

The Office of Tax Simplification

Phil Needham, a partner of Hornbeam Accountancy Services Ltd, was asked by John Whiting, the technical director of the Office of Tax Simplification, to give a short presentation to a meeting organised by the Institute of Fiscal Studies at the Royal Society on 6 April 2011. Phil's notes of his presentation follow:

"It is incredibly enjoyable to work with some of the best brains in the country and I have learned quite a bit since I volunteered myself for the OTS Small Business Tax Consultative Committee.

Let me give you an example. I am a full fat milk person, but my office manager always buys skimmed milk. I therefore organised a consultation. I have consulted my staff and found that of the 9 people in my office; 5 like skimmed milk, 2 like semi-skimmed milk, 2 don't use milk. Therefore after consulting widely I have instructed my office manager to buy full fat milk.

There is a serious point here. I had a debate with one of the senior HMRC officials about the HMRC web tool that informs contractors whether they should be operating IR35, the ESI. Lots of articles were published in the accountancy press about bias in the software. No one from the profession uses the tool, no one trusts it. His view was that HMRC developed the ESI in consultation with stakeholders including ICAEW. My argument was and is that a tool developed jointly and approved by Professional Contractors Group and ICAEW as well as HMRC would almost certainly be widely trusted and accepted, presumably used by both sides, etc. It may not be possible, but it seems to me to be an elegant solution to many of the problems with IR35.

Rather interestingly the proposal to improve the administration of IR35 came as a surprise to the consultative committee and was largely met with derision. I think most of the committee found it difficult to take seriously, none the less it was introduced at a middle stage, found its way into the final report as a serious recommendation, and from there into George Osborne's second budget.

Personally I fear that employing more experts within HMRC to better operate IR35 as proposed in the budget will simply lead to more hostility and more dispute. The same issues are unresolved, and the solution drives a bigger wedge between HMRC, the tax payer and the profession.

I was quite taken aback by the hostility of some of my colleagues to HMRC. What I find really disheartening is the HMRC's apparently negative view of the profession.

As a profession we sign up to a code of conduct that involves obeying the law and ensuring that our clients obey the law. Most of us wholeheartedly support that code of professional ethics and take pride in our professionalism. We are, to all intents and purposes, a couple of hundred thousand additional tax collectors. It seems that instead of appreciating, encouraging and building upon that resource HMRC and government have had a policy of denying, denigrating, and discouraging tax agents. There have been hundreds of small ways that this has been done. One of the biggest has been the wholesale dismissal of experienced and qualified tax inspectors. The mutual respect between inspectors and tax agents when I joined the profession was deep rooted.

It would be relatively easy for HMRC to recover and build upon some of that mutual respect. Approved agents could have a number of powers over HMRC functions, such as self filing of 64-8s, and issuing VAT registrations. This would help professional agents out compete the cowboys and the dishonest. It would give HMRC a powerful stick with which to beat rogue agents.

It remains to be seen whether any of this might be taken up. Instead of this we have a proposal to consider a flat rate tax scheme that can only further encourage dishonesty, tax fraud and distortion of markets.

From the very first I have argued that in a market economy if you have two similar modes of operating that are taxed at massively different rates then there will be a steady drift down the tax gradient. It is no good HMRC/Treasury, inventing terms like “disguised employment” or “the proper rate of tax” and inventing tax avoidance measures such as IR35. This is trying to push water up hill. Only a determined effort to bring different rates of tax on income into alignment will solve this problem.

For me the big issue surrounding IR35 was and is the issue of “Two taxes on income”. One tax is fairly broadly based and progressive. The other tax is a narrowly based regressive tax on hard work, job creation, and international competitiveness. For more than half a century politicians have found it easy to keep increasing this second tax whilst reducing the first. This is the fundamental reason for the huge imbalance between the tax paid by employees and the tax paid by contractors.

The increase in National Insurance and reduction in the small company rate of corporation tax in George Osborne’s second budget makes this problem significantly worse, and is for me, quite depressing.

On the bright side incorporating small businesses is my bread and butter, and this budget certainly gives this activity a significant boost.

There was a question at the recent meeting with the IFS as to whether simplification is in conflict with fairness and upon consideration I would like to draw another analogy. In the 1950s quality was thought to be in conflict with price. Rolls Royce achieved quality but at enormous cost. Toyota was amongst the first of international firms to realise that building quality into the manufacturing process could actually drive down price as well as increase quality.

I am quite optimistic that if the fault lines between different taxes are tackled, if the taxes paid by the self-employed, small companies, employees are the same or similar, most of the anti-avoidance legislation, such as IR35 will become redundant. So there certainly can be a synergy between fairness and simplicity.

Overall, I remain reasonably optimistic that improvements to the tax legislative process, the administrative process, driven in part by the OTS could bring some big improvements (sorry simplification) to the tax system.”

P Needham
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