New Generation

Think Small

A BLUEPRINT FOR SUPPORTING UK SMALL BUSINESSES

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FOREWORD BY ANDY STREET

Centre for Policy Studies

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Before entering politics, Nick primarily worked in the private sector, particularly in the sports industry and the wider leisure sector, both in the UK and abroad.

About the Centre for Policy Studies

The Centre for Policy Studies is the home of a new generation of conservative thinking. Its mission is to develop policies that widen enterprise, ownership and opportunity, with a particular focus on its core priorities of housing, tax, business and welfare.

Founded in 1974 by Sir Keith Joseph and Margaret Thatcher, the CPS is primarily responsible for developing a host of successful policies, including the raising of the personal allowance, the Enterprise Allowance, the ISA, transferable pensions, synthetic phonics, free ports and the bulk of the Thatcher reform agenda.

Acknowledgements

We spoke to too many business owners, representative bodies, politicians, diplomats, think tanks and other interested parties to thank each of them individually but we are grateful to them all for their interest in and help with this project. We are particularly grateful to Capital Economics for the modelling work behind our central recommendation and to YouGov for the polling work they have conducted on our behalf. We would like to put on record our thanks to all those who came to our roundtables and specifically to the Federation of Small Businesses, the Office of Tax Simplification and to ministers, special advisers and civil servants in various Departments for their help throughout the preparation of this report. The author would like to give particular thanks to Robert Colvile for his editorial expertise as well as to the rest of the CPS policy team for their invaluable assistance.

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Foreword

By Andy Street

Prior to becoming Mayor of the West Midlands, I spent 30 years in business, working my way up through the John Lewis Partnership.

Throughout those decades in industry, I saw first-hand the hard work and endeavour of those who ran Britain's small businesses. I know John Lewis' success then, just as much as now, depended in no small part on the brilliant small companies that are at the heart of the British economy.

But I also saw, up close, the challenges they faced: getting people with the right skills, accessing the capital they needed to grow, and in particular dealing with the paperwork and administration which are now required by Government departments and agencies.

In my current role, I am struck by exactly the same thing. Within the West Midlands Combined Authority I represent over 100,000 businesses – with many more than that across the West Midlands as a whole. Almost all of them are small businesses. And as I meet and visit these organisations, there is a clear irony. Businesses are being formed faster than ever, but their growth could still be much faster. I hear the same old complaints about bureaucracy, administration, and the level and complexity of taxation in the UK.

I therefore warmly welcome the efforts of Nick King and the Centre for Policy Studies in producing this report. As Nick himself says, this report is unapologetically aimed at supporting any and all small businesses.

This is a laudable ambition that should be shared by anyone within local or central government, and within a Conservative Party that is always at its best when it champions enterprise and entrepreneurship, and when it aims to put small and family businesses first.

The Simple Consolidated Tax, the central recommendation of this report, would be a significant simplification of the tax landscape for small firms, and a dramatic reduction in their reporting and administration burden. I strongly urge the Government to examine these proposals.

But it is not just this proposal which is worthy of our interest in this paper. Nick goes further and presents a raft of other ideas – a blueprint for supporting the UK's smaller businesses, as he puts it. Many of these would also be hugely welcome.

The polling commissioned for this report shows that both the British people, and the owners and managers of small businesses, think the Government could do more to support small businesses.

I hope that it will look at this excellent report carefully to see just how it could go about it.

Andy Street is the first elected Mayor of the West Midlands Combined Authority. He was Managing Director of John Lewis from 2007 to 2016

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- Small businesses are the backbone of the British economy. They make up **more than 99% of firms,** with SMEs providing **three-quarters of all new jobs**
- Yet YouGov polling for the Centre for Policy Studies shows that **just 14% of voters** think the Government is on the side of small businesses
- **Only 22% of those running small businesses** think the tax system is sympathetic to their needs. **Just 1% think it is too simple** rather than too complex
- Britain's tax system operates on a **'one-size-fits-all' model** which forces small firms to jump through the same hoops as large
- This report makes the case for **a new Simple Consolidated Tax (SCT)** – a simple levy based on turnover that should be offered to all business with revenue under £1 million as an alternative to Corporation Tax, Employer's NI, VAT and business rates
- This would **remove reporting burdens** and free small businesses to hire, invest and grow

Executive Summary

In 1959, Volkswagen created what would later be hailed as the greatest advertising campaign of the 20th century: 'Think Small'.[1]

The campaign was aimed at promoting the unique attributes of the Beetle, one of the smallest cars of its day. DDB, the advertising agency responsible, said that the campaign was produced 'with simplicity in mind'.[2]

In both its promotion of 'small' things and its relentless focus on simplicity, that campaign provides a model for this report.

Because as we know, taken together, small businesses are not small at all. They make up the overwhelming majority of the business population, generate half of private-sector jobs and much of Britain's wealth. They are the backbone of our economy. Even at a time when the public are sceptical of big business, they still believe that small, local businesses should be protected and championed.

Reality paints a different picture. YouGov polling for the Centre for Policy Studies shows that, by a margin of 60 per cent to 14 per cent, voters do not believe that the Government is on the side of small businesses. Even Conservative supporters agree with this proposition, by a margin of two to one.[3] A special survey of more than 2,000 owners and senior managers of small businesses, also carried out by YouGov, reveals that those on the front line feel the same way.[4]

Successive Governments have been guilty of focusing on the 'sexier side' of business: tech start-ups, scale-up companies, globally mobile capital.

The Conservatives have cut Corporation Tax – a welcome boost to entrepreneurship, which is thriving as never before. But they have left many small companies to face the same burdens of taxation, administration and reporting as firms hundreds of times their size – a 'one size fits all' model which ensures that, while it has never been easier to start a business, it sometimes feels like it has never been harder to run one.

This report is built on the opinions and experiences of the millions of men and women up and down the country who have made the brave decision to set up their own businesses. They need not just admiration, but also support. Often these companies are family businesses, rooted in the local community and vital local employers – if Government is not on their side, then whose side is it on?

This report suggests a whole series of measures which, if adopted, will show Government firmly supports small business owners – but its central message, built around our extensive research into their situation, is that it is time to give them more control of their finances, their futures and their time by relieving the heavy burden of administration and reporting which weighs down so many small companies.

We need to free small business owners so that they can get on with running their companies – investing in growth, hiring more people and delivering the goods and services their customers want.

To free them from the current thickets of administration, tax and reporting, we propose the introduction of a new Simple Consolidated Tax (SCT). Companies with a turnover of less than £1 million would be able to opt into this system, which would replace Corporation Tax, Employer's National Insurance, VAT and business rates with a simple levy on turnover – while obviating the need for reams of paperwork and the vast number of days swallowed by administration, tax preparation and compliance.

At a stroke, those who signed up to this regime would find their business lives made dramatically easier. The system would be easy to understand, the revenue easy to collect for the taxman and it would not have to cost the taxpayer a penny extra. It would also make it much more attractive for many people to own and run a company.

Of course there would be some firms for which this system is unlikely to work, for example those which rely heavily upon tax credits and other allowances, or have high turnover but low profits. That is why it is vital that the system would be optional – following the precedent already set by the Flat Rate VAT Scheme – to ensure that business owners can decide what works for them.

The principle and the idea are simple, and their appeal relies upon that simplicity. But working out the details is not. We therefore partnered with Capital Economics, the respected economics consultancy, to examine the concept from all angles – and, crucially, to estimate the level at which this SCT should be set to ensure revenue-neutrality for the Treasury.

Our workings suggest that to reach a 'revenue neutral' figure – in other words, one which will raise the same amount that is currently received by the Treasury through those four existing taxes – the SCT should be introduced at a rate of 12.5 per cent. This means that a company with a £300,000 turnover would pay an SCT of £37,500. The methodology for our modelling work is contained in full in Annex A.

In carrying out this work, we have drawn on previous research projects, polling and other data to evaluate how many firms would benefit financially under an SCT, and how many would be attracted to it for the savings in time and administration – which will, for many small business owners, be just as attractive as the financial gains, or even more so.

We are confident that the results are robust. And crucially, we believe we have demonstrated that the principle is sound: even if the Treasury rejects our particular architecture for the SCT, it should treat the broader concept with the seriousness it deserves.

Yet it was while we were carrying out this modelling exercise that we discovered something that is emblematic of the lack of focus on small and family businesses in Whitehall. It took us far longer than expected to calculate how much revenue small companies are currently paying via each of these four taxes – because the Treasury does not actually know.[5]

“ If the Conservative Party wants to defend free markets, competition and free enterprise, the smartest way to do that is to focus on supporting small businesses. ”

That fact tells its own story. Small businesses do not feature as prominently in the thinking of the Treasury, or the Government more generally, as they should.

If the Conservative Party wants to defend free markets, competition and free enterprise, the smartest way to do that is to focus on supporting small businesses.

This is not just an economic issue, but a political one. The millions of men and women who own and work for these companies represent millions of voters. As Jeremy Corbyn continues to rail against private enterprise and his Shadow Chancellor threatens to 'ferment the overthrow of capitalism', it is not clear who speaks for them.

Our polling shows not only that voters favour small businesses, but that they think the Government should be squarely on their side. They overwhelmingly think that the tax system should aim to help small businesses grow (71 per cent yes, 10 per cent no). By an even wider margin (80 per cent to 5 per cent), they think the tax system should be simple for small businesses to understand – which at present, it is not. And by a margin of three to one (64 per cent to 19 per cent) they think that tax and reporting systems for small businesses should be simpler than for large companies.

The public, in other words, accepts and embraces the principle behind the SCT. And small business owners feel the same way.

YouGov surveyed more than 2,000 owners and senior managers of small businesses on the Centre for Policy Studies' behalf (the polling is reproduced in Annex B).

> **"Only 22 per cent felt that the tax system is sympathetic towards the needs of small businesses, with 68 per cent saying it is not."**

They told us that they overwhelmingly feel the current system of tax, administration and reporting is too complicated: 38 per cent said it is much too complicated, 37 per cent that it is a little too complicated, and just 1 per cent that it is too simplistic.

Only 22 per cent felt that the tax system is sympathetic towards the needs of small businesses, with 68 per cent saying it is not. By a near-identical margin, of 62 per cent to 24 per cent, they feel that the current Goverment is not on their side.

And they also told us that if a Simple Consolidated Tax were on offer, they would leap at the chance. Twice as many said that they would support its introduction as would oppose it.

Of those who expressed a preference, 72 per cent said that they would sign up for such a scheme if it meant paying the same amount of tax, compared to 28 per cent who would prefer to stick to the old system. And if there were a chance of lowering the tax burden at the same time, the result became even more lopsided: 79 per cent to 21 per cent.

The SCT, in other words, is practical, popular and proven. And it is what millions of small and family businesses are crying out for.

Too often in this country, small businesses' successes have come in spite of Government's efforts, not because of them.

This report – and this proposal – seeks to right that wrong.

WHY SMALL BUSINESS MATTERS

- The UK has 5.6m small businesses. They make up 99% of firms and **employ almost 13m people**, with SMEs generating three-quarters of all new jobs
- In 2017 alone, Britain created **more than 200,000 new companies**
- YouGov polling for the Centre for Policy Studies shows that voters feel **far more positively about the role of small, local businesses** than business in general
- By a margin of **60% to 14%**, voters told YouGov that they believe Government is not on the side of small businesses
- **Only 22% of those running small businesses** think the tax system is sympathetic to their needs. **Just 1% think it is too simple** rather than too complex
- The most recent survey by BEIS found that **only a quarter of businesses** think Government understands business well enough to regulate it
- We believe that Government should be **unapologetically on the side** of small businesses and those who run them

Introduction –
Why Small Business Matters

The phrase 'small business' gives the wrong impression entirely. Small business is anything but.

Small businesses underpin our economy, drive growth around the country, and are the building blocks upon which our post-Brexit prosperity will rest.

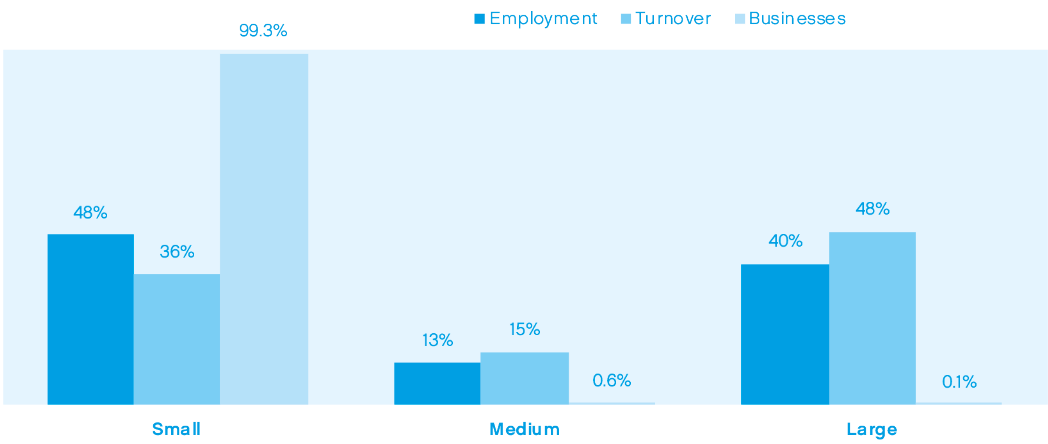
There are 5.6 million small businesses in the United Kingdom, constituting more than 99 per cent of the country's entire business population.[6] Collectively, these small businesses employ 12.9 million people, with a combined turnover of some £1.4 trillion.[7]

Many of these are family businesses, with husband and wife, or more than one generation of the same family, working together to earn a living. They are often rooted in the local community, and steeped in family values.[8]

Small businesses are also big employers. Those 12.9 million employees represent some 48 per cent of private sector employment. And that figure is set to grow. A report published in 2017 by NESTA and Sage revealed that almost three-quarters of all private sector jobs created since 2010 were within small and medium-sized enterprises (SMEs).[9] A recent report by the Institute of Directors predicted a similar level of performance over the next decade.[10]

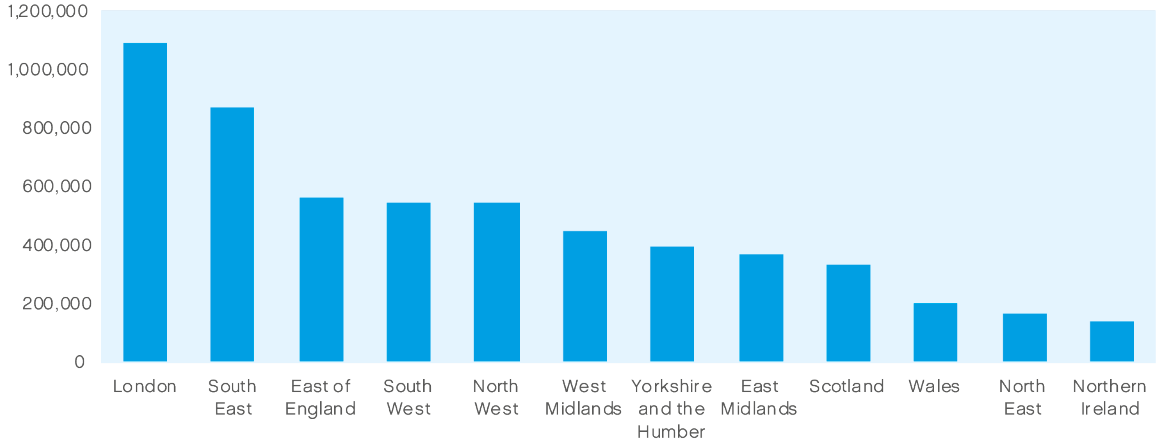
Small businesses really are, in other words, the backbone of our economy. They are in every town, every village, every part of the countryside. Napoleon's old adage that we are a nation of shopkeepers may no longer ring true – but we are certainly now a nation of small business owners.

Figure 1: Contribution of different-sized businesses to employment, turnover and business population, at start of 2018



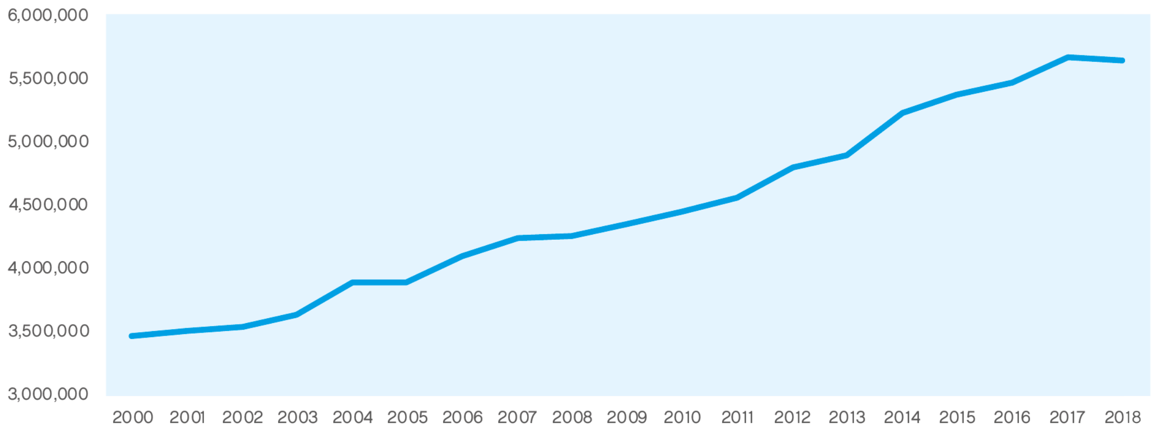
Source: BEIS, Business Population Estimates 2018

Figure 2: Number of businesses with fewer than 50 employees in each UK region



Source: BEIS, Business Population Estimates 2018

Figure 3: UK small business population since 2000



Source: BEIS, Business Population Estimates 2018

And that is becoming ever truer. In the 1970s, there were fewer than a million businesses in the UK. Today, there are more than five and a half million, with more than two million having been added since 2000.[11] In 2017 alone, this country created almost 200,000 new businesses.[12]

These statistics are astonishing – and very welcome indeed. They confirm that whatever its other problems, Britain certainly does not suffer from any lack of entrepreneurial ambition.

And it also suggests that the barriers to setting up your own company must be commendably low.

Sure enough, the Global Entrepreneurship and Development Institute ranked the UK as the fourth best country globally in terms of its entrepreneurship ecosystem in its 2018 Global Entrepreneurship Index. [13]

Successive Governments can take a great deal of credit for their efforts in this regard. Through targeted interventions and intelligent policy-making, they have created an environment which allows individuals to start their entrepreneurial journey with a minimum of fuss.

But once that journey has begun, many business owners feel that the next steps are far harder than they ought to be.

As Rishi Sunak MP pointed out in a recent Centre for Policy Studies paper, a survey of 14 OECD countries found that Britain came 13th in terms of the proportion of new firms that have 10 or more employees within three years of their creation.[14]

Equally worrying is that many small business owners do not feel as if they get the help they need – that the Government does not understand their needs and is not on their side. By an astonishing margin of 60 per cent to 14 per cent, voters told YouGov in our polling that they did not believe the Government is on the side of small businesses – despite a range of measures having been taken to improve the corporate landscape by the Conservative Party, most notably a dramatic and sustained fall in Corporation Tax rates.

This view is shared by businesses themselves. By 62 per cent to 24 per cent, the more than 2,000 small business owners or senior managers YouGov surveyed said that they felt the current Government is not on the side of small businesses.

There were variations across different sectors and regions, but in none of them did the supportive figure rise above 40 per cent, and it was usually much lower.

Similarly, the most recent Business Perceptions Survey carried out by the Department for Business, Energy & Industrial Strategy (BEIS) reveals that only a quarter of businesses think that Government understands business well enough to be able to regulate it.[15]

This is not good enough.

It is the job of any Government to be resolutely on the side of business – for it is the spirit of entrepreneurialism, competition and free enterprise which has driven our economy, and our country, forward.

It is business which has created the jobs that have lifted people out of poverty and provided stable incomes. It is business which has driven the innovation that has created the new products and technology which we love and increasingly rely upon. It is business that has provided the tax revenues which fund our schools, our police and our National Health Service.

Capitalism is thought by many to be a dirty word. Surveys show that big business comes close to rivalling politicians in terms of the lack of trust felt by members of the general public.[16]

But many people feel differently about the local businesses which are based around them – often businesses where they may know the owner or someone who is employed by the firm. The polling conducted by YouGov on behalf of the Centre for Policy Studies showed that 62 per cent of those surveyed felt positively about the role of small, local businesses, compared to just 47 per cent who said the same about business in general.[17]

It is these small businesses that are often overlooked by central government, which instead spends much of its time thinking about how to support high-growth start-ups, or looking to attract global capital through financial incentives or other targeted support.

“By 62 per cent to 24 per cent, YouGov’s panel of more than 2,000 small business owners and managers felt that the current Government is not on the side of small businesses.”

But it is small businesses and small business owners who actually employ most people in this country. These are people who are working hard, making something out of nothing, doing the right thing – and paying their taxes. As a recent paper from the OECD said: ‘SMEs and entrepreneurs are the backbone of OECD economies… they are key to strengthening productivity, delivering more inclusive growth and adapting to megatrends.’[18]

As well as the economic benefits that will come through generating a more supportive environment for small businesses to operate within, there is a vital political angle to be considered.

Millions of small businesses mean millions of voters, spread around the country, in every constituency in the land. The people they employ, the customers they serve and the other companies they buy from all have a stake in the future success and sustainability of these businesses.

To back these small and family businesses is therefore to back Britain. Their efforts should be recognised and rewarded. They are the part of the free enterprise system we should be working hardest to support.

That is why this report is unapologetically aimed at supporting any and all small businesses. After all, every big business was a small business once – and if the measures in this report are adopted, a greater proportion might find themselves able to make that journey in the future.

THE CHALLENGES FOR SMALL BUSINESSES

- The UK is one of the best places to set up a business. But **pretty quickly, it gets a lot more complicated**

- Small businesses face many challenges. But a major cause for complaint is **the amount of administration, reporting and tax-related regulation**

- We polled more than 2,000 small business owners and managers. **More than 70% said the tax and reporting systems are too complicated**

- The tax system operates according to **a 'one size fits all' model** in which small firms are subject to the same rules as large ones

- Small businesses **should be freed up to focus on running their businesses** – not jumping through hoops for HMRC

- Some **64% of voters** think tax and reporting systems for small businesses should be simpler than for large, **with just 19% disagreeing**

1. The Challenges for Small Business

It is all too easy to sit at a desk in Westminster and come up with theories about how to help small businesses.

In writing this report, we wanted to go further. Our research team spent months speaking to business owners, representative bodies, politicians, academics and other interested parties. We held roundtables and discussions with the Federation of Small Businesses, the Office of Tax Simplification, and ministers, special advisers and civil servants in multiple Departments. We are grateful to them all for their assistance.

We are particularly grateful to the businessmen and businesswomen who told us about their experiences on the frontline – their insights were invaluable. Many people in politics and the Civil Service genuinely want to help small business, but there is nothing like experiencing the issues first-hand. One could reasonably argue that some of the current issues within the tax system stem from it being devised by bureaucrats who won't be directly impacted, rather than the small business owners who will.

The most obvious thing to say is that small and family businesses are very far from a homogeneous group. The challenges they face will clearly depend on a range of factors including, but not limited to, the stage they are at within their life cycle, the sectors they operate in, and the ambitions of their owners.

Self-evidently, a global exporter with operations in multiple countries will face a different set of problems to a small business owner running a shop, or a sole trader (someone who runs a business but does not incorporate and run a limited company) with no employees at all.

Nevertheless, when asked about the main challenges that affect them, business owners of all types tend to point to very similar issues: rising costs; the level of taxation, regulation and compliance; issues with cashflow; and wider barriers to growth, including difficulties accessing capital and talent.[19]

“Octopus's most recent High Growth Small Business report suggests that 90 per cent of the UK's fastest-growing small businesses cannot find employees with the skills they need.”

These challenges are all the more keenly felt among smaller businesses, where the impact of polices such as pensions auto-enrolment and the GDPR falls disproportionately, as do cost pressures such as rising fuel bills and the hike in the National Living Wage.[20]

Issues like these are putting the brakes on small business at a time when we need it to be motoring.

Being confident enough to take on more staff (or any staff) and getting access to the right skills continue to be problems for the UK's SMEs.

Octopus's most recent High Growth Small Business report suggests that 90 per cent of the UK's fastest growing small businesses cannot find employees with the skills they need.[21] But for many small businesses the problem is much more basic that that – they are concerned about taking on any staff at all. This is because the implications of the added expenditure and responsibility are so much more burdensome in a company where cashflow and late payments are such serious issues, and where the rules around employment – especially when considering a first hire – feel overwhelming.

> **"Astonishingly, the regulatory and compliance requirements for small companies are broadly the same as those for big businesses. The same is largely true of the tax system."**

SMEs are also less likely to take on external finance, at least in part because they do not feel as if they have the same financing options available to them as the bigger companies do.

The banks are still not lending to small businesses in the way they once did. As the OECD put it in their Financing SMEs and Entrepreneurs 2018 Scoreboard, there has been a 'downward trend' in the stock of lending to SMEs since 2009 – though they do point out that alternative sources of finance have emerged in the meantime.[22]

One could compellingly argue that attracting the capital you need to grow your business, and hiring people who will help you do just that, are precisely what business is all about.

Later in this report, we will address some of the most common problems that small businesses say they face in doing so.

But the focus of this report will be on addressing a far larger cause for complaint – indeed, the one that emerged from our research and conversations as the main obstacle facing small and family businesses. And that is the burden, in terms of both time and money, of taxation, administration and reporting.

The 2017 Small Business Survey, published by BEIS in May 2018, details the views of SME employers on the factors affecting their performance.

When asked about major obstacles to the success of their business, 46 per cent mentioned regulations and red tape and 41 per cent mentioned taxation – these were the second and third most likely factors to be cited. Only 'competition in the market' came higher (51 per cent) – and competition is not a phenomenon the Centre for Policy Studies is going to take issue with! Among those SME employers who cited red tape as a major obstacle, the most common type of regulation they complained about was tax-related.[23]

Anyone who has owned or worked for a small business will be familiar with the seemingly endless administration needed just to work out the amount of tax owed.

Small business owners routinely express frustration about the amount of reporting and administration and the number of regulatory burdens they face. And such issues tend to be much more of a problem for small businesses than large. BEIS's 2018 Business Perceptions Survey found that 44 per cent of small employers agreed that the overall level of regulation is an obstacle to success, compared to 31 per cent of large employers. The most common frustration expressed was having to provide the same information multiple times. SMEs were also more likely to agree that 'completing paperwork' was a burden.[24]

In the YouGov polling for this report, an overwhelming proportion of small businesses – more than two-thirds – said that the tax system was not sympathetic to the needs of small businesses. More than 70 per cent thought that it was either 'much too complicated' or 'a little too complicated'. Only 18 per cent felt that the balance was about right – and under 1 per cent that it was too simplistic.

This is because, astonishingly, the regulatory and compliance requirements for small companies are broadly the same as those which apply to big businesses – meaning the administrative burden is disproportionately large. The same is largely true of the tax system. As the Office of Tax Simplification recently said, we currently have 'a corporate tax regime operating on a one-size-fits-all basis (modelled on a traditional company with third party shareholders and intending to grow)'.[25]

"Some 64 per cent of those we surveyed thought tax and reporting systems for small businesses should be simpler than those for big business, with just 19 per cent disagreeing."

As stated earlier, the UK is one of the very best places in the world to set up a business. But after someone takes that step, life gets a lot more complicated pretty quickly. Setting up Pay-As-You-Earn (PAYE) schemes; collecting VAT if your organisation goes above the £85,000 threshold, before making VAT deductions and quarterly payments; dealing with tax-deductible and non-deductible expenses; considering the National Insurance implications of your first hire; filing accounts – it can all feel pretty daunting to the average business owner.

Many of these burdens are virtually the same whether you run your own company out of your garden shed or you are a big manufacturer employing thousands of people.

Even the Treasury concedes that this is a problem. As it recently said of VAT: 'The administrative burden… for small businesses takes up their time and money, shifting these resources away from the main activities of the business.'[26]

Our polling suggests that members of the British public agree. Some 64 per cent of those surveyed by YouGov said that they thought tax and reporting systems for small businesses should be simpler than those for big business, with just 19 per cent disagreeing.[27]

It is this fundamental tenet which underpins the central recommendation of this report: Businessmen and businesswomen should be freed up to spend their time focusing on running their businesses – not doing administration or wrestling with HMRC.

Our ambition is to make the case for a new way of approaching the taxation of some of our smallest companies, to ensure our tax system is fit for purpose and able to support smaller companies as they grow. In the words of Stephen Herring, former head of taxation at the Institute of Directors: 'It is imperative to step back and take a strategic view. Instead of merely tweaking specific taxes, we need to take a broader view on the overall impact of business taxation upon the economy and its business and individual taxpayers.'[28]

The central recommendation of this report stems from the view that regulatory reform and tax simplification are long overdue.

THE CASE FOR A **SIMPLE CONSOLIDATED TAX**

- The Office of Tax Simplication is clear that **we need a better, simpler tax regime** for small businesses
- The average small business **loses three working weeks a year** to the demands of tax compliance, in addition to the financial costs
- Corporation Tax, Employer's National Insurance, VAT and business rates are **not just hard to afford but hard to administer**
- All firms with revenue under £1m should be able to **replace these taxes** with a simple levy on turnover
- Modelling by Capital Economics suggests this would be revenue-neutral for the Treasury at **a rate of approximately 12.5%**
- Businesses would strongly support the introduction of such a scheme. Excluding 'don't knows', **72% would choose to use it** if it meant paying the same amount of tax

2. The Case for a Simple Consolidated Tax

Thanks to a decision made in the early days of the Coalition Government, a body exists whose sole function is to consider how best to simplify tax.

Our starting point in reforming business taxes, therefore, should be the Office of Tax Simplification.[29] And they have been clear in saying they believe we need 'a remodelled small company landscape' and 'a tax environment in which business structures and tax obligations are simpler because they are better matched to the needs of different types of small business'.[30]

The principal reason we need to offer an alternative to the tax system which currently applies to our smallest companies is that it was never designed for them, and unfairly penalises them, inadvertently or otherwise.

As outlined in the previous chapter, smaller companies tend to be affected by all the same taxes and administrative requirements as their larger rivals.[31]

You might be able to argue that this type of system was acceptable if it were simple and easy to navigate. But complexity is built in. Tax reliefs abound, with the Government often using them as a means of trying to incentivise certain behaviour – but small businesses either don't feel well-informed about them or feel they're too complicated to justify trying to use them.[32]

More broadly we have a highly complex system of different taxes, reliefs and modifications with varying requirements and deadlines. Corporation Tax, Employer's National Insurance, VAT and business rates are challenging for many small companies not just to afford, but also to understand.

BEIS's own Business Perceptions report shows that there is an 'upward trend' of businesses being concerned by regulatory compliance.[33] Given that few of them would have in-house expertise, it is little wonder that smaller companies are far more likely to call on third-party specialists to help them understand and comply with taxation and regulations.[34]

“BEIS's own Business Perceptions report shows that there is an upward trend of businesses being concerned by regulatory compliance.”

Different studies have come out with different figures when estimating the impact and cost of the administrative requirements which affect smaller companies (see Table 2 below). But they all produce eye-watering totals.

None of this will come as a surprise to anyone who either runs one of these companies or is familiar with the research in this field. Virtually every study that looks into administration and compliance in depth paints a sorry picture.

Table 1: Businesses employing an agent for Corporation Tax obligations, by size

	Completed In-House	Completely Outsourced	Partially Outsourced
Micro	8%	74%	17%
Small	5%	83%	13%
Medium	8%	58%	30%
Large	22%	21%	56%

Source: HMRC & Ipsos Mori Research: Understanding Tax Administration for Businesses, 2015 [50]

The average mean spend on 'external support', such as accountants and HR and compliance advisers, was calculated to be £8,400 by BEIS when they recently produced their Business Perceptions report. That same survey reveals that the mean number of days spent dealing with regulation was 5.1 days for micro-firms (those with between one and nine employees) and 8.7 days for small companies.[35]

HMRC's own estimate says that micro-companies pay agents an average of £1,853 each simply for preparing and filing a Corporation Tax return – not to mention the owners' time being taken up, often at evenings and weekends.

Completely outsourcing the calculation of one's obligations for Corporation Tax to an agent was most prevalent among small and micro businesses.[36]

Despite the fact that they often outsource as much as they can, 46 per cent of business owners, according to a recent survey by the Institute of Directors, spend one to five days on tax administration and compliance and 15 per cent spend 6-10 days on the same. Of those surveyed, 43 per cent said that they spent between £1,000 and £5,000 as a result of the administration requirements, with a further 15 per cent saying they spent between £5,000 and £10,000.[37]

A report by the Federation of Small Businesses, Taxing Times, showed that 77 per cent of small firms use specialists to get their taxes right, spending £5,000 on average on tax compliance each year. The same report revealed that the average small business loses three working weeks a year to tax compliance and a third of those surveyed said that tax had stopped them from growing their business.[38]

Taken together, these surveys show that something is going very badly wrong when it comes to the way small companies are treated.

Virtually all of these costs are as a result of having to meet the stringent and stretching reporting requirements of HMRC and Companies House, with little or no obvious benefit to the companies themselves.

> **"The average small business loses three working weeks a year to tax compliance, and a third of those surveyed said that tax had stopped them from growing their business."**

These small business owners don't want to spend their time working on tax and wider administration when they could be looking to invest in their business or hire new staff. They want Government to recognise that having to deal with a lot of paperwork is a serious issue for them – rather than feeling that HMRC typically 'treats them as potential tax evaders'.[39]

Table 2: Selected estimates of tax administration costs for small businesses[40]

Author-Institution (year)	Sample basis	Summary of findings and estimated administrative costs (annual)
Federation of Small Businesses (2018)	1,071 small business owners	£5,000 total cost (half on external) and 3 working weeks in total. Identifies tax-specific time costs: business rates: 7hrs; Corporation Tax: 14.7hrs; Income Tax: 16.5hrs; VAT: 44.7hrs; Employer's National Insurance: 19.9hrs; Self-employed insurance contributions: 8.5hrs; PAYE: 29.9hrs; Capital Gains Tax: 5.7hrs; IR35: 12.9hrs
HM Treasury (2018)	Internal database on VAT that SMEs pay	One-third of businesses commissioned VAT to external agents; VAT threshold leads to limited productivity to avoid VAT registration; 40% of SMEs' total financial costs to comply are spent on VAT alone, and 50% of time allocated for tax compliance is spent solely on VAT
OMB Research (2018)	2,001 20-minute telephone interviews with the person responsible for legal and compliance issues (February-April 2018)	£8,400 spent on administrative costs related to filing taxes per year (£48,970 for large businesses). In terms of time spent per month on total regulatory compliance, micro firms spent 5.1 days, small firms spent 8.7 days, medium firms spent 15.2 days and large firms spent 29.6 days. More than 50% of businesses believed that the total cost of complying with regulation had increased over the last 12 months; 59% considered that time spent on complying was a burden; 91% used external support to help them comply (93% used an accountant). Use of accountants was more common among micro firms
Office of Tax Simplification (2016)	258 businesses of all sizes	VAT threshold adversely affects growth and efficiency; 80% of SMEs prefer assigning corporate tax to agents; 60% feel confident dealing with VAT, PAYE, NICs, business rates and income taxes
Grant Thornton (2016)	Online survey of 925 members of the Institute of Directors (September 2016)	43% of respondents spent £1,000-£5,000 on accountancy services while 15% spent £5,000-£10,000. 46% of business owners spent 1 to 5 days on tax administration and compliance while 15% spent 6 to 10 days
Ipsos MORI (2015)	59 interviews with businesses of all sizes (August-September 2014) and 1,464 telephone interviews (October-November 2014)	Businesses spent the following, on average, on administrative costs to file taxes: VAT: £991; Corporation Tax: £2,490; Income Tax: £426 for self-employed or £990 for partnerships; £885 for individual partner return; Customs: £3,132; PAYE: £1,254 for P60 form plus £929 for full payment submission for existing staff or £992 for new starters. Businesses spent the following number of hours, on average, on administrative costs: VAT: 6hrs for SMEs, 17hrs for large companies; Corporation Tax: 15hrs for SMEs, 55hrs for large companies; Income Tax: 4.3hrs for self-employed, 12hrs for partnerships and 10hrs for individual returns
Hansford and Hasseldine (2012)	41 members of Association of Chartered Certified Accountants (ACCA) working within SMEs	£20,000 total cost for compliance (£13,000 median): £5,500 for external; £14,600 for in-house out of which £6,000 on VAT, £4,300 on Income and Corporation Tax, £3,600 for PAYE, £600 for Capital Gains Tax. Three quarters of in-house costs related to recording, calculating and returning information on tax returns

This message – that HMRC treats small businesses with suspicion – is one which is commonly heard when talking to the owners of these enterprises. This is unsurprising, given that HMRC is on record as saying it thinks small businesses underpay tax to the tune of some £13.7 billion each year.[41]

In trying to explain why some people might not pay the tax due, HMRC argues that 'some taxpayers make simple errors in calculating the tax that they owe, despite their best efforts, while others don't take enough care when they submit their returns. Legal interpretation, evasion, avoidance and criminal attacks on the tax system also result in a tax gap.'[42]

Remarkably, it does not seem to occur to HMRC that part of the problem might be the complexity of the tax code as it currently stands. Tolley's Tax has 2,194 pages on VAT and 2,600 pages on Corporation Tax – and that is before we even get started on calculating the paperwork dedicated to National Insurance and business rates.[43]

"Tolley's Tax has 2,194 pages on VAT and 2,600 pages on Corporation Tax – and that is before we even get started on calculating the paperwork dedicated to National Insurance and business rates."

The idea that small businesses should have to deal with such a volume of paperwork is patently absurd. The public emphatically agree: when asked by YouGov whether it should be an aim of the tax system that it is simple for small businesses to understand, 80 per cent of those surveyed said yes, and just 5 per cent said no.[44]

Given the complexity of the current regime, the perverse outcomes which it produces, and the strength of public feeling on this issue it is our strongly held view that the Government should embrace a dramatic simplification of the tax and administration environment for small businesses.

What we propose is to make life as simple as possible. Small businesses should be given the option, instead of wading through the thickets of Corporation Tax, VAT, Employer's National Insurance and business rates, to pay a new 'Simple Consolidated Tax'. This would replace not only four separate taxes to which they are subject, but also as many as possible of the accounting and reporting requirements which take up so much of their time and energy.

Introducing the Simple Consolidated Tax

The Simple Consolidated Tax (SCT), as its name suggests, is meant to have simplicity at its core – which is what should make it appealing to small business owners and Government alike.

The SCT would be paid in place of the four main taxes which small businesses face: Corporation Tax, VAT, Employer's National Insurance and business rates. To make the revenue due an easy figure to calculate, and to avoid economic distortions, it would be charged as a percentage of turnover.

It would only have to be paid on an annual basis – though there is no reason why company owners could not choose to make payments throughout the year, or even why the payments could not be fully automated and taken at a time when invoices are paid by customers. But, importantly, it should be paid on a cash basis – that is to say, only on income already actually received by the company.

Any existing or future company with a turnover of less than £1 million per annum would be able to avail itself of this new regime, with its concomitant benefits in terms of the increased opportunity to focus on growth – but the SCT scheme would remain optional so that any company preferring to operate within the current system of taxes and reporting rules would be able to do so. This guarantees that not a single business would have to lose out as a result of this proposal.

But the SCT is not just about finances. Under an SCT, small businesses would not have to wrestle with the monstrous complexities of the VAT system. They would not have to agonise before hiring a single extra staff member about National Insurance requirements, consider making appeals regarding their business rates or struggle under the burden of excessive paperwork regarding their expenses. They would be free to focus on actually running and growing their business, with enormous associated benefits for the country as a whole.

> **"Any existing or future company with a turnover of less than £1 million would be able to avail itself of this new regime."**

This is a plan which would be warmly welcomed by small businesses. In our polling of more than 2,000 owners and managers of small businesses, some 68 per cent of those that expressed a view said that they would support the creation of such a system; just 32 per cent were opposed.

The introduction of the SCT would, of course, mark a dramatic change in the corporate and taxation landscape, and one with significant implications. Accordingly, we have made rigorous efforts to evaluate its costs, complexities and potential consequences. In undertaking this task, we have been assisted by Capital Economics, the respected economics consultancy. We asked them to identify any potential pitfalls of the scheme, consider the modelling the Centre for Policy Studies had conducted – and work out the appropriate rate at which the SCT should be levied in order to ensure revenue neutrality for the Treasury.

Producing these estimates has been a challenging exercise. This is because of the imperfect nature of much of the data which HMRC appears to have or be willing to release about the small business population.[45]

In order to consider the implications of the SCT, Capital Economics developed a model which created exemplar financial statements for businesses of various sizes across a range of sectors. They then calculated the total taxes paid by a typical company within each size and sector grouping. (See Annex A for list of size and sector groupings and more detailed methodology.)

The model assumes that a typical company's gross surplus (before taxes) is equal to the business's total turnover less funds paid towards staff costs (e.g. employee salaries) and input costs (e.g. purchase of materials). The model includes turnover and taxes paid both including and excluding VAT payments. (Again, see Annex A for allowances and assumptions factored into the tax calculations paid by the typical business.)

From here, the average tax liability for typical firms, across different sizes and sectors, was calculated. These estimates were then scaled up by the number of companies in each sector and size band.

Based on the modelling undertaken by Capital Economics, we estimate that companies with turnover of less than £1 million have a combined turnover (inclusive of VAT) amounting to roughly £395 billion. These firms pay roughly £46 billion in total through Corporation Tax, VAT, Employer's National Insurance and business rates.[46]

While an SCT, once established, would be a wonderful vehicle for cutting business taxation (on the grounds that a public sceptical of 'big business' is much more likely to endorse cuts to the rate of tax paid solely by small, local, family businesses), we wanted in our proof of concept to establish to the Treasury's satisfaction that there would be no loss of revenue if the SCT were introduced.

Clearly, it would be foolhardy – certainly from the Treasury's point of view – to put such revenue at risk without a clear understanding of the consequences.

This meant ensuring that the model we developed was 'dynamic' rather than 'static': in other words that it accounted for firms' likely behaviour under the new regime, in particular the fact that companies which benefited from the SCT would tend to move over and those which would lose out would prefer to remain under the old regime.

> "In order to stress-test the idea, we ran calculations based on **both optimistic and pessimistic** assumptions."

However, whether a firm would benefit or lose out from the SCT would depend not only on the amount of tax paid under the existing regime compared to the SCT, but also the difference in administration costs. So in estimating the rate at which the SCT should be set, we did not just look at whether companies would benefit financially. As outlined above, the burden of administration is a source of huge frustration for many companies.

During our fact-finding, we were inundated with observations from businesspeople saying that they might even be willing to pay more tax, if they had to spend less time on the administration involved.

We asked YouGov to put different scenarios to our panel of small business owners and managers. The numbers who said they would opt in typically depended, as one might expect, upon the amount of tax they would have to pay under the SCT. But even when given the scenario in which they might have to pay more, more than a quarter of those who expressed a view said that they would prefer the new system. In a situation where the change was tax-neutral, this soared to 72 per cent (and then to 79 per cent if there was a tax reduction on offer too).

We therefore built in assumptions for: a certain proportion of firms being willing to make the switch even if it cost them a small amount in tax; the monetary value of the administration costs saved as well as the tax costs; and the reduced cost to the Treasury and HMRC in operating this vastly simplified tax regime. (The full calculations are available in Annex A.)

In order to stress-test the proposal properly, we then ran our calculations based on two alternative sets of assumptions: one which was relatively pessimistic about the administrative savings to both companies and HMRC, and one which was more optimistic.

At the optimistic end of the spectrum, we calculated that the SCT would be revenue-neutral if set at a rate of 11.5 per cent.

At this level, on a purely financial basis – i.e. assuming no savings in administrative costs – roughly 42 per cent of those companies with an annual turnover of under £1 million would face a reduced tax bill under the SCT.

To work out the maximum fiscal downside for the Treasury of the SCT, you simply assume that all of these firms would move to the new scheme, while all of those which would lose out would stick with the old. This would result in a loss to the Treasury of some £6.4 billion – this represents, in effect, the maximum possible downside of the scheme if the SCT is set at a rate of 11.5 per cent.

However, this is hardly the end of the story. That £6.4 billion shortfall to Treasury would be offset by the savings for companies, the Treasury itself and the boost to the wider economy as a result of the SCT.

As mentioned, it is unrealistic to think that businesses will not also factor in administrative savings. Those companies that may see a higher initial tax bill under the SCT will likely opt in if the administrative savings realised under the new scheme are attractive enough. This will increase the number of companies opting in. The Treasury itself will also realise savings in efficiency improvements internally, as this new scheme will likely be easier to administer.

Furthermore, the Treasury will see additional revenues from wider growth and productivity in the economy: if companies have more time and capital to focus on growing their business and hiring new people, this will in turn result in more taxable income and revenues. Finally, there is the intangible cost in terms of time and mental energy saved.

> **“If companies have more time and capital to focus on growing their business and hiring new people, this will in turn result in more taxable income and revenues.”**

We estimated the likely savings both to the Treasury and the firms concerned, with extensive reference to the existing literature.[47] We found that if companies benefited from the expected administrative savings of 5 per cent of turnover on average, while the Treasury benefited from savings equivalent to roughly 8.2 per cent of tax receipts (which includes knock-on benefits from growth in the economy), an SCT of 11.5 per cent could be revenue-neutral for the public coffers.

As mentioned above, given the wide range of estimates and uncertainty surrounding the scale of administrative savings to various businesses as well as potential productivity gains to the wider economy, it was sensible also to consider a more conservative situation where the savings overall were lower.

If the average administrative saving for companies is lowered to a highly conservative estimate of 3 per cent, and we assume that the savings to Government and the wider economy decrease by roughly 70 per cent, the required SCT rate to deliver revenue neutrality to the Treasury would be 13.5 per cent – higher, but still attractive for many small companies.

> **“The essential principle of the SCT is simplicity – to make life as easy as possible for small and family businesses, and give them more control of their time and their finances.”**

In other words, our modelling reveals that the rate at which the SCT would have to be set to provide ‘revenue neutrality’ would be between 11.5 per cent and 13.5 per cent. We have therefore used an illustrative figure of 12.5 per cent in this report – but obviously the Treasury would make its own calculations before introducing any such reform.

As ever, there will be margins of error associated with any results using incomplete data. But we are confident that the approach and assumptions used to estimate these figures are sensible and robust.

Of course, it is possible to argue with our chosen architecture for an SCT. Some might say that the diverse nature of the small business population means that it might be preferable to have different rates for different business sectors, rather like how the Flat Rate VAT Scheme operates.[48] The rate could be altered as a firm’s turnover increases.

You could also argue that an SCT should grandfather in some of the existing tax reliefs and allowances, deducting them from either the initial turnover figure or the final tax obligation via the SCT.

Yet the essential principle of the SCT is simplicity – to make life as easy as possible for small and family businesses, and give them more control of their time and their finances. Our core ambition, therefore, has been to keep things as simple as possible. That is why we argue for a single SCT rate, sector-blind and with no room for tax reliefs or wider allowances, incorporating all four of the main business taxes.

This need for simplicity applies in particular to the interaction between the SCT and the VAT system. As we showed earlier, managing VAT is a complex, cumbersome and time-consuming process – at least when dealt with outside the confines of a new SCT.

“Our purpose in this report is to establish a core principle: that we should give small businesses the chance to replace the myriad reporting, administrative and accounting requirements that currently burden them with the simplest possible calculation of what they owe.”

It is these complexities which make VAT's inclusion necessary. Evidence suggests that the fact that some companies currently prefer not to register for VAT and stay below the VAT registration threshold is not because it will cost them money but because of its complexities – indeed, it should cost them nothing at all, given that they are merely collecting a tax which is passed on to the Government.

There is significant evidence which suggests that having to make VAT calculations (that is to say, having to work out the difference between the VAT they have paid on their various purchases and the VAT they have charged on their sales) and the quarterly reporting involved are vastly off-putting for companies.[49]

The SCT avoids these burdens. In return for being part of the SCT scheme, companies would be obliged to register for VAT and collect it when invoicing for work or selling goods. But they would simply include the VAT collected as part of their company's turnover (akin to the method currently used by the Flat Rate VAT Scheme), and then use that as the base figure from which to calculate the tax due. This removes the need for quarterly reporting of VAT and would bring reporting requirements down to an absolute minimum.

This is not, in other words, just about money. Under the SCT system, it would not just be reporting requirements for VAT that were pared down to an absolute minimum. There would be no need to file the current set of required accounts and tax returns with their different deadlines and different audiences, no need to worry about Employer's National Insurance, or whether expanding your premises would incur a higher tax bill. You would be free simply to focus on what actually mattered.

Of course, beyond that basic principle, we accept that there are many potential blueprints and architectures for an SCT. Our modelling and consultation has identified the version that we think is most suitable and most effective. But it may be that, as our proposal is scrutinised by those with better access to the data, an alternative model might be preferable.

We would not object to that. Our purpose in this report is as much to establish a core principle: that we should give small businesses the chance to replace the myriad reporting, administrative and accounting requirements that currently burden them with the simplest possible calculation of what they owe. That is something that will make overwhelming sense to small and family businesses, and appeal profoundly to their owners. It would also make the UK, we believe, one of the most attractive places in the world not just to start a business, but also to run one.

THE IMPACT OF A **SIMPLE CONSOLIDATED TAX**

- While the SCT is novel in the UK context, there are **precedents both here and abroad** for such a system
- Latvia saw participation in suhc a scheme **increase from 7,194 firms to 47,169** within five years
- Because the SCT would be voluntary, **no small business need end up worse off**
- If just 250,000 companies opt in to the SCT, the total administration saving could amount to **£450 million**
- If business owners were able to devote just 10% more of their time to helping their companies grow, **£4.7bn could be added to the economy**
- The SCT would not just make life easier for small businesses, but **show that the Government supports small firms** and the people running them

3. The Impact of a Simple Consolidated Tax

The introduction of a Simple Consolidated Tax would undoubtedly feel like a fundamental reform for the UK and its business environment.

In and of itself, this is no reason to be deterred – now more than ever, our country needs fresh thinking, innovative approaches to public policy, and a determination to find 'what works'.

Yet as discussed in the previous chapter, any such change needs to be carefully evaluated.

In this chapter, therefore, we will examine in greater detail the potential impact of an SCT – for businesses, for Government, and for the country.

The first thing to point out is that while the SCT itself is a novel and radical proposal in the UK context, there are precedents both here and abroad for many of its most significant elements – the adoption of a consolidated tax; the use of turnover as the means and measure of taxation; and the introduction of a 'voluntary' tax in place of an obligation on all companies of a similar nature to follow the same regime.

The introduction of the SCT would, we believe, put Britain at the forefront of the developed world in creating a pro-business environment. Yet if we are seeking a proof of concept, there are several other countries that have adopted more limited versions of the same scheme, including South Africa, Hungary, New Zealand, Brazil, Estonia and Latvia.

Of these, the Latvian approach is probably the most developed: a micro-enterprise tax, levied at nine per cent of turnover, paid in lieu of various taxes including corporation tax.[51]

Although the Latvian model is more limited than that advocated in this report (it currently only applies to businesses turning over less than 40,000 euros, and those businesses cannot employ more than five people) it is similar in that it rolls several taxes into one single tax.

> **"Latvia saw business participation in a similar scheme increase from 7,194 in 2010 to 47,169 in 2015, and tax revenue rise from 0.04 million euros to 58.85 million."**

The results speak for themselves: in the years since the scheme's introduction, Latvia has seen record business growth. Participation increased from just 7,194 in 2010 to 47,169 in 2015, and tax revenue increased from 0.04 million euros to 58.85 million over the same period. The scheme is also thought to have reduced undeclared wage payments and VAT fraud.[52]

But we don't have to look so far afield to find other useful precedents. The Flat Rate VAT Scheme, introduced in 2002, offers UK companies with annual turnover below £150,000 the chance to pay a flat rate of tax on their VAT-inclusive turnover.

This means the business can avoid the usual complications involved in having to calculate the difference between the VAT paid on their purchases and the VAT they have charged on their sales.

Like the SCT, the scheme is voluntary, so businesses can weigh up the potential benefits of paying their relevant flat rate compared with using the normal VAT accounting procedure. Like the SCT, the idea is not necessarily to reduce the amount of VAT the company pays, as the different flat rates are set with the intention of roughly balancing out.[53]

There is also the question of whether a tax on turnover might lead to unintended consequences – for example, companies not investing in measures which will lead to growth, or their trying to keep income off the balance-sheet.

We take all these concerns seriously and would not want to see any of them realised.

People might worry that a turnover tax of this sort would operate as a brake on investment because it taxes you on the size of the business, rather than letting you write off the kind of spending that serves to grow both your company and the economy as a whole, or it precludes you from benefiting from tax credits.

In fact, the objective of the SCT is to allow owners to focus on the growth of their companies rather than having to deal with endless administration. It is not because some expenses can be deducted from income that companies typically grow, but because they invest in people and seek out new opportunities.

It is also worth reminding ourselves that less than half of small companies consider themselves to be knowledgeable about the various reliefs and tax incentives which exist, so this problem should not be overstated.[54] Moreover, it is worth reiterating that this scheme is entirely voluntary and those businesses which use a large number of reliefs and capital allowances do not have to use the SCT.

As for the potential for evasion, or distortion of behaviour, that is a concern – but it is also a concern with any kind of tax system. The four taxes that the SCT would replace all distort behaviour – for example, by discouraging firms from taking on more workers because of the Employer's National Insurance bill, or from upgrading or expanding their premises because of the burden of business rates.

Existing fraud detection systems would easily be able to spot those firms with suspiciously low levels of activity – and a turnover-based system is actually much harder to game because all the taxman has to do is take a look at the transactions in your bank account, rather than having to unpick a complicated and potentially misleading set of accounts.

“ The SCT allows small business owners and managers to focus only on their companies' growth, rather than having to deal with endless administration. ”

Furthermore, as the Latvian example has shown, the simplicity inherent in the SCT is likely to reduce fraudulent behaviour rather than promote it. In fact, the main reason why small business people currently keep turnover low is to avoid creeping over the VAT registration threshold of £85,000. The SCT obviates the need for this threshold by insisting all companies using the scheme collect VAT and include it within the turnover which is subject to the SCT. Once again, the introduction of the SCT simplifies matters and removes perverse consequences.

Given its simplicity and popular appeal, some might suggest that a voluntary turnover tax on small businesses should pave the way for a compulsory turnover tax on all businesses. But the point of this report is to find a means of making things as simple as possible for small businesses and to free them up to spend their time and money as they see fit, rather than dealing with the burdensome obligations presently imposed upon them. In other words, we want to right an existing wrong – not impose additional burdens on businesses, of whatever size.

In short, we have evidence that adopting a consolidated tax works; that a simple tax on turnover works; and that giving companies the chance to opt in or out of a particular tax model need not result in hideous complexities for HMRC. It is time, then, to explore what an SCT would mean in practice.

What the SCT means for business

The most obvious objection to the SCT is that some companies will do better out of it than others. Every company has a different balance of turnover, margin, staff costs and so on. A volume retailer and a boutique consultancy firm will have very different profiles, and very different incentives when it comes to the SCT.

Yet because the SCT is offered on an entirely voluntary basis, and businesses would have to opt in to use it, no business would need to be worse off in terms of the tax it pays to the Treasury. And even for those firms which did not see an outright tax benefit, the administrative savings, reduction in record keeping and filings, and genuine simplicity of the scheme make it far more appealing than dealing with the labyrinthine nature of the British tax code.

The SCT would not only make things easier for existing firms. It would push people towards setting up companies in the first place. We can confidently say that at least some of those sole traders who have considered incorporating but have been concerned by the implications would decide to take the plunge and to register their businesses with Companies House if the SCT were introduced.

Moreover, we can also assume that there would be others attracted to the idea of setting up their own businesses for the first time, because this new simple system would make the task of setting up a company much less daunting.

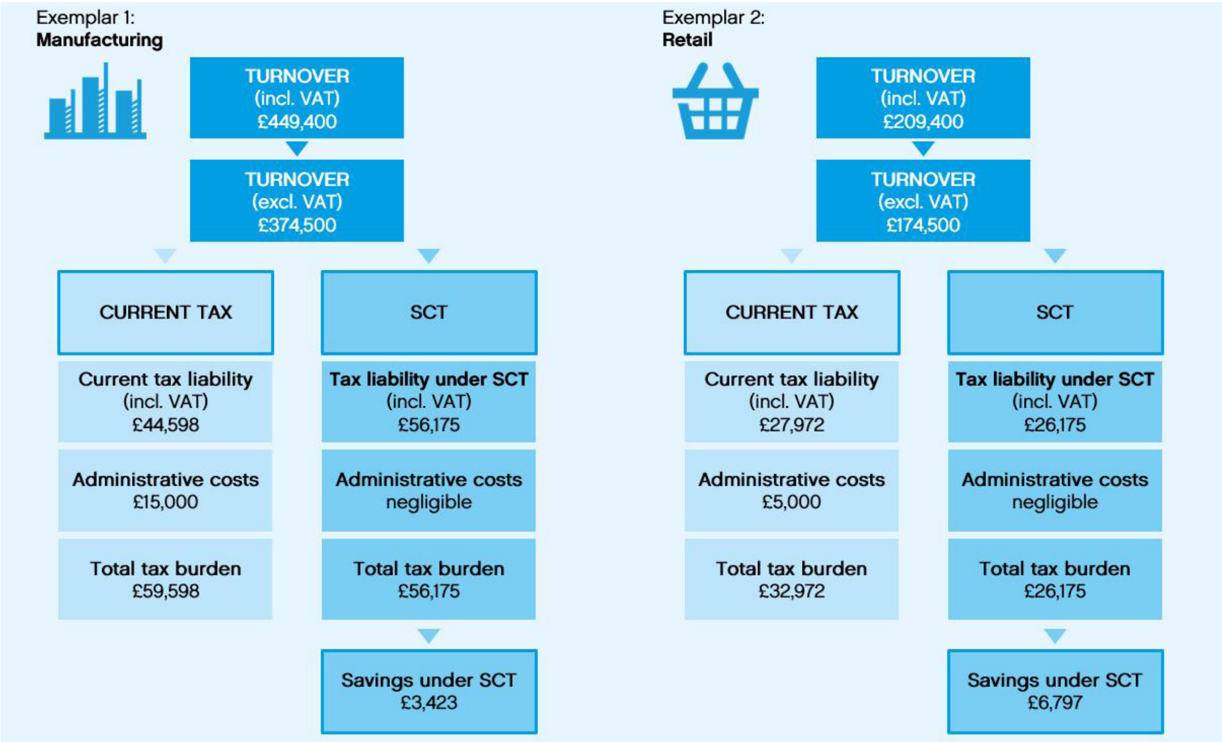
Our work with Capital Economics evaluated as wide a spectrum as possible of different businesses. Below, we provide four examples of businesses across a range of sectors, and assess the financial and administrative implications of the SCT compared to their current tax liabilities.

“The SCT would not only make things easier for existing firms. It would push people towards setting up companies in the first place.”

First, we consider a business in the manufacturing sector. This exemplar business generates annual turnover of £374,500 (excluding VAT) and likely has up to five employees. Staff costs total £84,367 (roughly 23 per cent of turnover) while input costs total £242,074 (roughly 65 per cent of turnover). This leaves the business with a gross surplus before taxes of £48,059.

This employer will also be subject to Class 1 National Insurance on its employees' earnings above a threshold of £8,424 per annum. This amounts to a bill of roughly £7,221 for all of its employees. After claiming the £3,000 employment allowance, its total Employer's National Insurance bill comes to roughly £4,221. This firm uses a property with a rateable value of roughly £24,000, and is therefore subject to business rates, which will total £11,667 per annum.

Figure 4: Indicative SCT impact on exemplar SME businesses in manufacturing and retail sectors



Source: Capital Economics

The business also spends an estimated £20,463 on equipment and machinery, and can deduct this full cost from its profits. This leaves the firm with a gross profit of £11,707, to which Corporation Tax of 19 per cent is applied. The company will also be subject to a VAT bill of £26,485. It therefore pays a total of £44,598 in taxes.

> **"This firm will be subject to Class 1 National Insurance on employees' earnings above a threshold of £8,424 per annum"**

As this company currently pays Employer's National Insurance, business rates, Corporation Tax and VAT, the current administrative burden is likely up to £15,000 per year, equivalent to roughly three per cent of the company's turnover inclusive of VAT. The total tax-related costs for this business are therefore roughly £59,600.

If this company adopted the SCT, it would be subject to a turnover tax rate of 12.5 per cent, which would result in a total tax bill of £56,175. While this is roughly £11,600 higher than its current tax liability, factoring in the costs that the company pays on administration and compliance, it would fare better under the SCT, with savings of roughly £3,400.

Second, let us examine a small business in the retail sector. This exemplar business generates annual turnover of £174,500 (excluding VAT) and likely has up to five employees. Staff costs total £61,333 (roughly 35 per cent of turnover) while input costs total £80,085 (roughly 46 per cent of turnover). This leaves the business with a gross surplus before taxes of £33,082.

This firm will be subject to Class 1 National Insurance on employees' earnings above a threshold of £8,424 per annum. This amounts to a bill of roughly £2,800 for the five together. However, the firm can claim the £3,000 employment allowance on its payroll. So it will pay no Employer's National Insurance.

This business is run from a small shop which has a rateable value between £12,000 and £15,000 and is therefore subject to business rates. It will pay roughly £5,760 per year on this. The business also spends around £9,803 on equipment, and can deduct this full cost from its profits.

This leaves a gross profit of £17,519 to which Corporation Tax of 19 per cent is applied. The company will also be subject to a VAT bill of £18,883. This business therefore pays a total of £27,972 in taxes.

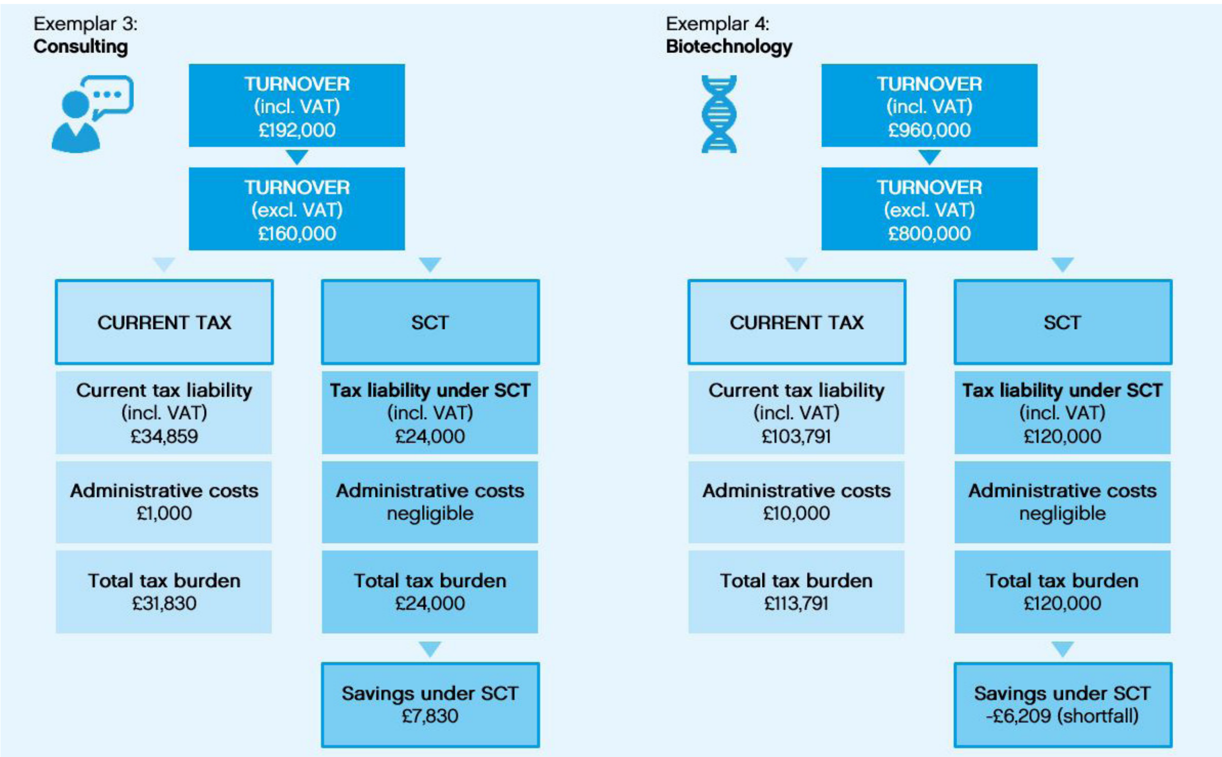
If this retail company adopted the SCT, it would be subject to a turnover tax rate of 12.5 per cent, which would result in a total tax bill of £26,175. This is lower than its current tax liability. Factoring in the administrative and compliance cost and time savings, this company would likely opt in to the SCT, and reap savings of roughly £6,800 – roughly a 24 per cent saving on its tax bill.

> **“Overall, this consulting business pays a total of £30,830 in taxes, inclusive of VAT.”**

Third, we examine a successful IT consultant who generates annual turnover of roughly £160,000 per year. This business employs one person apart from the owner, with staff costs totalling £25,000, and input costs of roughly £62,000.

This leaves the business with a gross surplus before taxes of £72,642. The owner will not pay business rates, and can claim the entirety of the firm’s Employer’s National Insurance contribution under the annual employment allowance. The business will pay Corporation Tax and VAT. Overall, this consulting business pays a total of £30,830 in taxes, inclusive of VAT.

Figure 5: Indicative SCT impacts on exemplar SME businesses in consulting and biotech sectors



Source: Capital Economics

If this consultancy company adopted the SCT, it would be subject to a turnover tax rate of 12.5 per cent, which would result in a total tax bill of £24,000, which is considerably lower than its current tax liability. Even without factoring in administrative and compliance cost and time savings, this firm would likely opt in, and reap savings of roughly £6,830 – or £7,830 including administrative savings.

Fourth, we will consider a business that may be more hesitant to adopt the SCT. This exemplar business performs research and development in biotechnology. The company has an annual turnover of £800,000, and has high staff and input costs, leaving it with a gross surplus of £35,546 before taxes. The firm is able to claim credits to help subsidise research and development. Total taxes from Employer's National Insurance, business rates, VAT and Corporation Tax amount to £103,791, leaving the business with little profit.

If this biotechnology company adopted the SCT, it would be subject to a turnover tax rate of 12.5 per cent, which would result in a total tax bill of £120,000. This would mean a 16 per cent increase in tax liabilities for this business. Even if administrative savings are taken into account, this company would see a shortfall under the SCT.

As these examples show, the Simple Consolidated Tax would not be appropriate for every business. But for so many of our small businesses, it would be powerfully appealing – in terms not just of money saved, but time.

The SCT would be a popular and pragmatic idea. And there is a proven model for Britain to follow – even if no other country has applied it on such a scale. The voluntary nature of the model would mean that no business would have to lose out – while so many of them would undoubtedly gain. And it would transform the business landscape in ways that were entirely positive both for the country, and for its companies.

There is one other obvious objection from the business perspective. Faced with the transition to this turnover tax, might firms not artificially depress their turnover to ensure they are still under the £1 million turnover mark? In other words, could leaving the SCT become a new cliff-edge within the tax system?

The fact is that there are currently only 142,000 companies with a turnover of between £500,000 and £1 million, but more than 1.5 million with a turnover between £0 and £500,000.[55] If even a small percentage of those moved closer to the £1 million threshold, it would do wonders for the UK economy.

The cliff edge, in other words, would be a nice problem for the country to have. And there are many potential options to resolve it, such as a tapering regime for those firms approaching the £1 million threshold, or a phased approach that would see those who move over the threshold remaining partly on the SCT regime while they adjusted to life among the bigger beasts.

What the SCT means for Government

Despite all of the advantages outlined above, it is still possible – even likely – that the Civil Service will be instinctively nervous about a scheme of this sort. After all, it changes the basis of taxation from the one with which is it familiar, and many believe that there is a 'not invented here' bias within the Treasury which might hinder any proposal which does not originate from within its walls.

Yet aside from the popularity of this idea with voters and small businesses, there is much to recommend it to Government as well.

The most obvious benefit is the saving in administration. There would, of course, be set-up costs for the Government to consider. But, before long, there should be huge operational benefits for Government.

HMRC currently has a customer cost reduction target of £400 million by 2020. If small businesses just had to show the taxman their turnover, and let him take a given slice, it would go a long way towards helping it achieve that ambition.

If we assume that just 250,000 of the companies that could benefit from the SCT opt in, and each of them saves three quarters of the average £2,379 spent on accountancy by micro-businesses for Corporation Tax and VAT alone, then the total saving made would be roughly £450 million.[56]

If the same micro-businesses were able to save three quarters of the average 18¼ hours spent doing administration for Corporation Tax and VAT – which, under this plan, they would – then the overall benefits for the economy would be similarly significant.[57]

“The SCT would show that the Government supports small businesses and the people running them.”

Of course, there would be administrative changes. Although National Insurance is income tax under another name (as outlined in Make Work Pay, a recent CPS report by Tom Clougherty), it does technically go into a separate pot, the National Insurance Fund. Similarly, a large proportion of the money raised through business rates goes to local authorities.

This proposal does not seek to suggest that the National Insurance Fund or local authorities should receive reduced funding – self-evidently, some of the money raised by the SCT would need to be dedicated towards these causes.

We also need to consider how these taxes are collected, since not all of the taxes which the SCT would replace are administered by Whitehall. Business rates, for example, are collected by local authorities and their administration is devolved to each of the home nations. Accordingly, if the Government were to introduce the SCT, it would only initially come into effect in England.

Nonetheless, given our confidence in the SCT as being a prudent policy measure, we would hope that the devolved administrations would follow suit, meaning that companies across the whole of the UK could benefit from the advantages conferred by the SCT.

The next obvious objection is that under an SCT, large numbers of employees might turn themselves into companies (‘Personal Service Companies’ or PSCs) to benefit from the simplified tax system.

Yes, such contractors might well be better off under the SCT. But the potential problem of people artificially turning themselves into companies is overblown. First, the Government’s IR35 rules (which govern this exact issue) have been tightened by the Treasury, ensuring that those who are primarily working for one particular company should be treated as employees of that company.[58] Second, if this sort of chicanery were to take place following the introduction of the SCT, the simplest solution would be to enforce the law properly rather than bemoaning its exploitation. In addition, those setting up such companies would still be taxed on any income they took out of the company via dividends, substantially reducing any tax advantages.

We believe the simplicity of the scheme would mean many businesses would be drawn to it. Yet ultimately, this system should be as appealing to the Government as it is to the businesses who would operate within it: a simplified and streamlined tax system should make it easier for HMRC to collect the taxes due and help close that £13 billion tax gap which it claims exists.

Far more importantly from a political perspective, the SCT would not only make life much easier for many small businesses and for HMRC, but would demonstrate that the Government supports small businesses and the people who run them. As our polling has shown, this is something both businesses and the public are acutely sceptical of.

And if there is still lingering caution within the Treasury about the impact on revenues, or the potential for avoidance (for example by firms moving activity off the books) then it could consider a phased introduction. In the first year, the SCT could be made available only to companies in certain sectors or to those firms with a turnover of £150,000 or less – in other words, up to the upper end of those eligible for the Flat Rate VAT Scheme – before moving up towards the £1 million threshold.

This would also enable the Treasury to get real-world evidence for the scheme's effectiveness, and adjust the rate of the SCT to ensure revenue-neutrality. (Though we would, of course, argue that lowering the tax burden on small and family businesses via SCT reductions should be a priority for Government.)

Alternatively, if there is a concern about individuals artificially turning themselves into companies, the scheme could be introduced first for those firms with employees beyond the owner.

What the SCT means for the UK

More than anything else, the Simple Consolidated Tax is a pro-business, pro-enterprise measure. It would allow the owners of small companies to do what they went into business to do – run their businesses. As the Federation of Small Businesses said in the lead-up to the 2017 General Election, 'the burden of regulation remains one of the biggest barriers to growth across the small business community'.[59] We must reduce it.

The SCT would allow businesses to focus on creating jobs and delivering growth, which will benefit not just the companies themselves, but the country as a whole. It would certainly unleash more economic growth and increase employment – effects which we have touched on in our modelling, but hope and expect to be more substantial still.

Whether it is existing companies which benefit from the introduction of the SCT, or sole traders who decide to incorporate for the first time, or entirely new companies being formed, there would likely be a significant benefit to the economy.

To give just one example, a report from the Centre for Economic and Business Research and Creative Auto-Enrolment found that if business owners were able to devote just 10 per cent more of their time to activities that helped their companies grow, an additional £4.7 billion a year could be added to the UK economy.[60]

But the benefits of the SCT are not just financial. Its introduction would make it clear to people around the country – whether they own small businesses or not – that the Government understands the challenges that small and family businesses face and is willing to take bold decisions to back people who have taken a risk and are working hard.

Of those surveyed by YouGov, 60 per cent said that they didn't think the Government was on the side of small business. Moreover, 80 per cent thought the tax system should be easy for small businesses to understand. And by 64 per cent to 19 per cent, they thought that tax and reporting systems should be simpler for small firms than large.

The SCT would be an emblematic way for the political class to show that it truly supports small business and that it believes in the system of free enterprise which has helped raise billions of people out of poverty, driven down prices for consumers all around the world, and created untold opportunity. We urge the Government to embrace it.

FURTHER SUPPORT **FOR SMALL BUSINESS**

- The Simple Consolidated Tax is **far from the only thing we should do** to help small businesses
- We should cut administration – for example by letting the smallest firms **submit accounts every two years**
- We should improve access to finance by **doubling the SEIS limit**
- We should do more to support family business, including **making it easier to transfer firms** from one generation to the next
- We should bring in a **PAYE and Employer's National Insurance holiday** for all new hires made by firms with eight or fewer employees
- The Government should **help the self-employed and sole traders**, for example by guaranteeing not to tinker with their National Insurance rates

4. Further Support for Small Business

The Simple Consolidated Tax would be a landmark change in terms of the treatment of small companies in the United Kingdom.

It would reduce administrative requirements and make the lives of company owners much easier, allowing them to focus on running and growing their businesses. It would demonstrate the Government's support for enterprise in general, and small business owners in particular. And it would lead to higher growth, employment and economic performance all over the country.

But as mentioned at the very start of this report, the business landscape is marvellously diverse. As our modelling has shown, there are many firms which would probably not opt into the Simple Consolidated Tax.

If we want to stay true to the fundamental impulse that has driven our research, we therefore need to go further. In consequence, this latter part of the report outlines a series of additional measures that will give back control to small businesses, and help release the full vigour of British enterprise. These fall into five broad categories:

1) Reducing reporting and administration

2) Tackling late payment

3) Improving access to finance

4) Promoting employment

5) Supporting the self-employed and sole traders

1) Reducing reporting and administration

The SCT would represent a sea change in terms of reducing the administrative burden on small companies. But because not all incorporated businesses would opt into the system, a large number of firms would continue to be subject to the current set of tax rules and administration and reporting requirements.

> **“Even without the Simple Consolidated Tax, there are a host of measures that could give firms greater control of their fates.”**

As our initial research identified, these obligations are far too onerous. So even without the SCT, there are a host of measures which could and should be taken to give businesses greater control of their fates.

Let us return to the fundamental point identified above. According to a recent report by the Research Foundation of the Institute for Family Business, almost 50 per cent of SME family firms identified tax and compliance requirements as an obstacle to their success.[61]

A useful starting point in addressing this would be to include tax administration within the Government's target for reducing business administration.

The Small Business, Enterprise and Employment Act 2015 committed the Government, by law, to address the burden of business regulation and administration. It obliged Whitehall to produce an annual evaluation of the cost imposed on firms by its decisions, and to set a 'business impact target' – a total figure by which, over the course of the parliament, the burden should be reduced. (The target was initially £10 billion across 2015-20.)

However, when the target was first established, the Treasury refused to sign up to the same rules by which everyone else had to operate.[62] HMRC therefore retains separate targets for reducing tax administration, independent of other cross-government measures.[63]

> **"Small businesses overwhelmingly believe that the current system of tax, administration and reporting is too complicated."**

Including tax administration within the business administration target would focus minds and push the Treasury to pay more attention to sensible ideas such as those from the Office of Tax Simplification – and indeed those contained within this report.

To give just one example of a sensible idea that should be adopted: why not simplify the registration process for new companies? It isn't appreciated by many of those starting new firms that they have to register for Corporation Tax with HMRC as well as registering with Companies House. If they fail to complete the second step they are then liable for a penalty of 30 per cent on unpaid tax – so why not ensure that they register for both at the same time?[64]

To go further, why is there not a 'one-stop shop' for business registration? Why not allow a company to be registered as an entity, while simultaneously registering for tax, PAYE and VAT? There have been moves in this direction – but anyone who has wrestled with the Government Gateway online service knows how difficult, and time-consuming, the process can be.

Similarly, why not reform and unify filing and reporting dates for VAT, statutory accounts, annual returns and paying Corporation Tax? This is something that the Office of Tax Simplification has looked at in some depth. As it says: 'The profusion of filing and payment deadlines in respect of companies' accounts, annual returns, payment of CT, and the filing of the CT return was seen by many to be an unnecessary complication.'[65]

Although the authors accept that more work needs to be done by Companies House and HMRC before action can be taken, the Government should announce its intention to take this step as soon as possible.[66]

The next problem, touched on above, is that companies often have to make submissions both to HMRC for tax purposes and to Companies House for accounting purposes, and can suffer significant fines for late filing.[67] This siloed approach to administration makes things harder for businesses.

Improved coordination between the different arms of Government could bring great benefits. In particular, developing a single reporting process with a single Government portal should not be beyond the Civil Service's capabilities. As our polling showed, small businesses overwhelmingly believe that the current system of tax, administration and reporting is too complicated.

A further recommendation, which could bring large benefits to small companies, is greater acceptance of, and a general move towards, cash accounting rather than accruals accounting.

At the moment, many small companies prepare multiple different sets of figures: accounts to be published; tax records (which will lead to Corporation Tax figures); and cash records. Moreover, their accounts have to be prepared according to 'generally accepted accounting principles' (GAAP).

There are good reasons for some companies to use accruals accounting – for example, to provide a clear picture to owners and shareholders or to stay on top of cashflow issues. But it is not always necessary for the proper running of a business – hence the fact that non-incorporated businesses do not always have to adopt the same procedure.

The Government should therefore consider the case for reducing reporting requirements for all businesses with a turnover of less than £1 million, thus lessening the need for companies to hire costly accountants and other advisers – in addition to the dramatic reductions in similar requirements for those firms opting into the SCT. This should apply to tax reporting and also to financial accounting.

“Why do our smallest firms have to report on an annual basis?”

At the moment the EU Accounting Directive makes this difficult, since such a move would require an exemption to be granted by Brussels – but as we exit the EU, there is an opportunity to bring about a more sympathetic regime for the UK’s smaller companies. This would bring us into line with countries such as the USA, where companies with receipts of up to $5 million have been able to use a cash-based system – a figure recently raised to $25 million.

Finally, why do our smallest companies have to report on an annual basis? Alongside considering the reforms suggested above, the Government should look to introduce biennial reporting as standard, meaning only one set of accounts, ideally prepared on a cash basis, needs to be submitted every 24 months. This would, as outlined above, produce substantial savings for such firms in terms of both money and time.

2) Tackling late payment

For those running small businesses, late payments are a scourge. The Government has repeatedly promised to act – but with little effect.

The Federation of Small Businesses claimed recently that ‘if all payments were made on time, it could prevent over 50,000 business deaths a year and boost the economy by £2.5 billion’.[68]

The approach taken to date has tended to be carrot rather than stick, with the Government relying on transparency and reporting standards to try to tackle the problem. The changes announced at the 2018 Conservative Party Conference continued that trend, aiming to strengthen transparency arrangements around the Prompt Payment Code and to have Government ‘leading by example’ by paying 90 per cent of undisputed invoices from SMEs within five days.[69]

These measures, however, fail to get to grips with the most egregious types of behaviour. So it is time for the worst practices to be outlawed for good.

For example, some companies use ‘pay to stay’ mechanisms, under which small businesses have to pay a fee to be considered a supplier, but with no guarantee of work whatsoever. Others change prices retrospectively, in full knowledge that small businesses won’t feel able to challenge the new terms, as they are too reliant on the buyer’s custom.

These practices should be banned. A free market is not free if one party is held hostage by another.

Further proposals should also be considered, such as whether or not we should adopt compulsory holding accounts (a type of Escrow), in which monies can be kept while services are being delivered, and then released upon their successful delivery.

Some bigger businesses will oppose this idea vehemently, arguing that their arrangements with suppliers should be covered by existing contractual terms. But some of the practices which exist are clearly beyond the pale. According to the Institute for Family Business, almost a third of family business SMEs have raised late payments as a significant issue.[70] And the Government itself has said that more than half the SMEs which experience late payment wait one month or longer beyond the agreed terms for the invoice to be paid.[71]

In other words, if businesses want to be considered as good corporate citizens and a force for good, paying their bills on time would seem a sensible place to start.

> **“According to the Institute for Family Business, almost a third of family business SMEs have raised late payments as a significant issue.”**

3) Improving access to finance

The traditional practice for a small business that wanted to grow was simple. First, you would go to see your bank manager.

But banks nowadays do not lend to small businesses in the way they once did – the days of a friendly local bank manager who knew your business inside out and would be a mentor as much as a lender are gone.

As the most recent evidence from the Federation of Small Businesses makes clear, there is less bank credit available, fewer businesses are applying for capital, and fewer of them are successful in their applications.[72]

The fall in bank lending to small business has, in part, been compensated for by a variety of new ways to access finance. The British Business Bank's most recent report into Small Business Finance Markets revealed that while bank lending had remained flat over the year, equity investment had gone up by 79 per cent. Asset finance had risen by 12 per cent and peer-to-peer lending by 51 per cent.[73]

One could argue that this wider range of options is why accessing capital for growth is not regarded by small businesses as much of a concern when compared to administration, taxation and regulation – the key areas of focus of this report.[74] But this lack of concern might also reflect the fact that many small businesses do not want to access external finance – 42 per cent of SMEs recently surveyed said that they do not currently use external finance and do not want to.[75]

There are varying, and strongly held, views about whether SMEs face actual difficulties in getting finance, whether it is a perceived difficulty, or whether such firms simply prefer not to take on debt or give up equity.

The 'State of the Nation' report by the Research Foundation of the Institute for Family Business suggests that the truth falls somewhere between the first two of these. It shows that family businesses – which make up the vast majority of the small businesses we are talking about – are more likely to have difficulties obtaining external finance than other businesses.

In total, 13.6 per cent of such firms had had their finance application rejected and a further 17.6 per cent did not even apply for external finance as they believed they would be rejected.[76] British Business Bank statistics show that only 1.7 per cent of SMEs applied for a bank loan during the first half of 2017.[77] The British Chambers of Commerce recently provided evidence to the Treasury Select Committee which also pointed out the fact that most businesses were not aware of 'alternative' forms of lending.[78]

To respond to the financial needs of small businesses, we need therefore to do two things. First, raise awareness of the finance options that are available. Second, provide a more sympathetic set of financing options for smaller firms, with family enterprises particularly in mind.

As regards the first, it is essential that all actors who are regularly engaging with small businesses play their part in ensuring these businesses are aware of the options that are available to them. The British Business Bank has already made clear that it will raise its game and is pushing its Business Finance Guide as far as it can. But the Government should encourage banks, HMRC and Companies House all to play their part.

> **“Banks nowadays do not lend to small businesses in the way they once did. The days of a friendly local bank manager who knew your business inside out and would be a mentor are gone.”**

The recent moves towards a new system whereby any bank which turns down a prospective borrower is obliged to pass on their details to alternative lenders (in anonymised form) is very welcome. Nearly 19,000 small businesses that were rejected for finance by one of the big banks have been referred under the Bank Referral Scheme since it was launched in November 2016.[79]

But although many businesses are being referred, it has only led to £15 million of funding being secured to date. In order to promote enterprise across the economy, we should go further and insist that the bank that is set to decline the prospective borrower talks to them actively about other possible options, including alternative sources of capital and equity finance.[80]

After all, new sources of finance have been a clear success story over recent years. The Government should be congratulated for recent changes which have made invoice financing a source of capital for more companies. Schemes such as the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts are delivering more and more funding to small and growing businesses.[81]

Recent figures have revealed that almost 28,000 companies have received funding through the EIS and funds to the tune of more than £18 billion have been raised.[82] There are also higher numbers of ‘angel investors’ and the rise of peer-to-peer lending is making capital more readily accessible while widening investment opportunities.[83]

Nevertheless, various peculiarities exist around those otherwise successful schemes, and minor reform could make them even more effective. For starters, there is a strong case for looking again at the limits that apply to SEIS schemes and whether or not they are appropriately set.

As the Institute of Directors recently pointed out, a limit of £150,000 on the amount that can be raised through SEIS does not seem to make sense when it takes so much time and effort to complete the administrative requirements that allow you to benefit from SEIS in the first place. The SEIS limit should therefore be doubled to £300,000 to ensure businesses benefit as they might.[84]

> **“A closer look should also be taken at the role of families within business more generally – because the role of family-run businesses in our economy is often overlooked by policymakers and economists.”**

Beyond the current investment limits the EIS and SEIS, as currently drawn up, explicitly prevent some family members, or even founders themselves, from investing in qualifying businesses. This is the case despite – or perhaps because of – the fact that these people are the most likely to be investing in the business in the first place.

The Treasury might think that nothing is lost from excluding these people, as they are likely to invest anyway. But to exclude them on the basis that they are the firms' owners, or related to the owner, flies in the face of common sense and fairness.

The rules about 'substantial interest' should therefore be rewritten so that founders can invest in their businesses via the EIS or SEIS schemes, and family members are not treated as 'associates' when calculating whether investors have a substantial interest, reflecting the fact that these are the people who have the greatest stake in helping a business succeed.

A closer look should also be taken at the role of families within business more generally – because the role of family-run businesses in our economy is often overlooked by policymakers and economists. The values inherent in family businesses mean they tend to take a longer-term approach compared to other businesses, investing in people and places and embedding themselves in their communities.

An important consideration in supporting family businesses must be the ease with which businesses can transfer from one generation to the next. This is crucial in order to harness properly the advantages of the long-term business planning which is in the nature of family firms.

One of the reasons that Germany, for example, has a flourishing tier of mid-sized industrial companies is that its tax laws specifically promote family ownership of firms. Some 90 per cent of German firms are family-owned, and most heirs taking on family firms will pay no inheritance tax if they keep the business running for seven years and promise to protect jobs and wages.[85]

A full review of the family business regime is beyond the scope of this paper. But one obvious issue arises around Business Property Relief (BPR). In most cases, business owners can benefit from BPR to prevent prohibitive Inheritance Tax (IHT) bills which could otherwise force the sale of part or all of the business, or distort business decisions due to tax planning.

The Office of Tax Simplification is currently reviewing the inheritance tax system, including BPR. The Institute for Family Business have reported that companies are increasingly finding difficulties with BPR rules which restrict relief for 'joint ventures', which many enter into for perfectly sound business reasons. The government should look to extend the scope of BPR to reflect the increasing prevalence of joint ventures and prevent the BPR rules from discouraging growth decisions.

"Some 90 per cent of German firms are family-owned, and most heirs taking on family firms will pay no inheritance tax if they keep the business running for seven years and promise to protect jobs and wages."

There is a further issue around Capital Gains Tax (CGT) relief. Succession planning is not just about inheritance tax – in many cases, good succession planning will involve gradual transfer of ownership between generations. The rules for this are much stricter than for BPR in IHT. For CGT relief, 80 per cent of the company must consist of trading activities, compared to 50 per cent for BPR. This can mean succession planning is delayed purely for tax reasons, to the long-term detriment of the company. The rules for CGT relief should therefore be brought into line with the BPR requirements, which would also simplify the two taxes and reduce complexity for businesses.[86]

4) Promoting employment

As Tom Clougherty argued in his recent CPS report, Make Work Pay, a primary function of the tax system should be to ensure that it always pays to work. This is also a principle endorsed by the public, in overwhelming numbers.[87] But our current business administration system does not fully embrace that principle.

The prospect of taking on their first employee is considered by most sole traders and small companies to be the most daunting of steps. The PAYE implications; grappling with employment law; the financial burden of not just paying a salary but also auto-enrolment into a pension; the stultifying effect of Employer's National Insurance – all of these make it decidedly off-putting. It is therefore no surprise that more than three quarters of UK businesses do not employ anyone beyond their founder.[88]

Yet the potential opportunity for employment around the country is enormous. If just half of those businesses without other employees took someone on, unemployment – already at record lows – would be wiped out overnight.

The employment allowance is aimed at helping ease the pressures created by employing someone, by letting most employers reduce their Employer's National Insurance bill by up to £3,000 each tax year.[89]

"The Government should immediately introduce an Employer's NI and PAYE holiday for all new hires made by businesses with eight or fewer existing employees."

This undoubtedly helps. But cashflow issues still remain, which make it hard for businesses to invest in new staff to help attract or service new clients, when they won't receive payment until some months down the line.

The Government should therefore immediately introduce an Employer's National Insurance and PAYE holiday for all new hires made by businesses with eight or fewer existing employees (that is, those that would still be regarded as micro-businesses even after taking on the additional hire). Often businesses recruit in advance of attracting new customers, as a means of generating more trade. A three-month NI and PAYE holiday would mitigate some of the cashflow issues they face and help businesses both grow and employ more people.

Crucially, it would not cost the Government any money – it would simply mean a delay of three months before the money was collected by HMRC. And it would mean employers could manage their cashflow much more easily.

Going further, many people are concerned that Employer's National Insurance is acting as a brake on the potential for extra employment and more jobs. A 2017 survey by the Federation of Small Businesses found that 44 per cent of small businesses had found Employer's National Insurance to be a hindrance to growth – a higher percentage than thought the same for VAT or PAYE.[90]

It is obviously outside the scope of this report to carry out a full examination of the Employer's NI regime – but we need to acknowledge that it acts as a disincentive for many companies to employ more people, or any people. In an ideal world, if it had multiple billions to spare, the Government should consider either reducing Employer's National Insurance substantially or even abolishing it altogether. As it is, ministers should at least consider reducing or abolishing this tax for those companies with fewer than 10 employees.

This would obviously have revenue implications, but fewer than one might imagine (see below). In addition, a forthcoming report from the Centre for Policy Studies identifies some £30 billion in savings that could be made to public spending every year over the coming spending review period, some of which could be used to plug any gaps.

One advantage of the Treasury introducing this sort of change is that it would result in much more honesty about the taxation burden which actually exists on businesses. There are countless stories of employees not understanding that a 13.8 per cent surcharge is paid on their salaries by employers.

As the Labour Party rails against Britain lowering the rate of Corporation Tax to ensure it is at a globally competitive level, it should remind itself of this additional tax paid by employers up and down the land. In just the same way that we should think about combining Employee's National Insurance with Income Tax to ensure a more accurate picture of personal taxation, we should introduce a bit more honesty about business taxation. The Office of Tax Simplification agrees, proposing that Employer's National Insurance be reformed and renamed.[91]

But the most important argument for reducing, or even abolishing, Employer's National Insurance is the fact that it would remove one of the main disincentives towards employing people. This is of particular importance at a time when we are considering how to respond to increased automation and the spectre of future job losses.

> **“Employer's NI acts as a disincentive for many companies to employ more people, or any people.”**

The Adam Smith Institute has argued that if Employer's National Insurance were abolished, the money saved by employers, and foregone by the Treasury, would be recycled into the system and would, in turn, boost productivity and economic growth. Its 2012 paper Unburdening Enterprise concluded that the average saving for a small business with 10 employees if it were exempted from Employer's National Insurance would be enough to hire an additional worker at almost no extra cost.

The paper argued that abolishing Employer's National Insurance for SMEs could create 500,000 jobs and that the additional revenue from corporate taxes, employment taxes and expanding consumption, plus lower spending on welfare benefits, would be enough to offset all of the forgone revenue for the Exchequer.[92]

While we would not go so far as to suggest that the policy would be revenue-neutral (at least not in the short term, and especially given that there may be less scope to expand employment than when the report was written in 2012), the impact on the Exchequer should be much less than the headline figures for lost National Insurance revenue would suggest. Not only would businesses benefit in cash terms from a tax cut, they would also benefit from reduced compliance costs.

Another area in which small businesses are not properly catered for is in the provision of apprenticeships, which are not as open and accessible to small businesses as they ought to be.

The primary means of paying for apprenticeships now is through the 'apprenticeship levy', which is charged as a percentage of payroll on employers with a pay bill of more than £3 million a year. It is only right that small businesses are exempted from the apprenticeship levy. But this does mean that, all too often, small businesses are precluded from taking on apprentices.

In an attempt to help tackle that problem, the Chancellor announced at the last Conservative Party Conference that large employers will be able to spend 25 per cent of their levy allocation on apprenticeships in their supply chain.[93] But as both the Federation of Small Businesses and the Association of Independent Professionals and the Self-Employed (IPSE) have consistently made clear, the system as currently constituted does not work for small businesses and the self-employed. They consider the cost burden too high, they don't feel they have access to necessary information or adequate skills provision, and more generally they find the system hard to navigate.[94]

A taskforce should therefore be formed immediately to look at how small businesses can both take advantage of, and offer opportunities to, would-be apprentices.

5) Supporting the self-employed and sole traders

Many of the measures recommended above would support sole traders – who because they are not companies, would not be able to take advantage of the Simple Consolidated Tax without incorporation.

But it is also worth considering what changes might be recommended with sole traders alone in mind. After all, they total millions in number and their employment figures, collective turnover and profit make up a large proportion of the wider small business total.

In particular, to show that the Government is backing these people and their entrepreneurial spirit, it must immediately put paid to any notion that it still hopes to increase Class 4 National Insurance contributions. This was mooted as an idea in 2017 but the Chancellor was forced into a hasty U-turn after an unsurprising backlash from business owners and politicians on both sides of the Commons.[95]

The resulting uncertainty should be brought to an end with a clear and unequivocal commitment on the part of the Government not to tinker with Class 4 National Insurance rates any further.

More generally, though, it is vital that the Government spends much more time thinking about the impact of its policies on the self-employed. Even more than the wider grouping of 'small businesses', the self-employed tend to be put into a 'too difficult' box or seemingly overlooked by Government thinking.

Worse still, sometimes the Government takes decisions which actively target these people.

The abortive attempt to increase Class 4 National Insurance contributions is one such example. Another is the recent decision around 'loan charges' which sees HMRC targeting people who used a tax reduction scheme years ago and are now being chased for taxes due. Whatever the merits of the original scheme, punishing people now for being given bad advice many years ago seems an excessive reaction.[96]

In his 2018 Budget, the Chancellor commendably acknowledged that there is a need for increased training levels for sole traders and the self-employed. But that same Budget failed to provide the sort of concrete proposals that would really make a difference. Even more disappointingly, the Treasury took the opportunity to say that it had ruled out the extension of tax relief for self-funded work-related training.[97]

> **“It is vital that the Government spends much more time thinking about the impact of its policies on the self-employed”**

Ensuring that a wider range of training and professional development could be treated as a tax-deductible expense would have helped incentivise sole traders to get the skills and training they need to improve in the workplace. This decision should be reconsidered as a priority, given the need for our workforce – including sole traders – to upskill and retrain throughout their lifetimes.

But skills provision is only the start of it. The Government should undertake a full review of the role and treatment of the self-employed, covering every element of how relevant policy affects them. As well as training, this review ought to consider employment status, pension provision, and the interaction between the self-employed and the social security system.

Helpful outcomes from this might include taking on sensible suggestions from IPSE such as developing a 'sidecar pension', which divides contributions between a pension pot and an emergency fund, and creating a new statutory definition of 'self-employed' to clear up definitional issues and protect people from employers who force them to become 'self-employed' against their will.[98]

Conclusion

Small companies do not get the support they deserve from Government.

All too often, they find themselves succeeding despite the state's actions, not because of them. They struggle, in particular, with tax, administration and reporting rules that were designed for far larger firms, and which hinder rather than help them.

It is clear from our polling, both of small business owners and the wider public, that people think that small business should be championed – and that the Government is not currently doing so with the necessary vigour.

But this is not about what is popular. It is about what is right. Small and family businesses are our best bet for the future – both in terms of helping restore the reputation of the capitalist system of competition and free enterprise upon which we rely, and delivering economic growth, jobs and commercial success.

This report has put the Simple Consolidated Tax at the heart of its ambition to help small businesses. The SCT is a simple concept, but its route from this paper to adoption by the Treasury will be far from simple. It is for that reason that we have set out with, we hope, all necessary clarity and forcefulness how much of a problem the existing regime of administration, regulation and reporting is for so many companies.

A full recognition of these burdens would be a helpful starting place for the Treasury in its consideration of this idea – and the others contained within this report.

We believe that if the Treasury and the Government think small, our country will win big.

Annex A – The Modelling

Model overview

In order to consider the implications of a 'Simple Consolidated Tax' policy, Capital Economics has developed a model which estimates the revenue-neutral SCT rate for companies in the United Kingdom. The model creates exemplar company financial statements for businesses of various sizes across a range of sectors. Total taxes paid for a typical company within each size and sector grouping are calculated.

The model assumes that a typical company's gross surplus (before taxes) is equal to the business's total turnover less the funds paid towards staff costs (e.g. employee salaries) and input costs (e.g. purchase of materials). The model then assumes that the company is liable for three types of tax: Employer's National Insurance contributions, Corporation Tax, and business rates. The company's profit after taxes is then simply the gross surplus (before taxes) less the sum of all taxes paid. The model includes turnover and taxes paid both including and excluding Value Added Tax (VAT) payments.

From here, the average tax liability for typical firms, across different sizes and sectors, is calculated. This tax can be expressed in a variety of ways, depending upon how VAT is treated in each company's accounting systems (i.e. the tax rate as a share of turnover excluding VAT, or the tax rate as a share of VAT-inclusive turnover).

These estimates for the tax liability for the average business are then scaled up by the number of companies in each sector and size band. This allows us to estimate the average tax rate paid, or the revenue-neutral tax rate, for small businesses.

The model looks at companies that are registered for VAT/PAYE only. In order to scale up to account for all companies, including sole proprietors, partnerships, public bodies, etc, we have multiplied our aggregated figures by the share of registered VAT/PAYE companies to all companies. This also allows us to sense-check our model to make sure that when scaled up it falls in line with the actual United Kingdom total.

Size and sector groupings

Capital Economics created exemplar company financial statements for businesses of various sizes across a range of sectors and sizes. The model groups companies into 11 turnover size-bands and 15 major sector groupings. (See table below.) Aggregated groupings were made on companies for the following turnover size-bands:

1. Under £85,000
2. Between £85,000 and £1,000,000
3. Under £1,000,000
4. Under £5,000,000
5. All turnover size-bands

Allowances

There are numerous allowances afforded to small businesses in the United Kingdom. The model incorporates these allowances to ensure that the financial statements of our exemplar companies are representative of the actual taxes that businesses of all sizes are currently paying.

Table 3: Capital Economics exemplar company groupings

Turnover size-bands	Major sector groupings
1. £0 to £49,999	1. Agriculture, forestry and fishing
2. £50,000 to £84,999	2. Mining, energy, water and waste management
3. £85,000 to £99,999	3. Manufacturing
4. £100,000 to £249,999	4. Construction
5. £250,000 to £499,999	5. Wholesale and retail
6. £500,00 to £999,999	6. Transport and storage (incl. postage)
7. £1,000,000 to £1,999,999	7. Accommodation and food services
8. £2,000,000 to £4,999,999	8. Information and communication
9. £5,000,000 to £9,999,999	9. Finance and insurance
10. £10,000,000 to £49,999,999	10. Property
11. Greater than £50,000,000	11. Professional, scientific and technical
	12. Business administration and support services
	13. Education
	14. Health
	15. Arts, entertainment, recreation and other services

Small businesses currently benefit from allowances related to the following taxes:

Value Added Tax: Businesses with an annual turnover of £85,000 or more are legally required to register for VAT. These businesses must charge an additional 20 per cent on their products and services which is then paid to HMRC. In return, they can reclaim VAT on goods and services purchased by their business. Those businesses with an annual turnover under £85,000 over the past 12 months are exempt from paying VAT. Capital Economics' model includes this allowance for all companies with annual turnover under £85,000.

Corporation Tax: Businesses can claim capital allowances on items that they keep to use in their businesses, such as equipment, machinery, and business vehicles. These are known as 'plant and machinery'. In most cases, businesses can deduct the full cost of these items from their profits before corporation tax using the annual investment allowance (AIA). The current AIA amount is £200,000 per year.

National Insurance contributions: Employers pay 'secondary' Class 1 National Insurance contributions (NICs) on their employees' earnings. Employers pay Class 1 NICs of 13.8 per cent on all earnings above the secondary threshold of £162 per week (£8,424 per annum). The employment allowance reduces the amount of Employer's National Insurance payable up to a limit of £3,000 per year. Employers that pay less than the £3,000 annual allowance total will be exempted from Employer's National Insurance completely. The employment allowance is designed to encourage employers to grow their businesses by recruiting more staff.

Business rates: Some properties are eligible for discounts from the local council on their business rates. This is called 'business rates relief'. Businesses can get small business rate relief if their property's rateable value is less than £15,000. Businesses will not pay business rates at all on a property with a rateable value of £12,000 or less. For properties with a rateable value of £12,001 to £15,000, the rate of relief will go down gradually from 100 per cent to 0 per cent. Small businesses are also subject to a lower small business multiplier (0.480 compared to 0.493 for standard businesses). Capital Economics' model includes this allowance for all companies that have a property, or properties, for which a business rates tax is applicable.

Assumptions

Due to limited data availability on a range of small business metrics, a variety of assumptions were made regarding the treatment of the various allowances, as well what the typical company in a particular sector and size grouping looks like. Where appropriate, Capital Economics' assumptions were conservative in nature.

In order to estimate the average turnover of a typical company, it was assumed that the turnover of each sector is the mid-point for each turnover grouping. For example, the mid-point for a company with annual turnover between £100,000 and £249,999 would be £174,500.[99] To estimate average staff costs, Capital Economics applied the total amount each sector spends on compensation of employees as a share of that sector's total turnover, using the United Kingdom input-output tables.[100] Similarly, input costs were assumed to be the total amount each sector spends on intermediated consumption as a share of total turnover. To estimate the average investment that a typical company makes in plant and machinery each year, Capital Economics used the input-output tables again to apply estimates of gross fixed capital formation for each sector as a share of total sector turnover to our exemplar businesses' turnover.

To calculate how much a typical firm pays on Employer's National Insurance contributions, Capital Economics assumed that the employees at each firm are paid the median wage in the United Kingdom for their associated sector.[101] This median wage data was adjusted based on the turnover size-band (those companies with lower turnover pay employees a proportionally lower median salary). After identifying the median annual pay for employees by sector and turnover size-band, the earnings threshold of £8,424 per annum was deducted from each grouping to provide Capital Economics with the adjusted earnings to which the 13.8 per cent Class 1 Employer's National Insurance contribution is made. The employment allowance of £3,000 is then deducted.

To calculate how much a typical firm pays on business rates, we separated companies into two separate groups: those that pay business rates and those that do not.

First, we used data from the Valuation Office Agency on the total number of rateable value properties, by sector. We manually grouped data on the number of rateable properties by property category into our 15 sectors, and calculated the average rateable value for properties in each of these sectors.[102]

Working assumptions were made on the share of companies without a property, the number of properties per company and the number of properties over the £12,000 threshold by turnover size-band and sector. Capital Economics' assumptions were based on some knowledge of overall distribution:

1. Roughly 64 per cent of the total number of all business properties are below the rateable value threshold of £12,000.[103]

2. Small businesses account for roughly 6.1 per cent of all business rates revenue.[104]

3. The largest 100 United Kingdom companies pay £4.8 billion (there are 6,700 companies in the top turnover bracket).[105]

To calculate the number of properties over the £12,000 threshold by turnover band and sector, assumptions were set to sum to the overall total number of properties in the United Kingdom. Final numbers represent the number of properties on which business rates are paid by size and sector.

Working assumptions were also made on the average rateable value for properties of at least £12,000 in different turnover bands. As above, assumptions were flexed in order to sum to overall United Kingdom totals.

Annex B – The Polling

On 25 & 26 October 2018, YouGov put the questions below to a sample of 1,644 British adults on behalf of the Centre for Policy Studies.

Their findings are summarised below. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+). All figures rounded to nearest percentage.

1) How positive or negative do you feel about the role of businesses in Britain today?

Answer	%
Very positive	4
Fairly positive	43
Fairly negative	27
Very negative	6
Don't know	20
Total: Positive	*47*
Total: Negative	*33*

2) And more specifically, how positive or negative do you feel the role of about small, local businesses in Britain today?

Answer	%
Very positive	13
Fairly positive	49
Fairly negative	18
Very negative	5
Don't know	15
Total: Positive	*62*
Total: Negative	*23*

3) Do you think the current Government is or is not on the side of small businesses?

Answer	%
Is on the side of small business	14
Is not on the side of small business	60
Don't know	26

4) Do you think the tax system should or should not be aiming to help small businesses grow?

Answer	%
Should be an aim of the tax system	71
Should not be an aim of the tax system	10
Don't know	18

5) Do you think an aim of the tax system should be that it is simple for small businesses to understand?

Answer	%
Should be an aim of the tax system	80
Should not be an aim of the tax system	5
Don’t know	15

6) Do you think the tax and reporting systems for small businesses should be simpler than those for big business, or should they be the same for big and small businesses?

Answer	%
Should be simpler for small businesses	64
Should be the same for both big and small businesses	19
Don’t know	16

Between 23 October & 3 November 2018, YouGov put the questions below to a sample of 2,108 owners and senior managers of small businesses on behalf of the Centre for Policy Studies.

Their findings are summarised below. The survey was carried out online. The figures have been weighted and are representative of British business size. All figures rounded to nearest percentage.

1) Generally speaking, do you think the current UK Government is or is not on the side of small businesses?

Answer	%
Is on the side of small business	24
Is not on the side of small business	62
Don’t know	15

2) Thinking about the current tax system for businesses in Britain ... Generally speaking, do you think it is or is not sympathetic towards the needs of small businesses?

Answer	%
Is sympathetic towards the needs of small business	22
Is not sympathetic towards the needs of small business	68
Don’t know	10

3) Thinking generally about the current system of taxes, administration requirements and reporting dates for businesses in Britain. To what extent do you think this system is too complicated, too simplistic, or is the balance about right?

Answer	%
Much too complicated	38
A little too complicated	37
The balance is about right	18
A little too simplistic	0
Much too simplistic	0
Don't know	6
Total: Too complicated	*75*
Total: Too simplistic	*1*

4) Please imagine small businesses were able to choose between paying the existing business taxes, or choosing to pay a single tax calculated as a percentage of turnover. Generally speaking, would you support or oppose this new tax system being introduced as an alternative that small businesses can opt into if they choose, instead of paying tax under the existing system?

Answer	%
Strongly support	13
Tend to support	38
Tend to oppose	13
Strongly oppose	11
Don't know	25
Total: Support	*51*
Total: Oppose	*24*

For the following question, please think about the financial reporting that businesses have to do and the taxes that businesses have to pay (e.g. Corporation Tax, VAT, Employer's National Insurance, business rates etc.). Still imagining small businesses were able to choose between paying the existing business taxes, or choosing to pay a single tax calculated as a percentage of turnover... Which would you most prefer for your business in each of the following situations? (Please select one option on each row)

5) If the new method required less paperwork and administration, and involved paying a slightly higher amount of tax

Answer	%
I would prefer my business to pay the existing business taxes	58
I would prefer my business to pay a single turnover tax	21
Don't know	22

5a) If the new method required less paperwork and administration, and involved paying a slightly higher amount of tax *(Results excluding 'don't knows')*

Answer	%
I would prefer my business to pay the existing business taxes	73
I would prefer my business to pay a single turnover tax	27

6) If the new method required less paperwork and administration, and the same amount of tax was paid under both methods

Answer	%
I would prefer my business to pay the existing business taxes	23
I would prefer my business to pay a single turnover tax	59
Don't know	18

6a) If the new method required less paperwork and administration, and the same amount of tax was paid under both methods
(Results excluding 'don't knows')

Answer	%
I would prefer my business to pay the existing business taxes	28
I would prefer my business to pay a single turnover tax	72

7) If the new method required less paperwork and administration, and involved paying a slightly lower amount of tax

Answer	%
I would prefer my business to pay the existing business taxes	17
I would prefer my business to pay a single turnover tax	67
Don't know	16

7a) If the new method required less paperwork and administration, and involved paying a slightly lower amount of tax
(Results excluding 'don't knows')

Answer	%
I would prefer my business to pay the existing business taxes	21
I would prefer my business to pay a single turnover tax	79

Notes

1 Adweek (2016), “This Short Documentary Tells the Story of the Great Volkswagen Ads of the ’60s.”

2 Ibid.

3 See Deltapoll for Prospect magazine (2018), “The Conservative Party Brand”, p41.

4 See Annex B

5 See Hansard (9 Oct 2018), Sir Graham Brady, Written Question 173981

6 This uses the common definition of a small business as one with 0-49 employees. Technically, a small company is defined by the Companies Act 2006 and needs to have at least two of these features:
• Turnover not exceeding £6.5 million
• Gross Assets not exceeding £3.26 million
• Fewer than 50 employees

7 BEIS, Business Population Estimates 2018

8 As defined on p4 of “The State of the Nation: The UK Family Business Sector 2017-18”, Oxford Economics and Institute for Family Business (2018)

9 Nesta (2017), “The State of Small Business”, p24

10 Prelude Group, Institute of Directors and Grant Thornton (2016), “Britain Unlocked: A Tax Code for Global Ambition”, p20

11 According to Prelude/IoD report (2016) and Business Population Estimates (2018)

12 BEIS, Business Population Estimates 2018

13 See Global Entrepreneurship and Development Institute (2018), “Global Entrepreneurship Index 2018”, p30

14 Sunak, R. “A New Era for Retail Bonds”, Centre for Policy Studies (2017)

15 BEIS, Business Perceptions Survey 2018: Research Report, p32

16 See for example the 2018 Edelman Trust Barometer (UK findings)

17 See Annex B

18 OECD (2018), “Strengthening SMEs and entrepreneurship for productivity and inclusive growth”

19 See BEIS, Business Perceptions Survey 2018

20 See for example Federation of Small Businesses (2018), “Voice of Small Business Index, Q3”, for increase in costs (pp19-20) and wider small business confidence

21 See Octopus (2018), “High Growth Business Report 2018”, p17

22 OECD (2018), “Financing Small Business and Entrepreneurs”, p190

23 BEIS (2018), “Small Business Survey 2017: Cross-sectional Report”, pp24-26

24 BEIS, “Business Perceptions Survey 2018: Research Report”, p17 and p25

25 Office of Tax Simplification (2016), “Small Company Taxation Review”, p4

26 HM Treasury (2018), “VAT Registration Threshold: Call for Evidence”, p10

27 See Annex B

28 Prelude Group, Institute of Directors and Grant Thornton (2016), “Britain Unlocked: A Tax Code for Global Ambition”, p9

29 The Office of Tax Simplification was established in 2010 following the formation of the Coalition Government

30 Office of Tax Simplification (2016), “Small Company Taxation Review”, p4

31 The Government does make some concessions on VAT for smaller businesses and it does have some reliefs from business rates, yet small business owners still consider themselves disproportionately affected by tax and administration, as demonstrated earlier in this report.

32 The Federation of Small Businesses’ ‘Taxing Times’ report (2018) suggests that 55 per cent of small businesses don’t feel informed about available tax reliefs (p29) and 17 per cent of those surveyed said the schemes were too complicated (p35)

33 BEIS, Business Perceptions Survey 2018, p15

34 See Ipsos Mori/HMRC (2015), “Understanding Tax Administration for Businesses”, p5, and BEIS, Business Perceptions Survey 2018, p28

35 Ibid. p22

36 See Ipsos Mori/HMRC (2015), “Understanding Tax Administration for Businesses”, p5, and BEIS, Business Perceptions Survey 2018, p22

37 Prelude Group, Institute of Directors and Grant Thornton (2016), “Britain Unlocked: A Tax Code for Global Ambition”, p11

38 FSB (2018), “Taxing Times”, p3

39 Office of Tax Simplification (2016), “Small Company Taxation Review”, p19

40 a. FSB (2018), “Taxing Times”

41 HMRC, (2018), “Measuring Tax Gaps 2018 edition”, p10

42 Ibid. p3

43 See Amazon page counts for ‘Tolley’s Value Added Tax 2018-19’ and ‘Tolley’s Corporation Tax 2018-19’
b. HM Treasury (2018), “VAT Registration Threshold: Call for Evidence”,
c. BEIS, Business Perceptions Survey 2018
d. Office of Tax Simplification (2017), Annual Report 2016-17

e. Prelude Group, Institute of Directors and Grant Thornton (2016), “Britain Unlocked: A Tax Code for Global Ambition”
f. Ipsos Mori/HMRC (2015), “Understanding Tax Administration for Businesses”, p5, and BEIS, Business Perceptions Survey 2018
g. Hansford, A. and Hasseldine, J. (2012) “Tax compliance costs for small and medium sized enterprises (SMEs): the case of the UK.” eJournal of Tax Research

44 See Annex B

45 See Hansard (24 Oct 2011), Luciana Berger, Written Question 74605; Hansard (9 Oct 2018), Sir Graham Brady, Written Question 173981

46 There are 1.68 million companies registered for VAT or PAYE with turnover under £1 million. The £46 billion tax receipts from companies with less than £1 million turnover is made up of: £8.7 billion of Corporation Tax, £32.2 billion of VAT, £1.3 billion of Business Rates, and £3.8 billion of Employer’s NIC. See Annex A for methodology surrounding these estimates. Limited publically available data on SMEs makes it challenging to corroborate these figures. HMRC does not collect business rates information for SMEs and turnover information for SMEs is only available by number of employees, not by turnover. Our estimates of tax revenues raised by SMEs under £1 million turnover are in line with estimates put forward by the Financial Secretary to the Treasury and Paymaster General. See Hansard (2018), Sir Graham Brady, Written Question 173981

47 As mentioned earlier, the Institute of Directors reports that 43 per cent of small businesses surveyed spent between £1,000 and £5,000 on administrative requirements. Similarly, the Federation of Small Businesses reports that 77 per cent of small firms spend £5,000 on average on tax compliance. A paper by Hansford and Hasseldine estimates total compliance costs of up to £20,000.

48 Gov.uk, “VAT Flat Rate Scheme: Work Out Your Flat Rate”

49 See, for example, the recent Government response to its consultation on reducing the VAT threshold, para 3.4

50 Ipsos Mori/HMRC (2015), “Understanding Tax Administration for Businesses,” Table 5

51 The scheme is not identical to that advocated in this paper, not least as it also includes employee taxes, but the principle is the same.

52 For more information and sources please see:
Republic of Latvia. State Revenue Service. Microenterprise Tax & World Bank Group. Latvia Tax Review. P18, P86 and P94.

53 The Flat Rate Scheme is predicated on the idea that the VAT a company is liable to pay should correlate with how much value it has added to a product or service through its business activity (as is the nature of a value added tax). For example, the difference between what a catering services business charges its customers and what it is paying for its purchases is likely to be much greater than for a food retailer, and this difference will be reflected in the VAT the two companies collect on their sales and the VAT they pay on purchases. The Flat Rate Scheme therefore operates as a flat charge on turnover by basing the flat rate a company pays on what category of business it falls into - that is why catering services are subject to a 12.5 per cent flat rate, while food retailers pay 4 per cent

54 FSB (2018), “Taxing Times”

55 These figures refer to estimates by the Office for National Statistics on the number of VAT and/or PAYE based companies (including building societies) in the United Kingdom.

56 Based on average costs of £1,853 for Corporation Tax compliance and £526 for VAT. See Ipsos Mori/HMRC (2015), “Understanding Tax Administration for Businesses”, p40

57 Based on average time spent on Corporation Tax of 778 minutes and 316 for VAT returns. See ibid. p36

58 HMRC (2018), “Off-payroll working in the private sector”

59 See FSB (2017), “Small Business, Big Ambition”, p9

60 Creative Auto-Enrolment is a company that advises on employee benefits. A link to its report can be found in the bibliography.

61 Oxford Economics and Institute for Family Business (2018), “The State of the Nation: The UK Family Business Sector 2017-18”, p28

62 Small Business, Enterprise and Employment Act 2015, P23, Section 22 (4)(a)(i).

63 See BEIS (2018), “Business Impact Target: Final Report for the 2015-17 Parliament,” p12

64 Gov.uk, ‘Penalties for not telling HMRC your company is liable for corporation tax’

65 Office of Tax Simplification (2016), “Small Company Taxation Review”, p68

66 See Office of Tax Simplification (2016), “Small Company Taxation Review”, pp22, 59, 68 and 69 for further details

67 See fines for late accounts to Companies House at: Gov.uk, “Late Filing Penalties.” See fines for late company tax return at: Gov.uk, “Company Tax Return: Penalties for Late Filing”

68 FSB (2017), “Small Business, Big Ambition”, p10

69 See BEIS and Cabinet Office Press Release (2018), “Ending late payments to small businesses.”

70 Oxford Economics and Institute for Family Business (2018), “The State of the Nation: The UK Family Business Sector 2017-18”, p27

71 See BEIS and Cabinet Office Press Release (2018), “Ending late payments to small businesses.”

72 Federation of Small Businesses (2018), “Voice of Small Business Index, Q3”, pp30-32

73 British Business Bank (2018), “Small Business Finance Market 2017-18”, p3

74 Just 8 per cent of those surveyed regarded it as their ‘greatest challenge’ according to BEIS’ “Business Perceptions Survey 2018”.

75 British Business Bank (2018), “Small Business Finance Market 2017-18”, p17

76 See Oxford Economics and Institute for Family Business (2018), “The State of the Nation: The UK Family Business Sector 2017-18”, p28

77 Page 82 of the report makes clear that H1 2017 figures represent new debt application rates across all applications in the 10 quarters ending Q2 2017

78 See Treasury Select Committee (2018), “Written evidence submitted by the British Chambers of Commerce”.

79 HM Treasury (2018), “Bank Referral Scheme: Official Statistics”

80 Ibid

81 BEIS Press Release (2018), “Government announces new measures to boost funding for small businesses”

82 HMRC (2018), “Enterprise Investment Scheme Seed Enterprise Investment Scheme and Social Investment Tax Relief: Statistics on Companies raising funds”, p5

83 See for example UK Business Angels Association (2015), “The Angel Ecosystem: Developments, Challenges and Opportunities”, and OECD (2018), “Financing Small Business and Entrepreneurs”, pp190-192

84 See Prelude Group, Institute of Directors and Grant Thornton (2016), “Britain Unlocked: A Tax Code for Global Ambition”, pp60-62

85 Financial Times (2016), “Germany changes inheritance tax to protect family business”

86 Institute for Family Business (2018), Submission to Office of Tax Simplification Inheritance Tax Review, pp5-6

87 Clougherty, T. (2018), “Make Work Pay”, Centre for Policy Studies

88 BEIS, Business Population Estimates 2018, p3

89 The recent changes in the 2018 Budget have restricted access to the Employment Allowance for some employers but all small businesses remain able to access this Allowance

90 FSB (2018), “Taxing Times”, p25

91 Office of Tax Simplification (2016), “The Closer Alignment of Income Tax and National Insurance.”

92 Vukovic, V. (2012), “Unburdening Enterprise”, Adam Smith Institute, p6

93 CCHQ Press (2018), “Philip Hammond Speech to Conservative Party Conference 2018”

94 Association of Independent Professional and the Self-employed (IPSE) (2018), “Eight ways to upskill the self-employed”

95 BBC News (2017), “U-turn over Budget plan to increase National Insurance”

96 Dale, I. (2018), “The loan charge scandal: The Treasury U-turn destroying the lives of hardworking families”, Spectator

97 See HM Treasury (2018), “Taxation of self-funded work-related training: summary of responses”

98 See IPSE (2018), “A Brexit deal for the self-employed”, pp 8-9 for more detail

99 There are two exceptions to the turnover mid-point assumptions. First, for the £0 to £49,000 grouping Capital Economics assume that average turnover is £32,667 compared to the actual mid-point of £24,500. This is more in line with the median income across all United Kingdom sectors. Second, for the £50 million and greater turnover band Capital Economics assumes the mid-point is roughly £124.7 million. This average turnover scales up the model in line with the United Kingdom actual totals.

100 Office for National Statistics (2018), “Input-output supply and use tables”. The “input-output” tables help to quantify how different sectors of the economy fit together.

101 Office for National Statistics, Annual Survey of Hours and Earnings (2018), “Earnings and hours worked, industry by two-digit SIC”, Table 4.

102 Valuation Office Agency (2018), “NRD Stock of Properties”.

103 British Property Federation (2015), “Better Rates for Better Business”, page 31

104 Ibid.

105 PricewaterhouseCoopers (2017), “Total Tax Contribution survey for the 100 Group: A sustained contribution in uncertain times”

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Small and family businesses are at the heart of Britain's economy. But they are not getting the support they deserve. Most of the tax, administration and reporting requirements they are subject to are the same as for firms many times their size – a 'one size fits all' model which means that while it is easy to start a firm, it is far more difficult than it should be to run one.

That is why we should offer small firms the chance to replace the four main business taxes with a single, simple levy on turnover.

This Simple Consolidated Tax would be revenue-neutral for the state – but revolutionary for those firms that adopted it. Alongside this report's other proposals, it would send an unmistakable signal that Government is firmly on the side of small business.

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