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Ref: J Harnedy20

Mr John Harnedy
CT Calculation Review Team
Room 2/E1
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

20 February 2009

Dear Mr Harnedy

Simplification Review: CT calculations and returns for smaller companies

I am writing to you on behalf of The Institute of Chartered Accountants of Scotland (ICAS) in response to the questions put in your discussion document entitled 'Simplification Review: corporation tax calculations and returns for smaller companies' published with the Pre-Budget Report on 24 November 2008.

About ICAS

ICAS is the world's first professional body of accountants, receiving its Royal Charter in 1854. Since then, ICAS has played a leading role in the accountancy profession. It was the first to adopt the designation 'Chartered Accountant' and the designatory letters 'CA' are still an exclusive privilege in the UK for its 17,000 members. CAs hold key positions right across commerce and industry, the public sector and private practice.

The Institute's main objective is to uphold the integrity and standing of the profession of Chartered Accountancy in the interests of society and the membership through excellence in education, the development of accountancy, the enforcement of professional standards and service to members.

Introduction

We support well-directed efforts to reduce administrative burdens on business, and we are pleased to have this opportunity to comment on the proposals to simplify the processes involved in the preparation and submission of accounts and corporation tax computations of small companies.

We note that these proposals go beyond mere simplification of existing procedures, and would involve fundamental alterations in the basis of accounting, the basis of taxation, and the Companies House filing requirements. For reasons explored in greater detail below, we believe that the proposals if implemented would not result in any significant simplification overall.

Change in itself can impose administrative burdens, while also causing uncertainty. Businesses, particularly small businesses, are currently faced with commercial and financial uncertainties as they address the problems involved in trying to survive through an exceptionally harsh recession. This is

not therefore an appropriate time for the Government to impose significant changes and the uncertainties which they would bring.

The timing of these proposals is unfortunate, since HMRC is investing heavily in developing software to enable small companies to meet their obligations to file XBRL-based accounts, corporation tax computations and tax returns online by April 2011, when this will become mandatory. There are already significant doubts about the willingness of the tax software industry to develop and market software to help small companies meet this new e-filing obligation. If either of the proposals set out in the discussion document were to proceed, the resulting uncertainty and confusion would cause further disillusionment among software providers and undermine both the credibility and the timing of the move towards XBRL-based online filing.

Having regard to all these circumstances we cannot support either of the proposals contained in the discussion document, and this is reflected below in our answers to your specific questions.

Statutory accounts – incorporating tax obligations

The accounting rules and standards by reference to which accounts are prepared have evolved over time, and reflect the result of concerted efforts by the accountancy profession in the UK and worldwide to develop a means of reporting a true and fair view of the state of affairs of a business. They include measures to ensure that the accounts of smaller businesses are kept as simple and straight forward as possible, while maintaining a consistency of approach with the standards applied by larger entities.

We see no merit in diverging from this established approach and allowing small companies to prepare accounts on an alternative basis devised by the Government and based on UK tax rules.

1. Would moving to a new statutory accounting standard which incorporates tax rules as outlined above deliver real simplicity and savings for smaller companies?

No. It would move the accounts of small companies away from accepted accounting rules and standards, so that the accounts might no longer show a true and fair view. It would impose additional complications and compliance burdens on small companies, diverting their proprietors away from the more important task of running their businesses.

This option was explored in an earlier round of consultation, and in a survey early in 2008 a statistically significant sample of our members ranked it as their fourth choice out of five possibilities then being considered by the Government. More recent discussions have revealed no support for this option among our committee members consulted.

2. Where and for whom would the benefits and savings occur in practice?

We believe that such a move would deliver no net benefits or savings. The process of preparing accounts and agreeing tax liabilities would be different, but the combined processes as a whole would be no less burdensome.

3. What drawbacks, if any, do you see with this approach to integration of statutory reporting and tax calculation obligations for smaller companies?

The move to this new basis would impose additional costs and compliance burdens on small companies. Since there would inevitably have to be a threshold above which a company was no longer regarded as small, there would be additional costs and compliance burdens on companies breaking through that threshold.

All those involved in corporate tax compliance, including HMRC, would have to learn to deal with the intricacies of an additional optional accounting and corporation tax regime. Small companies taking reasonable care in managing their tax affairs would wish to consider whether or not to elect for the alternative option, if applicable, and this would involve extra time and effort; many of them would incur professional fees in seeking advice on this.

If such a basis of accounting were adopted, the accounts of some small companies would diverge sharply from the true and fair view that they show currently. For example, accounts might no longer reflect an appropriate depreciation charge over the useful lives of fixed assets, and the book values of fixed assets in the balance sheet would be misleading. As another example, a pension scheme charge for the year might have to be excluded on the grounds that it had not yet been paid, thus overstating the profits earned.

It is also unclear to us how permanently disallowable items of expenditure would be accommodated. It would appear that they would have to be adjusted in preparing the accounts rather than in preparing the tax computations derived from those accounts, and we cannot agree that this would achieve any degree of simplification in practice.

Since in very many instances the altered accounts would no longer reflect a true and fair view, their value would be diminished for all users except HMRC. In many cases other users of accounts would have to prepare additional calculations in order to make use of the altered accounts for their purposes, thus incurring extra costs.

4. What other user interests must the development of such a standard for smaller companies consider?

Accounts are used not only by HM Revenue & Customs for tax compliance purposes, but also by banks, other lenders, investors, suppliers and customers in assessing creditworthiness and other risks, and by business partners and employees in monitoring performance, sharing profits or losses or determining performance-based remuneration. The suggested move to a new standard incorporating tax obligations might prejudice the interests of many of these third parties.

Calculating tax on a cash flow basis

There might be initial attractions to calculating the tax liabilities of the very smallest companies on a cash basis. However, your discussion document lists so many impediments to this that it demonstrates very clearly that this is not a route which offers any obvious simplification.

5. Could introducing a new tax regime incorporating cash flow deliver real simplicity and administrative savings?

No. We see no obvious savings to be derived from such a change.

The introduction of the new basis would be disruptive, except for new companies starting thereafter. There would be additional costs and compliance burdens for companies breaking through the threshold above which they would no longer be regarded as qualifying among the smallest companies; those factors, and the possible extra tax that would be charged on a change of basis at that stage, might act as a disincentive to growth or at the margin might push activities into the black economy.

6. Where and for whom would the benefits and savings occur in practice?

We see no benefits and savings. Compliance would become more burdensome, not only for HMRC but also for small companies and their tax agents. All those involved would have to learn the intricacies of a new corporation tax regime, including transitional provisions and special factors affecting companies at or near the threshold.

7. What are your views on the various issues this approach raises, and ideas on how a workable regime could be constructed?

We believe that this option does not offer a workable solution. It too was explored in our member survey early in 2008, and respondents ranked it as the most unpopular and least relevant of the five possibilities then being considered by the Government. In more recent discussions our committee members have shown no enthusiasm for this option.

Conclusion

There is a need for businesses to prepare accounts for a variety of purposes, including tax compliance. For tax purposes there is a need for those accounts to be adjusted in computations which reflect the tax rules. The process of adjusting the profit or loss for tax purposes is relatively simple for most small companies and well understood by most of those who perform the work.

Some small companies are unrepresented and prepare their accounts and tax computations unaided. Most companies engage the services of qualified accountants to advise them on a range of business issues from which the business is likely to benefit. In either case, preparation of the tax computation is usually a very small part of the total work involved. We therefore suggest that any attempt to simplify the corporation tax computations in either of the ways considered in the discussion document should be abandoned.

We have a further reason for opposing the proposals. In recent years there has been a growing tendency to introduce tax computational provisions that apply to companies but not to unincorporated businesses, and we believe that this increasing divergence of tax treatment is unjustified. We see a need for the tax regime to be simplified for all small businesses, and a focus on trying to simplify tax compliance for only those that are incorporated is inappropriate. Instead, applying the same measurement of taxable profits to companies and unincorporated businesses would be an important step towards simplification.

Yours sincerely

Donald Drysdale
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