# An update on the work of the Office of Tax Simplification (OTS)

**Employment Tax** **OMB**

01 January 2017

Recent developments at the OTS include the appointment of Paul Morton to success John Whiting.

## New Tax Director

Paul Morton has been appointed as the new Tax Director of the OTS. He succeeds John Whiting who is retiring from the position he has held since the OTS was established in 2010. Paul was formerly Head of Group Tax at RELX Group plc and will attend OTS board meetings from 1 January 2017.

## ‘The Closer Alignment of Income Tax and National Insurance’ – further report

In its second review on the closer alignment of income tax and national insurance contributions (NICs), the OTS reaffirms its call for the ‘outdated’ system to be modernised to make it fit for the future. The OTS has been considering a move to an annual, cumulative and aggregated (ACA) basis for employees’ NICs. The OTS’s conclusion is that NICs should be calculated in the same way as PAYE income tax, meaning both taxes would be calculated on an employee’s total income, on the same amounts. Because NICs have a different purpose to income tax, the government wishes to keep them separate so merging the two is not an option that is being considered.

The OTS recognises that changing the way that NICs are calculated will see some employees pay more NICs and some pay less. About 40% of all employees who pay NICs could see some change. Typically, those paying less would be part-time

employees, women, those under 35, and those in lower paid service industries. Typically, those paying more would be people with more than one job and those who earn more than £20,000 a year.

Some of the losers do, however, gain more entitlement to contributory benefits, notably state retirement pension. Others may have their loss cushioned by receiving more Universal Credit to match the fall in their net earned income. The Low Incomes Tax Reform Group (LITRG) provided the OTS with examples showing not only the direct tax impact of the ACA but also how an individual's entitlement to state benefits could change (see paragraphs 2.74 – 2.81 of the OTS's report).

The CIOT and LITRG have welcomed the further work done by the OTS but both have called for careful thought to be given to the transition particularly to the effect on the lower paid. One approach may be for the government to raise the primary threshold for employee NIC closer to the level of the income tax personal allowance so that the lower paid are properly protected.

The OTS also looked at employers' NICs and concludes that a simpler system might be a tax that is calculated on the total cost of an employer's payroll, with no tax free allowance, but at a lower rate of tax instead. The OTS has produced some interesting analysis as to how this might be done, looking at the trade-off between the rate of the levy and the amount of employment allowance that may be available to each employer. They recommend that further work is done to find the right balance between a simpler tax and a fair outcome for employers.

The OTS suggests a five year timetable for the full package of reforms, to create a system that is simpler, works better for everyone and is fit for the future.

# Small Company Taxation Review – final reports

## Lookthrough Taxation

The OTS has concluded that a Lookthrough system of taxation would not deliver simplification for small companies. On balance they feel that it would actually be more complicated than the current corporation tax system, given the additional rules that would be needed. Because Lookthrough increases the tax immediately due on retained profits, they point out that it also risks damaging investment. Making Lookthrough optional would be a possibility, but that creates complexity of

choice and risks it becoming another lowest tax calculation. Their conclusion corresponds with the views of both the CIOT and ATT in their responses to the OTS paper (see November's Technical Newsdesk).

The OTS report concludes by saying that they can see 'considerable merit in a long range, strategic review of taxation in this area, to look at the whole question of how labour income should be taxed and whether capital returns should be taxed differently'.

## Sole Enterprise with Protected Asset (SEPA)

On the other hand, the OTS thinks that the SEPA model (providing sole traders with a way of protecting their primary residence without needing to incorporate a company) has the potential to be a useful simplification for those that would otherwise consider incorporation and recommends that it should be developed into a formal proposal.

## Review of the Corporation Tax (CT) Computation – new consultation paper

This paper follows up one of the key recommendations from the OTS's 2014 Competitiveness Review, and considers what a simpler system might look like and the relevance of the CT computation for today's companies. It reports initial views from stakeholders and sets out a number of areas – a mixture of policy reforms and process changes – where simplification could be considered. These are:

- Adjustments between accounting profit and CT profit: burden vs value.
- Ways of relieving or incentivising capital expenditure: complexity and certainty.
- The 'Schedular' system – are there any obstacles to its removal, including whether the distinction between trading and investment companies is still relevant and the extent to which capital gains are paid by companies.
- Making Tax Digital – where this creates opportunities for a simpler CT regime.
- Reporting and compliance processes that could be simplified: benefits vs risks.
- The distinction between small and large companies:
    - a) simpler tax for smaller companies
    - b) streamlining tax processes for large and complex companies
- International aspects and comparisons.

The OTS recognises that some of these areas present opportunities for simplification in the shorter term but others, such as relieving capital expenditure, are areas that cannot be considered without a much wider debate on the implications and these would be much longer term changes.

The OTS will be publishing its final report and recommendations before Budget 2017.

## OTS response to recent HMRC consultations

As part of its work to place greater focus on simplification as policy is being made, the OTS has submitted its response to recent HMRC consultations on Making Tax Digital, partnership taxation, the PAYE settlement agreement process and salary sacrifice.

For further details please refer to the OTS's website.