No magic money tree

General Features | Management of taxes



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Giles Mooney shares his views on how the government can build a simple, fair tax system

Key Points

What is the issue?

As the world returns, gradually, to full time business on the other side of the Coronavirus pandemic and discovers the ‘new normal’, it will, for a range of reasons, be a very different environment to the one we left behind.

What does it mean for me?

While it will be down to all those in business to rebuild the economy, the Treasury will have a big part to play in encouraging certain behaviours and implementing a clear, reliable and functioning tax system.

What can I take away?

We have to accept that bills will go up, but efforts to raise revenues should bring greater simplicity and easier administration to our tax system.

As the world returns, gradually, to full time business on the other side of the Coronavirus pandemic and discovers the ‘new normal’, it will, for a range of reasons, be a very different environment to the one we left behind. While it will be down to all those in business to rebuild the economy, the Treasury will have a big part to play in encouraging certain behaviours and implementing a clear, reliable and functioning tax system.

If we are, as is predicted, facing the greatest economic downturn in a century, with the government borrowing beyond peacetime comparison, perhaps now is not the time to adjust or tinker. It may be the time to look at the tax code as a whole and make fundamental changes. Rather than just recouping the huge costs of the Coronavirus Job Retention Scheme and Self Employed Income Support Scheme, we should make the systems easier to use now and into the future.

Working from home

While many people have been crawling up the walls, desperate to get back to the office, many others have realised that working from home can be more productive, with huge advantages to family life. Add in the ongoing environmental pressure on driving, the new desire to reduce reliance on commuting via public transport and the pressure on rental values in town and city centres, and there is a clear need for the government to support homeworking more than it has previously.

The recent increase in the amount that can be claimed for working from home from £4 to £6 per week is a positive step, but is nowhere near representative of the actual costs of homeworking. An increase of two or three times that amount is needed to give a fair saving for the employee without unnecessary calculations and personal estimates. There will also be costs for the business in providing better IT equipment and more ergonomically designed workspaces to ensure the health of employees. While the Annual Investment Allowance would more than cover this for most businesses, an enhanced allowance, perhaps a deduction of 125% or 150% of costs, could encourage businesses to make the relocation decision.

Small business tax

The recent calculations of and entitlements to the Coronavirus Job Retention Scheme and Self Employed Income Support Scheme have reopened the arguments over taxation and national insurance for small businesses, especially the differences between limited and unlimited structures and the extraction of profit. In his speech launching the Self Employed Income Support Scheme, the chancellor Rishi Sunak said that those who would benefit must accept that, in the future, they would not be treated differently from the employed.

The wording of the Coronavirus Act 2020 gives Sunak the ability to increase NIC and it seems inevitable that this will happen in the very near future. He will use the regime to collect some of the vast costs incurred, with suggestions of a 2% or 3% increase in employee contributions matched with a 5% or 6% increase for the self-employed to bring the two in line. But would he be better to take the bull by the horns and merge the income tax and national insurance regimes?

A basic rate of 34% with a higher rate of 42% and an additional rate of 47% might be too difficult to sell politically. However, the posited rise in NIC could seem unfair if also extended to the 2% band when no one with profits over £50,000 can benefit from the Self Employed Income Support Scheme.

One additional benefit of this change would finally see the end of Class 2 NIC for the self-employed. It is an outdated system that the government has openly said it would like to see the back of. Perhaps the age of the ‘stamp’ should finally come to an end.

The change raises the question of contributory benefits and the state pension. I accept this is a difficult circle to square. Perhaps simply having paid a minimum level of tax in the UK in a number of years would cover us.

Rental income, savings and dividends

The personal savings allowance has worked well to create a 0% band for savings. Members of the public are able to understand how it works and HMRC is able to administer it. An increase to £2,000 to match up with the dividend allowance and an extension of the regime to cover rental income would keep many people outside of tax altogether while, with the raised tax rates detailed above, still raising significant tax revenues.

Many would like to see dividends taxed at the same rate as other income. I think it is important to recognise the risks taken by owners of businesses and, in return, the ability to enjoy the rewards. Many company owners have fought to keep their businesses alive and their staff paid in full in recent months. Any increases in corporate tax or employer’s national insurance would seem inappropriate; but equally a cut in those rates is probably unaffordable at this time. Those businesses need certainty, not tax cuts.

That leaves us with the option of a preferential tax treatment for dividends. At the same time, the government is being encouraged to act to stop the low salary, high dividend route of extraction. Perhaps a slight increase in rates, similar to the increases suggested above, would be the answer. Dividend taxation at, say 25%, 35% and 40% would offer the reward (compared to my suggested merged rates above), while reducing the appeal of structuring deliberately to reduce tax liabilities.

Accuracy

One of the most important aspects of the suggestions made above is that they encourage behaviour – not by threatening action after the fact, but rather by keeping the rules simple and harder to circumvent, and by minimising the advantages of doing so.

Having a tax system which is understood and manageable is key to any future regime. There is a very simple improvement to the tax system which, for many years, we thought was already made.

In this year’s Budget, changes were made to bring certainty to the top slicing regime. While the clarification on claiming the personal allowance for the sliced gain was the big news for many, the allocation of income within the personal allowance was a positive first step to the way the whole income tax computation should work.

The ordering of taxation of earnings, then savings and then dividend income is well known. However, the ability to allocate within the personal allowance for maximum benefit has caused confusion and, in many cases, errors in the calculation of tax, especially when it comes to e-filing. If we are to create a new world of simplicity and comprehension, removing the personal allowance complexity and insisting that the earnings, savings, dividend rule is also included within the personal allowance would be a great first step.

As well as simplicity, it would help the accuracy of calculations, minimising the need for paper filing and the need for computations to be reviewed long after the January deadline.

Pensions

The taxation of pensions has never been, and is unlikely ever to be, simple. Various schemes and rates have been tried over the years to encourage people to save for their futures; and while each scheme benefits some, it hinders others.

As we enter a time when the government’s reserves are challenged, we should expect further encouragement to invest and look after our own pensions rather than counting on the state. The current pension regime is filled with arbitrary cut offs and allowances. While the £40,000 annual allowance is very generous to most people, its reduction to £4,000 as people get wealthier makes little sense. It is so high for lower earners as to be a figure that can’t be related to.

I would like to see a return to the old calculation with a percentage of net relevant earnings used to decide how much can be paid into an individual’s pension. The increases in the percentages as people get closer to retirement make sense, as people look to put a higher share of their income into retirement planning. Equally, for younger people, the percentages act as a target to save. The same system applying to everyone irrespective of their wealth would, again, increase the simplicity of the regime. In one final simplification, by fixing relief at the basic rate for all contributions, the government would achieve its goal of encouraging basic

rate taxpayers to take responsibility for their contributions at a greater rate than wealthier individuals.

The future

As we look to the ‘new normal’ post pandemic, we have to accept that bills will go up. We’re often told there is no magic money tree and expecting tax and NIC rates to remain low is foolish. My suggestions to raise revenues are, I think, fair. Just as importantly, they bring greater simplicity and easier administration to our tax system. A simple, fair tax system.

What’s not to like?

- We should very much appreciate your completing our survey about the impact of coronavirus on you and your organisation. We are gathering this information to help us continue to support and inform you. Please click here to complete the survey. The closing date is 30 June and we shall provide a report on our websites in July.