

**Office of Tax Simplification Discussion Paper:
Lookthrough Taxation
Response by the Chartered Institute of Taxation**

1 Introduction

- 1.1 The Chartered Institute of Taxation (CIOT) is pleased to respond to the Office of Tax Simplification's (OTS) paper which is considering a Lookthrough taxation model for small companies.
- 1.2 The OTS attended a recent meeting of the CIOT's Owner Managed Business technical sub-committee to discuss the proposals with CIOT members of the sub-committee. This response includes the points made by members at that meeting, as well as from our wider membership.
- 1.3 In accordance with our charitable objectives, the CIOT aims to work for a better, more efficient tax system for those affected by it, to make recommendations for the improvement or simplification of the law and practice of taxation, to draw attention to anomalies in, and to comment on proposed changes to, the law of taxation. It is with these objectives in mind that we comment on the OTS's proposals.

2 Executive summary

- 2.1 The CIOT's view is that there is an intellectual appeal in trying to even out the taxation treatments of different businesses structures, but that in practical terms it will be very challenging to devise a satisfactory model. We do not believe that the way to address the differential is to introduce a completely new taxing mechanism, such as Lookthrough taxation, which would overlay the existing system.
- 2.2 We are unclear whether the policy objective of the measure is merely simplification as a key effect of Lookthrough taxation, particularly if it were to be made mandatory, seems to be to generate an increase in the tax yield from small business. We also believe that the recent changes to dividend taxation should be given time to bed in and take effect, before further changes are made to the way in which the participators in small companies are taxed.
- 2.3 As we have indicated, the Lookthrough approach suggested in the OTS document does not have our support. It is too complicated. It will not, in our view, provide a

simpler tax system for those taxpayers who will be affected. In addition, we imagine that it will be extremely unlikely that businesses would opt to use it, as in many (if not the majority of cases) it will probably increase their tax liabilities.

- 2.4 A mandatory system would be extremely unpopular and would effectively be targeting the small businesses that the government considers to be the backbone of the UK economy. With both Brexit and Making Tax Digital (MTD) on the horizon, it seems to us that now is a completely inappropriate time to be putting more costs and burdens onto the small business sector.
- 2.5 If the idea of a Lookthrough approach is progressed, then we are strongly of the view that a formal consultation process should be conducted by HM Revenue and Customs (HMRC) and HM Treasury in line with the usual consultation principles.

3 Question 1: Do you agree with the five key issues above? If not, how would you change or add to them?

- 3.1 The key issues identified by the OTS seem correct.

4 Question 2: Do you agree with the OTS's conclusion from the small company taxation review of the characteristics of companies that could materially benefit from the simplification offered by Lookthrough?

- 4.1 We agree that the potential beneficiary companies are reasonably identified but we think there will be few take-ups. We do not agree with the OTS view that a large proportion of the micro-company population would benefit from the simplification offered by Lookthrough, when weighed up against any potential tax increases. We do not think Lookthrough offers overall simplification.
- 4.2 We do think however that there are many very small businesses being run through a corporate structure which would prefer not to be. This might be for a variety of reasons – professional costs, administrative burdens and so on. We think that there is a strong case for widening and extending the availability of 'disincorporation relief' to provide these companies with a simple and low cost means of exiting the corporate structure.
- 4.3 Improved disincorporation relief would be much simpler than introducing Lookthrough, and, if combined with some kind of 'limited liability protection' for unincorporated businesses, may be very attractive to many small companies.

5 Question 3: Do you think Lookthrough would have an impact on growth companies if applied to them? If so, how?

- 5.1 Yes, because there would be an impact on cash reserves. Many small businesses utilise internally generated reserves, rather than external funding, to grow. Lookthrough would diminish these and discourage retention of reserves.
- 5.2 There may be difficulties in defining and identifying which companies fall into the 'growth' category.

6 Question 4: Leaving aside your views on whether Lookthrough is a good or bad idea, should the target group of companies be defined according to a turnover limit like the cash accounting limit? Of are there other methods that would better target a group of potential Lookthrough companies? Do you think Lookthrough should have a limit at all?

- 6.1 As a matter of broad principle, we think it is unhelpful to have too many different thresholds for different purposes within the tax system, so, should Lookthrough be considered further, we think that pinning a Lookthrough threshold to an existing threshold in the system would have an appeal. It should be noted, however, that the HMRC consultation document ‘Simplifying tax for unincorporated businesses’ is currently examining whether to increase the cash basis accounting threshold for unincorporated businesses from its present level (ie the VAT registration threshold – currently £83,000).
- 6.2 As the paper notes, having a hard ceiling may introduce distortions. Implementing rules to try to iron out distortionary behaviour is understandable but it turns the proposal into something that looks very complicated. This is ultimately counter-productive since the overall ambition is simplification.
- 6.3 If Lookthrough were to be optional, rather than mandatory, then there would seem to be little reason why there should be a threshold at all.

7 Question 5: If allocation is made, should salaries be added back or left to stand?

- 7.1 In our view it would be simpler if salaries were left to stand.

8 Question 6: Are there other significant ‘other issues’ that need to be considered beyond the five noted above?

- 8.1 In our view, the issues already identified by the OTS in the discussion paper will be very challenging to overcome. We have identified some further issues.
- 8.2 What taxation figure would be required for the company’s statutory accounts filed at Companies House? Would this be a nominal ‘corporation tax’ figure calculated as if the company paid corporation tax, or would it be the actual income tax and NIC paid under Lookthrough by the proprietor(s)?
- 8.3 How would retained profits in the company be computed?
- 8.4 We have a concern with undistributed funds being taxed on participators as business profits, and whether creditors would have any claim on those funds.
- 8.5 What would be the position of minority shareholders who may be taxed on profits never distributed to them?
- 8.6 Difficulty could arise with share valuations attached to dividend yield, since the enforced taxation of undistributed profits could affect yields.

- 8.7 There may be a risk of double taxation, for example on liquidations, unless taxed retained profits were separately earmarked. Compulsory distribution at the time of taxation is not feasible as profits do not equate to cash available for distribution.
- 8.8 There would be increased complexity if shareholders were non-resident.

9 Question 7: What other types of income do we need to consider for Lookthrough?

- 9.1 We cannot think of any.

10 Question 8: Do you agree with the outline treatments above or do you have any suggestions on how they should be treated differently?

- 10.1 Corporate capital gains and reliefs could present problems, since currently the rules for calculating them are different to the rules applying to individuals, for example companies are eligible for indexation relief.
- 10.2 The changes being introduced over the next few years by HMRC's MTD project will need to be factored into any Lookthrough mechanism. Software would need to be able to cope with the adjustments required by a Lookthrough system. Given the huge challenges presented by MTD anyway, it makes no sense to try to introduce a Lookthrough mechanism at the same time. MTD will bring enough changes for small businesses to have to cope with without adding Lookthrough to the list. What MTD does need is real simplification to legislation prior to its commencement, which we do not see Lookthrough bringing.

11 Question 9: Do you think Lookthrough, if it is introduced, should be optional/default or compulsory? Do you have any further points for your preferred route beyond those mentioned above?

- 11.1 If it is introduced, it should be optional. Having said that, we do not think that Lookthrough should be introduced at all for the reasons already stated.
- 11.2 We would strongly resist any proposals to make it compulsory.

12 Question 10: Would cash accounting be a useful simplification for Lookthrough companies?

- 12.1 We are not sure that cash accounting should be extended to companies. It would involve making wider changes beyond the tax system, eg company accounting rules would need to be amended and the Companies Act may require significant changes. If this idea is developed, a much wider consultation with interested parties would be necessary. This was consulted on some years ago and the idea was dropped, mainly due to a number of the points mentioned above.

13 Question 11: Would cash accounting be useful to companies even if they still had to produce a corporation tax return?

13.1 See paragraph 12.1 above.

14 Question 12: What do YOU think? Can Lookthrough deliver simplification?

14.1 Our overall opinion is that Lookthrough will not provide a simpler tax system for those taxpayers affected and consequently we strongly believe that the idea should not be taken forward.

15 Acknowledgement of submission

15.1 We would be grateful if you could acknowledge safe receipt of this submission and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

16 The Chartered Institute of Taxation

16.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,600 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
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