Office of
Tax Simplification

Annual Report 2017 - 18:
Simplifying the tax system to make it easier for the taxpayer to use

July 2018

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Foreword

Welcome to the second Annual Report of the Office of Tax Simplification – or OTS as it is more commonly known. This year has been the first full year for our new Tax Director, Paul Morton, who has brought new and fresh thinking to the organisation.

The OTS is the independent adviser to the government on simplifying the UK tax system. During the past year, it has continued to focus on the quality of the experience of taxpayers, whether private individuals or someone running a business, when dealing with the tax system. We undertake formal reviews agreed with the Chancellor, and work undertaken on our initiative covering some of the many issues brought to our attention. The aim with everything we do is to recommend to the Chancellor ways of making taxpayers' experience as simple as possible.

Some highlights from the past year include:

- the OTS looked at the operation of the business VAT threshold and confirmed that it currently acts as a cliff edge and so can deter some businesses from growing. Following the OTS's report in November 2017 the Chancellor announced a full consultation which he launched at the Spring Statement
- recognising that deciding which assets qualify for capital allowances can be complex, the OTS has explored the impact of moving to a simpler system, potentially relieving a wider range of assets, by using accounts depreciation. The report showed that while such a move was possible, it would be complex and result in losers as well as winners. As a result, we recommended a number of changes to make the current arrangements more straightforward
- with productivity being a key government concern, the OTS has reviewed the impact of various features of the tax system on the business lifecycle, both recommending changes and paving the way for further in depth reviews
- the OTS is currently engaged in a major review of Inheritance Tax and has already received over 3,000 responses

The OTS could not do its work without the help and support of others both inside and outside government. We are grateful to the Financial Secretary to the Treasury for his active engagement and support and to all those stakeholders in business and the profession who freely and openly provide their views, advice and time, and we are indebted to all OTS staff, past and present.

Angela Knight CBE – Chair

Chapter 1

Tax Director's Report

This is my first Annual Report on the work of the OTS, for its stakeholders and all those who take an interest in our work. We are the independent adviser to government on simplifying the UK tax system and while we are based within HM Treasury (HMT), we offer an independent view under the responsibility of our Board. We were placed on a statutory footing two years ago, in Finance Act 2016.

What we do

We see our role as focusing on two broad areas:

- making the administration of the UK tax system (particularly the "customer experience") easier for businesses, individuals, advisers and HMRC to deal with, thus reducing administrative burdens
- making structural and detailed aspects of the way the tax system works simpler, not least by making them fit better with changes in the economy and the world of work

We produce three kinds of report:

Our primary focus is on simplifying the user experience through simplification of the tax system and key to this will be the use of new technology. With our Technology Advisory panel, and input from a very wide range of stakeholders, we are in a good position to observe how the latest technology is improving the customer experience in other fields and to explore how technology might be deployed in tax administration in the short, medium and long term, recognising the constraints on HMRC posed by the need to prepare for Brexit and to implement Making Tax Digital.

Our Strategy

Our strategy is based on three principles:

Our work

We regularly assess our pipeline of reviews against these criteria and at the same time aim to be working across a wide range of areas within the tax system. For example, our review of inheritance tax touches on an area which is new to the OTS and, indeed, which has never been comprehensively considered from a complexity point of view, despite the fact that many people worry about the tax at some point in their lives.

All of our reports and papers are published on our website, as we see an important feature of our work as being the development of a public debate on tax simplification. We welcome the discussion which this has triggered in the media and the many comments from members of the public. Indeed, an important part of our role is to open up areas for wide discussion and debate.

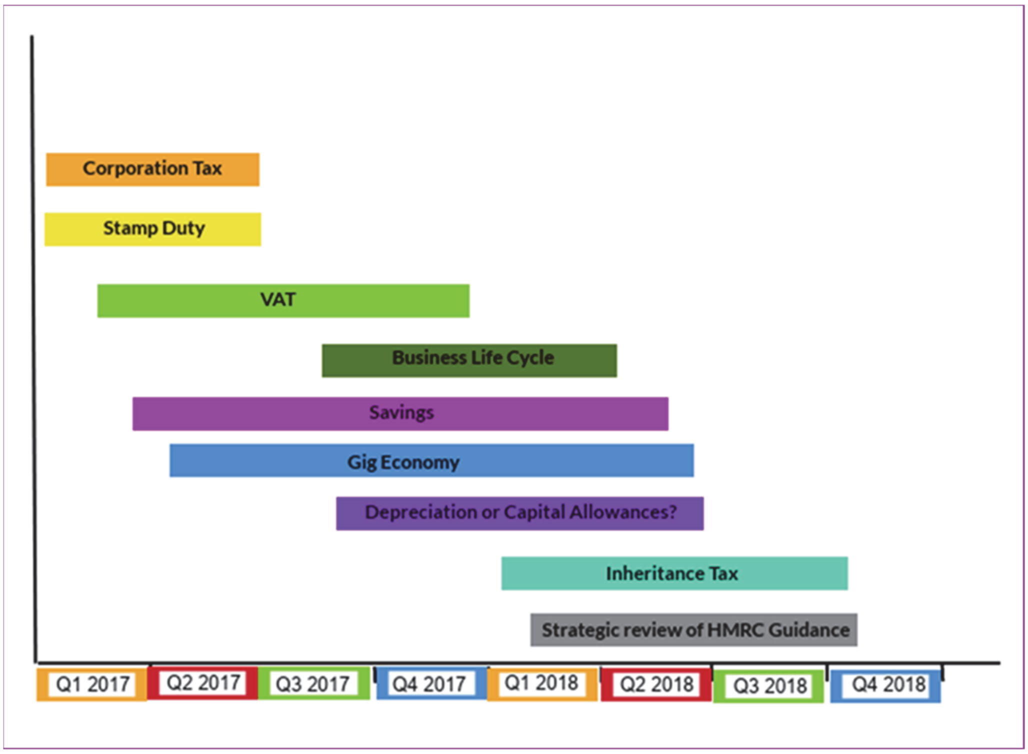
For example, our past work on the alignment of income tax and national insurance contributions stimulated a useful discussion in this area although we are not proposing to undertake further work in this area in the near term.

Our work highlighted the enormous difficulties in simplifying an area where millions of taxpayers would be adversely impacted or the cost would be unaffordable.

We have recently completed one review requested by the Chancellor, into the **relief for capital expenditure by business** – where we examined whether the capital allowances system could be replaced by the depreciation charge into the accounts, and look forward to completing another Chancellor requested review – into **inheritance tax** – in a few months' time, where we are reviewing both the administrative aspects of the tax as well as the design of features such as gift reliefs.

We are pleased to have published our first review of the **Business Lifecycle** and have also recently published a review of the taxation of income from **savings**. In both cases, these were wide examinations of broad areas of the tax system and we have highlighted a great deal of complexity. We plan to continue to look at the business lifecycle and key events in the lives of individuals and to consider all of the taxes which apply. It is often the interaction of the various taxes which creates the greatest complexity.

Main areas of OTS work during 2017-18



Future work

Looking ahead, there is huge potential for further work. We are particularly interested in the tax issues which arise for individuals as they go through life, where they might encounter new complexity when, for example, child benefit is withdrawn through the tax system or when they withdraw a lump sum from a pension scheme and have to submit a tax return for the first time.

Low income taxpayers encounter complexity as they enter the tax system, for example, or when reliefs are available to be claimed. A question we are keen to consider is the extent to which reliefs can be provided automatically rather than by means of a claim.

Guidance is key to the taxpayer experience and we see that while some of the materials available to support taxpayers are exemplary in clarity and accessibility, other materials can be hard to find and even harder to understand. We will continue to examine the more strategic aspects of taxpayer guidance in parallel with the excellent work being undertaken within HMRC.

As noted above, the opportunities provided by **technology** underlie all of our work. Although HMRC is heavily engaged on Making Tax Digital in the near future, we see huge opportunities beyond that for processes which can dramatically improve the user experience. Pre-population of returns, the use of machine learning, more interactive and real-time ways of providing information and data to HMRC and more intensive use of mobile technology will all provide ways of improving the user experience.

Some of the deeper questions which will need to be addressed include whether technology should be deployed to "paper over the cracks" of the underlying complexity, the extent to which every taxpayer should be able to understand the underlying computations and the degree to which a taxpayer might become disengaged from the tax system if everything is done for him or her. We propose to address these and similar questions over the coming years.

Our staff and our links

Having been placed onto a permanent footing we have now begun to recruit from the private sector on a permanent basis. This enables us to develop a work programme which is more integrated in the sense that related issues emerge in more than one project and can be considered by more than one team. A good example of this is the inheritance tax reliefs for passing a business on to the next generation.

There are clearly aspects which will arise in our review of inheritance tax. However, we were also able to consider the complexity issues in the context of the Business Lifecycle and this can provide useful alternative perspectives and integration.

We are maintaining a unique mix of team members with both public and private sector experience and this, together with our strong links with the external tax community as well as HMT and HMRC, places us in a unique position to bring together all points of view.

We are very grateful to our colleagues in HMT and HMRC for their invaluable support and challenge and their help in ensuring that our recommendations are achievable.

At the same time, we acknowledge the care with which HMT and HMRC respect our independence which allows us to express our views and offer recommendations which are derived solely from the evidence.

We look forward to building on our widest ever ongoing programme of work, our outstanding team of policy advisers and the enormous willingness with which external stakeholders, HMT and HMRC offer their time and thoughts to deliver an ever-improving user experience in an ever more complex world.

Paul Morton – Tax Director

Contacting us

We welcome comments and suggestions for further areas of our work from members of the public as well as tax professionals in business, in professional firms and in HMT and HMRC. Experiences and perceptions are all valuable in deepening our understanding of the impact of tax complexity. Please email us at ots@ots.gov.uk or write to the Office of Tax Simplification, 1 Horse Guards Road, London SW1A 2HQ.

Chapter 2
Themes and impacts

Technology and the gig economy

New technology is impacting on almost every aspect of our lives. This year the OTS has gathered together a technology advisory panel to act as a sounding board and source of informal advice on issues as broad as blockchain and distributed ledger technology, artificial intelligence (AI) and machine learning.

Technology is transforming the way business is done and the experience of consumers in every sector. As well as the wider implications for the tax system we are also examining the opportunities for improved accounting processes and tax administration and considering best practice from other countries. This exploration is at an early stage but the OTS aim to bring forward focus papers exposing pertinent issues for discussion and debate.

In the related area of the Gig economy, the OTS has explored the topic in more depth this year (following on from the focus paper published in June 2017). In particular, looking at the idea that technological 'platforms' (for example, Uber and Deliveroo) that connect gig workers with work could potentially do some more of the things an employer does for its employees, in particular providing them with a 'PAYE-like experience' if that was what the worker wanted.

So, for income tax, it could deduct tax at source and save the worker both the administration and any worry about having to retain cash to pay the tax at a later date.

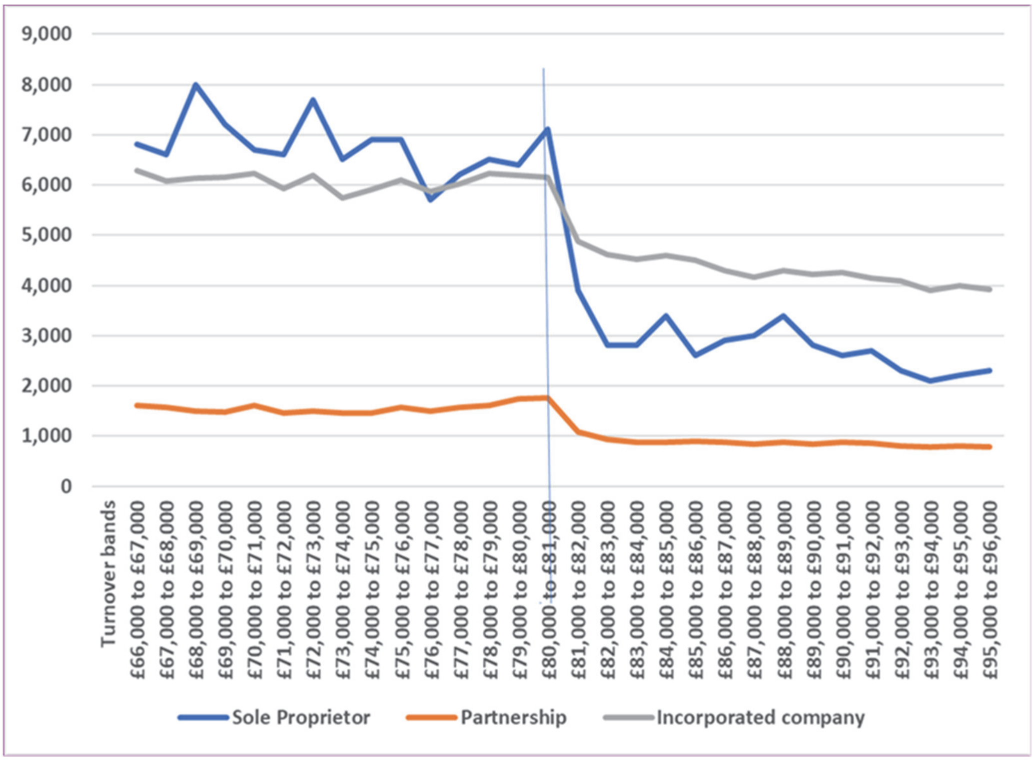
VAT and Corporation Tax

At the request of the Chancellor, the OTS published reports on each of these major taxes this year.

The report on VAT exposed the distorting cliff-edge effect of the registration threshold and within weeks led to the announcement of a major government consultation around this issue, which was launched at Spring Statement 2018. The present high level of the threshold (by international standards) clearly keeps things simple for small businesses which have no reason to seek a turnover exceeding £85,000 a year; it equally clearly distorts behaviour and inhibits the growth of businesses.

The VAT report also drew out a total of 23 recommendations covering a wide range of other, sometimes long-standing, technical and operational concerns about the VAT system. These are forming the basis for a constructive ongoing dialogue with HMRC.

VAT threshold effect



Source: HMRC data from 2014/15, when threshold was £81,000

The July 2017 report on the **corporation tax computation** brought together a wealth of proposals concerned both with small and large businesses, in particular pointing the way to getting tax close to accounting wherever possible in the small business arena.

Alongside a set of specific recommendations aimed at simplifying the operation of the present capital allowances systems, one major recommendation was that further work be done to look at the merits and impacts of a switch to using depreciation instead, coupled with the extension of the scope of the relief.

This further work on **depreciation and capital allowances** has now been completed, in a report published this June.

The key findings are that fewer than 30,000 businesses invest in qualifying capital expenditure above the level of the Annual Investment Allowance, and that complexities of making such a change appear to outweigh the benefits.

In light of this, the report goes on to point the way to further, less dramatic but potentially more effective, ways of simplifying the system.

Lifecycle and customer experience work

The **business lifecycle** paper published in April marked a new departure for the OTS, taking a holistic view at how a business starts, develops, matures and is passed on to others and the different tax charges and reliefs that can apply during the different stages of its ‘lifecycle’.

The Business Life Cycle

Source: OTS

The patchwork of tax charges and reliefs that apply at various points in the life cycle, and their various (sometime distorting) interactions, create a complex picture that has a pressing need to be overhauled to better enable British businesses to fulfil their potential – a need that is all the more urgent as Brexit approaches.

The OTS is also working to shed light on the taxpayer experience for individuals: The **savings** paper published in May and the Inheritance Tax review which is underway are more 'traditional' in that they look at a specific tax or topic within a tax, but are also strongly directed to people's practical experience of the tax system.

In relation to savings, the paper calls for a personal taxes roadmap, to help ensure that there is a joined up long term agenda for ironing out the considerable complexity that results from the interaction of a considerable number of rates, allowances and reliefs in this area. On IHT, the OTS beginning to analyse the results from the call for evidence and survey which closed on 8 June.

The OTS also published a report on **paper Stamp Duty** (which arises almost entirely on share transactions) during the year. It proposed digitising the tax (retiring the physical stamping machines which, amazingly to many, are still in use) to ease customer experience and proposed a range of technical simplifications.

Engagement with HMT and HMRC

More widely, the OTS continues to engage with HMT and HMRC on tax policy more generally, and to play a part in influencing government initiatives at an early stage. In this regard, it has been encouraging that HMRC is looking for ways of benefitting from the work the OTS did on its complexity index.

We remain engaged with HMRC's Administrative Burdens Advisory Board, Joint Initiative Steering Group and with Making Tax Digital.

Impact of our work

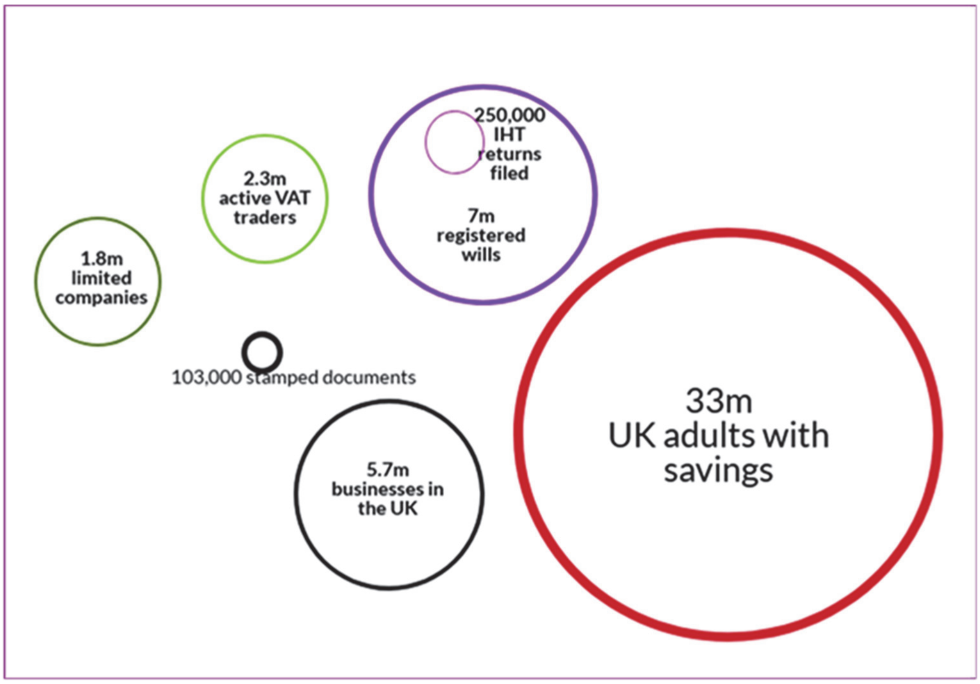
The impact of our work has potential to be felt across a very wide range of those affected, or potentially affected by different aspects of the tax system, as illustrated in the graphic below which reflects some statistics relating to different areas of our work this year.

That in turn is reflected in the considerable increase in the media coverage that our work has attracted this last year, most notably in relation to our VAT report and our current work on Inheritance Tax, illustrated in 'Making the Headlines' below.

We have also, naturally, continued to monitor the action taken or being considered in response to the recommendations in OTS reports.

The OTS has made a total of 534 recommendations or specific observations across all of its reports and papers since 2010. Over half of these have been accepted, or are either being pursued or under active consideration.

Currently, 200 recommendations remain the subject of ongoing discussion with HMRC. Within this total, 64 are already being pursued, either through government action (such as a policy consultation) or further work by the OTS, and an additional 91 remain under consideration for potential action in due course.



Making the headlines

FT 25/5/18

OTS review

Plan to streamline dividend tax set to hit richer savers

JOSEPHINE CUMBO
PENSIONS CORRESPONDENT

People running their own companies and wealthier, older savers could pay more tax on dividend income under a radical proposal to simplify the tax system.

The tax rates for dividend income are currently lower than they are for other forms of income, meaning higher earners typically pay a lower rate of tax on dividends than on earnings.

But a wide-ranging review of the savings tax system published today said the taxation of company dividends gave rise to some "complex calculations".

The Office of Tax Simplification, an independent adviser to the Treasury, said one "radical" option to simplify the system would be to end differential tax rates for dividend income.

The Institute for Fiscal Studies think-tank said the move would hit those receiving dividends from shares held outside pensions and individual savings accounts, such as business owners or people who had received shares from privatisations and demutualisations.

The option was one of a number of proposals floated in the OTS's 50-page report, which looked at ways to simplify the tax savings it said were "difficult and confusing" for savers.

"This is the first broad review of its type into the application of the tax system to savings and investment income," said Paul Morton, OTS tax director.

"It seeks to identify ways to remove some of the real complexities in the system and help taxpayers understand their position."

Individuals are currently offered a range of tax incentives to encourage them to set aside money for a rainy day or retirement, including an allowance that sees the first £1,000 of savings income untaxed.

Up to £20,000 can also be invested annually in an individual savings account with no tax payable on interest or other income fron[illegible] people hold shares dividends of less th[illegible] taxed.

The OTS review fo[illegible] "working well" for m[illegible]

£20,000
Tax-free amount that can be invested annually in an Isa

cent of adults curre[illegible] savings income. Bu[illegible] there remained "sig[illegible] ties" in some areas, i[illegible] ular ISA products [illegible] were "poorly unders[illegible]

The OTS called fo[illegible] review of the tax sav[illegible] ing a streamlining o[illegible] allowances.

The body also reco[illegible] Revenue & Custon[illegible] guidance that has le[illegible] being hit with emei[illegible] sion lump sum witho[illegible]

Asked about th[illegible] Treasury said: "Nin[illegible] people pay no tax at[illegible] income thanks to o[illegible] tions."

GOING FOR GROWTH Lowering the revenue level at which a company is liable for VAT would increase red tape for small bus[illegible]

Small companies fear tax changes may be half-baked

Wednesday January 31 2018 | THE TIMES

Hammond paves way for new overhaul of inheritance tax

Andrew Ellson
Consumer Affairs Correspondent

The chancellor has raised the possibility of a big upheaval to inheritance tax less than a year after George Osborne's reforms came into effect.

Philip Hammond has written to the Office of Tax Simplification (OTS) asking for a review, describing the present regime as "particularly complex".

The letter raises the possibility that generous reliefs that can be used to mitigate inheritance tax (IHT) bills may be limited or removed entirely.

It may also be seen as a rebuke to Mr Osborne, who added another layer of complexity to the tax by introducing an extra IHT-free threshold for people who leave a main residence to a family member. The changes, announced in the budget of 2015, are being phased in and will eventually mean that parents will be able to pass a main property worth up to £1 million to their children without paying IHT.

The taxman took £5.3 billion from people's estates last year and official projections suggest that a further £1.2 billion will be collected by the end of this tax year.

The letter states: "Inheritance tax, and the system within which it operates, is particularly complex and I would like to request that the OTS carry out a review. I would be most interested to hear any proposals you may have for simplification, to ensure that the system is fit for purpose and makes the experience of those who interact with it as smooth as possible."

The letter adds: "It could also look at how current gift rules interact with the wider IHT system, and whether the current framework causes any distortions to taxpayers' decisions surrounding transfers, investment and other relevant transactions."

This opens the door to a crackdown on reliefs such as potentially exempt transfers that allow people to gift any amount of money to friends or relatives without the funds being subject to IHT, provided that the gift was made at least seven years before death.

However, the Office for Tax Simplification has not been given a mandate to try to raise revenue, so any new rules to limit reliefs may be compensated for in a higher threshold at which the 40 per cent IHT levy applies.

Financial planners welcomed the review as long overdue. Sarah Coles, an analyst at Hargreaves Lansdown, the investment broker, said: "Mr Hammond suggests the Office of Tax Simplification looks at whether the inheritance tax framework distorts decision-making: well, we can save them the time, because of course it does. The tax framework distorts people's behaviour and financial decisions, and inheritance tax is no exception."

She added: "Anyone who has ever wrestled with estate planning and inheritance tax can appreciate that the whole system can be a nightmare of complexity. The pension freedoms and the additional residence nil-rate band may have reduced IHT for many, but they have made things much more complicated rather than less, so it's about time someone took a big red pen to the myriad rules and regulations."

Revenues from inheritance tax have grown in recent years despite house prices stalling, suggesting that HMRC is taking a more draconian approach to enforcement.

THE TIMES | Saturday May 26 2018

Isa bonanza: tax shake-up could be good news for savers

Plans are afoot for a radical overhaul of individual savings accounts, including removing the limit on the number that can be opened each year.

The signal from the Office of Tax Simplification (OTS) that a shake-up of the tax-free savings wrappers known as Isas is on its way has been welcomed by accountants.

James Hender, the head of private wealth at Saffery Champness, an accountant, says: "Isas have become so complicated over the past few years, it is putting people off. There's Lisas, Isas and Jisas — you need a lot of advice and knowledge to find your away around them. Anything that can be done to keep it simple is highly welcome."

A review of the tax paid on savings and investments published by the OTS yesterday recommended making Isas simpler, more flexible and easier to use. Although the number taking out Isas has dipped from 12.7 million in 2015-16 to 11.1 million in 2016-17, half of the adult population of the UK is believed to have one. You can save up to £20,000 tax-free in an Isa each financial year.

The review suggests removing the ban on partial transfers of money between Isas in the year in which it is invested; removing the restriction on investors taking out more than one type of Isa each year; making it easier to transfer money from a Help to Buy to a Lifetime Isa (Lisa); and noting that there are calls to extend the age at which a Lisa can be taken out from 40 to 50.

50%
The percentage of the UK population that has an individual savings account

The OTS is an independent body that advises the Treasury. It cannot make policy, but often triggers investigations by government that lead to changes. It is highly likely that the chancellor will recommend a review of Isas and other allowances based on the report.

Although tax thresholds and allowances mean that 95 per cent of people pay no tax on their savings and investments, for those that do there are potential complications. The OTS says: "Interactions between the rates and allowances is sufficiently complex at the margins that HM Revenue & Custom's [HMRC's] self-assessment computer software has sometimes failed to get it right. It is proving to be very difficult to create an algorithm that calculates the tax correctly in all circumstances and HMRC does not expect to bring the complete calculation online until 2018-19."

It also suggests not having to declare income from savings and dividends to the tax office if it is below the taxable threshold. It says that savings could be exempt from tax for basic-rate tax payers and pensioners, or that the threshold at which you start paying tax on income (£5,000) and the personal savings allowance (£1,000) could be combined into one £6,000 allowance for basic-rate tax payers and £5,500 for higher-rate payers.

"Making savings exempt is an interesting idea which would be welcomed by a lot of people, mostly

Continued on page 67

Source: The Times/Financial Times

Chapter 3
Projects, Partners and People

Projects

The OTS has worked on the following reviews requested by ministers in 2017-2018.

- Corporation Tax Computation review (report published 3 July 2017)
- Paper Stamp Duty review (report published 10 July 2017)
- VAT review (report published 3 November 2017)
- Capital Allowances and Depreciation review (call for evidence published 3 October 2017 and report published on 14 June 2018)
- Inheritance Tax review (scoping document published 15 February 2018, call for evidence published on 27 April 2018 and due to report autumn 2018)

During 2017-18, the OTS has also published:

- a focus paper on the 'Gig economy' (22 June 2017, updating the November 2016 paper)
- an evaluation of the OTS recommendations (27 June 2017)
- a focus paper on the future of disincorporation relief (26 July 2017)

Partners

HMT and HMRC are our key partners within government; without their constructive engagement and challenge, and the data that only HMRC's Knowledge Analysis and Intelligence Directorate (which develops the Exchequer costings validated by the Office of Budget Responsibility) can provide, our ability to bring private sector concerns and experience together with public sector perspectives and priorities would be impossible. These relationships operate within a published framework agreement.

We have a particularly close relationship with ABAB, with its chair being a member of our board and our Tax Director being a member of ABAB.

We also have active relationships with other parts of government, including BEIS.

Outside government we consult widely with a wide range of stakeholders, both in relation to particular reviews and strategically. Our published reports list the organisations, businesses, representative bodies and other we have met or from whom we have received written input in relation to the project concerned.

Among those we most consistently engage with are many leading representative bodies, including the AAT, ATT, ACCA, BCC, CBI, CIOT, FSB, IOD, LITRG, ICAEW, ICAS and the LSEW.

People

The Board

Legally, the OTS consists of its Board, whose members from 1 April 2017 to 31 March 2018 were:

James Bowler

Director General,

Tax and Welfare HMT

(to 1 August 2017)

Beth Russell

Director General,

Tax and Welfare HMT

(from 2 August 2017)

John Cullinane

Tax Policy Director

Chartered Institute of Taxation

Teresa Graham

Chair of the Administrative Burdens

Advisory Board (ABAB)

Paul Johnson

Director of the

Institute of Fiscal Studies

Angela Knight CBE

OTS Chair

Paul Morton

OTS Tax Director

Kathleen Russ

Head of Tax, Travers Smith

Edward Troup

Executive Chair, HMRC

(to 1 January 2018)

Jim Harra

Second Permanent Secretary, HMRC

(from 2 January 2018)

Teresa Graham, who has been a member of the Board since 2010, is the OTS's Senior Independent Director.

The Team

The OTS team, or secretariat, is led by David Halsey who acts as secretary to the Board. During the year to 31 March 2018, a total of 20 people worked for the OTS at some stage, either full-time or part-time, who were Charlotte Alderman, Peter Allen, Angela Brown, Chris Burns, Ruth Corkin, Gary Deans, Peter Drummond, Richard Dowling, Marian Drew, Simon Jackson, Daphna Jowell, Zoë Judd, Nigel Mellor, Sylvia Otieno, Andrew Parrock, Eileen Rafferty, Andy Richens, Randeep Sidhu, Sue Youngman and Olimpia Wojtyczko. Across the year as a whole this amounted to the equivalent of 8.25 full time people.

Throughout its life, the OTS has employed a mix of staff on secondment from HMT and HMRC, and those recruited directly from the private sector, the latter generally part-time and on fixed term appointments. We have also benefitted from some secondees generously provided by private sector firms. We welcomed Ruth Corkin from Grant Thornton on this basis for part of the year to 31 March 2018.

The Budget

The OTS's budget for the year April 2017 to March 2018 was £870,000, of which the pay element was £680,000.