Autumn Budget Representation 2018
The Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

28th September 2018

Please note our recommendations outlined here assume a Brexit Withdrawal Agreement and subsequent transition toward a negotiated future economic partnership with the EU. Under a no-deal scenario, it goes without saying that businesses will expect that additional resources be made available to Government departments, regulators, and firms to provide support for the economy in the time running to 29th March 2019.

The Institute of Directors is Britain's oldest representative body for directors, founded in 1903 and awarded a Royal Charter in 1906 obliging us to foster a climate favourable to entrepreneurialism and wealth creation. While the IoD consists of over 30,000 members, predominantly the leaders of small- to medium-sized businesses, the below representations reflect our view of what would be most beneficial to the UK business community and economy at large, and therefore the well-being of the country itself.

Overview of IoD Recommendations to HM Treasury for Autumn Budget 2018
Brexit
Issue immediately redeemable planning vouchers for small and medium-sized enterprises to help them prepare for Brexit
Productivity
Create a new Enhanced Capital Allowance to support productivity growth in SMEs
Drive business investment by extending and simplifying existing capital allowances
Provide support to develop a more formalised national business support framework
Develop a world class training system by committing to reforming the Apprenticeship Levy
Remove the Immigration Skills Charge to reduce barriers to skilled migration from the rest of the world
Accelerate digital and physical infrastructure projects to drive connectivity and international competitiveness
Costs
Commit to building a competitive, efficient and fair corporate tax system
Reduce the burden of business rates on SMEs by providing additional relief

1. Context

1.1 After entering 2018 with cautious optimism, business leaders' confidence in the economy is now at an annual low (**Figure 1**). This is largely driven by underlying economic conditions, Brexit uncertainty, and ongoing concerns around skills shortages (**Figure 2**). These factors, alongside heightened business costs, are weighing down businesses expectations for investment and employment in the year ahead (**Figure 3**), which may act to dampen economic growth in 2019.

1.2 With that in mind we would expect the Government, at the very least, to ensure that businesses and individual taxpayers do not face tax increases, existing reliefs and incentives are neither curtailed nor abolished, and that beneficial tax reforms remain on the agenda. This includes confirming its commitment to guaranteeing the UK has the lowest corporate tax rate in the G20, reviewing and ensuring no further increases to business rates, reforming and simplifying the tax system, and upholding and improving reliefs such as the Enterprise Investment, Seed Enterprise Investment and Venture Capital Trust schemes which encourage investment in start-up and scale-ups.

1.3 Over and above these proposals we still consider the Autumn Budget to be a critical and opportune moment to provide supplementary support to help businesses navigate Brexit, drive firm-level productivity growth, and lower the cumulative cost burden facing enterprises. These issues are of priority both for the business community and wider economic growth, particularly as the economy enters a period of flux. In light of this, and recognising the Government's own fiscal constraints and existing spending commitments, we have presented a targeted set of recommendations for our representation this year below.

2. Policy Recommendations

2.1 Preparing Businesses for Brexit: The additional £3 billion set aside for Brexit planning in the last Budget was a prudent move, and it is crucial the business community is given ample support to make necessary adjustments to help them prepare. With little clarity on future arrangements, only a third of IoD members have done any contingency planning so far, yet over 80% have commercial ties to the European Union[1]. Smaller companies routinely report cost and resource allocation challenges in underlining the difficulty of planning for the unknown. Nearly two-thirds believe a no-deal scenario would adversely impact their business, but only a quarter of IoD members who have read the Government's technical notices/guidance have found it useful, at this point, for preparation. As these notices set out, only professional and legal advice can ultimately help companies understand the specific implications and next steps for their business, and that advice can be costly. Moreover, 'uncertain trading status with the EU' was the top business concern among our members in our pre-Budget survey (**Figure 2**).

Brexit Planning Vouchers for SMEs: Smaller enterprises have less capacity to comprehensively plan for Brexit, and given the pressing need to support contingency strategies in these firms, the Chancellor might consider introducing immediately redeemable Brexit advisory vouchers for SMEs. These already have precedent in Ireland and the Netherlands[2], while over half of IoD members say they would be likely to take advantage of financial support to help with their preparations.

The scheme would ideally target SMEs[3], with firms submitting applications for grants via an online form. Criteria for qualifying for the grant must also include that the business has a satisfactory trading record and the voucher must be redeemed against Brexit-related activity. However, in light of feedback to the Business Growth Voucher scheme, it is essential to make the application process simple and streamlined so that smaller businesses do not find it overly onerous. It would be sensible to have the scheme in place for the duration of the envisaged transition period.

With a grant total between £2000 and £3000 (based on the InterTrade Ireland and Enterprise Ireland rebates), fees on Brexit-related advisory services from approved suppliers need not be prohibitively expensive[4].

---

[1] IoD September 2018 *Policy Voice* survey
[2] https://intertradeireland.com/brexit/brexit-start-to-plan-vouchers/;https://www.rvo.nl/subsidies-regelingen/brexit-vouchers&prev=search
[3] 250 employees or less
[4] Indicatively, a rough extreme upper bound outlay could be around £700m if all UK SMEs with ties to the EU took up the voucher. Approximating cost as, total UK SMEs x UK SMEs with ties to EU x Expected take up rate x Fee = 5.7 million x 23% (UK SMEs which export to EU or have supply chain exposure, BIS, May 2016) x 27% (IoD SME members who are 'very likely' to take-up support, *Policy Voice* Survey, September 2018) x £2000 = £708 million

2.2 Productivity: The UK's poor productivity performance over the past decade is closely tied to subdued levels of business investment in new equipment and technology, which in turn has largely been the result of a low demand environment, risk aversion, and spare capacity. Driving business productivity growth by offering meaningful and targeted investment incentives should be a particular priority now, alongside building up the SME support network, and boosting the national skills, training, and infrastructure systems.

Create a new Enhanced Capital Allowance targeting business productivity: Our forthcoming research paper *Lifting the Long Tail*, in response to the Department for Business, Energy & Industrial Strategy's Business Productivity review, highlights the need for financial incentives to help support the adoption of tried-and-tested practices in the long-tail of low productivity SMEs. Indeed, around 1 in 3 of IoD SME members say technology investment incentives would be most likely to improve productivity in their organisation (**Figure 5**).

Currently, given weak signposting and technical complexity, only SMEs who hire a professional accountant are likely to understand, and take advantage, of existing capital allowance support in this space. Meanwhile, banks are also more cautious in lending money for investment in intangible capital[5]. As such, given the economic benefit of encouraging technology investments, there remains significant scope -- in fitting with other G7 nations, including France, Italy and Germany, which offer specific tax incentives to invest in established digital technologies[6]—to enhance tax reliefs for productivity-enhancing investments in the UK.

As a base, HMT should consider replicating the Enhanced Capital Allowance (ECA) for defined productivity-enhancing technologies[7], and advisory services, specifically for SMEs. The aim would be to create an additional incentive – above and beyond what is already available[8] -- and a clear signpost for making technological investments that can drive business productivity and assist in the diffusion of best practice into the long tail.

A new ECA for this purpose will need to consider the optimal write down rate to incentivize and support capital expenditure (e.g. on IT equipment) and 'on-going' operational expenditures (e.g. on software licenses), alongside the dynamic nature of what 'best practice' encompasses. Covered advisory service fees should ideally focus on operational support, and the diagnostics and implementation of best practice productivity projects -- ideally with a clear qualifying criteria, and a simple and streamlined application process.

Drive investment by extending and simplifying existing capital allowances: With many of our members holding back on significant capital outlays whilst broader economic concerns remain, loosening existing investment allowances are crucial. Indeed, changes to the cost of capital have been shown to have notable impacts on influencing both the rate and timing of business investment[9].

Our members, particularly those running mid-sized businesses, continue to emphasise the importance of the Annual Investment Allowance ('AIA') in incentivising spending on plant and machinery. At the same time, the UK is ranked poorly among G7 peers for the overall competitiveness of its capital allowance regime, which acts as disincentive to both domestic and foreign investment[10].

As such, the Chancellor should consider a temporary increase to the AIA cap. An increase in the cap to at least £500,000 per annum – the level in 2014/5 – for the duration of the Brexit transition would be a timing cost and

[5] Federal Reserve Board, Capital misallocation and secular stagnation, Caggese and Perez-Orive, 2017
[6] Made Smarter Review 2017
[7] For 'best practice' technologies such as enterprise resource planning software, data analytics, cloud computing etc.
[8] In addition to the Annual Investment Allowance, and above the 100% upfront allowance available
[9] The impact of investment incentives: evidence from UK corporation tax returns, Maffini, Xing and Devereux, January 2016
[10] OUCBT tax database

would have an outsized effect on business behaviour in the short- to medium-term. Increases to the overall write down allowance rate for plant and machinery, and efforts to simplify capital allowances – reflecting the latest Office of Tax Simplification recommendations[11] -- would equally be welcome moves.

Provide support to develop a national business support framework: Reducing the gap between the weakest and strongest business could boost UK productivity by 13%—and raise around £270billion in terms of GDP[12]. Yet the UK lacks a formalised national business support network which can help drive the diffusion of technological and management best practice into SMEs – a key part of the Government's Industrial Strategy.

In *Lifting the Long Tail* we identify five key layers[13] of support that can be built out of the LEPS/Growth hub network and connected to existing help provided by the private sector. With this in mind, the Government should commit to reshaping and retooling the existing business support infrastructure with an emphasis on improving the take-up of tried-and-tested productivity practices in SMEs.

LEPS/Growth hubs should be adequately resourced to provide initial free support, through partnerships, on best practice information, basic business and operational issues, simple diagnostics, and in directing and referring SMEs to relevant private support. Existing resources and demands need to be assessed at each layer and geography, and any gaps should be plugged, particularly given the potential loss of European Regional Development Fund funding for existing programs.

Complementary funding should be given to strengthen the delivery 'spokes' of best practice. This includes extending the scope of Innovate UK's Knowledge Transfer Partnerships to provide general access to valuable digital and academic skillsets for SMEs; supporting the development of networking, mentoring, and coaching programs; and driving a national campaign to broaden awareness of technological best practice.

Reform the Apprenticeship Levy: Employee skill gaps have consistently featured among IoD members' top concerns over the past year. Yet, as the Government's flagship training initiative, only 14% of IoD members who pay the Apprenticeship Levy think it is fit for purpose. To that end, funding the ongoing reform of the system is important.

In particular, this means: raising support for non-levy payers by reducing the amount they are currently asked to co-invest, extending the proportion of the levy that businesses are able to transfer to other organisations in their supply chain[14] and ensuring the Institute for Apprenticeships has the capacity to speed up the delivery of standards while safeguarding their quality, particularly in sectors and regions with acute skills shortages.

In the longer term, the goal should be for the scheme to become a wider training levy, considering the need for businesses to access different forms of training on top of apprenticeships. This includes flexible access to the digital, management, and leadership training needed to raise business productivity in time-constrained SMEs. While we understand that this may be out of scope for the purposes of this Budget, we would like to see the Chancellor establishing a narrative whereby such a training levy would be the long-term goal.

Remove the Immigration Skills Charge: Many businesses have now been paying the charge for over a year at a time of significant cumulative cost increases to SMEs. With subdued investment and a tightening market for UK-

[11] Green Light for Reform, Taxation, August 2018
[12] Bank of England, Andrew Haldane, The UK' Productivity Problem: Hub No Spokes, June 2018
[13] The five layers of support include: A best practice community, basic business enquires and operational outsourcing, diagnostic advice, implementation and project consultancy, and referrals to assist in finding relevant support
[14] Raising this to 50% would be a reasonable goal

bound talent from across the EU, it makes little sense to maintain barriers to skilled migration from the rest of the world. Additionally, in terms of the charge's intention to increase employer investment in training and upskilling the domestic workforce by tightening employer access to skilled migration, it is clear that this is not an either-or choice. Nine out of ten of IoD members who employ from abroad also invest in training domestically.

The Migration Advisory Committee has recently called for the removal of the Tier 2 migrant cap, recognising the net benefit that skilled migration brings to the UK economy. The IoD has also advocated such a move for some time. However, to do so without also removing the immigration skills charge would be seen by businesses seeking out talent as economically counter-intuitive.

Accelerate digital and physical infrastructure projects: Ongoing development of the UK's road, rail, air, and digital infrastructure is central to boosting international competitiveness, enhancing national networks, and driving regional productivity growth. These investments continue to be a core priority for our members (**Figure 4**).

In the near term, emphasis should be placed on speeding up the rollout of fibre broadband, enabling universal 5G coverage, the rapid digitisation of rail signalling, pushing forward major projects proposed in the Northern Powerhouse and the Midlands Engine, and optimising road investment through better data capture. An in-depth assessment of our infrastructure policy recommendations can be found in our July 2018 *Future of Connected Business* report[15]

2.3 Costs: The majority of our members expect costs to remain elevated in the coming year (**Figure 3**). Currently businesses are facing a cumulative burden of costs from a raft of regulations including, business rates revaluation, increased contributions through pension auto-enrolment, a rise in the national living wage, the Immigration Skills Charge, and the Apprenticeship Levy, on top of high imports costs tied to the weakness in sterling. These are squeezing the margins available for reinvestment and wage growth, and reemphasise the importance of supporting business productivity and in alleviating the pressure of major business taxes.

Commit to building a competitive, efficient and fair corporate tax system: We encourage ongoing reform and simplification of the UK tax system; this includes responding to global tax developments so that the UK remains a competitive destination for business, levelling the playing field with regards to the taxation of employment /self-employment and traditional/digital economies, and improving the interface between HMRC and business taxpayers. Indeed, it's important to recognise that the broader opportunity costs of time spent complying with, and understanding, regulation adds to the overall tax burden for businesses (**Figure 2**).

Additional business rates relief for SMEs: The move to CPI uprating in the Autumn Budget 2017, while welcome, does not go far enough in alleviating the absolute burden of business rates upon SMEs in particular. And though we continue to support a comprehensive review of the business rates system more generally, there remains a pressing short-term need to extend existing reliefs for business rates.

As this tax is levied on all businesses occupying property, regardless of profits, it unduly harms small enterprises which have tighter margins. For example, it is estimated that the average microenterprise in London is expected to pay around £17,000 per annum in business rates[16]. This significantly limits the ability of small businesses to grow and offer wage increases, while the lack of support for businesses with rateable value above £15,000 can act as a disincentive to expansion.

[15] Institute of Directors, The Future of Connected Business, July 2018, https://www.iod.com/news/news/articles/The-future-of-connected-business

[16] Federation of Small Businesses

The Chancellor should consider extending small business rates relief to *all* SMEs[17] below a higher rateable value. This would not be overly expensive for the Exchequer[18], as the majority of business rates are paid by much larger corporations. Secondly, it will have a significant revenue-generating impact by unlocking growth among 99% of the business community and potential wage growth for 60% of the labour market. Removing plant and machinery from business rates valuations would also be a supportive measure, particularly as its current inclusion disincentivises productivity-boosting investments in capital.

Institute of Directors -- *Policy Voice* Survey Results[19]

Business Conditions

Figure 1: IoD Members Confidence, Net, %

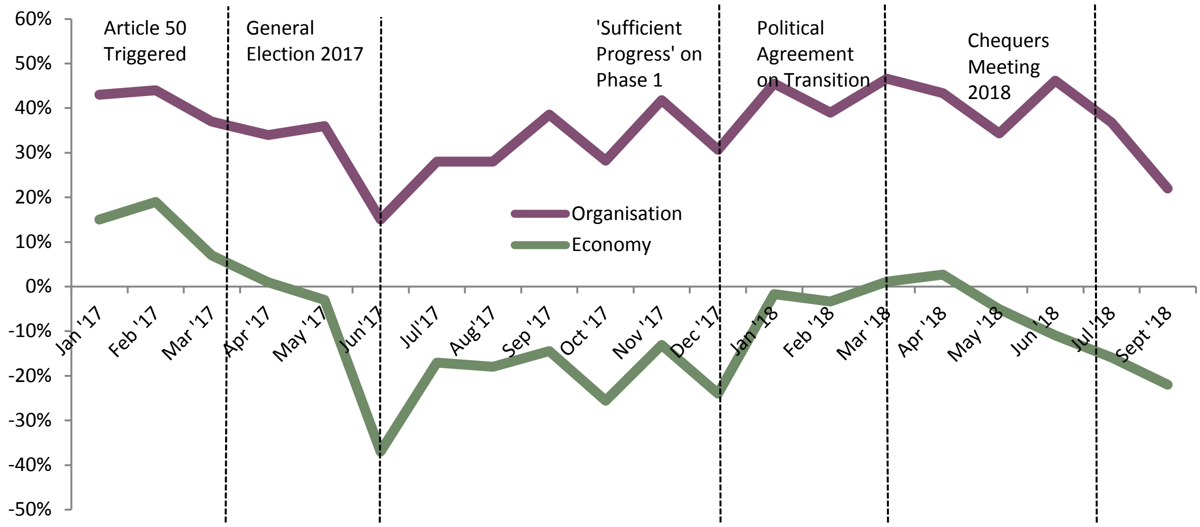
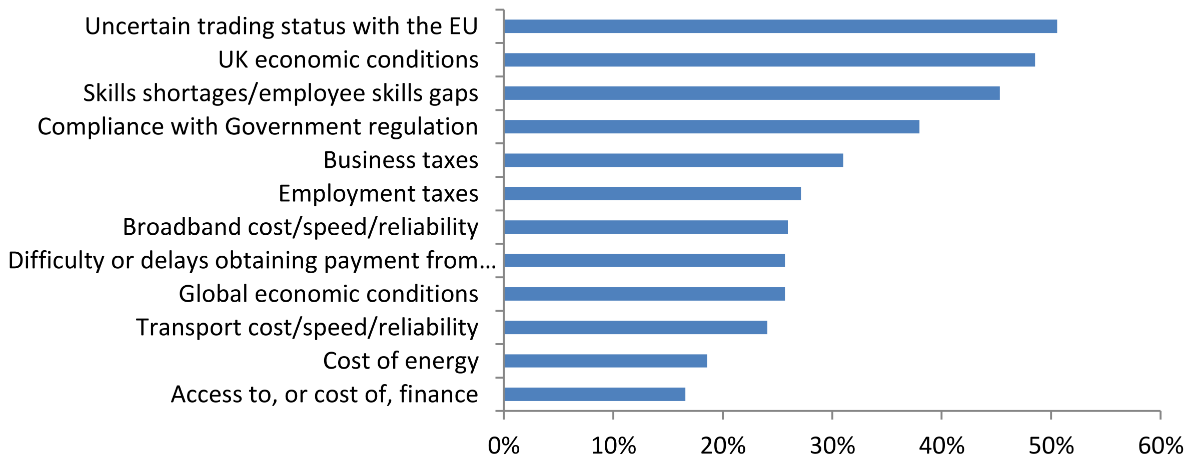


Figure 2: IoD Members Top Business Concerns, September 2018, %

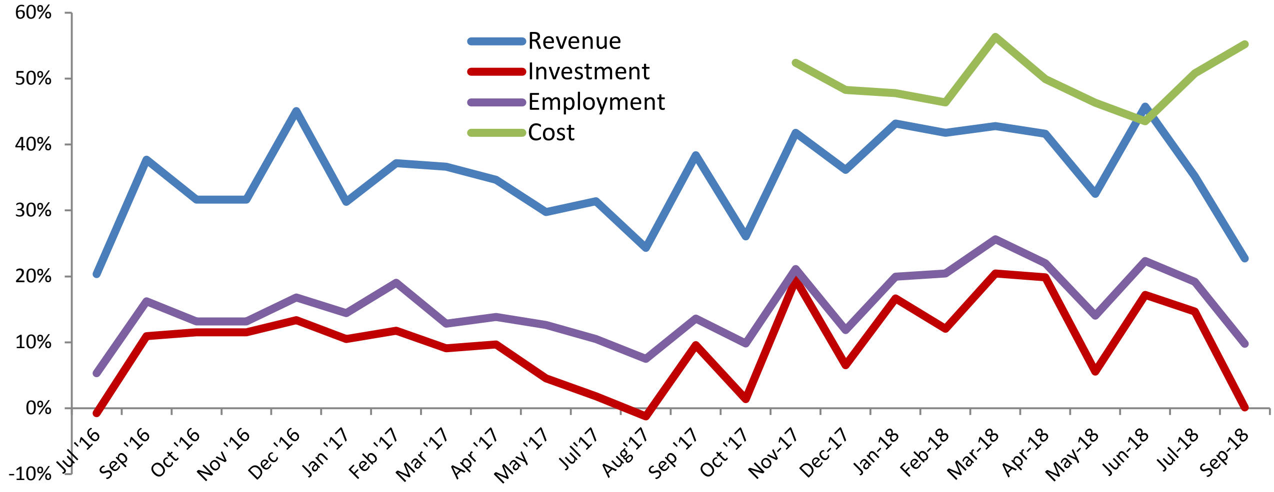


[17] For example, widening reliefs available to firms with rateable value under £15,000 to for example £100,000 only for SMEs

[18] An indicative outlay could be around £550 million if say just 20% relief was offered to all SMEs with rateable value up to £100,000. Assuming roughly 100,000 SMEs, with rateable values between £15,000 and £100,000, qualify for a discount at a crude average saving of £5600 = 0.2*(£57,500 x £0.487, the mean 2018/9 business rates multiplier)

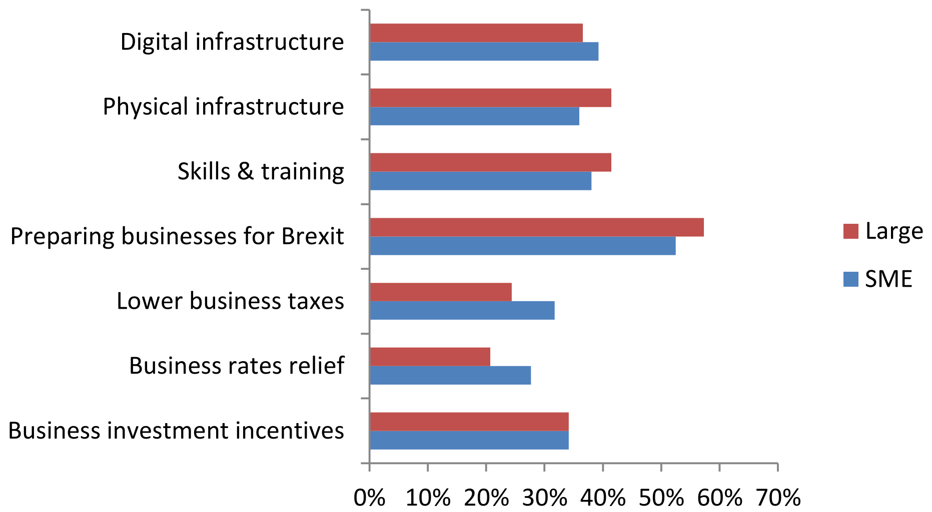
[19] Numbers of respondents vary between 700-1,000

Figure 3: IoD Members Business Expectations, Net, %



Budget

Figure 4: IoD Members Autumn Budget 2018 Priorities, %



Productivity

Figure 5: IoD Members Policy Priorities for Business Productivity, July, %

Contact Details:

Tej Parikh
Senior Economist
tej.parikh@iod.com
020 7451 3263

Jamie Kerr
Head of External Affairs
Jamie.kerr@iod.com
020 7451 3264

Edwin Morgan
Director of Policy
Edwin.morgan@iod.com
020 7451 3392