

The Office of Tax Simplification

Simplification of the Corporation Tax computation

'...what do companies, large or small, find difficult or time consuming about corporation tax?'

Progress report and call for evidence

November 2016

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Foreword

The new Financial Secretary to the Treasury, Jane Ellison MP, said recently that one of her priorities is “making sure our taxes are supporting our businesses”, and she went on to say that “it’s also important to businesses that taxes are simple”¹. Although many elements of Corporation Tax (CT) have been re-engineered in recent decades and new provisions added, significant aspects of its underlying mechanics remain from its 19th century origins. A key question for this review has been the relevance of the way the computation works for a modern company.

This review originates from a key recommendation in the Office of Tax Simplification (OTS) 2014 Competitiveness review², and so we are working on the basis that simplification of the CT computation is already seen as desirable. We now need to dig down into what a simpler system might look like and what the implications would be.

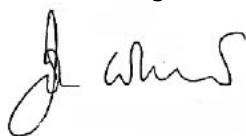
The majority of CT rules apply both to large multinationals and to small one-person companies. There are, of course, hugely important issues about the taxation of multi-national entities operating across multiple jurisdictions. But those specialist issues affect only a small proportion of companies: in 2013-14, out of 2 million companies making CT returns only around 30,000 companies had a turnover over £10m.

This review is about the ‘bread and butter’ of CT as it affects every company, large and small. There may be areas where tax needs to remain specialist, but a taxpayer should be able to understand what they have paid and why. Is the way the computation works still ‘fit for purpose’ for the generality of companies, bearing in mind changing work and business patterns?

We will be drawing on some valuable insights from a variety of stakeholders and commissioning some new analysis. We will of course be factoring in the expertise of our newly-appointed Board members and also our Consultative Committee of private sector representatives. We are working alongside HMRC’s Making Tax Digital programme, to ensure that opportunities for simplification are seized and, where possible, our proposals complement each other. Bringing this all together, our team in the OTS adds a mix of private and public sector experience to the review.

This progress report and call for evidence summarises our thoughts and reflects the diverse views heard. It sets out the themes we plan to focus on, and invites all concerned with this important part of the tax system to contribute to the next phase of our work. As always, we welcome opportunities to meet with interested stakeholders; equally just drop us a line with your thoughts – or share them with us via our on-line survey (see chapter 3). Please do, though, contribute to our evidence gathering: you can contact us at ots@ots.gsi.gov.uk.

John Whiting



¹ <https://www.gov.uk/government/speeches/financial-secretary-to-the-treasury-on-a-tax-service-for-the-21st-century>

² OTS: Competitiveness of UK tax administration review: 8 December 2014:

<https://www.gov.uk/government/publications/competitiveness-of-uk-tax-administration-review>

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Introduction

1.1 We want to engage companies and their advisers in a discussion on how the corporation tax computation could be simplified and to help us identify the areas that would most benefit from reform.

Why simplify the CT computation?

1.2 The OTS has previously reported on the view from the corporate sector that there should be as few adjustments as possible within the CT computation and these should be in accordance with a clear and well understood policy. In 2014 we recommended a review of the rules to establish whether accounting and tax profits could be more closely aligned, considerably reducing the time taken on CT administration. This would, in turn, contribute to the government's aim of having a more competitive tax system for business.³

1.3 The burden for companies is not only the cost of preparing and submitting a CT return to HMRC, but also the underlying cost of information gathering and decision making by tax professionals after (or alongside) the calculation of accounting profit. With rates of CT reducing to 17%, the net value of adjustments will diminish, and incentives become less valuable, compared with the cost of calculating and claiming them. More so, proportionately, for smaller amounts in smaller companies.^{4 5}

What we said we would do

1.4 The starting point for this review is that simplification of the CT computation is desirable. We will identify areas of both policy and process where simplification could be achieved and, in advance of Budget 2017, report on the benefits and challenges that simplification measures might create for companies, HMRC and the Exchequer. Our Terms of Reference are in Annex A.

What we have found so far...and how you can get involved

1.5 We have already met with a wide range of businesses and their representatives, as well as policy specialists in HMRC and HM Treasury, to help us identify the areas of the CT computation that have potential to be simplified. We have considered available data, and commissioned new

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/362302/competitiveness_review_final_report.pdf

⁴ Some businesses have suggested to the OTS that they would accept higher (or less reduction of) CT rates in exchange for a simpler system including more straightforward reliefs.

⁵ References to 'companies' includes groups of companies; references to 'businesses' are used where we are referring more generically to the business population.

analyses to help us build a richer picture. We also recognise the changes planned through Making Tax Digital (MTD) and the opportunities this offers for creating a simpler system.

Chapter 2 reflects the views we have heard and sets out our emerging themes

1.6 We would like companies, advisers and others involved with the CT system to tell us whether these themes are the most relevant and beneficial areas to focus on, and why, and propose any other areas that we should be exploring.

1.7 These themes are summarised below and are a mix of policy reforms and process changes. Some of these are areas where simplification could be achieved in the shorter term but others, such as relieving capital expenditure, are areas that cannot be considered without a much wider debate on the implications and these would be much longer term changes.

1.8 Many of the rules and principles of the CT system currently read across to the income tax regime for unincorporated businesses. Whilst this review is specific to CT we will need to highlight where there are implications for income tax.

We think these are the main areas where simplification could be considered, and where there is potential for reducing the differences between accounting profit and tax profit. What are the benefits and challenges that need to be considered? What is the prize?

- The many adjustments between accounting profit and CT profit: burden vs value?
- Ways of relieving or incentivising capital expenditure: complexity and certainty
- The ‘Schedular’ system – including whether the distinction between trading and investment companies is still relevant and the extent to which capital gains are paid by companies.
- Making Tax Digital – where this creates opportunities for a simpler regime
- Reporting and compliance processes that could be simplified
- The distinction between small and large companies:
 - a) simpler tax for smaller companies
 - b) streamlining tax processes for large and complex companies.

1.9 We would welcome your contribution to this review. Please take time to consider the themes and questions posed in Chapter 2 and let us have your views. Chapter 3 sets out our contact details and also links to our two on-line surveys for small businesses and their advisers.

<https://www.surveymonkey.co.uk/r/smallbusinesstaxpayer>

<https://www.surveymonkey.co.uk/r/professionaladvisers>

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Emerging themes

The themes below have emerged during our conversations with business, their advisers and representatives, as those areas that would benefit most from simplification. We have reflected some of their views below, and posed some questions for you to consider. Chapter 3 sets out how you can contribute.

From accounting profit to taxable profit...and all steps in between

2.1 The starting point in calculating profit for corporation tax (CT) purposes is the company's accounting profit, prepared in accordance with international and UK financial reporting standards. We note the desire for there to be as few adjustments as possible to arrive at taxable profit, and that these adjustments should reflect clear and well understood policies. They need to be relevant to a modern business, and simple to administer (in proportion to the complexity of the business).

2.2 The CT computation has many functions and components: it provide incentives and reliefs for business, raises specific revenues for the Exchequer, and discourages certain behaviours. The current range of adjustments includes:

- wholly & exclusively rules, and discrete disallowances, such as entertaining
- capital/revenue issues, such as in relation to the deduction of professional and legal fees or the setting up of a new pension scheme
- incentives and reliefs, such as R&D
- provisions for timing differences, such as pension contributions
- international and financial matters, such as overseas branches or loan relationships
- industry-specific or discrete taxing/relieving rules, such as creative industry tax relief
- anti-avoidance provisions, such as loss buying or transactions in securities
- some of the rules are replicated for unincorporated businesses, such as computation of trading profit
- some provide for large or small companies, such as enhanced deductions for expenditure on R&D
- some have a readily recognisable rationale and some are more obscure, such as some features of the management expenses rules

2.3 These adjustments have accumulated piecemeal over 150 years. As rates come down to 17%, the value of these adjustments (either taxing or relieving) will diminish in absolute terms and the compliance burden will become proportionately greater.

2.4 As an ambition, CT adjustments need to be relevant, clear, simple, and add material value either to the business (incentives and reliefs) or to the Exchequer (discourage non-compliance or measures to tax specific items). Considering the categories above:

- which CT adjustments do you find complex or burdensome in relation to the tax outcome? Is it the rules that are complex, or the process?
- for which CT adjustments does the information gathering and record keeping feel disproportionate to the tax outcome?
- which CT adjustments add value to business (that is, support the business' activities)?
- which CT adjustments are not clear in their purpose, or don't fully align with business activities?
- there are some regimes which, to an extent, follow or replicate accounting treatment (for example leasing/intangibles, loan relationships, forex, derivatives). What is your experience of administering these, and how they align with the accounting position? Are they helpful simplification models to follow?

2.5 To help illustrate these questions we are creating a table highlighting the most widely used CT adjustments, to try and build a more dynamic picture of the way small and large businesses engage with CT, and the costs and benefits of doing so. We will be publishing this as a 'starter for ten' in early November, and we would like companies, their agents and representatives to review, add and comment on it, to help us identify the specific adjustments that business would most like to see simplified.

How capital expenditure is incentivised and relieved

2.6 The most frequent tax adjustment to accounting profits is the replacement of depreciation with capital allowances (CA). The origin of the current regime was a statutory allowance 'as representing the diminished value by reason of wear and tear' of plant and machinery introduced in 1878. It was the Income Tax Act of 1945 which introduced concepts such as initial allowances and writing down allowances (WDA), for example, to provide relief for capital expenditure and promote capital investment, which has developed into the regime as we know it today.

2.7 Originally, the WDAs for plant and machinery were set at 25% and relief for industrial buildings was also given. The WDAs rate was reduced to 20% and 10%, then 18% from 1 April 2012, and 8% in relation to integral features and long life assets. Industrial buildings allowances were phased out by 1 April 2011.

2.8 Given the fall in both the CT rate and allowance rates, as well as the associated administrative burden (for example in determining what qualifies, or in tracking, short life

assets⁶) the advantage of CAs over the accounts depreciation deduction has diminished. This raises two important questions:

1. Does the CA regime (in its current form) continue to relieve capital expenditure and incentivise capital investment in a way which recognises the commercial reality under which business make decisions?
2. Can this be achieved more simply?

2.9 From the conversations we have had so far, the overall feeling is that the CA regime is something businesses understand and have become used to, even if the rules contain a range of complexities. Many cited concern about uncertainty in the CA system driven by the government's continuous 'tinkering' around the boundaries which made them 'nervous'. Many felt reluctant to see wholesale changes made to the CA regime in the short term, in case this risked greater uncertainty. This was especially true for large businesses considering investing in long term projects.

2.10 However, it's not been evident from our discussions that CAs provide an incentive for businesses, big or small, to invest; rather than giving relief for expenditure that they would have made anyway. Many businesses told us that they were unclear as to the broader intention of the CA regime because the rules of the regime didn't really reflect how they currently operate or invest. Many of the professional advisers and businesses we spoke to were critical about the complexity and uncertainty involved in deciding which purchases or expenditure qualify for relief, and – in some sectors – the need to identify and track deferred revenue expenditure. These comments resonate with observations made in our UK Competitiveness (2014) report.

2.11 An alternative to CAs would be to take a deduction for accounts depreciation for tax purposes. Accounts depreciation should provide a truer reflection of the commercial rationale for capital expenditure (compared to tax treatment) and remove the need to carry out additional analysis of capital expenditure in the context of the CA regime⁷. This would more closely align taxing profits to accounting profits. However, this would only be beneficial as a simplification if the distinction between qualifying and non-qualifying was largely removed, and a different approach adopted that allowed a more holistic view of total expenditure across investment projects.

2.12 Such an approach would clearly not be without its challenges (not least the Exchequer consequences) and there would be both gainers and losers and significant sectoral/industry differences. Moving from a common rules-based system, to a system based on individual companies' accounting decisions would also create a difficult balance between maintaining consistencies between companies on the one hand, and aligning tax to commercial reality on the other. There could also be challenges to ensure companies do not secure a competitive advantage by accelerating the depreciation of their working assets (though nowadays

⁶ The burden of which may increase following withdrawal of the renewals allowance

⁷ For example, on purchase of a commercial building, considerable analysis needs to be undertaken in ascertaining plant & machinery comprised within, and reference to previous owners' claims and elections.

accounting standards provide significant control for larger companies whilst for smaller companies the Annual Investment Allowance (AIA) effectively allows this in tax terms).

2.13 Another option could be to move to a different style of allowance which creates a more immediate link between investment decisions and relief (to the extent that is the policy objective). An obvious example would be R&D relief or other approaches akin to grants. Such an approach could offer an opportunity to replace the current (complex) rules with a modern set of rules, which are simpler to follow and provide better certainty over availability of relief.

2.14 Of course these changes could simply move complexity from one place to another, or create new uncertainties as the rules bed down.

2.15 We recognise that any changes to CAs are not a short term solution but need careful consideration, and in our final report we will consider whether there is evidence to suggest that simplification is a desirable option for CAs, and what the next steps might be.

2.16 To develop all this further, we will look at the following:

- whether the CA rules for relieving capital expenditure can be simplified. This will include looking at what qualifies as eligible expenditure (such as, potentially, business' desire for the scope of the regime to more closely reflect commercial decisions and investment) and whether a 'broader brush' approach would ease the administrative burden when applying the current set of rules, and the impact this may have
- the rules concerning classification of capital expenditure in the context of repairs and replacements
- what the transition rules would look like if there was a move away from the current WDA regime, and identify gainers and losers
- how AIA would work as part of an alternative approach and whether a move to cash basis for smaller companies would absorb any negative impact on small companies (see paragraphs 2.45-2.51 below)
- understanding the difference between 'small' and 'large' companies in terms of their interaction with the CA regime and whether something different can be done for small companies
- establishing international comparisons: how do other countries give relief for or incentivise capital expenditure?

The 'Schedular' system

2.17 The terms of reference for this review make a number of references to our examining the categories or sources of income, in the modern context, and the potential for combining at least some of these, while maintaining a separation between capital and revenue.

2.18 This picks up one of the recommendations in our Competitiveness Review which drew attention to some of the features of the Schedular system (which goes back as far as 1803).⁸ In particular some of its consequences seems anachronistic rather than going with the grain of businesses seeing everything they do as part of one overall enterprise.

2.19 One particular challenge from an Exchequer perspective is that Schedular reform would imply pooling losses – as well as profits - from any categories or sources of income that are merged. This would have potentially significant short term yield consequences which would need to be managed.

2.20 The Government's current proposal to reform corporation loss relief is therefore significant, as the new rules for post-2017 losses take a significant step towards such a pooling of losses for the future.⁹ 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 loss restriction) which will generally give the same result as pooling (even though the revenue protection rules depend on them being tracked separately). And, more widely, the remaining pre-2017 losses will, unless effectively stranded forever, work their way through the system over the coming years.

2.21 Reform of the Schedular system has, of course, been considered by Government before, in particular in 2005¹⁰. At that time there was a clear desire for any change to be all-embracing, if the benefits were to be worth the disruption, but it seems going the whole way would have involved too great an Exchequer impact.

2.22 Accordingly, the current context, given the loss reform proposals and lower CT rates, is potentially a fruitful one in which to re-examine this area.

2.23 Under the Schedular system, income and expenditure from different sources, including from each trade, property, investments and non-trade loan relationships has to be separately computed. A key benefit of amalgamating all of them, and developing a set of common rules, would be the removal of the need to consider these and other categories (such as management expenses) or the separate rules that apply to each of them at present. It would also enable generic deduction rules to be applied to fewer, larger, pools of expenditure.

2.24 Our initial discussions with stakeholders, in particular with business and the tax profession, suggest that there remains strong interest in reform of this area.

⁸ OTS: Competitiveness of UK tax administration review: 8 December 2014: Pages 8 and 35-36

⁹ HMT/HMRC: Reforms to corporation tax loss relief: consultation on delivery: May 2016

¹⁰ 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, 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>.

2.25 More specifically, in conjunction with the work on tax/accounting differences and mindful of the opportunities of Making Tax Digital, we will:

- test the idea that all income categories and related deductions be amalgamated into one income pool, bringing items such as trading, property¹¹, non-trading loan relationships miscellaneous income, income losses, management expenses and charges together – building on the direction of travel of the present loss reform proposals
- identify and evaluate consequences which would need to be considered, such as the removal of the investment company concept, how one would bring existing deductions rules across trading and investment companies together, the position of any remaining ‘tax nothings’ (expenditure for which relief is presently not available either as revenue or capital), or double taxation relief

2.26 In short, is there a general view that Schedular reform is worth pursuing? What are the key issues that would need to be resolved in bringing income streams and expenses together? What impacts, consequences and ramifications would there be?

2.27 In addition, on the capital gains side, whilst not considering substantive change to reliefs such as SSE, we will consider whether there are areas in which there is scope to reduce the burdens involved, bearing in mind the limited extent to which CT is paid on chargeable gains. This could be by a variety of means in relation to different asset classes, for example by exemption or bringing them into an income regime (subject to handling the position of losses). Are there ways in which this area could be simplified without adverse Exchequer effects?

Making Tax Digital

2.28 In the March 2015 Budget, the government set out its vision for a new, transformed, tax system, signalling the end of the tax return. This vision is set out in the Making Tax Digital (MTD) reforms.

2.29 The government’s aim for MTD is to make HMRC one of the most digitally advanced tax administrations in the world. For most incorporated businesses, this means that by 2020 they will be required to use software to keep their records electronically and update HMRC quarterly or more frequently should they choose.

2.30 HMRC released six consultation documents on 15 August covering a wide range of elements of MTD, with a focus on unincorporated businesses. The OTS will be formally responding to a number of these consultations in due course. HMRC has confirmed that it will publish a separate document that focuses on incorporated and complex businesses. We are liaising with HMRC on this, to explore synergies between our work and theirs.

¹¹ Note that s44 CTA09 (letting surplus accommodation) already provides for cross schedular treatment

2.31 Although the consultations issued to date focus on unincorporated businesses, there are a number of key points to note from the consultations already published, which are listed below.

1. Recording tax adjustments – HMRC’s preferred approach is to allow flexibility to businesses as to when tax adjustments are made to profits during the tax year.
2. Reliefs and allowances – HMRC will help businesses understand which reliefs and allowances might be available to them. Again, the preferred approach here is to provide businesses with flexibility as to when to record the effect of reliefs and allowances with no requirement to claim these before the end of the period.
3. Providing HMRC with updates – HMRC has provided guidance on the level of detail required, time periods the updates must cover and when they should be submitted.
4. ‘End of year’ activity – HMRC considers that any end of year activity (such as final tax adjustments that may require professional advice) should be a standalone process from the provision of regular updates.
5. Tax administration – as part of the new provision of regular updates, HMRC have proposed new penalty models to adapt its existing administration powers to MTD.

2.32 From our initial discussions with stakeholders, it is clear that both businesses and advisers agree with HMRC’s future ambition for a modern digital tax system and they can see the opportunity for simplifying the tax system alongside MTD. However, alongside this, we have heard concerns about the extent of the administrative burden that quarterly updates could create.

2.33 A number of themes and issues are explored in this progress report which could help create a simpler tax system, in particular Schedular reform and reducing the number of adjustments to accounting profit. Simpler and better targeted underlying policies and processes will help deliver MTD more smoothly and reduce the overall burden of reporting.

2.34 Our review will provide recommendations to this end and we will continue to take advantage of opportunities that will allow us to put these forward.

2.35 With a particular focus on the CT computation processes, what simplifications would you like to see introduced alongside MTD to support its implementation?

The burden of reporting and compliance for business

2.36 In this section we have reflected some initial views and questions from stakeholders on areas of CT administration that affect a range of companies, from large and complex to smaller companies.

Data gathering

2.37 A large number of methods are used to gather tax data for computation preparation, ranging from bespoke accounting systems with tax capability, though off-the-shelf systems to individually designed spreadsheets. Then, the transfer of data to the computation preparer (in-house or external) is undertaken in many different ways. HMRC guidance requests that information is kept to support all entries in the computation (although with no concept of materiality) so many feel that very detailed records must be kept against the possibility of HMRC enquiry.

Reporting

2.38 A CT return consists of:

company accounts + freeform CT computation + prescribed form CT600

The first two are xbrl tagged and filed with HMRC in ixbrl format. A Self-Assessment return for an unincorporated business of any size consists of a prescribed taxonomy of information inserted directly onto the tax return. If tax were simpler, could the CT system replicate the IT (SA) system where accounts and computations are not filed as part of the return?

2.39 Some agents have told us that they are disappointed they will not be able to access the free CATO HMRC software.

2.40 We have also heard many comments from companies and advisers about the burden of ixbrl: HMRC has not always been clear what it is for and how it is used (recognising that HMRC is only responsible for the tax aspects, and not the accounts tagging). These companies want to understand how ixbrl is improving compliance or driving targeted policy decisions, how it will interact with MTD, and whether it will still be needed at all?

The distinction between small and large companies

2.41 Among the population of companies which submit CT returns to HMRC each year, adjustments for depreciation, profits or losses on sale of fixed assets, capital allowances, loan relationship credits (including bank interest received) and entertaining are arguably the most frequently made, to arrive at the taxable profits from the accounting profits. It might be expected that, in the tax computations of larger, more complex companies, there would be a greater incidence of adjustments for such adjustments as transfer pricing, R&D relief and management expenses.

2.42 Of course smaller companies can also have complex tax affairs and hence large numbers of adjustments, but the expectation is that the proportion of such companies is smaller than among larger companies.

2.43 We will consider whether it would be advantageous for small companies to have a regime that exempts them from many more of the more complex adjustments (for example loan relationships or intangibles) and perhaps instead allows them to claim or be subject to only a small number of reliefs and adjustments such as AIA or R&D (this is discussed below). This

would build on existing instances in tax legislation which exempt smaller companies from having to make certain adjustments such as transfer pricing, CFCs and the Worldwide Debt Cap.

2.44 Furthermore, any simplifications for larger, complex companies would also, though less frequently, be of benefit to smaller companies.

Making tax simpler for small and less complex companies

2.45 The vast majority of businesses (including the majority of companies) in the UK are within the EU definition of 'small' or 'micro'¹². The OTS has published a number of reports into small business taxation, and after a further round of conversations with small businesses and their advisers, we find that the messages have not changed. Our initial sense is that, AIA aside, for most small companies the difference between tax and accounting profit is not always significant, and furthermore, the monetary value of those differences will diminish as rates come down to 17%. However, the burden of calculating these tax adjustments will increase in proportion.

2.46 We would like to test the proposition that the complexity of the tax computation for these small companies could be almost entirely removed, whilst retaining a clear and simple set of incentives such as AIA.

2.47 Most of the small company directors that we spoke to were aware of and valued the key tax incentives that support their business, but were less clear on the government's overall objectives for sustaining small business growth. Greater clarity on these objectives would help reaffirm which of those incentives for small business are appropriate to the tax system, and provide an opportunity to create a simpler set of rules for small or less complex companies.

2.48 For the smallest companies, agents have told us that the preparation of accruals accounts can represent the greatest part of the CT600 compliance burden, and the cost of preparing the tax computation is not always distinguishable. Cash basis has proved very successful for unincorporated businesses within the VAT turnover threshold, with 1.1 million businesses taking up the option. MTD is looking to extend the threshold, and options are set out in the recent consultation documents. We continue to feel that an optional cash basis of accounting could also be used beneficially for the smallest companies¹³.

2.49 For the smallest companies, would a combination of cash accounting (either within or outside the current EU accounting directives), removing the need for a tax computation and with the provision of a clear set of tax incentives, make tax much simpler, reduce the burden, and support business growth?

2.50 The majority of businesses in the UK are within the EU definition of a small or micro business. Those businesses have a wide range of characteristics, and therefore it is not always clear who we are referring to when discussing 'small business' issues. We understand that

¹² http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en

¹³ <https://www.gov.uk/government/publications?departments%5B%5D=office-of-tax-simplification>

broad universal definitions allow for consistent analysis across government, and that individual policy makers will create more detailed breakdowns when considering the impact of new policies. However, we continue to consider that a more transparent and realistic range of definitions would enable better targeted policy making and administration¹⁴. We recognise that MTD, with its rich source of real time data, should create opportunities for this.

2.51 While this review is considering the tax computation for companies, we also recognise that many of the complexities for small companies apply equally to unincorporated businesses subject to income tax, and we will be taking this into consideration to avoid creating further distortions, including:

- what are the most important incentives and reliefs for smaller companies, and could the tax system be the simplest and most effective way of claiming them?
- is there an opportunity to explore a cash basis for smaller companies, either within or outside the current EU accounting directives? Would cash basis remove the need for AIA? What risks and impact would this have?¹⁵
- how can we improve our definitions of smaller businesses? Where would sensible boundaries be, that reflect their different characteristics and requirements?
- where do or could our proposals read across to unincorporated businesses, without creating further differences between the two?

Streamlining tax for large and complex companies

2.52 Discussions with both HMRC and private sector bodies, and examination of available data, has identified that many of the issues referred to in our report above (accounting vs tax, Schedular system, capital allowances) are of particular relevance to large companies because they arise so frequently and in complex situations. So, for example, a large and complex group or company is much more likely than a small one to have multiple income sources and a variety of asset classes attracting different capital allowance rates. In addition, the large group company is potentially exposed to such areas as the transfer pricing and Controlled Foreign Company regimes.

2.53 As well as the matters set out in earlier sections of this report, our discussions with large companies have identified the following issues as being particularly relevant to our review:

- timing differences between accounts and tax – for example pensions, share-base payments, deferred remuneration, provisioning
- any feature of the rules which requires long term tracking of large numbers of individual items (for example, intangibles, indexation, financial instruments, cars, short life assets, base costs of assets for capital gains purposes)

¹⁴ OTS Small Business Tax Review Final Report: HMRC Administration: February 2012: para 3.10

¹⁵ We recognise the wider implications for the Companies Act, which would need to be amended.

- “wholly and exclusively” and comparable rules – could this be replaced by a “business purpose” test as a common test across all income sources?¹⁶
- UK:UK transfer pricing – as we found in previous reviews, this creates lots of work for little or no perceived benefit
- capital allowances – the desire for a broader approach to relieving asset investment and infrastructure projects, with the main concern that long term certainty and stability is critical
- redesign of the CT 600, targeted at particular industries/sectors to remove irrelevant data reporting, although we await HMRC’s plans for digital updates under MTD
- Surplus Advance Corporation Tax - a regime of decreasing relevance and only for a small proportion of the CT population.
- an Aggregated Group Return could reduce the compliance burden on groups, although this is not a universal view
- group relief administration and group tax payment arrangements are still largely a manual process - could the compliance burden be reduced? Does the facility to nominate a single company to claim/surrender group relief reduce the burden and could it be further simplified?

2.54 We think that these could be the priority areas for streamlining CT for large business. We will be exploring them with accounting and other firms who do tax compliance work, industry bodies and individual large companies and groups with in-house tax teams, as well as with HMRC and HM Treasury, and welcome your views.

International aspects

2.55 In considering the above emerging themes, we are looking to learn from relevant international experience. Are there any international comparisons that can be made or case studies that we can learn from where other regimes have implemented simplifying changes to their corporation tax systems?

¹⁶ We recognise that a simplification that created any loosening of this test could have significant Exchequer impacts.

3

Next steps

We want to engage companies and their advisers in a discussion on how the corporate tax system could be simplified and to help us identify the areas that would most benefit from reform.

3.1 In this report we have identified some key themes and priority areas, where we think simplification could make a difference. Please let us know whether you think these are the right areas to focus on, and why. And whether there are different areas that need to be included. Let us know about approaches used in other countries that you think it would be useful for us to consider. What are the benefits, concerns and challenges that we will need to think about? Is there a simplification prize?

You can contact us on ots@ots.gsi.gov.uk. We are always happy to meet with interested parties to hear your views and share ideas.

3.2 We have also created an on-line survey for small companies and their advisers, to help us build a richer picture of this diverse business group.

<https://www.surveymonkey.co.uk/r/smallbusiness taxpayer>

<https://www.surveymonkey.co.uk/r/professionaladvisers>

3.3 For larger business, as a smaller population, we will continue to discuss their issues with key stakeholders. These include accounting and other firms who do tax compliance work, industry representative bodies, individual large companies and groups with in-house tax teams, as well as with HMRC and HM Treasury.

3.4 We will be publishing our final report and recommendations before Budget 2017 and, although we think this is an ongoing conversation, it would be helpful to have your responses by the end of 2016.

We think that these are the main areas where simplification could be achieved, and where there is potential for reducing the differences between accounting profit and tax profit.

1. Adjustments between accounting profit and CT profit
 - a. Considering these adjustments, where does the burden feel disproportionate to the outcome or value?
 - b. Which adjustments are not clear in their purpose, or don't fully align with business activities?
2. Relieving or incentivising capital expenditure
 - a. What key improvements could be made to simplify the current system and ease the administrative burden?
 - b. Do you think the current system incentivises businesses, or could this be done in a different way?
3. The 'Schedular' system
 - a. Are there any particular obstacles to its removal that we need to consider?
4. Making Tax Digital - opportunities for a simpler regime?
 - a. With a particular focus on the CT computation process, what simplifications could be introduced to make the most of MTD and help its implementation?
5. Reporting and compliance processes that could be simplified
 - a. Are there aspects of reporting and compliance that could be simpler?
 - b. What are the benefits vs the risks of simplifying these processes?
6. Simpler tax for smaller companies
 - a. Could the complexity of the CT computation for smaller companies be almost entirely removed, whilst retaining a clear and simple set of incentives such as AIA? What benefits and concerns would this give rise to?
 - b. Could smaller companies operate a cash based system? What problems would this create? Would cash basis remove the need for AIA?
 - c. Can we create a more appropriate series of definitions for small or simpler businesses, to better target policies and processes according to different needs and circumstances? Where would the boundaries be?
 - d. What are the implications of simpler CT for unincorporated businesses, where the rules read across to income tax, and how could these be addressed?
7. Streamlining tax processes for large and complex companies.
 - a. Our report identifies some priority areas for simplification: do you agree with this list (in paragraph 2.53) and are there other areas that you think should be included in our review, and why?
8. International aspects
 - a. Are there any international comparisons that can be made or case studies that we can learn from where other regimes have implemented simplifying changes to their CT systems?

A Terms of Reference

OTS review of the corporation tax computation

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.

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.

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.

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

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

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.