

Office of Tax Simplification

John Whiting
Tax Director
Office of Tax Simplification
1 Horse Guards Road
London SW1A 2HQ
T: 020 7270 1169
John.whiting@ots.gsi.gov.uk



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Rt Hon Andrew Tyrie MP
Chair, Treasury Committee
House of Commons
Westminster
London SW1A 0AA

Dear Andrew,

OTS reports on (1) Closer alignment of income tax and (2) Small Company taxation

I am pleased to enclose copies of our recently-published reports on Closer alignment of income tax and NICs and Small Company taxation, together with a copy of the letter from the Financial Secretary to the Treasury we received with the Budget.

The differences between IT and NICs, and the administrative burdens the tax system imposes on small companies, have long been cited as major sources of complexity in the UK's tax system, not least in previous OTS reports. The OTS was asked to conduct two reviews to consider the benefits and impacts of, and required processes for, bringing the income tax and NICs regimes closer together; and to seek ways to simplify tax, technical and administrative, for small companies.

The wider context is that the UK working landscape is changing. Helped by new technology and platforms, there is a growing trend for people choosing to have more control over how they work and changing the traditional employee-employer relationship. Our reports have shown that this adds to the need for reform.

Closer alignment of income tax and NICs

Our report highlights the need for change, setting out a seven stage programme to bring IT and NICs closer together. The result would be a system for the two taxes that is easier to administer (for employers and HMRC) and easier to understand (for taxpayers and employers). However, this is clearly a long-term, far-reaching reform that will take a time to implement and require considerable further work.

We proposed carrying out further work on key aspects of our proposals and you will see from the letter that our plans have been endorsed. This will mainly involve analysing the impact of the possible changes and testing their impact on:

- Moving employees' NICs to an annual, cumulative and aggregated basis; and
- Reforming employers' NICs.



Our plan is to work towards publishing papers on these areas, probably at the end of September. The government is planning a full response to our report in the autumn, once we have published these further papers.

Small company taxation

Our report contains a range of recommendations, a mix of short-term and structural, administrative and technical. As you will see from the Financial Secretary's letter, the government has welcomed our report and has accepted or is considering 12 of our 13 main recommendations. This includes our plan to conduct further work on:

- Whether a 'look-through' basis of taxation could offer real simplification for a defined subset of small companies; and
- Whether a model of protecting personal assets for unincorporated businesses could be viable, meaning a sole trader did not have to incorporate their business to gain limited liability.

We are well aware that both these topics arouse a certain amount of controversy but we do think we need to develop and test them further, either to develop a coherent proposition that commands support or to show that they will not ultimately simplify the system. We plan to publish our conclusions in the autumn.

If you would like a fuller briefing on the reports or on any aspect of our work, we would be only too pleased to meet with you.

Best wishes
Yours sincerely



John Whiting
OTS Tax Director



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

**Angela Knight CBE, Chair
& John Whiting OBE, Tax Director
Office of Tax Simplification
1 Horse Guards Road
London SW1A 2HQ**

16 March 2016

Dear Angela & John

UPDATE ON TAX SIMPLIFICATION MEASURES

The Chancellor made several announcements relating to the work of the Office of Tax Simplification (OTS) at Budget. I am writing to explain these in more detail, highlight wider areas of interest and set out the topics of your next reviews. I would also like to thank you and your team for your excellent work since the Autumn Statement.

Business tax roadmap

You will have seen that we published a roadmap setting out our plans for business taxes to provide businesses with certainty. It includes much of interest to the OTS, of which I want to highlight four issues.

First, the roadmap commits to significant investment in HMRC to improve its customer service. By 2017, HMRC will provide a 7-day a week service, with extended hours and Sunday opening for online services and tax and tax credit phone lines. HMRC will introduce a dedicated phone service for new businesses and will recruit over 800 new staff into its call centres to improve call waiting times.



Second, the Government will modernise the corporation tax rules for losses, resulting in a more flexible system for business. This builds upon a major recommendation from your competitiveness review and relates to your future work on corporation tax.

Third, the roadmap states our intention to consider reforms to make the tax system fairer and more sustainable, with a more level playing field for people working for themselves regardless of their business structure. You considered this issue as part of your small companies review and it also relates to your future work.

Finally, building on your past recommendations, the Government will abolish Class 2 NICs in April 2018. In future, the self-employed will be able to build contributory benefit entitlement through a reformed Class 4 NICs. This will be a long overdue modernisation of the complex and outdated self-employed National Insurance system.

Small companies review

Thank you for your review of the taxation of small companies. The Government will accept or further consider nearly all of your recommendations, as detailed in the annex to this letter.

I particularly welcome your proposal to develop the design of a look-through taxation system and a new, simple business model that would provide the self-employed with limited liability for their assets. I encourage you to work with the Government and the business



community to further consider how these policies might work in practice and any implementation issues that could arise.

The one recommendation that I have not accepted is for a study of a consolidated turnover tax. As your report notes, a tax based on turnover would fail to take account of a business's expenses and, consequently, its profitability, leading to distortions and unfair outcomes between different types of businesses.

I believe that Making Tax Digital can achieve many of the simplification benefits of a turnover tax without the distortions by making it feel like businesses are paying one tax instead of many. I understand that John has been invited to join the Digital Advisory Group chaired by Rebecca Benneworth. I encourage the OTS to work through this forum to ensure that HMRC's digital agenda delivers real simplicity.

Income tax and NICs review

The closer alignment of income tax and National Insurance contributions is often called for, but as you set out in your report, this is not a straightforward issue. There are both benefits and challenges to fundamental reform. Your report has made a valuable contribution to the debate on this important issue.

Given the complexity of these issues, I welcome your proposal to conduct two further reviews: one on the impact of moving employee NICs to an annual, cumulative and aggregated basis and another on the reform of employer NICs. The Government will consider your



recommendations and respond in full to your review of income tax and NICs alignment after the publication of these further reviews in the autumn.

Different forms of remuneration

You have often highlighted the disparity between the tax and National Insurance treatment of different forms of remuneration. I would like to draw your attention to a number of relevant measures in this Budget.

First, the Chancellor announced reforms to the rules for termination payments. While it is true that the rules retain some complexity, it is important for the Government to support individuals when they lose their jobs, so the income tax threshold and employee NICs exemption will not be changed. However, we will align employer NICs with the income tax treatment by charging employer NICs on payments above £30,000 where income tax is due. We will tighten the rules to put beyond doubt that if the payment is an existing entitlement, it will be subject to tax and NICs in the normal way. We have also reviewed the other exemptions as you recommended. HMRC will publish a technical consultation on the draft clauses over the summer.

I appreciate that this reform does not go quite as far as you have recommended, but your report encouraged us to look critically at the underlying rules to ensure they remain fit for purpose.

Second, the Chancellor announced changes to the intermediaries legislation, which governs when employment taxes should be paid by



people who work off-payroll through their own limited company. These changes will apply where individuals are working off-payroll for a public sector body. Further details of the reform can be found in a technical note published today by HMRC on the Government's website.

Finally, the Chancellor announced that the Government is considering limiting the range of benefits that attract tax and National Insurance advantages when provided through salary sacrifice arrangements. This will narrow a disparity between the tax and National Insurance treatment of different forms of remuneration.

Other OTS recommendations

Building on the previous package of reforms to expenses and benefits, HMRC will consult on proposals to simplify PAYE settlement agreements (PSAs). This consultation will consider proposals to reduce administrative burdens and clarify the rules for which benefits can and cannot be included within a PSA.

As you know, my officials published a discussion document on the taxation of travel and subsistence in the autumn. However, responses made clear that the current rules are generally well understood and work effectively for the majority of employees. I feel that the benefits of replacing the current system do not outweigh the costs, both in terms of potential revenue lost to the Exchequer and the additional burdens on employers. I am pleased that employers recognised that HMRC's guidance has improved and I feel it is appropriate that employers have time to familiarise themselves with the new guidance.



We will continue to look for improvements to employers' reporting requirements for travel and subsistence, though we will not make further changes at this time.

You may be interested to know that the Government will shortly launch a consultation on how partnerships calculate their tax liabilities. This will look at areas where the taxation of partnerships could be seen as uncertain, as highlighted in your partnerships report.

Future reviews

Along with further work on the impacts of reforming employee and employer NICs, you have suggested that the OTS should review the options to simplify the computation of corporation tax. I agree that this is a complex area that could be simplified over the long term and would benefit from a review. We will agree the Terms of Reference for all of this work in the coming weeks.

To conclude, I would like to thank you and your team for your work. I look forward to meeting with you to discuss your next reviews on the impacts of moving employee NICs to an annual, cumulative and aggregated basis and employer NICs to a payroll basis; and the options to simplify the computation of corporation tax.

A handwritten signature in black ink, appearing to read "Gauke" with a stylized flourish below it.

David Gauke MP