THE VOICE OF BUSINESS

STUCK IN THE MIDDLE

ADDRESSING THE TAX BURDEN FOR MEDIUM-SIZED BUSINESSES

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Foreword

Medium-sized businesses (MSBs) punch well above their weight in the UK. They make up just 1.8% of businesses, but employ 16% of the total UK workforce and generate 23% of private sector revenue. They've also done much of the heavy lifting in the UK's economic recovery. Between March 2010 and March 2013 nearly one third of the increase in private sector jobs occurred in the MSB sector.

We believe that with the right support, this forgotten army of firms has the potential to play an even greater role in our economy.

As we set out in our landmark *Future champions* report, these firms are rarely recognised for the jobs and growth they create in the UK.

Led by the CBI, we've started to see a welcome shift in approach in recent years.

We've worked with the government to introduce dedicated trade missions for MSBs, and supported their efforts to knock down barriers on access to finance so they have the right patient capital to grow.

The tax system has a role to play in all of the big-picture challenges facing MSBs:

- Generating confidence and ambition
- Building up new skills and competencies
- Plugging the finance gap.

But right now the tax system is acting as a brake on the very firms we want to be driving the economy forward. This new CBI report supported by Grant Thornton sets out the steps government needs to take to address the tax barriers facing MSBs:

- Improve cashflow by reducing the number of MSBs caught within the corporation tax advanced payment system by raising the threshold for making quarterly payments from £1.5m to £5m
- Free up management time and reduce outside compliance fees by giving MSBs a named HM Revenue & Customs (HMRC) contact for enquiries ('CRM lite')
- Support MSB export ambitions through radically simplified transfer pricing and transfer of assets rules.

MSBs are critical to the UK's future growth prospects. It's time for the tax system to get plugged into the 'M' agenda.

Matthew Fell
Director for competitive markets, CBI

Foreword

Grant Thornton is delighted to be associated with this report that examines the tax burden on MSBs and how that burden may be lessened. As the UK's economy continues to gather pace as we emerge from the recession, it is vital that all businesses do not face administrative burdens that impede their growth.

This is especially true for MSBs. These organisations face particular challenges in coping with tax law. They are not so large that they can self-resource the skills needed to resolve complex tax legislation, or to have the dedicated support that the HMRC CRM affords. Neither are they so small that many of the complexities highlighted in this report are not relevant to them.

The MSB community often struggles to find a voice. Yet when asked, all have a lot to say. Many cite tax complexity as a barrier to growth, with an amazing 45% stating that complexity is a barrier to growth orientated business decisions. All asked as part of the research into this report quote a variety of taxes as being problematical, with corporation tax, employer-related taxes and VAT emerging as the biggest source of complaint and concern.

This report proposes a practical approach to the problem and builds on Grant Thornton's work generally into mid-sized businesses – the agents of growth in the UK economy – as well as that of the Office of Tax Simplification. All of us involved in representing or assisting this critical growth orientated business community – ambitious to employ, to export and to boost profits – wants to see simplification and a reduction in the compliance burden. This report identifies key issues and presents sensible solutions to achieve those aims.

Jonathan Riley
National head of tax, Grant Thornton UK LLP

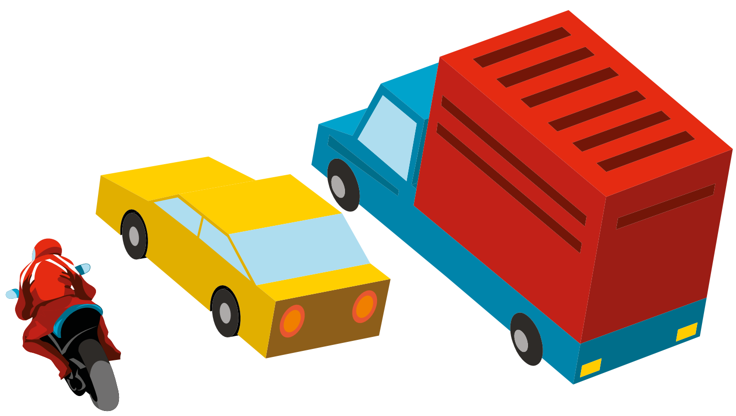
Executive summary

Medium-sized businesses (MSBs) are engines of growth in the UK. Yet they are stuck in the middle of the tax system. Tied-up finances, wasted time and reduced ambition for international growth are just some of the outcomes created by road-blocks in the tax system.

MSBs[1] do not have the resources that large companies have to manage their tax and do not receive the targeted support that the government directs at small businesses. As a result, the cost, use of management time and risk generated by the tax system falls disproportionately on this group of companies. The upshot is that the resources which could otherwise go into investment and new market entry – both time and money – are unnecessarily diverted into tax administration.

Based on our research, the need for action is clear. MSBs have to re-route finances away from their business to ensure tax bills are paid in advance. The administration burden reduces the time available to focus on strategic decisions, and their ambitions are dented from negative experiences when entering new markets.

The government has acknowledged the challenges faced by MSBs and businesses have welcomed government efforts to support export and investment ambitions. However, there is more to be done to extend the MSB agenda across all policy areas. This report makes the case for bringing the debate to the tax system, focusing on the road-blocks standing in the way of three critical resources MSBs need to grow: cashflow, management time, and export ambition.



TO REMOVE THESE ROAD BLOCKS, GOVERNMENT SHOULD:

- Improve cashflow by reducing the number of MSBs caught within the corporation tax advanced payment system by raising the threshold for making quarterly payments from £1.5m to £5m
- Free up management time and reduce outside compliance fees by giving MSBs a named HMRC contact for enquiries ('CRM lite')
- Support MSB export ambitions through radically simplified transfer pricing and transfer of assets rules.

Stuck in the middle

SECTION 1

The CBI has identified the central role played by MSBs in the UK's economy – employing 16% of the workforce and generating 23% of private sector revenue – and have been vital to leading the economic recovery. Grant Thornton underlined this in its Agents of growth report[2] which concludes 'MSBs are integral to the recovery prospects and long-term health of UK plc', contributing £285bn to UK GDP.

However, despite this strong performance, it's not often that we hear about the positive contribution of MSBs. They still remain under-recognised in policy, in the media and by the wider business community. There is more we can all do to champion MSBs as the growth engines of our economy and to ensure the business environment is as supportive as it can be.

The CBI has investigated many of the barriers to growth faced by MSBs. In 2011 the CBI's *Future champions* report[3] set the agenda by making the case for the 'forgotten army' of MSBs in the UK.

Exhibit 1 Taxes businesses must comply with

Taxes that businesses pay 2013/14 (£bn)	
National Insurance contributions	61.7
Corporation tax	39.3
Business rates	26.6
Fuel duty*	13.1
Irrecoverable VAT*	12.4
Stamp taxes	4.6
Customs & Excise duty	3.4
Insurance Premium tax	3.1
Taxes that businesses collect 2013/14 (£bn)	
PAYE	135.5
VAT	103.3
Employee NI	44.9
**Amount of tax paid by business (not total receipts)*	

Source: CBI analysis of HMRC data 2014

The major issues facing MSBs are:

- Generating confidence and ambition
- Building up capabilities
- Plugging the finance gap.

The tax system plays a big role in all three. To secure MSB growth, action needs to be taken to address the tax obstacles that are restraining the availability of cash, time and ambition.

Businesses need to pay, collect and report on a variety of taxes, not just corporation tax. There are eight categories of tax that the majority of businesses need to comply with in the UK (**Exhibit 1**), not to mention particular sectors (for example, construction, waste management, oil and gas) which face a host of industry specific taxes. Each tax has its own legislation, associated case law that has built up over years of interpretation, varying thresholds for calculations and qualification of reliefs, and a myriad of payment dates, reporting deadlines and filing requirements. It is difficult to comprehend, let alone manage.

It is not just the CBI that has identified the tax burdens businesses are facing. In fact, in the autumn statement 2013, the chancellor tasked the Office of Tax Simplification (OTS) to undertake a review of the competitiveness of UK tax administration[4] with a view to pushing the UK up the ranks to a top five position in the World Bank's *Doing business* report.[5] HMRC is also in the process of bolstering its support for MSBs following its research published earlier this year[6] which we fully support.

In this report we focus on the three critical resources MSBs need and set out our recommendations to ease the tax burdens standing in the way.

Improving cashflow to boost investment

Finances are directed away from business investment to pay tax. When MSBs are taxed like large businesses their ability to grow is undermined. Cash is the lifeblood of MSBs so timing of payment is critical to their success. For example this can be addressed by raising the threshold for making quarterly payments from £1.5m to £5m.

Freeing up time for strategic decision-making

MSBs are forced to waste precious management time dealing with tax compliance. Complying with tax legislation is an uphill struggle for many businesses. It takes time and effort to ensure that a business is fully compliant in the taxes it needs to collect on behalf of the government and pay in terms of its liabilities – distracting it from commercial priorities and reducing management capacity for strategic decision-making. MSBs are clear that freeing up management time and reducing the outside compliance fees by giving MSBs a named HMRC contact would make a real difference.

Supporting ambition to enter new markets

Ambition for international growth can be sapped by MSBs' experiences overseas, often owing to the complexities of the tax system, for example transfer pricing. It is impossible for a MSB to navigate domestic and international tax systems on their own – these businesses don't (and shouldn't be expected to) have the extensive in-house tax expertise to comply with the current complex requirements. As businesses grow and encounter complex 'life events', such as entering a new market, the complexity of the tax system may mean delaying commercial ventures to ensure the tax considerations have been met in advance or not proceeding at all – all of which suppresses ambition.

Despite the scarcity of resources, ambitious MSBs are keen to pursue growth. This report sets out how to make the journey easier, by getting the tax system up to speed with the rest of the government's pro-growth MSB agenda. The three themes of cash, time and ambition are explored in the next few sections with a series of recommendations for the government to take forward for MSBs stuck in the middle of the tax system.

"As a young export-oriented company tracking an aggressive growth line, we are dis-incentivised from breaching the quarterly instalment payments threshold. Working capital management is essential in our pursuit of growth and paying two tax liabilities, concurrently, in the one financial period is inhibiting."

AJ Power Limited, Northern Ireland

Improving cashflow to boost investment

SECTION 2

The cost of tax for a MSB and crucially, the timing of those payments can undermine the availability of finance to fund business growth. Raising finance continues to be a challenge for growing businesses,[7] so once it has been secured, businesses want to be able to use it strategically instead of having to use it to meet the demands of paying their tax bill in quarterly payments. The tax system should not jeopardise the cashflow of MSBs.

Despite their size, MSBs pay their way

MSBs pay their way, through substantial contributions to the public finances. In fact, companies paying corporation tax at the small profits rate[8] contributed 34% (£11.7bn)[9] of total corporation tax receipts for 2012/13 (**Exhibit 2**). Although this is only illustrative of a proportion of MSBs paying the small profits rate (with profits not exceeding £1.5m) it is a sizeable contribution. Despite the contribution made by MSBs, this has not been matched by a government strategy for the taxation of MSBs.

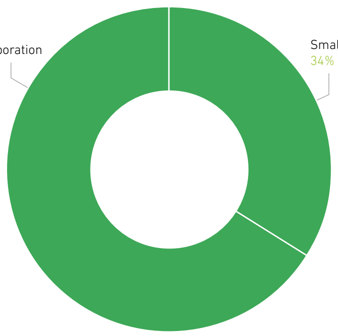
Cash is king

The transition to quarterly instalments payments (QIPs) for corporation tax creates a cashflow issue for MSBs in the first year the rules bite. Companies that breach the £1.5m profit threshold are expected to pay their corporation tax liabilities in advance of the year end. Many MSBs find this transitional year difficult from a cashflow perspective as they do not have the cash reserves of large businesses to manage this. MSBs can be dis-incentivised to grow to the next level when financing is directed to paying tax liabilities instead of boosting investment. Not only can the timings of payments be difficult to meet, but it was apparent in our conversations that many MSBs had a tendency to overpay QIPs to avoid perceived penalties or other consequences such as losing the gross payment status for those in the construction industry scheme (CIS).[10]

The illustration of the cashflow impact on a company transitioning into the QIPs regime is shown opposite (**Exhibit 3**). In the space of three months the company will need to make three tax payments during the year compared to one tax payment following the year end.[11] More detail explaining this transition is outlined on page 22.

While the exemption for the first year that a company breaches the threshold certainly eases companies into the rules, the fact that the threshold of £1.5m has not been indexed means that the type of companies brought into the rules today are smaller and less tax-capable than those that the policy was originally intended for.

Exhibit 2 Corporation tax receipts by rate of tax, 2012/13



Source: CBI analysis of HMRC corporation tax statistics

Exhibit 3 Illustration of cashflow impact for a company transitioning into the QIPs regime

	Year end 31 December 2013	Year end 31 December 2014	Year end 31 December 2015
Profit £000	1,250	4,000	4,500
Corporation tax due £000	250	800	900
Payment dates	1 October 2014	1 October 2015	14 July 2015
			14 October 2015
			14 January 2016
			14 April 2016

Recommendation 1
Reduce the number of MSBs caught within advanced payment of corporation tax

To help MSBs make the transition to paying tax in advance, the threshold for companies expected to pay via QIPs should be increased to profits exceeding £5m (instead of the current £1.5m threshold) and should continue to increase in line with inflation (CPI) on a regular basis going forward. This would protect the smallest MSBs which are more vulnerable to cashflow problems. Currently, companies generating profits in excess of £1.5m are expected to pay their corporation tax liability up front on a quarterly basis.

The failure to uplift this threshold in line with inflation has dragged an increasing number of smaller and smaller firms into the advanced payment of corporation tax.

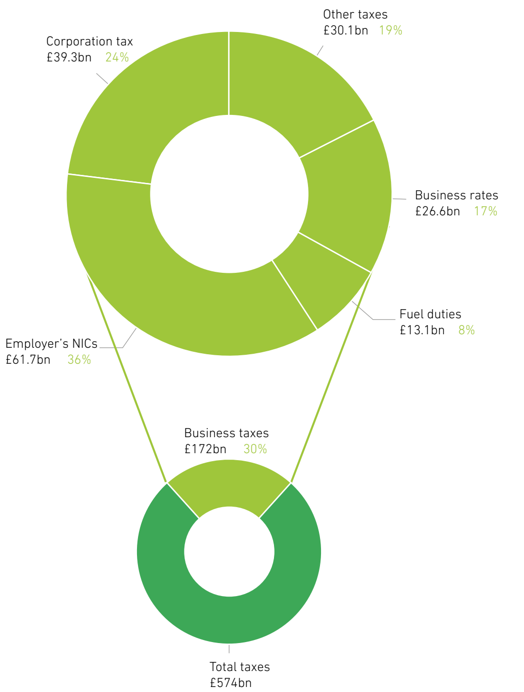
This measure would have a one-off impact on the presentation of the outlook for the public finances, but in the medium to longer term this move would help to make payments far more manageable for MSBs, by taking 37,500 companies out of the regime at no cost to the exchequer.

Recommendation 2 Set out a roadmap for direction on other business taxes

As corporation tax is not the only tax business pays, the government should undertake a review of the other taxes businesses pay (**Exhibit 4, page 12**). The stability and direction of travel that the corporate tax roadmap[12] provided in 2010 should be replicated to reduce the overall burden affecting businesses. In particular, a roadmap on NIC would provide certainty and comfort to MSBs that the cost and complexity is not on an upward trajectory.

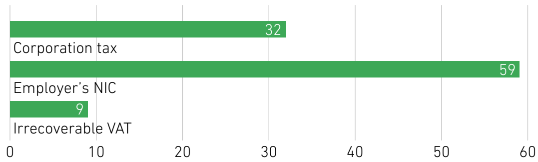
We have seen revenues collected from employer's NIC increase over time for all sizes of business and it is now the largest tax receipt from all businesses. Employer's NIC were frequently cited by MSBs as being their largest tax liability (**Exhibit 5, page 12**). In fact, many were concerned their employer's NIC liability would continue to increase, which cuts against the hope that MSBs will drive job creation in the UK.

Exhibit 4 Business tax contribution in 2013/14, by type of tax revenue



Source: CBI analysis of HMRC data

Exhibit 5 Which tax has the largest burden on your business by cost? (%)



Source: Grant Thornton pulse survey of finance directors May 2014 (182 respondents)

Further incentives or reliefs aren't on the wish-list

The primary concern of the MSBs we spoke to was ensuring they pay the right amount of tax at the right time. They did not call for any new incentives or reliefs to lower their corporation tax bill – in fact, any more incentives or reliefs would only add to the complexity they already face. However, they did identify some modifications to existing legislation to iron out peculiarities in the tax system that work against them.

Recommendation 3 Revise SME R&D rules to ensure non-controlling corporate investment not deterred

The small and medium enterprise (SME) research and development (R&D) partnership enterprise rules should be amended so that non-controlling corporate interests of less than 50% do not stop MSBs qualifying for the SME relief.

SME R&D relief is currently not available to companies that have non-controlling corporate interests of over 25%, even if the business meets the definition of SME for these purposes. Therefore, businesses that are considered commercially viable by corporate investors are precluded from the more generous SME R&D regime.

MSBs with R&D activities often think twice before receiving significant corporate funding if it means losing out on the more generous SME relief which helps boost cashflow. Given that business R&D expenditure only represented 1.1% of GDP in the UK in 2012[13] – a flat level since 2007 and substantially low by international standards – more can be done to support this activity. R&D expenditure is driven by private firms, so in both encouraging investment by MSBs, we can best ensure that these firms are able to scale up and help drive innovation in the UK economy.

The cost to the exchequer will increase slightly by making more SMEs eligible. However by expanding the scope of relief, more firms will be encouraged to spend more on R&D expenditure.

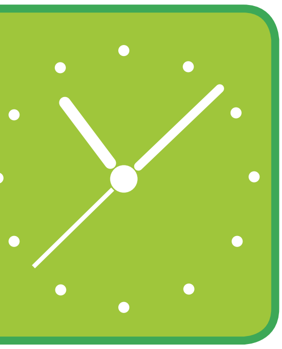
"Discrepancies in tax rules can disadvantage MSBs. For example, spin-outs from corporate enterprises are disadvantaged relative to spin-outs from universities and pure start-ups, because of the inconsistent way in which the SME R&D criteria are applied.

This inconsistency is also dissuading financial investors from investing in corporate spin-outs, because the unfavourable treatment reduces their return on investment."

Cambridge Consultants, Cambridge

Freeing up time for strategic decision-making

SECTION 3



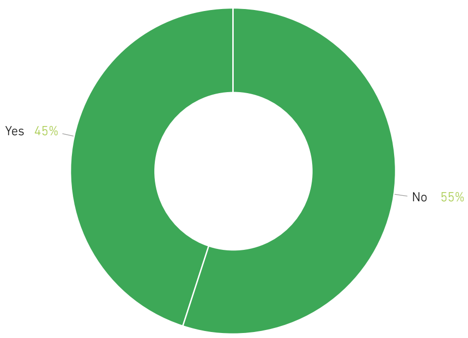
The tax compliance burden sucks up management capacity for strategic decision-making. The time-saving proposals set out below will reduce this burden and allow MSBs to focus on the key decisions that can unlock growth.

Complexity is a drag on commercial decision making

The UK is often cited as having one of the most complex tax regimes in the world, given the sheer size of the legislation (running to over 17,795 pages, including non-statutory references),[14] but as the OTS points out, length is not the only factor – the *"...clarity and ease with which legislation can be interpreted and applied"* is also critical. Although the length of the tax code does not always mean a complex tax system, it does make it inaccessible for many.

Finance teams within MSBs want to get on top of tax legislation but this is often heavily supported by professional advisers. In our conversations with MSBs it was common for the finance team to feel they slowed down commercial decisions in order to uncover hidden tax liabilities or registration procedures associated with new projects. In research conducted by Grant Thornton 45% of MSBs said tax was a factor in slowing down commercial decisions (**Exhibit 6),** proving the tax system needs to catch up with the MSB agenda.

Exhibit 6 Tax slowing down business decisions for MSBs



Source: Grant Thornton pulse survey of finance directors May 2014 (189 respondents)

Better access and increased customer focus from HMRC

A recurring theme in conversations with MSBs centres on their access to HMRC. Many reported being frustrated at the length of time they waited on the helpline, the quality of the response received on the helpline, and the inability to speak to the same person again regarding their case. Instead, many MSBs defer to their agents to lead discussions with HMRC.

One of the differences in treatment facing MSBs compared to large business is the formal clearance procedure.[15] For large businesses the clearance notice is directed straight to their CRM (customer relationship manager), although for small or medium-sized businesses, without a dedicated CRM, the clearance notice is sent to an anonymous HMRC office. It would be unusual for that office to fully understand the MSB and the intricacies surrounding the clearance notice, so it is inevitable that delays occur from additional questions.

Increasing the amount of direct engagement with this section of the business population will build a stronger relationship between the taxpayer and the tax authority. We commend the work currently underway by HMRC to improve the customer experience for MSBs and we understand the resource constrains it faces. However, the conversations we have had during this project have underlined the critical nature of this issue. Furthermore, the strategy HMRC pursues on its MSBs agenda needs to be communicated effectively to staff on the ground to ensure the experience for MSBs lives up to the strategy.

Recommendation 4 Improve access to HMRC

HMRC's proposals to provide access to a designated named HMRC official on a needs basis (a light-touch CRM service at particularly complex life events) should be rolled out as soon as possible. If successful and when public finances permit, the scheme should be extended to a larger proportion of MSBs.

In the meantime improved digital communication via emails and live chats would drastically enhance customer relationships.

Many business reported the difficulties accessing HMRC at critical points, to query correspondence, discussing disputes or advice when entering into complex transactions.

Although many of the complexities faced by MSBs are similar to large businesses, MSBs do not have access to a dedicated member of HMRC staff. As a result they waste a lot of timing attempting to speak to the right person or obtaining the right answer. Many MSBs give up and pass the work on to their professional advisers. A CRM-lite programme would encourage real-time conversations and provide the access to HMRC that MSBs require.

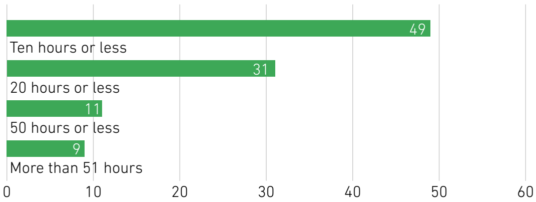
Recommendation 5 Update HMRC guidance

HMRC's online guidance is considered a valuable resource, but there is scope to improve it. In particular it should be updated frequently to publish HMRC's current interpretation of the law and how it should be applied. More commercial examples should be presented and for subjects such as capital allowances a regular publication of case law precedents would help MSBs make quick and informed decisions themselves.

Many businesses first turn to HMRC's online guidance to help them understand tax legislation. MSB finance teams rarely have qualified tax staff, so they are reliant on HMRC guidance to help them ascertain their tax position before engaging professional advice.

Furthermore, when businesses follow advice published online by HMRC there is a legitimate expectation by taxpayers that the guidance is correct, up to date and can be relied on. When it is not, taxpayers can look towards dispute resolution but MSBs have limited time and money to embark on this course of action.

Exhibit 7 The number of hours MSBs spend on tax administration per month



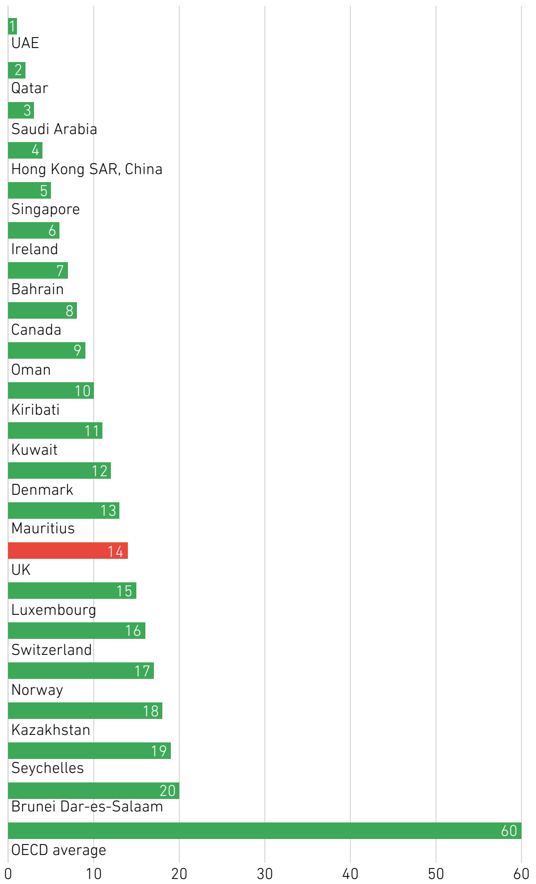
Source: Grant Thornton pulse survey of finance directors May 2014 (182 respondents)

Compliance is an uphill struggle

The UK ranks 14 in the list of 189 economies in the World Bank and PwC *Paying taxes: the global picture*[16] study (**Exhibit 8, page 16**) which looks at tax rate, hours spent and number of taxes to comply with. The study estimates that MSBs on average spend 110 hours a year dealing with tax compliance in the UK. However this flatters the reality of the tax responsibilities placed on business, by ignoring the frequency of payment of some taxes and the implementation of projects such as Real Time Information (RTI).[17] This is emphasised by Grant Thornton's research, where 51% of MSBs said they spent more than ten hours a month (120 hours a year) on tax management (**Exhibit 7**).

MSBs are clear that there is no single issue that can reduce the tax compliance burden alone, instead, it is the accumulation of a number of different tax compliance obligations. Any individual steps that can be taken will help to reduce the overall burden and make a difference. Particular frustrations include the differences between accounting treatment and tax treatment when preparing a corporation tax return (with businesses spending large amounts of time ensuring the treatment of small amounts of expenditure were correct for tax purposes) as well as the duplication of admin created by differences in PAYE and NIC legislation.

Exhibit 8 World Bank and PwC paying taxes rankings, 2014



Source: CBI analysis of World Bank and PwC paying taxes, 2014

Recommendation 6 Tax payments made up front should be based on last year's liability to reduce compliance

As recommendation 3 states, more MSBs should be taken out from the QIPs regime by raising the profits threshold. For those MSBs that remain within the regime, an option should be given to pay corporation tax each quarter based on last year's profits (with the ability to reduce payments if forecast current year profits are lower – similar to income tax self-assessment). This would avoid the compliance burden of estimating the liability each quarter and minimising the worry that the company has underpaid for the quarter.

The associated administration to estimate the liability (forecasts and draft tax computations) was highlighted as time consuming. Although a company does not need to produce documentation of the calculation for HMRC, it is perceived as an onerous undertaking and many MSBs were nervous about underestimating their liability.

Despite the complexities, inadvertent compliance mistakes by businesses are punished by not only having to pay the duty and interest, but by a penalty regime that takes little account of the increasing complexity and sheer amount of legislation MSBs are expected to comply with. The Construction Industry Scheme (CIS) is a good example, not least because most non-construction MSBs are unaware that it may apply to them. These issues highlight some of the difficulties faced by MSBs managing their tax compliance obligations.

> *"Legislation is constantly changing. RTI and auto-enrolment have been some of the latest complications that businesses have to deal with. They take time away from working with the rest of business."*

Design and manufacturing company, Somerset

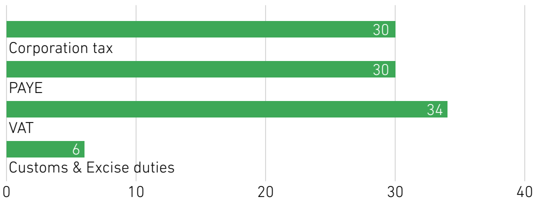
Recommendation 7 Push ahead with EU VAT web portal

The UK government should push ahead with an EU VAT web portal to centralise helpful resources and keep MSBs firmly in mind if there is a movement towards an EU standard VAT form.

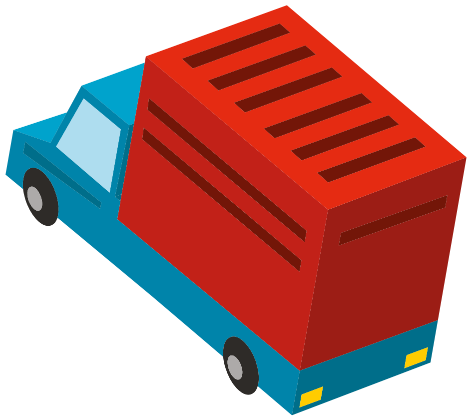
The paperwork associated with tax compliance is often disproportionate to the tax liability at stake. This was noted most frequently in relation to VAT (**Exhibit 9**).

For complex transactions, many MSBs found it hard to understand what returns needed to be filed, under what circumstances they needed to be filed and when they needed to be filed. Dealing with the consequences of errors that had been made unwittingly tied up more management time and resources in subsequent in correspondence with tax authorities. This was felt by businesses all the more acutely, given that they are unpaid collectors of these taxes on behalf of government.

Exhibit 9 MSB priorities for tax simplification



Source: Grant Thornton pulse survey of finance directors May 2014 (184 respondents)



"Compliance costs also tend to increase with the number of taxes that an entrepreneur is subject to, the complexity of the tax rules, the frequency of submitting tax returns, and the number of levels of government involved in levying and collecting tax."

Taxation of SMEs, OECD Tax Policy Studies, 2009

Supporting ambition to enter new markets

SECTION 4

The complexity of the international tax system can mean MSBs shy away from taking risks on new commercial ventures. We heard examples of businesses retracting from investments and pulling out from new markets because of tax road-blocks. Action needs to be taken to mitigate the complexities of the international tax system for MSBs.

Entering new markets multiplies the burden

Although the UK government cannot change other jurisdictions' tax legislation, further support for businesses expanding overseas is required if the government is to achieve its goal of increasing exports. Many businesses we spoke to have had their 'toes burnt' by overseas tax rules when stepping foot into the territory for the first time. Other members spoke of the frustration of working with other tax authorities which has led to a withdrawal from markets when a dispute has become too risky and costly for an MSB to pursue.

Recommendation 8 Set up international peer-to-peer tax networks for MSBs

HMRC and UKTI should co-ordinate with other tax authorities to set up peer-to-peer tax networks for businesses expanding overseas, enabling businesses to learn from each other, and avoid the duplication of costly and time consuming mistakes.

Entering new markets for the first time presents a number of challenges and uncertainties for businesses. Professional advice is often sought but it is expensive.

MSBs embarking on overseas expansion programmes were keen to speak to other businesses that have recently undertaken similar endeavours, to learn about the way they structured their business overseas and any hidden tax obstacles encountered.

And the burden is unrelenting

As businesses become more established in overseas jurisdictions, the tax burden only seems to increase. Many businesses found that differing transfer pricing[18] requirements are time-consuming and expensive. Although transfer pricing affects both large and medium-sized businesses, the requirements are not scaled down for MSBs so the burden is disproportionate to their size, risk and activity in that jurisdiction. In order to comply with transfer pricing, professional advisers are almost inevitably required to determine the 'arm's-length price', making it expensive to comply with across a number of jurisdictions.

> *"Entering new markets is incredibly expensive. There is limited help available to ensure you are structured correctly from a legal and financial perspective. Professional advice is expensive but necessary to ensure no surprises."*
>
> **AVF Group, Telford**

Recommendation 9 Reduce number of MSBs caught within transfer pricing rules and radically simplify the rules

Steps should be undertaken in the UK to reduce the number of MSBs caught within the transfer pricing rules. The threshold at which companies must comply with the rules should be increased to 500 employees (in line with the SME R&D definition).

Presently large and medium-sized business fall within the transfer pricing legislation. Many MSBs are caught as the SME exemption threshold is currently determined by the standard European Commission definition. It is normally the employees test (with an upper threshold of 250 employees) that pushes more MSBs into the regime, so this should be increased to 500 employees. We recognise state aid clearance may need to be sought, but on the basis it has been granted in relation to the R&D threshold, this should be achievable.

Partnership enterprise rules (regarding non-controlling corporate interests) for transfer pricing should also be amended in line with recommendation 3, again taking more MSBs out of the regime and reducing the compliance they face. These recommendations have the added bonus of harmonising some of the many different and confusing 'SME' definitions in the tax system.

Furthermore, action needs to be taken to simplify the transfer pricing obligations of MSBs still caught within the rules. MSBs would welcome the ease of a standard global transfer pricing template with a simplified format for MSBs, therefore the Government should continue to work multi-laterally with the OECD to implement the global transfer pricing master file currently under discussion.

Recommendation 10 HMRC should intervene at an earlier stage in MSB disputes with other competent authorities

HMRC should support MSBs by intervening at an earlier stage in disputes when requested and should adopt a more flexible approach on the type of issue they are willing to raise with other competent authorities. This will ensure that MSBs are given a level playing field internationally, and reduce the possibility of double taxation.

Currently, a company may enter into a dispute with another jurisdiction's tax authority if they feel a decision has not been made in accordance with the double tax treaty in place.

However to initiate this process it is often prohibitive for MSBs as they cannot afford to tie up resources (staff and money) in the stages that need to be undertaken before HMRC will step in. Often MSBs will walk away from the dispute with an unequitable tax outcome or retract from the market entirely.

"We rely on professional advisers to help us determine our liabilities and reporting obligations in each territory that we have representatives in, to ensure we do not fall foul of the legislation or risk surprises further down the line. It can be time consuming to make sure we are compliant, and it does feel like the finance team could be slowing down the operational side of the business at times in this respect."

Products supplier, East Midlands

Recommendation 11 Update 'transfer of assets abroad' legislation

The legislation surrounding the transfer of assets abroad and gains made by non-resident companies (controlled by five or fewer UK persons) should be updated to support MSBs in their international expansion.

UK SMEs are allowed to transfer or open up operations (with share capital) in the EU/EEA and not fall foul of the transfer of assets abroad anti-avoidance legislation.

However experiences of MSBs trying to expand internationally are different, with some reporting that HMRC appears to be only interested in finding reasons why the new EU relief doesn't apply to the company instead of supporting them in their internationalisation.

As neither of the provisions apply to large multinational businesses – since the CFC regime has been reformed and capital gains are excluded from the regime – it makes it significantly more difficult for MSBs to internationalise.

Recommendation 12 Ensure MSBs are not forgotten in the OECD BEPS agenda

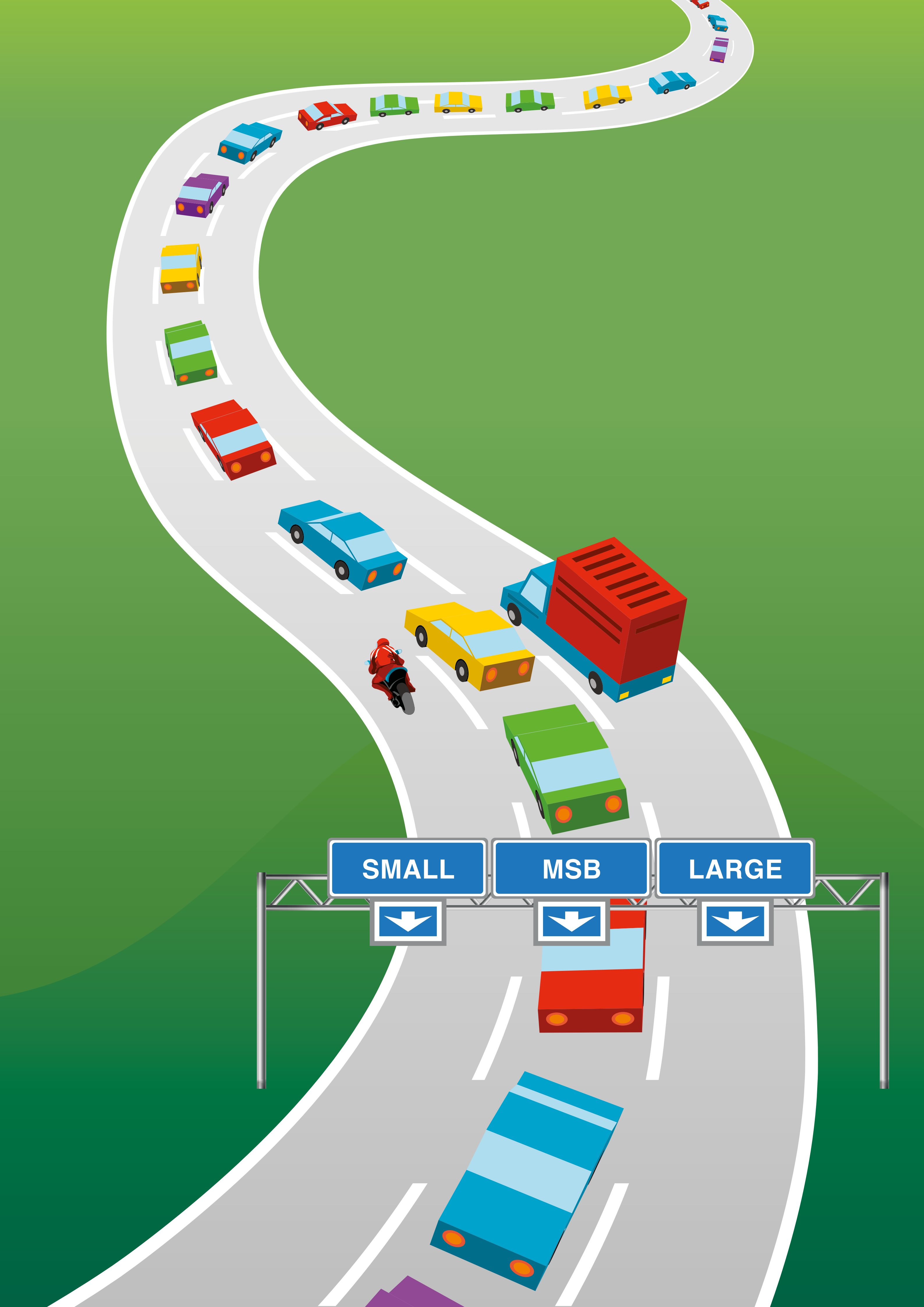
As the OECD moves ahead with the base erosion profit shifting (BEPS) agenda, the UK government needs to examine the impact of all of its proposals on the MSB community, and pragmatically adapt the rules where the compliance burden is clearly out of proportion with the target of the BEPS action being proposed.

Furthermore MSBs should be exempt from the new regime in line with the proposed thresholds for transfer pricing (see recommendation 9).

The current work being undertaken by the OECD to tackle BEPS will have a lasting impact on the international tax system. This has left some MSBs, especially in the digital economy, concerned over the likely changes that will come out from the OECD BEPS project and the disproportionate impact it will have on businesses of their size.

> *"Seemingly innocuous tax rules such as associated companies were a disincentive for companies receiving funding. It is good to see them eased but the government needs to ensure tax rules are not at odds with its broader agenda, such as access to finance."*

Michael Plaut – chairman, Northmace & Hendon, Cardiff


SMALL
MSB
LARGE

References

1 There are many definitions of medium-sized businesses (MSBs), but for the purposes of this report the CBI uses the definition set out in our original MSB report *Future champions*, focusing on businesses with a turnover of £10m-£500m

2 *Agents of growth: how UK mid-sized businesses are beating the market*, Grant Thornton UK LLP, 2014

3 *Future champions*, CBI, 2011

4 OTS review of tax administration, https://www.gov.uk/government/publications/competitiveness-of-uk-tax-administration-review

5 *Doing business 2013: understanding regulations for small and medium-sized enterprises,* World Bank, http://www.doingbusiness.org/reports/global-reports/doing-business-2014

6 *Understanding mid-size businesses: qualitative and quantitative research with the mid-size business population*, HMRC, 2014, http://www.hmrc.gov.uk/research/report305.pdf

7 *Financing for growth*, CBI, 2011

8 The title of the small profits rate is misleading as many MSBs are paying tax at this rate given the qualifying threshold is in relation to profits not turnover (defined as companies with taxable profits not exceeding £1.5m). Previously, the lower rate of corporation tax had been called the small companies rate but in April 2010 it was decided to make it clear that the size of profits, rather than the size of the company, determines the tax rate to be applied

9 *Corporation tax statistics*, HMRC, October 2013, http://www.hmrc.gov.uk/statistics/ct-receipts/corporation-tax-statistics.pdf

10 The Construction Industry Scheme (CIS) sets out the rules for how payments to subcontractors for construction work must be handled by contractors in the construction industry. The scheme mainly applies to contractors and subcontractors in mainstream construction work, although businesses or organisations whose core activity isn't construction but have a high annual spend on construction may also count as contractors and fall under the scheme

11 A company within the QIPs regime with a December year-end would be expected to pay two instalments of the expected liability during the year in July and October and then two further instalments in January and April the following year (**Exhibit 3**). The first year companies are expected to bring forward the corporation tax payment creates financial pressure as previously these companies would pay their corporation tax liability nine months and one day after the year-end. In the first year that the £1.5m threshold is breached (year-end 31 December 2014), the company is not expected to pay on a quarterly basis, but when the threshold is breached again the following year, the company will have three corporation tax payments due during the year-end 31 December 2015. One payment is in respect of the 2014 year-end (due on 1 October 2015) and the other two payments (due on 14 July 2015 and 14 October 2015) are in respect the 2015 year-end

12 *Corporate tax roadmap*, HMT, 2010, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193239/Corporation_tax_road_map.pdf

13 *ONS business enterprise research and development survey, ONS, 2012* http://www.ons.gov.uk/ons/rel/rdit1/bus-ent-res-and-dev/2012/stb-berd-2012.html

14 *Length of tax legislation as a measure of complexity*, OTS, 2012 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193496/ots_length_legislation_paper.pdf

15 There are dispute resolution processes in place so if a company thinks that the action of a tax authority of another country has resulted in taxation which is not in accordance with a double taxation agreement, they may ask the 'competent authority' of their own country to intervene

16 *Paying taxes 2014*, World Bank and PwC, 2013, http://www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2014.pdf

17 From 6 April 2013 employers started reporting PAYE information to HMRC in real time. This means that employers (or their accountant, bookkeeper or payroll bureau) have to send details to HMRC every time they pay an employee, at the time they pay them and use payroll software to send this information electronically as part of their routine payroll process

18 Transfer pricing refers to the prices charged between related parties. The rules apply to transactions between UK parties as well as transactions between UK and overseas parties

The wishlist

In our reseach we asked MSBs what was the one thing they'd like the government to do to ease the tax burden for business. Here are some of the other issues mentioned...

- *Align tax periods with calendar months.*
- *Simplification of VAT rules which are overbearing and significantly delay decision making processes within a number of sectors.*
- *We are penalised when we get compliance wrong: how about a reward when we invest in resources and get it right?*
- *Greatly simplify the system removing quirky step-changes in effective rates.*
- *Continue to maintain first-year allowances (howsoever named) at a meaningful level for SMEs to allow capital investment to be planned and utilised.*
- *Make it clear and concise.*
- *Simpler process for obtaining withholding tax.*
- *Reduce employer's NIC and simplify VAT.*
- *Stop enacting finance bills of 600-plus pages.*
- *Any initiative which enhances the competitive edge for the employer.*
- *Reduce the cashflow impact of instalment payments of Corporation Tax.*
- *Treat small businesses fairly: lessen the paperwork and make it simple.*
- *One database for all tax with single data entry points.*
- *Merge NIC with income tax.*
- *Stop changing the tax regime. This adds to uncertainty in the investment climate and adds huge administration costs each time there is a change.*
- *Reduce the rules and regulations around specific areas for reliefs.*
- *Answer the phone when I ring HMRC!*
- *Efficient processing by HMRC to prevent following-up past returns and payments not processed properly.*
- *Reduce level of Air Passenger Duty – crippling tax for anyone involved in an airline or related business and damaging to sustainability of regional transport infrastructure.*
- *Simplify VAT rules to reduce irrecoverable VAT.*
- *Tax simplification – in particular PAYE, NIC and employee benefits. It's so over-complicated!*
- *Provide incentives to employ the youngsters through apprentice schemes with a much lower employer's NIC charge, then we would look to educate the youngsters to be the next generation of engineers.*
- *Try to simplify the rules so that less advice is needed.*

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To achieve this, we campaign in the UK, the EU and internationally for a competitive business landscape.

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