure so that each transaction does not exceed £1,000. However, from our initial discussions with tax professionals from the jurisdictions we have looked at, none reported avoidance issues in respect of this type of relief. One possible reason is that with the values so small (and hence tax relief involved), it is not worthwhile. This will of course need to be looked at in detail as part of taking this recommendation further.

**4.82** With the increased focus on making the UK more competitive to do business, one place to start would be to learn from other jurisdictions on how to minimise the amount of administrative burden involved in complying with the tax system. Introducing an exemption for small capital expenditure would be one such measure.

**4.83** With the exception of Republic of Ireland, all other countries reviewed as part our international comparisons work operate a regime whereby low value assets can be written off in the year of acquisition. We found that this measure is primarily to reduce the admin a business has to deal with when it comes to analysing and pooling items of immaterial value.

### Short Life assets (SLAs)

**4.84** As part of considering a small capital de-minimis threshold, we have looked at the SLA regime.<sup>25</sup> We have heard from businesses that an SLA election performs a less useful role than on its introduction in 1985, especially with the introduction of the AIA. We heard that there was disproportionate burden involved with SLA elections, which involves; identifying qualifying assets, putting them in the computation, tracking each asset separately and identifying

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<sup>25</sup> A taxpayer may elect to place in a separate pool an asset with a life of less than 8 years. If the asset is disposed of within that period any remaining allowances due are given at that point, rather than run off over time with assets in the main plant & machinery pool. Despite the ability to group assets of a similar kind, taxpayers have told us that the record keeping obligations are onerous. Against that, though, these obligations are to an extent self-inflicted as the election is voluntary.

disposals. For large businesses, tracking SLA ‘ran on for pages’ and for small businesses we heard that SLA elections were mostly redundant because of the AIA.

**4.85** It is worth noting that the SLA regime is no more than an acceleration of relief which would be available anyway. Given this, and the fact that the CT rate is at a historical low (and falling), the cash flow advantage of this relief is very modest.

**4.86** As such, there is a case for abolishing the SLA regime and eliminating a complexity (even though it is one that taxpayers voluntarily take on) that achieves little and is administratively burdensome. However, the introduction of a small capital exemption would reduce the administrative burden outlined above for businesses which voluntarily elect for the regime.

## Further work

**4.87** The following points should be looked at as part of taking this measure forward:

- 1 further thought would need to be given to any avoidance rules required as part of introducing a small capital exemption, learning from other jurisdictions
- 2 although we have recommended a de minimis of £1,000 it would be interesting to understand whether this is an appropriate threshold to use

## Specific guidance on assets qualifying for CAs

<b>Issue</b>	Uncertainty on classification deters investment and causes taxpayers to waste resources
<b>Theme</b>	Stability, boundaries
<b>Suggestion</b>	Compiled list of assets qualifying for CAs to be produced in the form of specific HMRC guidance

**4.88** The uncertainty and burden involved in identifying whether an asset is qualifying or non-qualifying for CAs purposes is by far the biggest issue taxpayers and advisers have with the current CA system. We have discussed above extending the CAs regime to all (depreciating) assets but if that route is not possible – or as an interim simplification as such a change would take time – we think that providing better guidance would help greatly.

**4.89** Much of the uncertainty has been caused by technological advances and changes in how the rules are interpreted. This is compounded by the fact that rules are formed based on different sources (such as primary legislation or case law, for example) and so it is difficult for businesses and advisers to keep abreast of developments. As the system becomes more complex, we heard that the associated administrative burden has become significant and in some cases (we were told) outweighs the tax relief available. We have heard from business that they do not engage with some parts of the current system solely because of this.

**4.90** As part of our international comparisons work (see Annex E), we found that many jurisdictions provide detailed lists of qualifying assets and recommended useful life rates for tax purposes. We heard various feedback on the usefulness and practicability of guidance of this sort. Specifically, such an approach seems to have the following benefits:

- 1 A list confirming assets which qualify for CAs would go a long way in reducing the uncertainty faced by businesses and advisers as they will have reassurance of what qualifies in the form of HMRC guidance.
- 2 The fact that this list will incorporate information from multiple sources is appealing from an administrative burden perspective and this could potentially save business

time and money. Taxpayers would know that they can claim relief if their asset(s) is on the list without needing to incur professional fees.

**4.91** From our initial research, we want to highlight the Australian example, where the tax authorities publish a very extensive list detailing the effective life of depreciating assets<sup>26</sup>. This demonstrates that such guidance is practicable.

**4.92** This guidance provides two lists in the form of tables, one which lists assets based on trading activity and a second listing assets more generally. Given the detailed and wide scope of the document, coupled with the fact that this document acts as a binding ruling, i.e. the tax authority must apply the legislation in the way set out in this document if relied upon by the taxpayer, it is not surprising that we received very positive feedback from the professional advisers we spoke to. One adviser said that using the list is a 'no brainer' and that it was rare to find deviations from the guidance.

**4.93** As such, we believe that a simpler document listing out qualifying assets, by trading activity, would greatly reduce the administrative burden and certainty in the current UK system for the vast majority of businesses. This guidance could go one step further and also confirm at what CAs rate (18% or 8%) the asset should be claimed.

**4.94** We note that this list would need to be in the form of HMRC guidance to give businesses confidence in relying and preparing their tax returns based on this list. It would not be a statutory list (though it would be in effect based on statute as there would be something in statute requiring such a list to be produced and giving it appropriate status) as that would make the list static and hard to keep current. HMRC would have primary responsibility for ensuring the guidance is kept up to date, with for example, changes in interpretation and new case law. However, we think that professional and trade bodies should to a degree share this responsibility and workload by committing to engage with it and assisting with updating.

**4.95** Linking into HMRC's ambition for MTD to standardise the tax system, a key driver for software developers would be to build in as many 'black and white'/'vanilla' options or scenarios into the system as possible to make it easier for taxpayers to correctly allocate data in MTD. A list of qualifying assets would support this goal.

**4.96** Furthermore, if businesses are able to obtain certainty from the list of qualifying assets, they may be less inclined to use 'white space' notes within MTD, which otherwise could possibly allow businesses to avoid responsibility for correctly allocating tax data and ultimately hinder the effectiveness of MTD.

**4.97** We acknowledge that situations may arise where a certain asset may not appear on the list, either because of technological advancement or the business/industry is very niche and so the assets used are unusual. In these cases, the taxpayer can approach HMRC for clarity on whether these assets qualify, as possible currently (for example, a non-statutory clearance). Such an approach would lead to an amendment to the guidance.

**4.98** It is worth pointing out that this recommendation does not extend the scope of the current regime. As a result, the above outlined benefits do not come at an obvious cost to the exchequer. Another factor that needs to be borne in mind is that the development of such a list would mean fewer errors in the tax system (with consequent positive impact on the tax gap) and reduction in HMRC's efforts in policing the system (including fewer enquiries from taxpayers). Together with the simplification for businesses there is a compelling case for this recommendation to be taken forward.

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<sup>26</sup> <http://law.at0.gov.au/atolaw/view.htm?docid=%22TXR%2FTR20161%2FNAT%2FATO%2F0001%22>

## Next steps

**4.99** HMRC should develop a proposal for a compiled list of all assets qualifying for CAs with the purpose of providing a single point of reference for businesses and advisers, following a consultation with stakeholders. We suggest this approach could be trialled in one particular industry for a specific period of time to test the benefits of the measure. Although this would take a good deal of time and effort, it would be a good 'proof of concept' to try it for, say, agriculture.

## Providing certainty pre-investment

<b>Issue</b>	Uncertainty on classification deters investment and causes taxpayers to waste resources
<b>Theme</b>	Stability, boundaries
<b>Suggestion</b>	Introduce a binding contract arrangement with HMRC

**4.100** One cause for the rise in uncertainty for taxpayers in relation to the CAs regime has been the lack of clarity and certainty available from HMRC when approached to confirm a position. We noted that businesses felt that HMRC has become more reluctant in giving clarification in recent years and this was the case for both small and large businesses.

**4.101** Many businesses and advisers we spoke to provided illustrations of where the uncertainty on the availability of CAs impacted their commercial decision about capital expenditure. New technological developments and case law have made boundaries (such as; what is qualifying/non qualifying or capital vs revenue, and so on) less clear cut.

**4.102** It was suggested to us that a possible option could be for HMRC to provide a binding ruling arrangement service which taxpayers could use to gain certainty over their tax position.<sup>27</sup> This could have benefits for both the taxpayer and HMRC.

- 1 Taxpayers would receive certainty of their tax position before embarking on a project to which the capital allowance claim has a material impact, in terms of the feasibility and financing of the project. Furthermore, the ruling would provide reassurance that HMRC would not revisit their tax position in the future.
- 2 HMRC would receive upfront disclosure of transactions and deals and therefore, will be in a better position to discuss and challenge interpretation of legislation, prior to the transaction or deal taking place.

**4.103** By far the biggest area of contention with the CA regime relates to analysing whether an asset qualifies for relief or not. We heard an overwhelming message that more certainty and clarity from HMRC would significantly reduce the administrative burden relating to the current CAs regime. A binding ruling service could possibly be one way to provide this certainty.

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<sup>27</sup> The list of qualifying assets discussed in the previous section should deal with most of the queries taxpayers have and so would not require written clarification from HMRC, as proposed by this option. The list should ensure HMRC isn't flooded with ruling requests (because the list helps 90+% of the time) and so the two could work together.

#### **Box 4.B: Australian experience**

As part of this review, we have had discussions with advisers from other jurisdictions, one of which was Australia. From initial research, we have found that the Australian tax ruling system has much support and is well liked in practice<sup>28</sup>. Indeed, we heard that it was uncommon for any large transaction to go ahead without a tax binding ruling being received from the Australian Taxation Office (ATO) and having this was important to secure financing for projects. In other words, the Australian tax rulings is very integrated within the process of transactions/deals.

##### Characteristics of the Australian tax ruling system

- The authorities provide both private and public tax rulings.
- Private binding rulings are requested by taxpayers to seek clarification on the interpretation or application of tax legislation. Private rulings are published in the Register of Private Binding Rulings. The ATO publishes the Register of Private Binding Rulings (edited to protect taxpayer's identity) to promote integrity and transparency in the way it interacts with taxpayers.
- The ATO aims to provide rulings within 28 calendar days of receiving all the necessary information.
- Public tax rulings are made from time to time to express the authority's interpretation of tax legislation.

The ATO does not have a dedicated team for this service, but rather draws on various personnel from various parts of the organisation, from specialists to customer facing teams.

**4.104** More research would need to be done but, from the outset, the Australian binding ruling system appears to be a successful example which HMRC could possibly adopt. It is worth pointing out that there are many differences between the Australian and UK tax systems, as well as the public's perception of the tax system in each country which may make this proposal politically less desirable.

**4.105** Other jurisdictions such as the USA and Canada offer a similar service and there are important lessons that can be learnt. In the US, the taxpayer is required to pay \$100,000 to apply for a binding ruling from the IRS which in practice means only large businesses are able to take advantage of this service. This would certainly not go down well in the current climate, particularly with the increasing sensitivity around large businesses receiving reassurances/deals. Therefore, we would recommend against a fee-based binding agreement service.

**4.106** We have heard that it takes businesses a significantly long period of time to receive a ruling from the Canadian tax authorities which impacts commercial decision making. We have heard this is down to lack of resource and the fact the local case workers do not have the authority to provide rulings on behalf the tax authority. Therefore, any tax binding ruling service in the UK would need to ensure that rulings are made in a reasonable timeframe. For simplicity, this could be aligned to the current statutory clearance response period of 30 days.

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<sup>28</sup> The ruling system is available beyond capital investment issues.



**4.107** It is important to recognise there are other mechanisms that exist already in the UK’s current tax system which allow taxpayers to seek clarification on interpretation and application of CA legislation, namely, non-statutory clearance.

**4.108** In regards to non-statutory clearances, we heard that businesses generally refrained from applying when it came to CAs because they felt HMRC were reluctant to give any advance opinion relating to capital expenditure and we were given many reasons for this. We noted that it was felt HMRC would only pass judgement once the investment had been made and this lack of up front certainty didn’t help investment decisions. It was suggested that officials didn’t have the authority to give a ruling or to be open to discuss and understand the investment project in detail, which led to the process being drawn out.

**4.109** Large businesses have access to CRMs who can assist in providing the certainty businesses seek although we have heard mixed views about this service also. This is covered in more detail under the large business section of this report.

**4.110** One concern we do have to note is whether a rulings system, intended to help taxpayers resolve cases of genuine uncertainty, could become a route that taxpayers take for all transactions. The point would be that taxpayers might ‘go for a ruling’ automatically ‘just in case’ or their agents would feel they have to apply for a ruling in all cases to avoid any risk of being held to be negligent if any subsequent issues arise. This would seem to be manageable by requiring any application for a ruling to spell out why there is uncertainty, why existing guidance does not cover the situation and confirming that a ruling in the circumstances would be publishable and so reduce future applications.

**4.111** In summary, a binding ruling system has great merit and the advantages, as pointed out above, are clear. However, we do concede that implementation and the implications of such a service would be difficult and extremely resource intensive for HMRC.

**4.112** Based on this, **we recommend that HMRC look at ways to improve the current non-statutory clearance process in regards to CAs regime**, in particular, empower staff to be more forthcoming and reach conclusions on the tax status of assets prior to investment.

**Reduce the number of write down pools and have one rate of relief**

<b>Issue</b>	Too much taxpayer resources spent on classifying assets
<b>Theme</b>	Boundaries
<b>Suggestion</b>	Reduce number of CA pools and have one flat write down rate – not recommended

**4.113** Since the introduction of long life and special pools, we have heard that the annual compliance of the CA regime has grown more complicated. With the main CT rate coming down to 17% over the next three years, it was suggested that a possible simplification to the current regime could be to reduce the number of write down pools and have one blended write down rate.

**4.114** This would remove the requirement for taxpayers to distinguish between normal and long life assets as well as whether the asset should be added into a special pool. This could take away the administrative burden relating to tracking various pools.

**4.115** Notwithstanding the possible advantages of this proposal, this would, in effect, move the current CAs regime further away from the accounting treatment and our initial thoughts are that this is not a worthwhile change and would not be a significant simplification. As it in effect

is concerned with tax rates, it is arguably outside our remit, though our interest in the idea is from a simplification standpoint.

**4.116** Putting aside the rate of relief given for the main rate pool and the special rate pool, the fact that there is a distinction between assets, for example whether they are normal or long life assets, is broadly in line with the accounting treatment. We heard from some respondents that although the current rates (18% and 8%) are not perfect, on the whole they are roughly aligned to the accounts.

**4.117** A move to a single write down pool and rate would be a big change and the transition from the current system is likely to be significant. Further work would need to be done to determine the impact of this, as well as how policies such as the short life assets regime would fit into this.

**4.118** In summary, **we do not recommend a move to a single write down pool or a single rate** as this does not seem to be a worthwhile change, despite its simplification benefits.

### S198 CAA 2001 elections

<b>Issue</b>	Elections on asset disposal (s198) not well understood, cause significant compliance problems for vendor and purchaser and deny purchaser relief
<b>Theme</b>	Stability, writing off rates
<b>Suggestion</b>	Review less onerous mechanism

**4.119** From our discussions, s198 elections are not well understood by both businesses and advisers. As a result, we heard it was common to come across incorrect elections in practice with significant consequences.

**Example 1**

A small company sought to purchase an office from an institutional investor. The vendor’s solicitor’s confirmed that no allowances would be transferred and prepared a s198 election for the value of £2.

It transpired later that the vendor was a pension fund, which would not have been in a position to claim CAs in any case and therefore could not enter into a valid election to restrict the purchaser’s entitlement to claim CAs.

If this had not been picked up, this would have meant that the CAs investment incentive would be lost not just for this purchaser, but for all future purchasers of the property.

**4.120** We heard it was common to see taxpayers using nominal values such as £1 for the purposes of the election because it was a figure HMRC would not challenge, the main driver being that the compliance costs involved in identifying the original cost of the asset and every bit of expenditure on the asset(s) was excessive. This is compounded by the fact the rules require assets to be tracked individually and not as a pool. For example, one can imagine the compliance costs relating the sale of a factory and the vendor being required to individually track the associated assets.

4.121 We heard further examples of elections being incorrectly prepared as a result of the rules not being well understood. We heard that it was common to find elections made in respect of all integral features (copied from legislation), regardless of whether they exist in the building or not. Vendors then tended to repeat the list of integral features for the main pool not realising that they were contradicting themselves.

4.122 The consequence of this is that the election does not contain a list of those individual assets on which CAs have actually been claimed or the corresponding value.

4.123 From discussions we have had, the common view was that the formal requirements of the legislation relating to s198 were practically unachievable. In particular, because the compliance costs represent a considerably higher proportion of the costs of the deal, small companies often lose out the most as they are not in a position to establish entitlement to allowances or to negotiate with larger companies.

**Further work**

4.124 It is apparent from above that there are serious issues with the current compliance process regarding s198 elections and the behaviour it drives. **We recommend a separate review should be carried out by HMRC, consulting with taxpayers and advisers to develop a more detailed understanding of implications of the current rules and the impact it has on business.** This would form the basis for a reformed set of rules which deliver the policy objective for HMRC but manages the compliance burden on taxpayers.

**Energy & Water Technology schemes (Enhanced capital allowances or ECAs)**

<b>Issue</b>	The ECA regime generates significant compliance problems
<b>Theme</b>	Boundaries, stability
<b>Suggestion</b>	List of qualifying assets to be kept up to date and claim processes streamlined

4.125 The Technology schemes provide tax reliefs to businesses when they invest in eligible energy-saving or environmentally friendly equipment. The schemes provide relief by allowing taxpayers to write off the whole cost of the equipment in the year of purchase, providing a cash flow incentive to invest in cleaner equipment which is usually more expensive than less-efficient alternatives.

4.126 One crucial aspect of the Technology scheme is that a loss making company can also realise the tax benefit of investing in energy saving equipment and this is done by surrendering losses relating to the ECAs in return for a cash payment.

4.127 From the discussions we have had with businesses and advisers, we have heard that the Technology schemes are valuable reliefs but there are significantly high barriers to access it for a number of reasons including:

- 1 The list of ECA-qualifying assets is very narrow and relief is only available if an asset is on the list at the time of purchase. We also heard that the lists rarely represented the most energy efficient option available on the market.
- 2 According to businesses and advisers, the administrative burden in making a claim was found to be excessive and the Energy Technology List (“ETL”) website<sup>29</sup> was

<sup>29</sup> [https://etl.beis.gov.uk/engetl/fox/live/ETL\\_PUBLIC\\_PRODUCT\\_SEARCH](https://etl.beis.gov.uk/engetl/fox/live/ETL_PUBLIC_PRODUCT_SEARCH)

signalled out in this regard. Some advisers and companies we spoke to argued that taxpayers simply ignored the regime solely because of the excessive costs involved.

- 3 Currently the relief is not flexible enough to accommodate variations/changes to projects (for example a change in number of ECA-qualifying assets) which can result in losing the relief.

**4.128** In response to our consultation, we received a number of examples illustrating the issues raised above. One of these examples follows:

#### **Example 2**

A taxpayer decided to design and develop a building to be used in its trading activities which included various energy saving assets. The design stage was very time consuming and involved a collaboration between engineers, manufacturers and CAs advisers to design systems that met the energy-efficiency criteria.

Between the design of the building project and its completion, the interior layout and floor areas were altered, causing the number of air conditioning systems to be increased, and the configuration of systems to vary from the proposed design.

The taxpayer and their advisers had difficulty in navigating the ETL website to make a claim because it is designed on the assumption that equipment will be bought as one discrete asset acquisition, and does not accommodate a complex installation as part of a building project with multiple subcontractors. This caused a significant amount of cost to the taxpayer.

As the design development took time, several months passed between the building having been designed to incorporate the ETL equipment and the order for that equipment being placed. Although the taxpayer followed best practice during the process, they found that the equipment no longer qualified under the ECAs scheme. This is because the equipment was no longer listed as eligible under the scheme (at the time of purchase), which is the requirement to make a claim under ECA.

This loss of relief only came to light after the taxpayer spent considerable amount of resources in ensuring ECA relief would be available.

**4.129** This lack of certainty in terms of asset eligibility causes a significant burden and cost for the taxpayer. We heard from some advisers that this uncertainty and burden put many off from seeking to claim the relief in the first place. We also heard, as we did in the Competitiveness project work, that the availability of ECAs is not factored into investment decisions in many cases: it is simply a result worked out much later.<sup>30</sup>

### **Further work**

**4.130** It is apparent from the feedback we have received from businesses and advisers that the Technology scheme needs to be reformed such that the advantage of the tax relief is not outweighed by the administrative burden caused by the current claim process and that the qualifying list of items remains consistent and up to date with the market.

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<sup>30</sup> We also heard during our Competitiveness work that asset prices were adjusted to reflect the availability of ECAs though this is not something we heard again this time.

4.131 As such, we suggest HMRC carry out a separate review, consulting with stakeholders on the effectiveness of the scheme and how to streamline the process of making a claim.

## Next steps – summary of recommendations

4.132 There are a number of recommendations made in this chapter in order to further develop the conclusions and options presented. Overall, we are recommending further work be done (see paragraph 4.27) but we break that single recommendation into a number of areas, as set out in the chapter. The most important we think is the exploration of using accounts depreciation, instead of CAs.

	<b>Capital Expenditure: Recommendations</b>	<b>Short term</b>	<b>Medium term</b>	<b>Long term</b>
1	Changes to the CA regime should be accompanied with clear statements of the policy objectives	✓		
2	<b>Further work be done to explore more fully the impact of replacing CAs with accounts depreciation, addressing the points mentioned in paragraph 4.49. This further work will recommend whether accounts depreciation should replace the current CAs regime.</b>	✓		
3	Introduce a small capital exemption to allow 100% deduction for capital expenditure worth less than £1,000 per item	✓		
4	Develop a proposal to provide specific guidance, by way of a list, of all assets qualifying for CAs as a single point of reference		✓	
5	Improve current non-statutory clearance process in regards to CAs regime.	✓		
6	Review the effectiveness and compliance process for making a s198 election	✓		
7	Review the effectiveness and compliance process for making a ECA claim	✓		



# 5 Areas specific to large and complex companies

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## Why focus on Corporation Tax (CT) for large companies?

**5.1** There can be little doubt that the UK's largest companies make a very large contribution to the total tax payments to the exchequer by UK taxpayers. By way of illustration for the fiscal year 2014-15, 6,900 companies representing 0.55% of all CT paying companies, contributed 57% of all CT payable, with the 60 biggest CT payers each liable for in excess of £50 million and contributing £7 billion, or 16% of all CT payable.<sup>1</sup>

**5.2** On the basis that that a successful economy requires the continuing presence and health of such large businesses, as well as the smaller businesses that the government is rightly encouraging, a business environment should be created that will encourage businesses to stay in the UK, foster the growth of smaller companies, and attract external large businesses to locate operations in the UK.

**5.3** One way of doing this is to create a CT regime that responds to the needs of large, complex businesses while also meeting the needs of government to secure revenue. We make a number of recommendations below to assist with this, by reducing the compliance burden without reducing the amount of CT paid. Such a reduction in compliance burden will increase competitiveness and thus benefit the whole UK economy.

**5.4** Many of the largest businesses in the UK manage their CT affairs internally, employing in-house tax specialists. While specialist tax advice is also sought externally where required, frequently from large accountancy firms, the preparation and submission of CT returns is generally a responsibility of the in-house tax team, with ad hoc advice and support sourced externally. This model is particularly prevalent among FTSE 100 companies. We have therefore sought the views of large businesses about the CT regime through direct contact with some of the largest UK groups and a number of large business forums.

**5.5** The use of external advisers becomes more widespread, and covers a greater range of tax services, outside the FTSE100. We have therefore also held discussions with most of the major accountancy firms, whose tax services are most commonly used by large businesses. In addition, we have consulted extensively with technical, policy and accountancy specialists within HMRC.

**5.6** We have heard a wide range of opinions and of many different experiences. This is to be expected because large and complex businesses, by definition, have complex business affairs which in turn lead to their being exposed to the whole range of the UK's complex CT regime.

**5.7** From our discussions and written representations received we have identified three broad themes, which are considered in detail below:

- stability and certainty
- technical complexity
- administration and process

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<sup>1</sup> HMRC Analyses of Corporation Tax receipts and liabilities, Bank Levy and Bank Surcharge 31 August 2016 [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/548398/Corporation\\_Tax\\_Statistics\\_August\\_2016\\_FINAL.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/548398/Corporation_Tax_Statistics_August_2016_FINAL.pdf)

## Stability and certainty

**5.8** In our consultations with large businesses and their advisers, the one plea that stood out above all others was for a CT regime that provides stability and certainty, so that there is:

- **stability** so that there will not be sudden lurches in CT policy, giving a reasonable expectation of what the CT regime - and thus their own position - will be in the future; so that business confidence is increased and there is an enhanced willingness to invest
- **certainty** over a company's position, so that there can be reasonable certainty of HMRC's approach and confidence that, for the compliant and non-high risk company, what has been filed is correct and will be accepted as such by HMRC

**5.9** These factors were frequently cited as being much more important than reductions in the tax rate, or the introduction of new reliefs.

**5.10** These issues also affect small businesses, but we hope that our proposals to simplify the CT regime for small companies will, to a great extent, remove them from exposure to major changes to the regime.

**5.11** Certainty and stability allow businesses to make decisions based on a predictable CT out-turn. Such views resonate strongly with a recent IMF/OECD report to G20 finance ministers of the results of a survey of over 700 global large businesses and 25 tax administrations<sup>2</sup> on the subject of tax certainty. The reported results reflected the views expressed to us in the course of our work and suggest that tax uncertainty can adversely affect business decisions on whether to and where to invest. Some suggested solutions in the report would:

- reduce complexity and improve clarity of legislation, through improved tax policy and law design
- increase predictability and consistency by tax administrations
- enhance effective and timely dispute resolution mechanisms that are critical in establishing certainty

**5.12** We have identified two ways in particular that resonate with the findings and solutions proposed in the IMF/OECD report, and which would help to create a more stable and certain CT environment, and thus enhance the UK's attractiveness as a place to make investments and to locate businesses.

### Earlier, open consultation

**5.13** HMRC and HM Treasury committed, as far back as 2011<sup>3</sup>, to public engagement and consultation on tax policy. The volume of consultation documents being issued is a positive testament to that commitment.

**5.14** By way of illustration, in the course of 2016 HMRC released 48 consultations, all of which require the attention of large businesses, unless the consultations specifically say otherwise. There has been a particularly heavy stream of major changes to the CT regime in recent years, which tend to impact on the large business sector and where the consultation period in advance of introduction has tended to be too short to enable companies to plan ahead with confidence. While HMRC's objective to consult widely is to be applauded, consultations should be targeted

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<sup>2</sup> <http://www.oecd.org/ctp/oecd-secretary-general-tax-report-g20-finance-ministers-march-2017.pdf>

<sup>3</sup> HMT/HMRC joint Tax Consultation Framework March 2011



at those who need to have an input and significant consultations seen as medium term rather than short term exercises.

**5.15** Recent examples of complex and burdensome legislation introduced at relatively short notice include loss carry forward restrictions, restriction of losses and expenses being relieved against Controlled Foreign Company (CFC) charges, hybrids legislation and Diverted Profits Tax (a separate tax, so not CT as such, but nevertheless a tax on profits).

**5.16** While it is highly desirable that HMRC consult on draft legislation at an appropriate stage, it is also important that for the more significant changes there is open and early consultation on the direction and approach with those likely to be affected. Consultations should be framed so that the important structural issues are highlighted, and targeted at those most likely to be affected, while some administrative issues might not require as much attention. Longer consultation periods would also help manage the pace of change.

**5.17** Proper regard needs to be had to lead times for companies which need to adapt systems to changes in rules. That implies at least a year's notice for changes of any significance.

**5.18** In the light of the above, **we recommend the development of a 5 year CT roadmap, alongside the business tax roadmap, and a re-balancing of the approach to consultation towards earlier and more open consultation on major medium term or structural changes.**

### **The role of the CRM in a complex system**

**5.19** We have found widespread support from large businesses for the role and, generally, the current practice, of CRMs. The CRM role is a vital means of giving the UK's largest companies the tax certainty they seek and as a way of helping to ensure that the right amount of tax is paid at the right time. In this, the CRM role is a positive differentiator for the UK in comparison with administrative arrangements in other fiscal authorities in competitor economies.<sup>4</sup>

**5.20** HMRC's published Large Business Strategy<sup>5</sup> sets out its risk-based approach to large businesses, which contains, inter alia, the following statements:

"HMRC will invest in a resource-intensive, relationship-managed service for the largest customers, because the money and complexity involved make this the most cost-effective way of getting the right tax agreed early."

"HMRC will always seek to work issues in real-time with all customers no matter what their tax strategy... "and

"HMRC will provide assistance to resolve uncertainty around complex or significant issues and commercial transactions."

**5.21** HMRC has published an ongoing commitment to building on this in its recent undertaking to "prioritise resource ...in areas of genuine uncertainty, commercial urgency and absolute risk", as stated in the draft Framework for Cooperative Compliance (the Framework) in Appendix B of the Improving Large Business Tax Compliance - Summary of responses published in December 2015 which already forms part of the context for HMRC/business dialogue.<sup>6</sup>

**5.22** On the basis of discussions with large business and their representatives, it is clear that they agree the compliance relationship is most effectively managed where it involves the CRM

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<sup>4</sup> Though as some note, some other jurisdictions offer far more rulings and in that regard the CRM role redresses that lack.

<sup>5</sup> <https://www.gov.uk/guidance/large-business-strategy>

<sup>6</sup> <https://www.gov.uk/government/consultations/improving-large-business-tax-compliance>

providing certainty, in real-time, of the tax treatment of complex and otherwise uncertain issues. This reflects the Framework referred to above.

**5.23** All agree the CRM role offers the most cost-effective way of getting early agreement on the 'right tax'. However, it seems from the discussions we have had that while some encouragement can be drawn from the Framework, and other work currently in train within HMRC, there is further for HMRC to go in ensuring this approach is communicated and embedded consistently.

**5.24** For example, some companies feel that HMRC's approach has, in recent years, moved towards focusing the CRM role primarily on risk identification and management, aimed at securing yield, with CRMs being less willing, or less consistently resourced, to give confirmation about the tax treatment of significant issues.<sup>7</sup>

**5.25** We have heard suggestions that greater clarity would also be welcomed on the scope and uses of statutory clearances, non-statutory clearances and 'low-risk' opinions, and that consideration should be given to extending the range of matters on which such clearances or opinions are available. In addition, relevant material could more rapidly be incorporated into guidance.

**5.26** It has also been suggested that CRMs should have a role in helping companies to reduce their compliance burden (especially for those companies considered low risk), perhaps having objectives or targets to help reduce such burdens. One possibility would be for CRMs to agree how low-risk areas should be managed and reviewed, or to engage with their customers on the compliance burden of proposed legislative changes as part of the policy development and implementation process.

**5.27** Businesses tell us that relatively high CRM turnover hinders the development of business and technical understanding, and thus their capability to develop and share a consistent approach. We understand from HMRC that this is something they monitor actively and that the rate of turnover has reduced since the creation of Large Business<sup>8</sup> in 2014.

**5.28** Overall, we think that the CRM role works well for both HMRC and for large companies and that it is a role that needs to be consolidated and enhanced. **We recommend the role of the CRM within HMRC's longstanding Large Business Strategy, as set out in the Framework, be more consistently communicated and embedded.** The opportunity should be taken to do that, and to consider the suggestions canvassed above, in conjunction with the large business risk profiling consultation announced at the Spring Budget 2017.

**5.29** This desire for greater certainty is not confined to the largest companies: it is a factor for all sizes of companies. We do not suggest that a drive towards greater certainty in CT can only be delivered by enhancing the roles of CRMs, a relationship that HMRC cannot practically offer to all companies. Some of our recommendations for small companies (for example, basing the tax on the accounting profit) would contribute to certainty. But it may be that there is scope to enhance certainty for all by increasing resources, or streamlining procedures, or better signposting around issues such as Advance Pricing Agreements which naturally are going to be an issue mainly for large companies.

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<sup>7</sup> The Large Business Survey 2015 noted that 66% of business rated their CRM as 'good' in resolving uncertainty around complex or significant tax issues (69% in 2014) <https://www.gov.uk/government/publications/large-business-survey-2015>

<sup>8</sup> HMRC's Large Business directorate was formed in 2014 and manages the tax compliance of the UK's 2000 or so largest businesses, with a bespoke CRM relationship

## Technical complexity

**5.30** The general rule for arriving at profits chargeable to CT is that one begins with the accounting profits, calculated in accordance with GAAP, with adjustments then being made for items required or authorised by law in computing CT profits.

**5.31** As a result of over 150 years of taxing profits, there is now a huge number of such adjustments<sup>9</sup>, and having to consider all of these puts a very large compliance burden particularly on large businesses. Of course, some adjustments will always be required for tax purposes, either to disallow items considered inappropriate for deduction (e.g. bribes) or to give additional relief for policy reasons (e.g. enhanced R&D deductions). However, if the general approach was to minimise the number of such adjustments in law, the system could be closer to an accounts-based taxable profit and reduce the compliance burden accordingly.

**5.32** Large and complex business have, by definition, large and numerous complex business structures and transactions. They recognise the need for complexity within the CT regime to deal with those complex structures and transaction. However, it is important that the compliance burden is proportionate and appropriate.

**5.33** Large businesses believe that their compliance burden could be significantly reduced if measures were introduced to simplify legislation and to limit its scope. We have heard a large number of suggestions and explore below areas of technical legislation often encountered which appear to have the potential to be simplified. Some are also relevant to smaller companies.

**5.34** We make a number of recommendations for reviews of technical areas with a view to simplification, subject to appraisal of whether any material exchequer cost would be involved.

### UK:UK transfer pricing

**5.35** This was mentioned by almost every large business and adviser we spoke to. The law requires that transactions between related parties (so, for example, companies within a group) are priced for tax purposes on an arm's length basis. In reality, many such transactions are not priced in that way in practice (for example, recharges for head office-provided accounting and HR services, inter-company loans).

**5.36** To comply with transfer pricing rules groups have to make equal and opposite tax adjustments on the return of each of the companies involved. If both companies' profits are fully exposed to tax, and both pay at the same rate of tax, there is no overall tax effect.

**5.37** Quite apart from the compliance burden of calculating and recording these transfer pricing adjustments, there can be additional compliance costs where an otherwise dormant company is required to complete a tax return only for the purposes of reporting a transfer pricing adjustment, for example on imputed interest on an inter-company loan.

**5.38** Transfer pricing legislation has existed in the UK to deal with profit shifting between the UK and lower-taxed overseas regimes since 1951 without its being generally imposed on intra-UK transactions. It was only in 2004, in response to EU non-discriminatory concerns about UK and non-UK EU companies, that UK:UK transfer pricing was introduced.

**5.39** Once the UK leaves the EU there may be an opportunity to revert to the regime that prevailed before this EU requirement and remove the general UK:UK transfer pricing burden from companies. Indeed there are some who consider that UK:UK transfer pricing is not

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[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/569329/Adjustments\\_from\\_accounts\\_to\\_tax\\_-\\_supplementary\\_discussion\\_paper\\_.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/569329/Adjustments_from_accounts_to_tax_-_supplementary_discussion_paper_.pdf)

required by EU law at all. However, to the extent that such adjustments have a value in preventing tax avoidance or otherwise have a tax effect, it would be possible to still require such adjustments to be made by requiring UK:UK transfer pricing to be reported only where there was an asymmetrical result. Tax avoidance instances would include issues around accessing stranded losses and diverting profits to lower tax-rate paying entities. Other examples include banking groups where some entities are subject to the banking surcharge and others are not, or NHS Trusts where the main trust is exempt from CT but subsidiary trading entities are not.

**5.40 Overall, we think there is a strong case for restricting the need to operate the transfer pricing rules. We recommend that the aim should be to limit the scope for UK:UK companies to occasions where an actual tax difference will arise.**

### **Dormant Companies and transfer pricing**

**5.41** Transfer pricing issues are particularly pertinent in respect of inter-company loans where one or both entities are dormant and no interest is charged on the loan.

**5.42** Under transfer pricing rules generally, there is already an exemption for companies that are currently dormant and which were dormant in 2004, and have a potentially advantaged position i.e. if transfer pricing were imposed they would suffer an increased taxable profit. There is a case for extending this exemption to companies that have become dormant since 2004, and which are still dormant and potentially advantaged.

**5.43** Extending this exemption to all such dormant companies would reduce the compliance burden considerably in removing them from consideration of transfer pricing (both UK:overseas and UK:UK), thus eliminating the need to complete tax returns for such companies. **We recommend this be explored.** The potential cost to the exchequer of giving up transfer pricing adjustments in UK:overseas situations on such companies, in line with pre 2004 dormant companies, would need to be assessed first. As a fall-back, at the very least the exemption should be extended to UK:UK situations in line with paragraph 5.40 above.

**5.44** As an example of the burden that could be relieved by such a measure, we heard from a large group where formerly, for dormant companies with loan balances, HMRC accepted a matrix showing all the balances and HMRC would put through a single net adjustment off-return, or no adjustment if the net effect was nil. Now, even though no tax is at stake, the group has to prepare 100 additional dormant company tax returns. This is after an extensive preliminary exercise to weed out hundreds of companies which were dormant before 2004, and so outside the scope of UK:UK TP rules.

### **Denial of a deduction for employee remuneration remaining unpaid nine months after the end of the accounting period**

**5.45** Such deductions are allowed in the accounting period in which the remuneration is paid, rather than in an earlier accounting period in which it is debited in the accounts. This rule was introduced as an anti-avoidance measure in 1989 to prevent companies from claiming a CT deduction for remuneration that was either never paid, or paid much later so that the income tax on the remuneration was accounted for much later than the accounting period in which the associated CT relief was obtained.

**5.46** The rule can lead to delays in finalising tax computations as companies wait until deferred remuneration is paid, or so they can check whether it has been, before finalising the computation. More fundamentally, the rule is not aligned to the current accounting standard<sup>10</sup> that allows only amounts payable to an individual within 12 months of the accounting date, to

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<sup>10</sup> FRS 102 Section 28

be recognised in the accounts, or for longer-term all-employee benefits to be recognised only if there is a constructive obligation to make the payments and the obligation can be reliably estimated.

**5.47** So, if company accounts follow GAAP, there is no opportunity to reduce profits with long-term unpaid remuneration of individuals, except to the extent that it is an accrued, legally due and reliably estimated element of a long-term bonus or profit-sharing plan.

**5.48** Aligning the tax rule to coincide with the accounting rule for short-term remuneration, and extending it to accruals for long-term remuneration, would be a simplification benefiting all companies which would no longer need to make adjustments for such matters. If allowing long-term accrued remuneration were seen as a step too far, (on grounds that a CT deduction should not be given possibly many years in advance of income tax/NIC being paid on the remuneration) the alignment could be made for short-term remuneration only.

**5.49** Any concerns about possible exploitation of such relaxations can be countered by use of existing wholly and exclusively legislation and the requirement for accounts (whether audited or not) to be GAAP compliant.

**5.50** We therefore recommend that the deferred remuneration rules be amended to allow all remuneration charged to profit & loss account, or in the alternative that the disallowance should no longer apply to short-term remuneration so charged.

**5.51** It would be possible to encourage earlier finalisation of company computations by shortening the period allowed but (a) that would impact genuine commercial issues; and (b) it would not follow the accounts. Accordingly we do not recommend it.

### **Pension deductions**

**5.52** The basic tax rule is that deductions are allowed for contributions to a registered pension scheme by an employer in respect of payments actually made, but not for accruals in respect thereof. Accordingly, deductions are not allowed for unfunded pension liabilities.

**5.53** It is apparent from our discussions, both with taxpayers, and HMRC accountants who cite this as an area of frequent computational error, that the workings of these rules are not well understood, for example in respect of profit & loss deductions for other aspects of pension schemes, such as debits for interest and service costs.

**5.54** We have considered whether pensions should be allowed on an accruals basis along with the generality of expenses incurred by businesses and have identified two possible reasons why they should not. First, allowing accruals would create one-off deductions across the large business sector of at least £128 billion<sup>11</sup> potentially reducing CT receipts by around 50% in the year of implementation. Secondly, the movement on deficits of defined benefit pension schemes is generally charged directly to reserves, not to profit & loss account, so a separate tax rule would have to be introduced to allow the reserves debit as a tax deduction, thus replacing one complicated rule (cash basis) with another (additional deduction for reserves movement).

**5.55** On balance, we conclude that the existing cash basis for relief does give appropriate relief but **we recommend that consideration is given to whether some simplification of the more obscure rules concerning what is and is not deductible should be undertaken**

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<sup>11</sup> Mercer review FTSE250 Jan 2017 report on unfunded pension scheme deficits

## Deductions for employee share acquisitions

**5.56** Deductions are available when shares are granted to employees, either on exercise of an option or otherwise. The measure of the deduction is the market value of those shares, less any contribution made to the employer by the employees in receipt of the shares.

**5.57** Under legislation introduced in 2014, the available deduction is restricted, on a time-apportioned basis, in respect of employees of overseas group companies who spend some time working for a UK group company. We have been told by companies that a disproportionately large amount of time is spent in tracking the movements of such employees, in order to comply with these rules and so make what are generally relatively small adjustments in CT computation.

**5.58** We recommend that these complications are looked at to see if the restriction could be dispensed with entirely, or alternatively a threshold could be introduced (say less than 5% of workforce affected or of the remuneration of those concerned) beneath which it could be ignored.

## The intangible assets regime

**5.59** This regime, introduced in 2002, gives relief for expenditure on intangible fixed assets written off over time (amortised) to profit & loss account, and taxes receivables arising from such intangible assets. The regime has generally been welcomed. However, the regime does not apply to pre-2002 assets so that, goodwill in respect of a business that existed before 2002 does not qualify for any relief, whereas acquired goodwill from 2002 does qualify.

**5.60** So there was a two-tier regime between:

- goodwill that existed before 2002 and which remains within the capital gains regime
- goodwill acquired since 2002 which is relieved as a trading expense over time

**5.61** The situation, which was regularly raised with us in meetings, has been further complicated by legislation in Finance (No 2) Act 2015 which denies a deduction for goodwill and other assets such as customer lists and unregistered trademarks ('relevant assets') acquired on or after July 2015, even though any gains on such assets are still taxed as income. So there is now a three-tier scheme for goodwill depending on whether it was acquired before 2002, between 2002 and 2015 or after 2015. This does seem to be an over-complication, and while the 2015 changes appear designed to counter avoidance, they catch innocent transactions as well.

**5.62** We recommend that consideration be given to treating all goodwill (and related relevant assets) acquired after 2002, and any expenditure enhancing pre-2002 assets, as relievable or taxable under the income, as opposed to capital gains, regime. If there are concerns about perceived avoidance devices these should be dealt with under separate, suitably narrow, anti-avoidance legislation.

## Group relief in relation to companies leaving groups

**5.63** Relief is denied once there are "arrangements in place" for either the claimant company or the surrendering company to leave the group. This is a long-standing anti-avoidance provision which can catch the innocent as well as those being targeted.

**5.64** The point at which "arrangements" come into place is not precisely defined. To an extent that may be inevitable in an avoidance context, but as well as leading to disputes between companies and HMRC it also distorts normal commercial and governance activity within groups, It is even possible that an aborted deal for the sale/transfer of a company prevents an otherwise

permissible group relief claim from being made where the company in question never leaves the group.

**5.65** We recommend that consideration be given to reviewing the operation of the rule and addressing such issues, so that relief is available in real commercial situations, with denial limited to instances of avoidance, perhaps using a “main purpose” test.

### Surplus ACT

**5.66** The OTS Review of Tax Reliefs looked at simplifying the calculation of surplus ACT set-off, for those companies that retain unused surpluses. The final report<sup>12</sup> published in March 2011 recommended simplification and set out three potential solutions: outright abolition of relief, a form of compensation to relinquish their surplus, or abolishing the concept of ‘shadow ACT’, which would mean those companies still affected could set-off their surplus up to the prevailing rate of CT until the surplus is exhausted.

**5.67** As far as this CT review is concerned, surplus ACT remains an area of complexity though not one that has been raised often with us, reflecting its diminishing relevance. We think there remains scope to remove the complexity that exists in calculating the amount to be set-off in the CT computation, and bring forward the point when the surplus is finally relieved. **We suggest a review to quantify the number of companies affected and the amount of surplus ACT involved, with a view to providing the remaining relief in a less complex way.** As we are approaching the 20<sup>th</sup> anniversary of the abolition of ACT, that might be a good target for arriving at a route to remove it from the legislation.<sup>13</sup>

### Anti-avoidance legislation

**5.68** The introduction of large amounts of new and extended anti-avoidance legislation in recent years has contributed significantly to the growth in the volume of tax legislation generally and the resulting complexity which we see in the current CT code.

**5.69** Where anti-avoidance legislation combats a real and current abuse of the tax system, its purpose is clear and the need for taxpayers to deal with it is warranted. However, it sometimes entraps, or potentially brings within its scope, commercial structures and transactions which are not undertaken for tax avoidance purposes, but which are driven by legal and regulatory requirements. The burden it imposes is not reasonable or proportionate and detracts from the competitiveness of UK business in having to grapple with such measures.

**We have three recommendations to reduce the unnecessary burden on businesses in this area:**

**5.70** **Firstly**, there are a number of means available to limit the scope of anti-avoidance legislation - de minimis rules, gateways and “main purpose” tests. A review of a selection of what might be perceived as anti-avoidance measures (CFCs, transfer pricing, hybrids, transactions in securities, world-wide debt cap, “unallowable purpose” in financial instruments legislation, Diverted Profits Tax) reveals that the use of these exemptions and limitations is inconsistent.

**5.71** While there may be a good reason why each piece of legislation has different exemptions and thresholds, in that each is aimed at different types of behaviour, the differences undoubtedly are confusing and add complexity. In an extreme case, where anti-avoidance has

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<sup>12</sup>

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/198570/ots\\_review\\_tax\\_reliefs\\_final\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198570/ots_review_tax_reliefs_final_report.pdf)

<sup>13</sup> ACT no longer applied from April 1999.

no or only very limited exemption levels, this can lead to large numbers of transactions having to be tested against new and complex legislation.

**5.72** As an example, the newly-introduced hybrids legislation has neither a “main purpose” test nor any de minimis. We have been told by one company that they are having to test tens of thousands of transactions against this legislation.

**5.73** We recommend therefore that anti-avoidance legislation, both existing and newly-introduced, should be reviewed with a view to introducing consistent de minimis limits and motive tests.

**5.74** Secondly, new legislation imposes an additional compliance burden, particularly on large companies, unless that burden is reduced by de minimis exemptions or the repeal of some other measure. Because anti-avoidance legislation casts its net widely, potentially catching the commercial transaction as well as the tax avoidance driven one, large companies are obliged to review their transactions and structures in the light of new legislation, even when they were not practising the mischief being targeted. The output can be that no additional tax arises but considerable additional administrative effort is required.

**5.75** The compliance burden of proposed legislation is assessed by HMRC and published in a TIIN<sup>14</sup>, though that does not include the detailed methodology of how the burden is calculated. Understandably the burden indicated does not include the costs of testing transactions against the anti-avoidance measures. Companies can therefore feel that the burden of anti-avoidance legislation put upon them is neither recognised nor appreciated.

**5.76** Consultation on anti-avoidance measures should allow the burdens of compliance to be assessed. **We recommend that HMRC make it clear during consultation that they are seeking input on the issue and the results are discussed and agreed with the large business community.**

**5.77** Thirdly, much anti-avoidance legislation overlaps other legislation insofar as it applies different tests to the same transaction in an attempt to reclassify its effect for tax purposes. One such example is interest relief where interest can be disallowed under several tax provisions (wholly & exclusively, unallowable purpose, thin capitalisation, transfer pricing, quasi-distribution, soon-to-be-introduced interest deduction restrictions). Another is the overlap of CFC legislation and Diverted Profits Tax. These instances require a transaction to be tested multiple times against each anti-avoidance provision. A degree of simplification would be achieved if a transaction were subject to one anti-avoidance measure only, or at the very least all the tests to be applied to a transaction were brought together in one place within the legislation.

**5.78** We therefore recommend that anti-avoidance legislation is reviewed to identify and remove unnecessary duplication.

**5.79** We would note that many have suggested to us that with the advent of the GAAR there is considerable scope to eliminate some specific anti-avoidance provisions. We have sympathy with this view but have not explored it in any way.

## **Administration and process matters**

**5.80** The administrative burden of CT compliance for large groups is significant. For the largest groups which undertake their compliance work in house, the costs generally run to several thousand pounds per corporate entity (one FTSE group with about 100 CT reporting entities

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<sup>14</sup> Tax Information and Impact Notes: <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>



estimated its compliance costs at £9,000 per company) and we are told by the big accounting firms that the burden, and thus the costs, are growing despite a competitive market, as complexity increases year-on-year. Some of the reasons for this have been discussed above and recommendations made to reduce the complexity of legislation.

**5.81** The advent of Making Tax Digital will have an impact on compliance costs but exactly how is not certain and we do not see that it will affect the underlying complexity issues that lead to the costs noted in the previous paragraph.

**5.82** We make a number of recommendations for reviews of administrative areas with a view to simplification. We further recommend that HMRC and OTS should work together on such reviews, which would include appraisal of whether any material exchequer costs would result from the proposed changes.

### **Aggregated group returns**

**5.83** Under UK law, every corporate entity undertaking activity chargeable to CT is required to submit an annual CT return. In large groups sometimes hundreds of annual returns have to be prepared and submitted every year.

**5.84** We have considered the case for consolidated group returns and have noted that such an approach is adopted in a number of overseas jurisdictions (see Annex E). Jurisdictions differ with some such as the US providing for consolidated returns built from the underlying financial records of the business and others leaning more towards taking the consolidated financial statements as the starting point. Full consolidation might be seen as a longer term goal and in the meantime **we recommend, as an initial step, that there is consideration of the case for optional aggregated returns; that is returns which aggregate the tax results of wholly-owned or majority-owned UK companies within a group.** Aggregated returns are used in France and Germany.<sup>15</sup>

**5.85** Clearly there are practicalities to be considered but we would hope these could be managed to capture what appears to be a significant simplification and reduction in compliance burden for those companies who choose to adopt it.

**5.86** Such returns would automatically eliminate the need for UK:UK transfer pricing adjustments which cancel one another out, and integrate the handling of group relief, and thus would significantly reduce the administrative burden of otherwise having to produce, manage and submit many individual CT returns.

**5.87** This proposal does not have universal support from the large business community, though a majority that we spoke to were in favour. Those in favour pointed out, in addition to the transfer pricing and group relief issues referred to above, the time and cost savings in not having to prepare and file separate returns for each entity. Those against pointed out that each company's liability would first have to be computed in order to aggregate them, so that they felt that there would be little time saving and that an aggregated return would add to complexity. We suggest that the answer to this divergence of view is to make aggregated CT returns optional, as are group VAT returns, and perhaps to exclude companies subject to specialist regimes involving non-standard CT rates.

**5.88** Furthermore, to prevent any perceived abuses, and again mirroring VAT provisions, HMRC could have powers to deny a company admission to the aggregation regime, where necessary.

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<sup>15</sup> In the OTS's Competitiveness report, at paras 3.76-77 we recommended that an optional consolidated return system should be explored. The government's response was that this would be considered, though no formal moves on the idea have taken place so far. In recommending an optional aggregated return system be considered, we are in effect taking forward that consideration of a consolidated return system and proposing what might well be a stepping-stone to a consolidated return system.

## There is no statutory concept of materiality in computing tax liabilities

**5.89** Companies and their tax advisers (both in-house and external) are very concerned to make sure that their CT computations are technically correct. Corporate and personal reputations are at stake where there are understatements, especially if HMRC seek to impose penalties.

**5.90** This leads to:

- companies being required, or feeling obliged, to identify even very small disallowable item in the profit & loss account, even though under GAAP, such accounts will have been tested for audit purposes to levels of audit materiality (involving detailed analyses of very large profit & loss account debits such as legal & professional and repairs sometimes containing many thousands of transactions)
- companies undertaking a great deal of work to test whether transactions fall within the scope of, in particular, anti-avoidance legislation (e.g. hybrids)

**5.91** The result is sometimes to find no disallowable/taxable items, or only small items of capital expenditure on which capital allowances are then claimed, or small items of disallowable expenditure. The impact on CT payable is, more often than not, disproportionately small compared to the effort and time involved.

**5.92** The OTS's 2014 Competitiveness report recommended that businesses should be able to agree a materiality level with HMRC. This was one of the few recommendations in the report which was rejected. In the response letter from the Financial Secretary to the Treasury, the explanation given was: "HMRC is committed to helping businesses get their tax right. It does not believe that agreeing a level of materiality with each individual business is the best way to achieve this."<sup>16</sup>

**5.93** Despite this previous rejection, we have to reiterate our previous observation, as business continues to raise the issue with us. If anything the need for a de minimis approach has become greater with the reductions in CT rates. We accept that agreeing a separate materiality level with every company would have resource implications for HMRC. One route would be to say that CRMs should be encouraged to agree such limits; separately, that general de minimis levels could be introduced for the wider CT population. Accordingly, we again suggest that

- CRMs are encouraged to consider de minimis levels with companies, and that this is reviewed as part of the Framework for Cooperative Compliance (see para 5.21)
- de minimis levels are introduced<sup>17</sup>, for example in published guidance, below which the entries in the profit & loss and balance sheet would normally be accepted without enquiry
- consideration be given to a system of rolling (say every three or five years) analyses with adjustments for prior year based on current year (tested) experience being acceptable without risk of penalties
- small transactions be exempted from anti-avoidance legislation such as that for hybrids. We have commented on how this might be achieved in the discussion above about anti-avoidance legislation

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<sup>16</sup> Letter published:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/384136/FST\\_ltr\\_to\\_OTS\\_re\\_Autumn\\_statement\\_measures.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/384136/FST_ltr_to_OTS_re_Autumn_statement_measures.pdf)

<sup>17</sup> It is perhaps worth noting that there is of course now a 'trivial benefits' limit for employee benefits as an example of how a de minimis limit can help drive simplification.

**5.94** These measures would be in addition to the recommendations in the previous chapter to either follow the accounts in relation to capital expenditure, or alternatively that there be a £1,000 de minimis for capital expenditure charged to profit & loss account.

### Allocation of group relief among member companies of a group

**5.95** Provisions already exist to ease this process, enabling group representative members to make and surrender group relief between participating companies, by way of a Joint Amended Return (JAR) for the whole group.

**5.96** These arrangements do not however override the requirement for each entity to make a separate CT return in the first instance. Furthermore, they still rely on the production of spreadsheets by the taxpaying group and manual amendments and allocations of group relief by HMRC. Similar arrangements (Group Payment Arrangements) are authorised by statute to enable groups to manage and allocate tax payments among group companies.

**5.97** MTD for companies creates an opportunity to look at both of these arrangements to see if they can be digitised. It is worth stating here that our recommendation above to allow aggregated returns would eliminate these administrative burdens to a very large extent for companies choosing to use such a facility.

### Conclusion and summary of areas considered

**5.98** In this chapter we have made a number of recommendations with a view to simplification. Work on this would obviously need to include consideration of any material exchequer costs which might result.

**5.99** The recommendations we think would make the greatest difference in simplification terms are the first two in the following table, as they would answer the calls for a more stable and certain system. They can also be addressed in the relatively short term.

**Table 5.A: Summary of recommendations**

<b>Areas specific to large and complex companies: Recommendations</b>		<b>Short term</b>	<b>Medium term, link with MTD</b>	<b>Longer term</b>
<b>Improving stability and complexity</b>				
1	Build a 5 year CT roadmap, alongside the business tax roadmap, to include a commitment on earlier and more open consultation, at least one year before date of proposed implementation where possible.	✓		
2	Embed the Customer Relationship Manager role in line with HMRC's published strategy, to provide greater certainty in a complex system.	✓		
<b>Technical areas that could be simplified</b>				
3	UK:UK transfer pricing - can the scope be limited to instances where there is an actual tax difference arising.		✓	
4	Dormant companies and transfer pricing generally - can the existing exemption for pre -2004 dormant companies be extended to all dormant companies?		✓	

5	Deferred Remuneration - consider whether this legislation is still needed given the changes in accounting rules but in any event move to a 12-month rather than 9-month rule to harmonise with the accounts.	✓
6	Pensions - undertake a review of the application of the 'paid' basis of deduction to the various types of expenses associated with pension schemes, with a view to clarifying the rules.	✓
7	Share Based payments - consider whether the existing rules for mobile, international employees are unnecessarily complex.	✓
8	Intangibles - consider whether the current three-tier regime for goodwill is necessary and whether new expenditure on pre 2002 goodwill could be brought into the income-based regime.	✓
9	Group relief arrangements – consider relaxing the current rule that denies access to group relief for a company which does not in fact leave the group but in respect of which there are 'arrangements' during the relevant accounting period.	✓
10	Surplus ACT - quantify the number of companies with, and the amount of, unrelieved surplus ACT, with a view to providing the remaining relief in a less complex way.	✓
11	Anti-avoidance legislation – a review of existing and newly-introduced legislation considering (i) consistent de minimis limits and motive test (ii) ways of assessing the burden of compliance (iii) identifying and removing unnecessary duplication.	✓
<b>Administrative areas that could be simplified</b>		
12	Aggregated returns - introduction of optional aggregated returns for some or all UK companies in a group with HMRC having powers to refuse admission of an entity to such an arrangement.	✓
13	Materiality – CRMs encouraged to agree a de minimis levels; large pieces of analysis work (of low –risk accounts debits or transactions) to be undertaken every say 3 or 5 years , with agreement of CRM, with prior year adjustment's not being subject to penalties.	✓
14	Group relief and tax payments - existing arrangements to be reviewed in the light of MTD for companies with a view to digitising and simplifying.	✓

# A Terms of reference

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## OTS review of the corporation tax computation

**A.1** A company can receive income from a number of different sources. Although trading activity is often the main source of income, others commonly include income from property or from general investments. The specific calculation rules differ between the income categories and, as with many aspects of the tax system, such differences are often a matter of history. Today, with more companies undertaking multiple activities, and with the digital agenda in mind, it's an open question to what extent these differences remain appropriate or whether the rules could be simplified and made more cost effective, not least for smaller companies.

**A.2** The Office of Tax Simplification (OTS) has therefore agreed with the Chancellor and the Financial Secretary to carry out a review of the corporation tax computation. The basis of the project is that, as demonstrated in previous OTS reviews, simplification of the tax computation is desirable.

**A.3** The overall aim of the review will be to develop recommendations for the Chancellor and the Financial Secretary on how to simplify the computation and reduce the administrative burdens it imposes. This will involve picking up on some of the recommendations in the OTS UK Competitiveness report and the recent Small Companies report, and will have regard to the Business tax road map published in March 2016 and to HMRC's Making Tax Digital work.

**A.4** In conducting this review the OTS will provide a report before Budget 2017 that:

- provides analysis and evidence of the main areas where simplification could be achieved and the benefits that could result for companies and in the administration of corporation tax;
- recommends specific steps that could be taken to secure simplification; and
- considers and offers an initial evaluation of the impacts for companies, HMRC and the exchequer.

The OTS will provide an update on its work before Autumn Statement 2016.

### Terms of reference

**A.5** The review will consider the adjustments between accounting profit and the corporation tax profit, their significance in the light of the current business environment and the complexity and/or administrative burdens created, and will make recommendations for simplifying the calculation of taxable profits. This will include consideration of:

- the main categories or sources of income for corporation tax purposes (for example trading, property, loan relationships, chargeable gains) and the related allowable expenses, including management expenses and depreciation/capital allowances
- to what extent these categories fit the modern context
- the legislative and practical complexities that arise from them and their interaction with accounting or other business processes
- to what extent these categories are required to support tax policy imperatives

- the potential for reducing the differences between accounting profit and tax profit (including the possibility of combining some of the categories)
- the legislative, practical and Exchequer impacts of so doing - taking into account any implications for general transitional and loss relief rules (including the reforms announced at Budget 2016), and maintaining a separation between capital and revenue
- the relative significance and impact of the issues identified on companies and groups of different sizes or in different sectors, and the potential for having simpler rules for smaller companies

While the review will have regard to international matters (such as double tax relief) which could be affected as a consequence of any recommendations being considered, it will not be directed more widely towards international matters or issues within the purview of the Base Erosion and Profit Shifting work following the OECD initiative.

### **Further guidance for the review**

**A.6** In carrying out its review and developing its recommendations, the OTS should:

- research widely among all stakeholders
- involve HMRC's Administrative Burdens Advisory Board
- take account of the principles and design of HMRC's Making Tax Digital reforms, including digital tax accounts, integrated reporting and payment
- consider the likely Exchequer implications of recommendations
- have regard to the potential implications for corporate members of partnerships
- be consistent with the principles for a good tax system, including fairness and efficiency
- take account of relevant international experience

# B Consultative Committee

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B.1 We are very grateful for the time and support of our Consultative Committee members.

Andrew Jackson	UK200 Group
Andy Roberts	Prudential Plc
Brian Harris	Phoenix Tax
Chris Davidson	KPMG
Jennie Rimmer	Aspen
Mike Agate	Federation of Small Businesses
Mairi Morrison	BDO Stoy Hayward
Tim Voak	OTS Alumnus; formerly head of tax Tesco plc
Will Silsby	Association of Taxation Technicians





## C Who we met

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**C.1** We are very grateful to the wide range of bodies, businesses and individuals who gave their time to meet with us, and for the submissions we have received. Many of the organisations listed below arranged meetings and forums for us, enabling us to reach a very wide range of impacted stakeholders. We have listed them below and apologise to any that we have inadvertently omitted.

ACCA  
Administrative Burdens Advisory Board  
Aidan Lucey (Irish Tax Institute)  
AL Goodbody  
Angela Williams  
Aspen  
Association of Accounting Technicians  
Association of Taxation Technicians  
AstraZeneca  
Balfour Beatty Plc  
BDO Stoy Hayward  
British Property Federation  
BT  
CBI  
Chartered Accountants Ireland  
CIOT  
David King  
Deloitte  
Derwent London  
Ernst & Young  
Federation of Small Businesses  
FreeAgent  
FTI Consulting  
Grant Thornton  
GE  
Heathrow Airport Ltd  
HMRC Business Tax Forum  
HSBC  
ICAEW  
ICAS  
The Infrastructure Forum  
Jennifer Blouin  
KPMG  
Martin Gunson  
Marks & Spencer  
Michael Walpole  
NFU  
Oxford University Centre for Business Taxation  
Peter van Dijk  
PKF Littlejohn  
Prudential Plc  
PwC

Rolls Royce  
Smith & Williamson  
Standard Life  
Susanna Ingham  
Tesco  
UK200 group  
Utilities Tax Group  
Westminster Council  
Winmark Tax Directors Network

# D List of widely used CT adjustments

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**D.1** On 15<sup>th</sup> November 2016 we published a summary paper and table setting out the common adjustments made by companies in moving from accounting profit to taxable profit.<sup>1</sup> The list below, and the published tables, represent what we think are the most frequent adjustments that companies use. We want to continue to use this list to help identify those adjustments which would benefit from simplification.

## **D.2** The summary list of adjustments

### *Permanent or 'absolute' adjustments*

These adjustments involve adding or subtracting an amount from accounting profit. The list below is broadly in order of frequency for most companies:

- depreciation, amortisation, profits or losses on sale
- capital allowances (including managing various types of pools)
- entertaining
- penalties/fines
- wholly & exclusively /remoteness
- capital/revenue (for example some legal and professional fees)
- repairs/renewals
- deferred revenue expenditure
- capital-in-revenue
- R&D relief
- goodwill/intangibles
- splitting out capital gains
- 'tax nothings' (for example abortive capital expenditure)
- patent royalties

### **D.3** *Timing adjustments*

Although capital allowances and the related depreciation are, taken together, a timing difference, we have included them in the list above as they operate separately.

Other significant sources of 'timing' adjustments, include the following (these are not in frequency order):

- pension contributions
- 9 months rule on unpaid remuneration

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<sup>1</sup> <https://www.gov.uk/government/consultations/ots-review-of-the-corporation-tax-computation-consultation>

- share schemes, EBTs etc
- general/specific provisions

**D.4** *Adjustments that would be affected or potentially disappear with schedular reform*

- splitting out bank interest
- splitting out property or other forms of income/expense such as management expenses
- pre trading expenditure and post-cessation receipt rules
- distinguishing between trading and management expenses deductions
- splitting out donations

**D.5** *Specialist provisions, such as:*

- loan relationships (other than in relation to bank interest)
- financial instruments
- transfer pricing (including thin capitalisation)
- DTR
- sector-specific regimes or reliefs (for example oil, life insurance, creative industries)

# E International Comparisons

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## Introduction

**E.1** The aim of undertaking comparisons with a number of non-UK fiscal regimes was to establish whether other countries do things better (or worse) than the UK around the areas on which we are making recommendations, and to seek to inform these recommendations. We therefore approached tax professionals and academics from and with experience of other countries to gain a better understanding of what those countries do. We are extremely grateful to all the individuals who took the time to explain the intricacies of their tax system to us. We have also drawn on the extensive information available online, in particularly via the global tax summary pages and online guides published by the 'Big 4' accountants. Finally, we have consulted the 2017 World Bank group/PwC Paying Taxes survey<sup>1</sup>, which has provided some basic comparative data on the various jurisdictions, including, in particular, the time it would take a standardised company to comply with its CT obligations.

**E.2** The results of our work have indeed informed our conclusions in a number of areas, particularly in respect of capital expenditure.

**E.3** We have focussed on the countries listed below. These were chosen with three criteria in mind: the size of their economy, the similarity of their tax system to that of the UK and information in the Paying Taxes survey.

- Australia
- Canada
- Ireland
- France
- Germany
- Netherlands
- Singapore
- United States

**E.4** This Appendix is not intended to comprise a comprehensive review of the tax regimes of the countries on our list. Rather, it is intended to inform the UK corporation tax simplification debate by drawing out how some other countries approach certain issues addressed by our review. It is hoped that by pointing out features which seem to work, or not to work, in other jurisdictions, this summary review can offer a starting point for a more detailed review of specific systems, or aspects thereof, should this be considered appropriate. It should also be noted that the review covers only companies that are taxed as entities separate from their shareholders and, where relevant, addresses countries' federal taxation only, not their state or local taxation.

**E.5** Whilst we have made every effort to ensure the information provided here is accurate, we are not experts in these jurisdictions' tax regimes. We were able to interview only one or, at most, two experts for each jurisdiction covered. To the extent that our review provides opinions on other regimes, it merely reflects the views we have heard from our interviewees.

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<sup>1</sup> <http://www.pwc.com/gx/en/services/tax/paying-taxes-2017.html>

**E.6** The review is divided into three sections. Our summary observations are set out at E.6 to E.19 below. Tables 5.B to 5.E then set out more detailed summaries for each country. Finally, for ease of reference, we have pulled out the most relevant data from the Paying Taxes Survey for the countries that we are reviewing and this is set out at table 5.F.

## Summary

**E.7** Our review has identified various features which appear to be 'attractive' or 'successful' from a tax standpoint. Some of these features, such as a low tax rate, or capital gains participation exemptions, are beyond the scope of the OTS's current review. However, others are worth noting.

### Small companies

**E.8** No country that we reviewed operates an entirely separate regime for small companies. However, of the 8 countries that we reviewed, 6 operate certain simplifications for small business. The most popular criterion for defining a 'small' company appears to be one based upon gross revenue. This was used by 4 out of the 6 countries (albeit that it was not always the sole criterion used). Some jurisdictions indicated that this criterion was chosen because gross revenue is a difficult figure to manipulate. 4 out of the 6 countries that provide simplifications for small companies included either a simplified return and/or a simplified process of estimating the tax due for the purposes of ongoing payment obligations.

### Capital expenditure

**E.9** With the exception of Ireland, all of the countries we reviewed operated a regime whereby low value assets can be written off in the year of acquisition. Of the 8 countries we looked at only Singapore did not generally permit the tax depreciation of buildings. As regards obtaining certainty, in most of the countries we looked at (6 out of 8) the tax authority provides some sort of list to provide guidance around rates of depreciation. In addition, binding rulings systems can be used to obtain certainty. As noted below, the Australian binding ruling system is frequently utilised to provide certainty around the treatment of particular items of capital expenditure. Finally, it is worth noting that whilst the French and Dutch tax depreciation rules follow the accounting treatment, our interviewees in these countries did not say that the system was particularly simple or user friendly. In France in particular, following the accounts still meant a certain level of complexity owing to adjustments which it was then necessary to make to the accounting position.

### Methods of calculation: Accounts as the basis of the tax calculation

**E.10** Of the 8 countries reviewed, only one (the US) did not utilise the accounts as the starting point for the tax calculation (in Australia, the tax calculation does start from the accounts, however, this is not mandated by legislation).

### Methods of calculation: schedular systems

**E.11** Of the countries we reviewed, only 3 (Ireland, Canada and Singapore) operate an income streaming system beyond the distinction between capital and revenue. Both Ireland and Canada utilise income streaming to give effect to differential tax rates; with Ireland having a higher tax rate for non-trading income, and Canada offering a rate reduction for manufacturing and processing activities. Singapore operates a distinction between trading and non-trading income so that trading companies (as opposed to investment holding companies) are required to set off reliefs first against trading income. The purpose of this is not entirely clear to us. Australia also utilises something akin to streaming; however, this is in the anti-avoidance area where non-commercial losses cannot be offset against commercial profits.

## Methods of calculation: tax consolidations

**E.12** Of the countries we looked at, the only two not to offer a consolidation regime were Ireland and Canada. Most of the countries that operated a tax consolidation regime reported good levels of customer satisfaction with the regime. Tax consolidations appear to fall into two categories. In Germany and France each individual company within the consolidation is required to calculate its own tax, which is then aggregated with that of the other group companies for the purposes of the consolidated return. By contrast, in Australia, the Netherlands, Singapore and the US the only return filed is a single consolidated return.

## Interaction with tax authority: getting to certainty

**E.13** All of the countries we looked at other than Ireland offer some version of binding ruling. However, there was a great deal of variation in the detail around the binding ruling process. The US requires payment of \$100,000 for a binding ruling. Very few binding rulings are issued in the US each year. Australia on the other hand issued over 8,000 binding rulings in 2015. Australian binding ruling applications are not always made by advisers. Of particular interest is the fact that the binding rulings system is utilised by small businesses and individuals to provide clarity around the treatment of particular items in the capital allowances regime.

**E.14** Australia provides another interesting example of a practical approach to taxpayer interaction. In response to repeated calls for simplification, the Australian Tax Office has issued guidance setting out how to 'swim between the flags' in certain areas in order to be considered low risk. This guidance is not necessarily issued in areas of relevance only to large business. For example, it has been issued on fuel tax credits. The Australian Tax Office has also published guidance explaining what would cause it to categorise a taxpayer as being high or low risk.

## Changes to tax legislation

**E.15** Although we did not ask our interviewees a specific question regarding the pace of change of tax legislation and the quality of advance consultation, several interviewees mentioned this. Unsurprisingly, a slow pace of change was seen as a good thing, as was a long timescale for consultation. This was mentioned, in particular, in relation to Germany and Ireland.

**E.16** In Germany, although minor amendments have been made to the tax system, there has been no major reform since 2008.

**E.17** Ireland is of great interest as a comparator jurisdiction to the UK. Its corporation tax regime is very similar to that of the UK yet some consider it to be a simpler regime to comply with than that of the UK. This is reflected in the much shorter CT compliance time per the PwC/World Bank Paying Taxes survey.

**E.18** What is it, then, that gives rise to the Irish tax regime's reputation for simplicity? Some thoughts regarding what makes the Irish regime so successful were set out in the OTS's UK competitiveness review<sup>2</sup> and further observations were offered by our interviewees. Of particular note was the assertion that the Irish corporation tax regime is subject to less change than that of the UK. It was further suggested to us that one reason for the slow pace of change was that the low headline tax rate leads to reduced taxpayer appetite for avoidance and therefore less cause for broad new targeted legislation. This is an interesting observation in the light of the planned reductions in the UK corporation tax rate.

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<sup>2</sup> Review of the competitiveness of the UK Tax administration: final report October 2014, Annex D [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/362302/competitiveness\\_review\\_final\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/362302/competitiveness_review_final_report.pdf)

## Transfer pricing

**E.19** We did not ask our interviewees a specific question about transfer pricing. However, our research shows that of the four non-EU countries we looked at, two (the US and Singapore) apply transfer pricing legislation to domestic transactions. However, it is important to note that even where transfer pricing rules do not apply to domestic transactions, other domestic rules may apply to impose a fair value or arm's length standard on some or all transactions between connected parties.

**E.20** For those countries that do extend their transfer pricing rules to domestic transactions, it is important to consider the administrative burden of these rules in the context of group consolidations. Where group consolidation rules eliminate transactions between related subsidiaries, this can reduce the administrative burden imposed by domestic transfer pricing rules. This was a point made to us in the context of the French domestic transfer pricing rules. In Germany, the administrative burden of domestic transfer pricing rules is mitigated by reduced documentation requirements in comparison to cross border transactions. This is based on the logic that, in the domestic context, the tax authority could audit both sides of the transaction where necessary.



## Country summaries by topic

### Small companies

Table E: A

Country	Simplified rules for small companies?	Definition of 'small'	Key feature of small company simplification	How is the boundary between small and large, and between incorporated and unincorporated policed?	Do small companies have potentially to consider the same number of adjustments to their accounts as large companies?	Other
Australia	Limited aspects only	Based on revenue (aggregated turnover)	Simplified stock trading rules: no year-end stock take if value of stock has changed by less than AUD\$5,000.  Simpler capital expenditure regime – see table below.  Lower tax rate.	The threshold for a small business entity, set by legislation, is based on aggregated turnover (i.e. taking into account affiliates and controlled entities) which is hard to manipulate. Concessions equally apply to incorporated or unincorporated entities. There is an unincorporated tax discount to ensure that small unincorporated businesses are on a level playing field in the context of tax rates.	Yes although technically, the tax rules are not accounts based. Businesses generally use advisers to help complete returns.	See interaction with tax authority table below; the popular binding rulings system is used by small business as well as large.
Canada	No but lower tax rate and certain other advantages	Broadly, Canadian controlled private corporations with taxable capital employed in	An additional month to pay the balance of taxes due for the year.  Enhanced investment tax credits for certain expenditure.	Phased out where capital employed is CAD \$10-15million. Anti-avoidance measures required to avoid fragmentation of businesses in order to take advantage of the reduced rate.	Yes. The Canadian tax system is considered to be very complex for small (and large) business and many businesses use advisers.	The Canadian tax authority has a separate small business division which is generally staffed by more junior auditors. Small businesses are

		Canada of under CAD \$15 million.	Shortened statute of limitations from 4 years to three years.  Reduced tax rate on certain active business income earned in Canada. This is subject to an income cap of \$500,000.  Income from investment businesses (such as interest and rents) or personal services businesses is not eligible for the reduction.			generally audited only when risks are identified or by random selection, whereas large businesses are continually audited.
France	Limited aspects only	Based on revenue	Simpler procedure only; fewer filing obligations and simpler forms.	Revenue hard to manipulate	Yes. Small companies generally use advisers for tax and other admin requirements e.g. labour laws.	Small businesses can contact tax authorities via telephone or email but quality of the advice is variable. Best to contact local tax office via advisors.
Germany	Only for capital expenditure – see table below	N/A	N/A	N/A	N/A	Companies have simplified deductibility rules for interest up to a value of EURO 3million, and loss carry forward rules for income up to EURO 1million (not limited to small companies but mentioned here for completeness).
Ireland	Limited aspects only	Based on CT liability and in the case of	Companies with a CT liability of less than EURO 200,000 in the previous year make fewer	'Start up' regime is limited in time	Broadly yes.  Also, as for the UK, the Irish transfer pricing	

		the start-up regime, the date of commencement of trade	annual CT payments and can base their payments of 'preliminary' tax on the previous year's liability.  Special regime for some 'start-up' companies in their first three years of trading and (broadly) CT liability < EURO 40,000. Broadly, the scheme reduces CT by reference to the employers' PRSI (the Irish NIC equivalent). No 'preliminary' tax in the first year; only a final payment.		regime does not apply to small companies per the EU definition of 'small'	
Netherlands	No	N/A	N/A	N/A	Yes	Accounting simplification: small companies may choose to prepare financial statements based on tax accounting principles.  Large taxpayers benefit from co-operative compliance arrangements that are not open to smaller taxpayers – see Interaction with Tax Authority, below.
Singapore	Limited aspects only	Based on revenue, chargeable income and/or, in the case of the start-up	For eligible start-ups the relief is 100% on the first \$100,000 and 50% on the next \$200,000 of chargeable income.  Small companies with revenues of less than \$1m file a	Start-up relief is limited in time.	Yes	Corporate tax calculator available on Singapore Tax Authority website provides a framework.

		exemption, years of assessment	<p>simplified return and do not need to file accounts or tax computations.</p> <p>Companies that do not expect to have chargeable profits do not have to file an estimate.</p>			All companies are eligible for 75% relief on the first \$10,000 and 50% on the next \$290,000 of chargeable income (not a small company point but mentioned for completeness).
US	Limited aspects only	Multiple definitions for different purposes	<p>Cash basis reporting if (broadly) annual gross receipts are less than \$5m. Certain businesses excluded. Inventory taxed on an accruals basis.</p> <p>Simpler capital expenditure regime – see table below.</p> <p>Corporate taxpayers with under \$10m in assets have fewer filing obligations as regards the reconciliation of book and taxable net income. Those with under \$250,000 in assets don't have to make any such reconciliation.</p>	Hard to manipulate gross receipts; inventory accrual system is a backstop.	Tax rules are not accounts-based. US rules are considered very complicated and it is rare for businesses not to use a tax professional to prepare their returns.	<p>IRS is broken out into divisions according to the size of the business. Large and international divisions cover businesses with assets over \$10m.</p> <p>US system generally considered very complex and small businesses may not take up reliefs available to them due to complexity.</p>

## Capital expenditure

Table E: B

Country	Capex incentivisation (ignoring special regimes such as R&D tax credits)	Does the tax treatment follow book/statutory depreciation?	Does the tax authority publish guidance lists?	Capex allowance for buildings?	Other
Australia	<p>General depreciation rules and simplified depreciation rules for small business.</p> <p>Small business – immediate deduction for asset purchases under AUD\$20,000 (temporary concession available until 30 June 2017 after which the limit will be reduced to AUD1,000).</p>	No	Yes. Certain intangible depreciating assets (e.g. patents) are given a statutory rate of write-off, while others are written off according to their effective lives (self-assessed or based on the Commissioner of Taxation’s published determination).	Yes	<p>Investments of AUD\$300 on depreciating assets can be written off immediately if asset is used predominantly for producing income that is not from carrying on a business.</p> <p>There is an administrative concession that business expenditure of less than AUD\$100 can be treated as revenue expenditure and immediately deductible.</p>
Canada	Capital cost allowance	No	Yes, asset classes and depreciation rates are listed in regulations.	Generally yes	<p>If a business adopts a capitalisation threshold, whereby assets below a certain value are expensed for accounting purposes, this will be accepted for tax purposes provided that the practice is aligned with the accounting treatment.</p> <p>Record keeping requirements can be burdensome and often subject to lengthy review during audits.</p>

France	<p>Tax depreciation broadly follows the accounts but with many exceptions.</p> <p>Temporary bonus depreciation 40% uplift on price of certain investments (expires 2017).</p>	Tax depreciation broadly follows the accounts but with many exceptions.	Yes for information purposes only.	Yes	<p>Whilst the system broadly follows the accounts, it is not considered a simple one because of the large number of tax adjustments to the accounting numbers.</p> <p>Investments of EURO500 or less can be written off immediately.</p>
Germany	<p>The German tax authorities publish very detailed lists setting out the useful life of assets. There are general lists and industry-specific lists.</p> <p>For small businesses (definition depends; for trade businesses that prepare balance sheets those with total business assets of EURO 235,000 or less qualify) building up a tax effective investment reserve for up to 40% of the acquisition cost for future acquisitions of certain business assets within 3 years after the reserve has been built is possible. Once acquired depreciation of up to 40% can be made and is offset with reserve.</p>	<p>Not technically but, in practice, local GAAP generally follows the tax depreciation rates set out in the tax authority's published lists. Goodwill is one exception to this practice, where tax depreciation differs from accounting depreciation.</p>	Yes	Yes	<p>Immediate write off for assets up to EURO 410. Assets costing between EURO150-1000 (net) can be pooled and depreciated over 5 years.</p>
Ireland	<p>Capital allowances regime. Plant and machinery, depreciated on a straight line basis over 8 years and industrial buildings over 25</p>	No	No but can be the subject of Revenue opinions.	Yes for industrial buildings.	<p>Similar regime to the UK but Ireland have retained Industrial buildings allowances.</p>

	years. 100% first year write off for energy efficient equipment.				No formal lower threshold for immediate write off of capital expenditure.
Netherlands	Tax depreciation broadly follows the accounts but adjustments made for items including goodwill, minimum depreciation period, buildings, low cost assets and immaterial assets.	Tax depreciation broadly follows the accounts but adjustments made for various items. Also the depreciation must comply with 'sound business' practice.	No	Yes with restrictions.	Immediate write off for capital items costing under EURO 450 unless part of a 'complex of assets'.
Singapore	Capital allowances on plant and machinery. Depreciation over one to three years or over the prescribed working life of an asset. Year 1 write off applies only to certain computers and automation equipment and low value items.	No	Lists published of what is and is not considered 'plant'.	No	Immediate write off for capital items under \$5,000, up to a maximum of \$30,000, to prevent avoidance.  An enhanced allowance of 400% up to \$600,000 spending on certain IP, IT and automation equipment. Excludes some small companies as one of the eligibility conditions is 3 local employees who do not own the company.
US	Generally where annual capex on qualifying equipment is \$500,000 or less it can be immediately deducted. Gradual phase out once capex reaches \$2 million. Detailed rules apply depending on the asset ("S179 deduction").	No	Yes	Yes	Investments of \$5,000 or less can be written off immediately if certain conditions are met.

	Bonus depreciation – 50% first year allowance upfront deduction for certain assets.  Tax depreciation rules once s179 and bonus depreciation have been utilised.				
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## Methods of calculation

Table E: C

Country	Does the tax calculation involve starting off with a set of audited or filed accounts and then making adjustments?	Most common or problematic adjustments (based on the interviewees' impression)	Ignoring foreign source income, does the tax calculation require separation of income from different sources?	Do different rules/regimes apply to capital and income profits?	Grouping and consolidations	Other
Australia	As a practical matter yes but this is not mandated by legislation.	Forex gains and losses  Employee leave provisions (deductible only when paid)  Bad debt (deductible only when written off)  Provisions in accounts  Depreciation adjustments, foreign tax credits	No except as regards capital profits/losses. However, income streaming features in anti-avoidance legislation: non-commercial losses are quarantined and losses can be carried forward to offset only against that business; aim is to stop non-legitimate businesses.	Yes	Yes. Consolidation option is available for wholly owned resident groups. Group files a single tax return (filed by the ultimate Australian holding company), therefore intra-group transactions are ignored and losses are pooled. However cannot consolidate employment taxes.	1998 initiative to align accounts and tax scrapped because this would involve eliminating popular reliefs.
Canada	Yes	Property income, reserves, incentives, foreign income, interest expenses, specific	Yes, Canada retains the distinction between active and passive business income	Yes	No group consolidation for tax purposes and no group loss sharing regime.	



		expenses e.g. entertainment, goodwill, pensions, year-end accruals.	especially in the context of Canadian Controlled Private Companies (see Small Companies section).  Canada also taxes manufacturing and service income at different rates.			
Ireland	Yes	Depreciation, capital expenditure, entertainment expenses, amortisation, certain interest expense, non-trading income and expenses.	Ireland utilises a schedular system very similar to the UK. However, trading profits are taxed at a lower rate than non-trading profits. Can seek a Revenue opinion on whether a company is trading or non-trading and summary anonymised opinions are published.	Yes	No tax consolidation regime exists.  A group loss relief regime exists. Group loss sharing is available on a value basis depending on whether the loss is trading or non-trading.	The Irish regime is very similar to the UK. However, unlike the UK, Ireland does not have separate tax regimes for loan relationships or derivative contracts. These all fall under the main Irish CT regime.
France	Yes	Interest and other financial income, 'subsidiaries', unless made for commercial purposes, corporate income tax, non-deductible provisions, non-deductible depreciation, finance leases, partnership income, tax neutral mergers, some entertainment expenses, fines, penalties, dividend income, capital gains.  There are 240 potential adjustments to the	No	Sometimes	Yes, this is considered a successful aspect of the French regime. However individual company returns are still required and then aggregated at the parent level including loss offsets.	Consolidation regime somewhat reduces the burden of the domestic transfer pricing rules.

		accounts in 2015 per list published by PwC.				
Germany	Yes	Pension accruals, vacation accruals, goodwill depreciation, non-deductible expenses.	Generally, no. Corporates are generally deemed by law only to have 'commercial profit'.	Generally not, but tax exemptions apply e.g. for qualifying dividends / profits from sale in shares.	Fiscal unity regime is available upon entry into a profit and loss pooling agreement with a duration of at least 5 years if more than 50% of the shares are owed at the start of the fiscal year. Profit or loss of each member of the group is calculated individually and a tax return is filed for each member. The profits and losses are then attributed to the top company.	
Netherlands	Yes; in essence the system compares fiscal equity at the beginning and end of the year.	Fines, some interest charges, certain depreciation adjustments.  The taxable profits calculation utilises a concept of 'sound business practice' which may differ from GAAP.	No (except innovation box).	No but participation exemption for dividends and shares sales.	Parent may file a group consolidated return on behalf of itself and all elected 95%+ owned subsidiaries. If an election is made all the attributes of the subsidiary are attributed to the parent and intragroup relationships disappear.	Anti-avoidance rules to prevent abuse of consolidation regime.
Singapore	Yes	Trading vs non-trading income, depreciation, interest deductibility, medical benefits, insurance.	Distinction operated between trading and non-trading income and associated expenses.  Deductions must first be set off against trading income.	Yes	No group consolidated returns but group relief and group payment arrangements.	

			Special rules apply to investment holding companies.			
US	No	Depreciation, fines, bad debts, foreign profits, tax exempt interest, accounting for inventory.	No although special rules apply to interest and dividend income.	Sometimes	Yes, can elect to file a single consolidated tax return. Losses are therefore netted across the consolidated group. Complex anti avoidance rules especially around buying losses.	

## Interaction with tax authority – getting to certainty

Table E: D

Country	Advance ruling or other official mechanism to help the taxpayer obtain certainty	Does the mechanism differ according to the size of the company?	Other
Australia	Binding ruling system. Over 8,000 rulings made in 2015. Many but not all rulings are published (anonymised) for information purposes on the ATO website. 28 day timeframe for the majority of cases but for complex cases it can take a lot longer.	Anyone can apply for a ruling and it is clear from the published rulings that not all applicants used advisers.  Key client managers allocated for large/complex businesses.	Key client managers' direct traffic a bit for large/high risk customers but where large business has a query they tend to contact specialists directly via advisers contacts.  ATO appears to be keen to digitise, simplify and improve customer/employee relations. Practical guidance issued on how to 'swim between the flags' in certain areas. Also published statement of how taxpayers are assessed for high/medium and low risk.  Also, the ATO has published a 'Blueprint for change' sets out what customers and staff would like to change about the ATO, and provides clear goals for specific sectors e.g. small business, public companies, individuals, etc. as well as intermediaries (tax agents). Importantly, achievements are listed on the ATO website.

Canada	Confidential binding rulings are available.	No, however, the process is costly and time-consuming so may put off smaller businesses.	Some recent improvements to the binding rulings process have alleviated backlog. Appeals process is significantly backlogged.  There is no dispute resolution mechanism during the course of an audit.  Website is not considered user friendly.  Low satisfaction rates with the tax authority.
France	Binding rulings are available and are the only mechanism for obtaining pre-filing certainty. 3 month timeframe for responses. Most but not all binding ruling applications are done via advisers. No response from French Tax Authority is generally treated as a 'no'.	Large companies have a specific central tax office allocated to them, so better communication channels.	Large businesses tend to have better connections with their local tax office directly or via advisers and therefore can sometimes obtain better quality support.  Pre-filing interactions outside the APA/binding ruling process are not binding on the French tax authority.  APA procedure is separate from binding rulings and takes longer. Small companies can access a simplified APA procedure.
Germany	Binding rulings are available. If the value of the relief is less than EURO10,000, then no fee in applying for ruling. If above this amount, the taxpayer can choose to either pay EURO50 per 0.5hrs for the amount of time it takes the authorities to give a ruling. Alternatively, the taxpayer can go to the financial court for a ruling but must pay for the cost of proceedings (rare).	No	In the course of finalizing a tax audit the future handling of certain cases can be agreed in a binding way.
Ireland	Irish Revenue provide opinions on a variety of topics lasting a maximum of five years. However, these are not legally binding and it is open to the Revenue to review the position when the transaction is complete and all facts are known.	A co-operative compliance regime for large companies will soon be relaunched. If companies participate, they will continue to be allocated a caseworker. Large business is dealt with centrally, small business on a district basis.	Caseworkers for large businesses.  Significant investment in digitisation has been very well received by taxpayers.  Priority given to timely responses; statistics published by Irish Revenue on response times

		The Irish Revenue has a dedicated tax service that provides written responses to queries. This is utilised with success by small business. These responses are not legally binding.	to telephone service, complaints, registrations, repayments, correspondence, etc.
Netherlands	Confidential binding rulings are available.	Dutch tax authority is generally open to advance consultation with businesses of any size.  Horizontal monitoring programme can be entered into under certain conditions for 'real time' relationship with the Dutch tax authority. Not clear that this programme is popular or successful; success is dependent on the individual inspector.	Generally high satisfaction rates with the tax authority.  Group consolidation regime and participation exemption are generally seen as successful.
Singapore	Confidential binding rulings are available. Singapore tax authority provides examples of the sorts of cases that it would be willing to rule on as well as the sorts of cases that they would consider to be vexatious. No appeal against binding rulings; if the taxpayer disagrees they must wait for an assessment after submitting their return.	Most taxpayers have a dedicated officer, unless very small. Can informally call the hotline or email the tax office, and obtain a reply, usually within a few days.  Enhanced taxpayer relationship (ETR) programme for large business to resolve disputes. Approx 200 taxpayers take part.	High satisfaction rates with tax authority.  Website clear and easy to navigate.  Limitation period recently reduced to 4 years from 6 years.
US	Confidential pre-filing agreements can be obtained on most topics, however the taxpayer has to pay a fee of \$100,000.  IRS website data indicates that no more than 50 pre-filing agreements have been entered into per year since 2006.	No, however the cost is clearly an impediment to small business.	Many initiatives to expedite dispute resolution. E.g. Compliance Assurance programme (for large businesses with complex returns).  Large businesses tend to have contacts at the IRS. Continuous audit for circa. 1000 largest businesses is being phased out.  The tax court has an expedited process to resolve disputes involving \$50,000 or less.  Fin48 is a US accounting requirement that requires business to estimate and book in their accounts any tax costs upon audit. Means business is less able to 'play the audit lottery'.

## Data from the PwC/World bank 'Paying Taxes' report 2017

### Corporate income tax – ordered by time taken to file CIT return

Table E: F

Country*	Time taken to comply with CIT return (hours)	Time taken to comply with CIT audit (hours)	Time to complete a CIT audit (weeks)	Number of tax payments**	Total tax rate (all taxes borne, including CIT, as % of net profit before all taxes borne)	Total profit tax rate (CIT as % of net profit before all taxes borne)	Statutory CIT rate (%)
Ireland	12	2.5	Audit is unlikely	1	26	12.4	12.5
The Netherlands	21	4	Audit is unlikely	1	40.4	20.6	25 (€0-200,000 at 20%)
Singapore	24	17	12.6	1	19.1	1.8	17
France	28	4	Audit is unlikely	1	62.8	0.4	33
Australia	37	2.3	Audit is unlikely	1	47.6	26.0	30
UK	37	6.5	8.3	1	30.9	18.3	20-21
Germany	41	5	Audit is unlikely	2	48.9	23.2	15
Canada	45	16	12.7	1	21	3.9	15 (\$0-500,000 at 11%)
US	87	9	Audit is unlikely	2	44	28.1	34 (progressive schedule)

\* federal taxes only (where relevant), for calendar year 2015

\*\* online payments count as 1 payment event even if multiple tax payments must be made

# F

# Comparison of accounting, company law and HMRC compliance requirements

The table below compares legislation and guidance on record keeping, accounts preparation and filing requirements for companies, between Companies House, HMRC and GAAP

Case Study on completing joint Companies House / HMRC CATO filing facility	
Companies House	HMRC
<p>The filing portal initially runs through the Companies House information required:</p> <ul style="list-style-type: none"> <li>• Officers of the company</li> <li>• Directors report to include only those sections where the accounts include notes on them</li> <li>• Turnover, other income, purchases, staff costs, depreciation, other charges, tax, leaving profit/loss for balance sheet</li> <li>• Balance sheet (with help available on each item):               <ul style="list-style-type: none"> <li>○ Called up share capital (unpaid)</li> <li>○ Fixed assets</li> <li>○ Current assets</li> <li>○ Prepayments</li> <li>○ Creditors (falling due within one year)</li> <li>○ Creditors (falling due after one year)</li> <li>○ Provision for liabilities</li> <li>○ Accruals</li> <li>○ Called up share capital</li> </ul> </li> <li>• Balance sheet statements pre-filled on small/micro exemptions claimed</li> <li>• Additional notes only where included in the accounts – notes explain most micro-entities won't complete additional notes, e.g.               <ul style="list-style-type: none"> <li>○ Accounting policies</li> <li>○ Operating profit or (loss)</li> </ul> </li> </ul>	<p>The portal then, separately, moves to the HMRC details required:</p> <ul style="list-style-type: none"> <li>• Trading account (turnover, purchases, gross profit)</li> <li>• Expenses under three sub-headings, but which then drop down to multiple items               <ul style="list-style-type: none"> <li>○ Directors, employees and subcontractors costs</li> <li>○ Property costs</li> <li>○ Administration costs</li> </ul> </li> <li>• Adjustments to profit, namely:               <ul style="list-style-type: none"> <li>• Depreciation</li> <li>• Disallowable entertaining</li> <li>• Donations</li> <li>• Legal/professional fees</li> <li>• Net loss on sale</li> <li>• Penalties and fines</li> <li>• Unpaid directors remuneration</li> </ul> </li> </ul> <p>Details are then needed for the following deductions to accounting profit:</p> <ul style="list-style-type: none"> <li>• Remuneration previously disallowed</li> <li>• Profit on sale</li> <li>• Non-trade interest received</li> <li>• Income from property</li> <li>• Ancillary income</li> </ul>

<ul style="list-style-type: none"> <li>○ Assets or stocks</li> <li>○ Debtors or creditors</li> <li>○ Called up share capital</li> </ul> <p>After being asked to approve the accounts, submission is made to Companies House.</p>	<ul style="list-style-type: none"> <li>● Whether a claim to capital allowances wishes to be made, if so plant/machinery/car purchases/other qualifying capital expenditure details to be entered</li> <li>● Income from property</li> <li>● Trading losses</li> </ul> <p>Finally, after being asked to approve the accounts (again), submission is made to HMRC.</p> <p>We found it took around one hour (in a very straightforward example) to complete the Companies House submission, and a further one and a half hours for the HMRC submission.</p>	
<h2>Record-keeping requirements</h2> <p>Legislation (Accounting standards follow company law)</p>		
<p><i>s386 Companies' Act 2006</i></p>	<p>TMA 1970 12B (FA1994 Sch 19) <i>para 21&amp; 22 schedule 18 FA 1998</i></p>	<p><i>Proposed under MTD for Business</i> (this could be similar for small companies, with the addition of CT specific records) TMA 1970 12C (FA2017) (extracts) We have recommended that these requirements are integrated into iXBRL, to avoid any additional burden for companies.</p>
<p><b>Duty to keep accounting records</b></p> <p>(1) Every company must keep adequate accounting records.</p> <p>(2) Adequate accounting records means records that are sufficient—</p> <p>(a) to show and explain the company's transactions, (b) to disclose with reasonable accuracy, at any time, the financial position of the company at that time, and (c) to enable the directors to ensure that any accounts required to be prepared comply with the requirements of this Act...</p> <p>(3) Accounting records must, in particular, contain—</p> <p>(a) entries from day to day of all sums of money received and expended by the company and the</p>	<p>A company which may be required to deliver a company tax return for any period must keep such records as may be needed to enable it to deliver a correct and complete return for the period.</p> <p>(5) The records required to be kept and preserved under this paragraph include records of—</p> <p>(a) all receipts and expenses in the course of the company's activities, and the matters in respect of which the receipts and expenses arise, and (b) in the case of a trade involving dealing in goods, all sales and purchases made in the course of the trade.</p>	<p>7) the Commissioners...require a person to provide by electronic communication specified information...relevant to calculating profits, losses or income of the business, including information about receipts and expenses...at specified intervals...not more than once every three months...</p> <p>10) ...keep specified records relating to the business in electronic form (the conditions)</p> <p>11) (2)(d) for treating information as not having been provided or records as not having been kept unless conditions are complied with.</p> <p>11) (6) that information provided or records kept must meet standards of accuracy and completeness set by general or specific directions given by the Commissioners</p>



<p>matters in respect of which the receipt and expenditure takes place, and</p> <p>(b) a record of the assets and liabilities of the company.</p> <p>(4) If the company's business involves dealing in goods, the accounting records must contain—</p> <p>(a) statements of stock held by the company at the end of each financial year of the company,</p> <p>(b) all statements of stocktakings from which any statement of stock as is mentioned in paragraph (a) has been or is to be prepared, and</p> <p>(c) except in the case of goods sold by way of ordinary retail trade, statements of all goods sold and purchased, showing the goods and the buyers and sellers in sufficient detail to enable all these to be identified.</p>	<p>(6) The duty to preserve records under this paragraph includes a duty to preserve all supporting documents relating to the items mentioned in sub-paragraph (5)(a) and (b). "Supporting documents" includes accounts, books, deeds, contracts, vouchers and receipts.</p>	<p>Failure to meet those standards may be treated as a failure to provide the information or keep the records</p> <hr/> <p><i>Indicative list that will be in the regulations for specified information / records for businesses:</i></p> <p><b>Non-property businesses</b></p> <p>Income:</p> <ul style="list-style-type: none"> <li>• turnover, takings, fees, sales or money earned</li> <li>• any other business income</li> </ul> <p>Expenses:</p> <ul style="list-style-type: none"> <li>• cost of goods bought for resale or goods used</li> <li>• construction industry – payments to subcontractors</li> <li>• wages, salaries and other staff costs</li> <li>• car, van and travel expenses</li> <li>• rent, rates, power and insurance costs</li> <li>• repairs and renewals of property and equipment</li> <li>• phone, fax, stationary and other office costs</li> <li>• advertising and business entertaining costs</li> <li>• interest on bank and other charges</li> <li>• bank, credit card and other financial charges</li> <li>• irrecoverable debts written off</li> <li>• accountancy, legal and other professional fees</li> <li>• depreciation and loss/profit on sale of assets</li> <li>• other business expenses</li> <li>• goods and services for your own use</li> <li>• income, receipts and other profits included in business income or expenses but not taxable as business profits</li> <li>• disallowable element for each category</li> </ul>
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		<p><b>End of year information</b></p> <p>Tax adjustments and elections:</p> <ul style="list-style-type: none"> <li>• adjustment required where the basis period is not the same as the accounting period under section 203 of the Income Tax (Trading and Other Income) Act (ITTOIA) 2005</li> <li>• averaging adjustment applied to taxable profits where an election has been made for averaging under section 222 or 222A of ITTOIA 2005</li> <li>• adjustment required as a result of a change in basis under Chapter 17 of Part 2 of ITTOIA 2005</li> <li>• total of any construction industry scheme deductions taken from payments made to subcontractors under section 61 of Finance Act 2004</li> <li>• any other tax deducted from trading income (excluding deductions made by contractors on account of tax)</li> <li>• sums due to be charged under sections 277 to 285 of ITTOIA 2005</li> <li>• adjustments required under Chapter 7 of Part 3 of ITTOIA 2005</li> <li>• claims for loss relief under Chapter 2 of Part 4 of the Income Tax Act 2007 (Chapter 4 for property businesses)</li> <li>• disallowable expenditure</li> <li>• foreign tax deducted</li> <li>• any other tax adjustment</li> <li>• adjustment on change of basis</li> <li>• foreign tax deducted</li> </ul> <p>Capital allowances – claims and balancing charges:</p> <ul style="list-style-type: none"> <li>• annual investment allowance</li> <li>• capital allowances at 18%</li> </ul>
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		<ul style="list-style-type: none"> <li>• capital allowances at 8%</li> <li>• restricted capital allowances on cars costing more than £12,000 where bought before 6 April 2009</li> <li>• business premises renovation allowance</li> <li>• enhanced capital allowances: energy-saving relief</li> <li>• enhanced capital allowances: environmentally-beneficial relief</li> <li>• enhanced capital allowed: electric charge-points</li> <li>• enhanced capital allowances: gas refuelling equipment</li> <li>• allowances on sale or cessation of businesses use (where an asset has been disposed of for less than its tax written down value)</li> <li>• total capital allowances</li> <li>• balancing charge on sale or cessation of business use (where business renovation allowance has been claimed)</li> <li>• balancing charge on sales of other assets or on the cessation of business use (where an asset has been disposed of for less than its tax written down value)</li> </ul>
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**Guidance on record keeping**

<b>Companies House</b>	<b>HMRC (current guidance for staff)</b>
<p>Record keeping requirements are summarised on the Companies' House website in Life of a Company Part 1 Chapter 2, but broadly restate the above.</p>	<p><u><a href="#">Compliance Handbook 10000</a></u></p> <p>'The records that a person keeps will generally reflect the size and complexity of their affairs. They may range from the simplest of manual records for a sole trader to the most sophisticated computerised system for a multi-national company.</p> <p>The records do not have to be in any particular format, but they should be up to date and kept in sufficient detail to</p> <ul style="list-style-type: none"> <li>• allow the person to make a correct and complete return</li> </ul>

- allow the person to calculate the correct amount of tax or duty to be paid or claimed
- enable us to check the figures on the return or claim.

The precise nature and extent of the records needed to fulfil these requirements depends on the type and size of the business or the person's affairs.

Commercial and accounting practices that are common to certain trade sectors, such as self-billing and authenticated receipts in the construction industry, also influence the way in which records are preserved. And Section 386 Companies Act 2006 sets out the accounting records that a company must keep, see CH11400<sup>1</sup>.

We may require any person, see CH10400<sup>2</sup>, to make a Self-Assessment return. Generally, they must keep the records they need to make and deliver a correct and complete return for the tax year or period, even if they don't make a return every year. We do not specify in detail the type of record they must keep.

However, there are additional, more specific, requirements for

- persons carrying on a trade, profession or business alone or in partnership, and
- companies.

You must keep accounting records that include

- all money received and spent by the company
- details of all assets owned by the company
- debts the company owes or is owed
- stock the company owns at the end of the financial year
- the stocktakings you used to work out the stock figure
- who you bought and sold them to and from (unless you run a retail business)

<sup>1</sup> <https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch11400>

<sup>2</sup> <https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch10400>

	<p>You must also keep any other financial records, information and calculations you need to file your annual accounts and Company Tax Return (is includes records of all money</p> <ul style="list-style-type: none"> <li>• Spent by the company, e.g. receipts, petty cash books, orders and delivery notes</li> <li>• Received by the company, e.g. invoices, contracts, sales books and till rolls.</li> </ul> <p>You must also keep any other relevant documents, e.g. bank statements and correspondence.</p> <p>The duty to preserve the records is discharged by preserving them or the information in any form.’</p>
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## Accounts preparation

**True and fair view** in auditing means that the financial statements are free from material misstatements and faithfully represent the financial performance and position of the entity. Although the expression of true and fair view is not strictly defined we can reach the following general conclusions as to its meaning: **True** suggests that the financial statements are factually correct and have been prepared according to applicable reporting framework such as the IFRS and they do not contain any material misstatements that may mislead the users. Misstatements may result from material errors or omissions of transactions and balances in the financial statements.

**Fair** implies that the financial statements present the information faithfully without any element of bias and they reflect the economic substance of transactions rather than just their legal form.<sup>3</sup>

Accounting Standards	Company law	HMRC (current)
FRS105 (optional) / FRS102 S1A	S393 CA 06: Accounts to give true and fair view	<b>Guidance only</b> NB: some of this guidance is out of date, and does not reflect updated Company Law requirements
<p>The Financial Standard for Smaller entities (FRSSE) has been withdrawn, and replaced by two new standards (for accounting periods commencing on/after 1 January 2016):</p> <ul style="list-style-type: none"> <li>• FRS 102 Section 1A, amending s102 to bring small companies into its scope</li> </ul>	<p>(1) The directors of a company must not approve accounts for the purposes of this Chapter unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss—</p> <p>(b) in relation to a micro-entity..., the directors must disregard any provision of an</p>	<p><b>1. Overview</b></p> <p>Your company’s annual accounts - called ‘statutory accounts’ - are prepared from the company’s financial records<sup>4</sup> at the end of your company’s financial year. You must always send copies of the statutory accounts to:</p>

<sup>3</sup><http://accounting-simplified.com/audit/concepts/true-and-fair-view>

<sup>4</sup> <https://www.gov.uk/running-a-limited-company/company-and-accounting-records>

<ul style="list-style-type: none"> <li>FRS 105, a new standard applicable to entities meeting the criteria for reporting under the micro entities regime.</li> </ul> <p>There have also been the following key mandatory changes to company law (for accounting periods as above):</p> <ul style="list-style-type: none"> <li>A group is no longer ineligible if one of its members is a plc</li> <li>Small companies (whether under FRS 102 section 1A or FRS 105) will have fewer note disclosures required in the accounts</li> <li>Abbreviated accounts are replaced by an option for abridged accounts - P &amp; L has turnover and cost of sales combined so starts at gross profit, these form the full accounts for members, must still meet the requirement to give a true and fair view, deliver to CH (each year) a statement that all members agree to the abridgement</li> </ul> <p>FRS 102 section 1A and FRS 105 option for filleted accounts for CH submission:</p> <ul style="list-style-type: none"> <li>The P &amp; L and related notes and directors report can be stripped out from CH submission</li> <li>FRS 105 for micro entities removes the requirement for preparation of the directors report completely</li> </ul> <p><b>FRS 105: Micro entities</b></p>	<p>accounting standard which would require the accounts to contain further information in relation to that item, and</p> <p>(c) where the accounts contain an item of information additional to the micro-entity minimum accounting items, the directors must have regard to any provision of an accounting standard which relates to that item</p> <p>Regulation 5 of Small Companies (Micro entities accounts) Regs 2013 amends section 393 of the 2006 Act to identify, in the case of Micro-Entities, relevant considerations for company directors, when deciding whether to approve accounts on the basis that they give a true and fair view of the financial position of the company.</p> <p>It amends section 396 of the 2006 Act to introduce a presumption that Micro-Entities' accounts which comply with certain minimum requirements give a true and fair view. It also prescribes the statement to appear above the signature in the balance sheet, in circumstances where accounts are prepared in accordance with provisions applicable to companies which qualify as Micro-Entities.</p> <p><b>In guidance:</b></p> <p>2. What does a set of accounts include? Generally, accounts must include:</p>	<p>all shareholders</p> <p>people who can go to the company's general meetings</p> <p>Companies House (unless you send abbreviated accounts<sup>5</sup>)</p> <p>HMRC as part of your Company Tax Return</p> <p>You have different deadlines<sup>6</sup> for sending your accounts to Companies House<sup>7</sup> and your tax return to HMRC, but you may be able send them at the same time.</p> <p><b>How to put together statutory accounts</b></p> <p>Statutory accounts must include:</p> <p>a 'balance sheet', which shows the value of everything the company owns, owes and is owed on the last day of the financial year</p> <p>a 'profit and loss account', which shows the company's sales, running costs and the profit or loss it has made over the financial year</p> <p>notes about the accounts</p> <p>a director's report</p> <p>You might have to include an auditor's report - this depends on the size of your company<sup>8</sup>. The balance sheet must have the name of a director printed on it and must be signed by a director.</p> <p><b>Accounting standards</b></p> <p>Your statutory accounts must meet either: International Financial Reporting Standards</p>
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<sup>5</sup> <https://www.gov.uk/annual-accounts/microentities-small-and-dormant-companies>

<sup>6</sup> <https://www.gov.uk/prepare-file-annual-accounts-for-limited-company>

<sup>7</sup> <https://www.gov.uk/prepare-file-annual-accounts-for-limited-company/file-your-accounts-and-company-tax-return>

<sup>8</sup> <https://www.gov.uk/audit-exemptions-for-private-limited-companies>

<p>This is an optional standard, with the default position being to report under FRS102. The entity must meet at least two of the three requirements in two consecutive years to qualify (unless newly incorporated when qualify from first year):</p> <ul style="list-style-type: none"> <li>• Turnover not more than £632,000</li> <li>• Balance sheet total (fixed + current assets) not more than £316,000, and</li> <li>• Average number of employees no more than 10</li> </ul> <p>Key features:</p> <ul style="list-style-type: none"> <li>• Only two primary statements required, the P&amp;L and Balance Sheet (see above re fillet accounts submission)</li> <li>• Format of accounts e.g. fixed assets and current each presented as one total: prescriptive but simpler P&amp;L and Balance Sheet (or Financial Statement)</li> <li>• Only two legally required disclosures, advances, credits and guarantees granted to directors, and financial commitments, guarantees and contingences (presented as footnotes to the balance sheet)</li> <li>• No directors report required</li> <li>• Simplified accounting treatment – all accounting policy options are removed</li> <li>• No fair value or revaluation accounting</li> <li>• No requirement to provide for deferred tax liabilities, nor recognise deferred tax assets</li> <li>• Accounts presumed to give true and fair view, with no need to consider providing additional information</li> </ul>	<ul style="list-style-type: none"> <li>• a profit and loss account (or income and expenditure account if the company is not trading for profit)</li> <li>• a balance sheet signed by a director on behalf of the board and the printed name of that director</li> <li>• notes to the accounts</li> <li>• group accounts (if appropriate)</li> </ul> <p>And accounts must generally be accompanied by; GP2 June 2016 Version 4.6 Companies Act 2006 Page 9 of 48</p> <ul style="list-style-type: none"> <li>• a directors' report signed by a secretary or director and their printed name, including a business review (or strategic report) if the company does not qualify as small</li> <li>• an auditors' report stating the name of the auditor and signed and dated by him (unless the company is exempt from audit).</li> </ul>	<p>UK Generally Accepted Accounting Practice</p>
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Company law and HMRC filing requirements	
<b>Legislation</b>	
<b>S441 &amp; s444 CA 2006 amended by The Small Companies (Micro-Entities' Accounts) Regulations 2013</b>	<b>FA1998 Sch 18 para 4</b>
<p>Micro-entities are no longer required to prepare directors' reports.</p> <p>Small company will no longer be able to file (at Companies House) annual accounts which are an abbreviated version of the accounts which it prepares and sends to shareholders – instead a small company must file the versions of the balance sheet and may send profit and loss account (where the profit and loss account is filed) which are prepared and sent to the shareholders.</p> <p>Where the directors of a company subject to the small companies regime (a) do not deliver to the registrar a copy of the company's profit and loss account, or</p> <p>(b) do not deliver to the registrar a copy of the directors' report, the copy of the balance sheet delivered to the registrar must contain in a prominent position a statement that the company's annual accounts and reports have been delivered in accordance with the provisions applicable to companies subject to the small companies' regime. (s444(5) CA 2006)</p> <p>A small company may claim exemption from the audit requirements unless a member holding 10% of the nominal value of the issued share capital demands it (<i>s477 Companies Act 2006</i>).</p> <p>It exempts Micro-Entities from the obligation to draw up notes to the accounts other than the prescribed minimum notes.</p> <p>It dis-applies, in the case of Micro-Entities, provision for fair value accounting and provision for the filing of abbreviated accounts.</p> <p>It provides for two abridged balance sheet formats and one abridged profit and loss account format for Micro-Entities.</p>	<p>In the case of a company which—</p> <p>(a) is required to deliver a company tax return for a period...the power to require the delivery of accounts as part of the return is limited to such accounts, containing such information and having annexed to them such documents, as are required to be prepared under that Act (CA 1985). SI2003 – accounts and computations must be in iXBRL format.</p> <p><b>Company tax return</b></p> <p>Sch 18 para 3(1)The Inland Revenue may by notice require a company to deliver a return (a "company tax return") of such information, accounts, statements and reports—</p> <p>(a) relevant to the tax liability of the company, or</p> <p>(b) otherwise relevant to the application of the Corporation Tax Acts to the company,</p> <p>as may reasonably be required by the notice.</p>
<b>Guidance</b>	
<b>Companies House guidance for businesses</b>	<b>HMRC's guidance for staff</b>
Summarised on the Companies' House website in Life of a Company Part 1 Chapter 2, but broadly restate the above.	<p>CTM93090</p> <p>In practice the Paragraph 3 notice (form CT603) (previously Section 11 notice - form CT203) requires companies to make a return made up of:</p> <ul style="list-style-type: none"> <li>• a properly completed form CT600 (formerly CT200) (or an approved substitute version of it) and any relevant supplementary return pages,</li> </ul>



- computations showing how they arrived at the entries in the return and supplementary pages from the relevant figures in the accounts,
- a copy of the full accounts (including the reports of the directors and the auditors),

FA98/SCH18/PARA4 provides explicitly that 'delivery' of the return means delivery of all the:

- information,
- accounts,
- statements, and
- reports,

required by the FA98/SCH18/PARA3 notice.

This ensures consistency in the interpretation of 'delivery of the return' in relation to all the CTA provisions that bear upon it.

Thus, if a company delivers a completed return form but fails to deliver a copy of its accounts and computations, it does not satisfy the filing obligation and the enquiry 'window' does not open.

A company is usually required to deliver a copy of its accounts as part of its return.

Any other documents, such as directors' and auditors' reports, that the Companies Act requires the company to prepare must accompany the accounts, - see CTM93200.

Note: The Companies Act requirement does not extend to the preparation of a detailed trading and profit and loss account. It follows from Paragraph 11 that the notice to deliver a return does not require the company to prepare or deliver a detailed trading and profit and loss account. Most companies, however, include such an account as part of their computations (CTM93210). The notice to deliver (CT603/CT203) also requires the company to provide 'computations showing how entries on the return have been calculated from relevant figures in the accounts'. The computations can be in whatever format the company finds most appropriate for its business, but they must be sufficient to link the accounts with entries on the return.

Computations may include a detailed trading and profit and loss account along with any other analyses and explanations required for that purpose



### **Office of Tax Simplification contacts**

This document can be found in full on our website at:

<https://www.gov.uk/government/organisations/office-of-tax-simplification>

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