Autumn Budget Representation 2017
The Correspondence and Enquiry Unit
HM Treasury
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20th September 2017

The Institute of Directors is Britain's oldest business representative body, 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.

IoD Recommendations to HM Treasury for Autumn Budget 2017

Preamble

Our overarching concern for the Autumn Budget 2017 – and, indeed, the remaining Budgets in this Parliament – is that the Brexit process does not become an excuse for delaying much-needed and overdue broad-based reform of both the UK tax system and other key policies to boost UK business, economic growth, and employment.

We are now at the beginning of a new, fixed-term Parliament and our key message to Government is that bold fiscal reform and simplification ought not to be postponed if the tax system is to be aligned with the UK's economic imperatives. An ambitious programme is imperative to secure enhanced economic growth and facilitate entrepreneurialism. Neither Brexit nor the Parliamentary arithmetic should become insurmountable hurdles in delivering this.

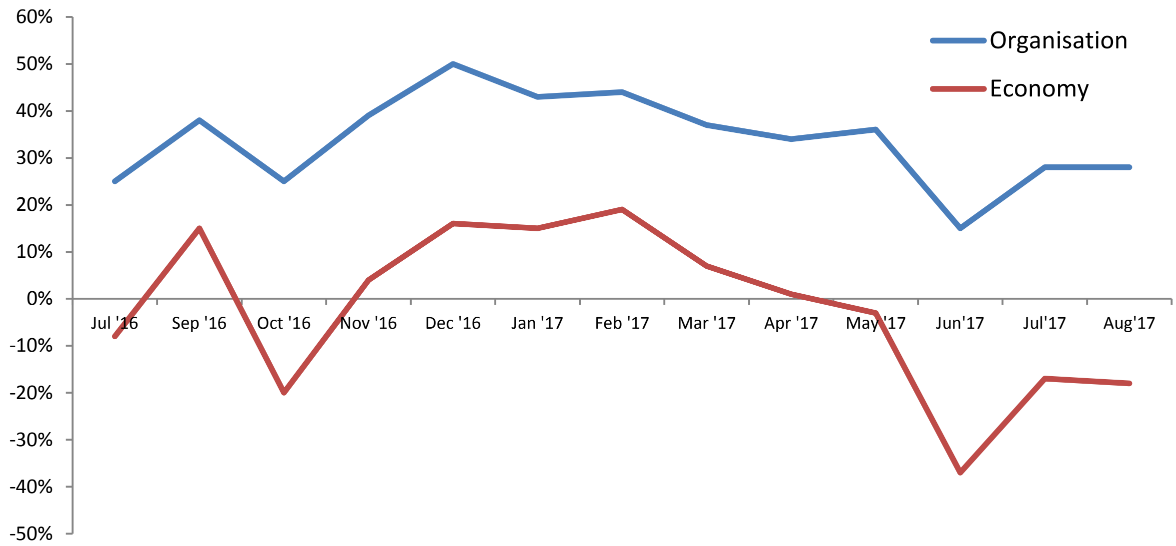
The Economic Context

Business confidence has been on a gradual downward trend since the start of 2017. Economic optimism fell into negative territory in May and—along with firm-level optimism—it dipped sharply after the election result in June. Organisational confidence has somewhat stabilised since, albeit near one-year lows (**Figure 1**).

Figure 1: How optimistic are you about the prospects for the wider UK economy and for your (primary) organisation over the next 12 months? Source: IoD Surveys[1]

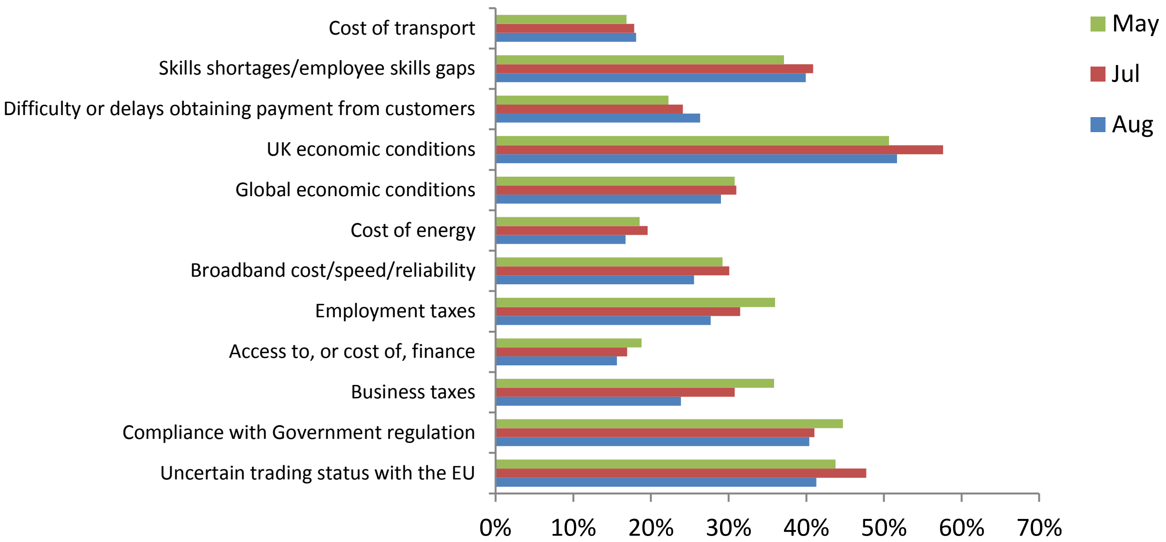
Net optimism	March	April	May	June	July	August
Organisation	37%	34%	36%	15%	28%	28%
Economy	7%	1%	-3%	-37%	-17%	-18%

[1] Number of respondents ranges from 750 to 1000



The sober mood reflects the anaemic macroeconomic environment, which itself is largely underscored by uncertainty surrounding Brexit negotiations, parliamentary arithmetic, skills shortages, and regulatory compliance concerns (**Figure 2**).

Figure 2: Which of the following factors, if any, are having a negative impact on your primary organisation? Source: IoD Surveys



Looking ahead, investment and employment prospects have weakened for businesses (**Figure 3**). And so, at a time when immediate business activity is being weighed down by economic and political concerns, strong emphasis ought to be placed on incentivising investment and supporting skills development to lift the corporate and economic growth outlook.

Figure 3: Comparing the next 12 months with the last 12 months, what do you believe the outlook for your (primary) organisation to be in terms of (Source: IoD Surveys):[2]

	Revenue	Profitability	Investment	Employment
Much higher	5%	5%	3%	1%
Somewhat higher	43%	33%	22%	25%
No change	26%	34%	48%	54%
Somewhat lower	21%	23%	19%	15%
Much lower	3%	4%	7%	4%
Don't know	1%	1%	1%	1%
Net (August)	24%	11%	-1%	7%
Net (July)	32%	14%	1%	11%

In terms of the Budget, we recognise the fiscal constraints on spending – alongside the significant political capacity absorbed by the Brexit process – yet we offset this against the pressing needs of the economy, in a significant moment of flux.

As such, our proposals urge the Government to kick-start a reform of the tax system, with a particular emphasis on stimulating business investment and domestic economic competitiveness. Furthermore, we are optimistic about the Government's Industrial Strategy, particularly with regards to an expected focus on skills, infrastructure, research, and innovation. We urge HM Treasury to work with business groups after the Industrial Strategy is published to ensure that those proposals felt to offer the greatest economic return are given adequate resources to succeed.

Our policy recommendations are based upon this economic context, as well as responses to the IoD's Survey conducted in August which can be found in the **Appendix (Page 12)**.

[2] Figures may not total 100% due to rounding

Recommendations

Key Themes

Tax Reforms

We highlight five areas where we consider that tax reforms should be prioritised:-

1. Aligning taxation with the increasingly flexible labour market so that taxation considerations do not take precedence over more important commercial choices.

2. Responding to global (including European) tax competition and developments so that the UK tax system – and tax rates – facilitates the UK re-establishing itself as a second-to-none choice for global entrepreneurs and foreign direct investment.

3. Demonstrating a determination to implement broad-based simplification of the increasingly complex UK taxation system faced by both business and individual taxpayers.

4. Improving the interface between HMRC and business taxpayers so that the continued public spotlight upon actual – and perceived– tax avoidance does not damage the UK economy by the perception that tax planning is undesirable or even unacceptable.

5. Recognising that multinational corporations; FTSE350 companies; mid-sized businesses; small companies; and microbusinesses ought to face (broadly) comparable taxation liabilities but require different focuses and policies to deliver this.

Furthermore, considering the pressing concerns of our members (**Figure 2**) and their forward-looking business issues (**Figure 3**), Treasury spending decisions need to align with what we expect to be a cross-cutting Industrial Strategy. In particular, we would focus on three main issues, employment, infrastructure, and fiscal policy:

Employment

The skills shortage represents a key test for the economy. Where appropriate, and working with both the Department for Business, Energy and Industrial Strategy and the Department for Education, the Treasury should focus on the following core areas:

- Supporting the retraining and reskilling of employees, and the self-employed, in older and potentially endangered industries. This should include using the Teaching Excellence Framework to incentivise education providers to expand their provision of computer-based, blended and flexible learning opportunities, and using the WorkerTech programme to seed, find, and back start-ups who can deliver innovative training services. Expanding flexible learning opportunities would enable employees and the self-employed to acquire and improve skills by enhancing access to education, at reduced cost, and in a flexible manner.

- 'Lifelong learning': Develop practical and simple criteria to enable employers and individuals to obtain an enhanced tax deduction for qualifying lifelong learning courses from accredited providers. This might include potentially creating a 'shadow personal allowance' offset against an individual's income tax liability and dependent on their engagement with lifelong learning programmes.

- Reform the Apprenticeship Levy to allow employers to utilise their contributions more flexibly by, for example, relaxing the existing time constraints and providing other forms of training and allowing employers to use their funds to train self-employed contractors.

- Incentivising employers and education providers to work closer together to share practical knowledge of employer needs to ensure students develop the skills they need to succeed in the future jobs market.

- Providing good career guidance in schools. Reflecting the recommendations of the Sainsbury Review, this includes; more professional careers advice within schools, alongside varied and high quality work experience—which should become compulsory for those aged 13 and over—and examining the education curricula on a continuous basis to advise schools on subject choice and to make curricula more relevant to ever changing labour market demands. The Gatsby Foundation estimates the implementation of 'good careers guidance' programmes to be less than 1% of an average school's budget[3].

- Tackling the teacher shortage crisis—as teacher vacancies rise, and the number of qualified entrants falls. In particular, the shortage of teachers in key subjects including science and maths threatens to have detrimental knock-on effects on the pipeline of graduate talent needed by employers.

- Sustaining labour mobility: It is paramount the Government supports immigration in the context of skills and business needs. This includes; ensuring unrestricted access of international students and academics, improving HMG's immigration data collection and use, as well as public service planning, boosting immigration law enforcement, and supporting integration.

[3] Good Career Guidance, The Gatsby Foundation, 2014

Infrastructure and Energy

Infrastructure, both physical and digital, must be a priority, while more must be done to lower the cost of energy:

- On physical infrastructure, the upgrading of the existing network – including, easily deliverable, and low cost, projects such as lengthening platforms, 'dualling' A-roads where they bottleneck, and improving rolling stock – is crucial. Though this must also be complemented by new projects, which reflect value-for-money, in order boost national connectivity and international competitiveness. And so, in particular, the Government should focus on:
    - Developing an infrastructure 'Best Value Index' to compare potential projects, to identify what the priorities areas are, and to decline projects where the return is insufficient. This, alongside boosting data collection, and transparency, on road traffic, accidents, costs, and pollution, can greatly improve investment efficiency.
    - Pushing for additional permissions for runways in the South East within the next decade, as capacities shrink – in conjunction with a new Airports Commission, alongside, investing in better connectivity and air traffic management systems to improve the efficiency of existing runways.
    - Assessing the viability of major investments in Maglev, or Hyperloop, transit systems, as part of wider initiatives to significantly bolster regional networks and growth. Consideration should take place in tandem with accelerating proposed projects in the Northern Powerhouse and the Midlands Engine.

- For digital infrastructure, it should remain the Government's ambition to lead the world in delivering faster internet speeds, and access, than those of our significant competitors for global inbound foreign direct investment – with a particular emphasis on:
    - Pushing forward more urgently with universal fibre coverage to premises, to ensure the UK has access to future productivity-enhancing technologies, including 5G. This should coincide with the on-going push for ultrafast broadband and improved 4G coverage – and replacing the Universal Service Obligation with a more ambitious target.
    - Committing to 'switching-off' the copper network – ideally within the next decade – and reducing access costs to existing physical infrastructure to ensure ubiquitous fibre optic cable.

- For energy, our members, whilst supporting lower carbon energy, have stated a clear preference for more competitive prices and greater energy security, this includes:
    - Increasing competition between energy suppliers, by driving forward a universal transparent standard default tariff, and reviewing the separation of the retail market from supply, and even billing from supply.
    - Delivering cheaper, more sustainable, nuclear energy beyond Hinkley Point C. To save money more quickly, the Government must prioritise finding a site to act as the UK's Geological Disposal Facility. Furthermore, to repeat the success of the Offshore Wind Auctions, large auctions ought to be organised for competing nuclear suppliers that additionally develop a scaled nuclear supply chain.

- Moving from fixed subsidies on renewable energy generation toward a more auction-based system for lower sized projects not included in the Contract for Difference Auctions. The falling prices for renewables make this a way to save money and increase deployment.
- Maximising our shale resources. Alongside energy security, a fully mature shale industry promises to generate significant employment opportunities in parts of the country that need them most.
- Review the £11 billion Smart Meters programme to assess where savings could be made, which the IoD estimate could run into the billions.

Fiscal Policy

Fiscal policy should be aligned with the overarching imperatives for the UK economy, and embrace the need for research, innovation, technology, and entrepreneurialism which are crucial to meet the productivity, agility, and competitiveness challenges required to secure the nation's long-term economic growth potential. Our policy recommendations below are driven by these objectives:

- Our members running mid-sized businesses continue to emphasise the importance of the Annual Investment Allowance ('AIA') to incentivise investment in plant and machinery and thereby improve productivity. There is little question that a response to uncertainty could be to hit the 'pause' button on significant capital outlay. While businesses are growing used to uncertainty and firm-level confidence is somewhat resilient (**Figure 1**), there is always the risk that (as has occurred in previous months) that confidence could decline significantly. The important thing when business confidence has stabilised is to build on it. As such, increasing the AIA cap for the current Parliament to £1 million per annum would boost investment, productivity and growth in this key sector of the UK economy and also employment opportunities. We are of the strong belief that there is relatively minimal medium term cost to the Treasury – indeed, the AIA is overwhelmingly a timing cost only but would have an outsized effect on business behaviour in the short- to medium-term.

- Our members continue to support the Government's manifesto pledge to deliver the lowest corporation tax rate in the G7, recognising that it is a valuable signpost for a business friendly tax system. If it appears that there will be downward pressure on corporation tax in the United States, then the United Kingdom should respond by announcing further Corporation Tax cuts to match the US rate. This would be particularly appealing not just to overseas investors considering capital investment in the United Kingdom, but would also be seen as encouragement to medium-sized firms looking to grow.

- We consider that the significant increases in business rates introduced from FY2017 should be re-visited. By this we do not mean that the overarching principle that business rates in aggregate ought to rise by the increase in the CPI – and no more – should be abandoned. But the substantial impact upon small and medium sized business should be recognised by significantly expanding the business rates reliefs already available to microbusinesses which occupy business premises with a rateable value of up to £15,000 (and £51,000 for the lower business rates multiplier). As most business rates are paid by much larger corporations, extending business rates relief to all SMEs will not be unduly expensive to the Exchequer in comparison to its broader economic impact including business continuation and expansion and the knock-on effects on employment. This would in particular benefit those microbusinesses looking to expand and grow; precisely the kind of 'scaling' we should be encouraging right across the UK economy. As such, a significant policy lever available to the Government would be to substantially alleviate the impact of the business rates increases which affect SMEs occupying business properties with rateable values up to, say, £100,000 rateable value. A crude estimate for the cost of this policy, at its upper bound, could be around £2.35 billion.[4] By comparison, a 1% movement in corporation tax collects, or costs, £2.5 billion.

- Furthermore, there are coherent arguments for a fuller review of the business rates system more generally, with modern technology and 'big data' advances in theory making it possible to have a more responsive, 'real-time' ratings system, as opposed to the five- or indeed seven-year cycle of plateaus and damaging cliff-edges.

- The Chancellor should reaffirm that, whilst the UK will implement the outcomes of the OECD/G20 BEPS, this will be responsive to the scale, timing and compliance approach adopted by other governments so that the UK does not 'gold-plate' the outcomes to the disadvantage of UK businesses, thereby reassuring investors that UK will not become a less desirable location for global entrepreneurs and foreign direct investment by multinational companies.

- Our members remain supportive of the crackdown by recent Governments upon tax abuse and aggressive, artificial tax avoidance. Unfortunately, that desirable objective is resulting in some undesirable collateral damage which might frustrate the Government's broader tax agenda. We consider it is imperative that tax compliant SME businesses are re-assured that authentic tax planning is permissible and indeed encouraged by instructing HMRC to issue a tax planning 'white-list', thereby encouraging genuine investment decisions and transactions to take place by removing unnecessary/perceived tax risks. Examples that have been mentioned by members include accelerating expenditure to obtain the AIA; utilising EIS/SEIS reliefs for investments which meet the intended criteria; and business owners succession planning arrangements.

- We remain very supportive of the Government's Making Tax Digital initiative but recommend that due regard is given to the suggestions for a somewhat longer rollout period for microbusinesses and that the proposed penalties are waived for a transitional period for such businesses.

- Please see the IoD's response to HMT's 'Financing growth in innovative firms' consultation for further details on our proposals to support investment in patient capital for both start-up and scale-up businesses.

- We consider that there are some changes which ought to be introduced to promote a wider adoption of Employee Ownership Trusts. These have a role to play in the provision of patient capital and the reforms proposed would provide considerable assistance to both existing and potential EOTs at a negligible cost to the Exchequer. These include treating vendor loan notes as eligible assets for inheritance tax business property relief purposes; treating simple vendor notes as bank debt for corporation tax purposes; improving the treatment of direct shareholdings held by employees for the control test; and improving and simplifying the treatment of EOTs for the purposes of capital gains tax by introducing a taper for clawback of CGT if the EOT shareholding falls below 50%.

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[4] Assuming roughly 100,000 SMEs, with rateable values between £15,000 and £100,000, qualify for an exemption at an average saving of £23,500 (£50,000 x £0.47, the 2017/8 business rates multiplier)

Consultations

We remain supportive of the Government's business tax roadmap for tax reforms excluding necessary remedies to counteract tax abuse and aggressive tax avoidance. Indeed, we consider that the roadmap should be extended to include all forms of business and personal taxation.

Accordingly, we recommend that the Government announces consultations upon the following key areas for tax reform and simplification, again bearing in mind that considering the political concerns around any radical reform of the tax system these consultations must happen in the near future if they are to be put into effect by the end of the Parliament:

- The potential advantages of reforming the taxation of SMEs so that they face a simplified tax system in comparison to MNCs and listed companies which, unavoidably, generally have more complex tax issues. The proposed ConDoc should examine areas such as the:-
    - Introduction of a replacement, simplified company tax for SMEs focussed upon verified accounting profits adjusted only by depreciation, capital allowances and AIAs.
    - Role for tax transparency for businesses which elect for this to remove the complex interfaces between corporation tax on profits, income tax on remuneration, bonuses and dividends and dividend tax on distributions. Such consultation should not be restricted to Government & tax technical bodies, and should take particular note of the perspectives of businesses, and introducing the possibility of electing for a fixed tax rate upon all forms of payments to owners of SMEs, similar to that of the S-Corps status offered in the United States.

- Combining capital gains tax and inheritance tax into a single capital tax which taxes capital gains upon lifetime disposals and gains accruing up to an individual's death whilst preserving the existing major exemptions and reliefs (apart from the CGT exemption for gains arising between acquisition cost and probate value). The objective being to remove arbitrary incidence of both existing taxes and tax - but not double tax - all gains outside key business and personal reliefs and exemptions.

- Simplifying, liberalising and democratising EIS/SEIS/VCT reliefs to encourage investment in start-ups and scale-ups including both relaxing the restrictive criteria for these tax reliefs and simplifying the relevant investor protection legislation so that the key over-arching risks are highlighted, but this is achieved at a lower compliance cost for such businesses seeking vital external equity capital.

- Whilst the EU State Aid regime will still apply when the November 2017 Budget is announced, after the UK has left the EU, there may be scope for removing the tax relief constraints imposed by the regime which have restricted the ambit of tax incentives provided to SMEs (including innovative firms) seeking additional equity capital. We strongly recommend that HM Government should look to maximise any new flexibility to remove such restrictions (subject to exit transitional arrangements). This includes, but is not limited to, liberalising and democratising the existing SEIS, EIS and VCT legislation after Brexit.

- Other areas where reliefs for tax investment should be expanded include allowing those with accumulated pension funds to invest, say 10% of their accumulated fund in the equity of trading company start-ups and scale-ups. Further details on this proposal can be found in our policy report entitled '*The Age of the Older Entrepreneur*' published in September.

- Launch a Tax Commission to report in Winter 2018 upon the impact of the flexible economy upon tax revenues and ensuring that a 'level playing field' is established between a) the employed /self-employed and b) the established/traditional and new/digital economies. This refers not just to the 'shared economy' and the attached platforms, but to the differences in business rate liabilities between, say, online-only stores and their warehouses in low-land-value areas, versus high street sellers, and so forth.

Longer Term Budget 2017 Reaffirmations

We recognise that there are many tax reforms, simplifications and reductions which the Government would like to introduce but considers it cannot introduce immediately.

Nevertheless, both businesses and individual taxpayers ought to be reassured that 1) such beneficial tax reforms remain on the Government's agenda or that 2) rumoured specific tax increases are *not* in prospect. Specifically, this forthcoming Budget should reaffirm that the Government:

- Intends to introduce a £12,500 personal allowance and a £50,000 higher rate tax threshold (i.e. a £37,500 basic rate tax band) during this Parliament and ensure that, in future years, these thresholds keep pace with consumer prices / earnings so that fiscal drag does not continue / re-commence.

- Wishes to remove the income tax 'spikes' at £50,000pa and £100,000pa thereby restoring incentives to individuals to strive for promotions, re-locate and move to more productive roles.

- Intends to restore the long-term political consensus for a top rate income tax of 40% by removing the fiscally inefficient additional (45%) rate of income tax which, inter alia, discourages bonuses and dividend distributions.

- Confirms that there will be no further restrictions to or reductions in the tax relief for personal pension contributions introduced in the current Parliament to prevent/reduce unnecessary speculation that the Government is planning to withdraw the existing reliefs available.

- Confirm the commitment to ensure that no other G20 country has a lower corporation tax rate than the UK.

- Confirm that local authorities will only be permitted to increase business rates for infrastructure improvements after having obtained the support of the local business community (e.g. through the existing LEPs).

Future Vision for Taxation Policies

- We are increasingly concerned that the links between economic growth, the level of taxation on businesses and individuals and the provision of public services has been weakened, partially because of the election cycle resulting in an upward-only ratchet for government spending upon high-profile services.

- The Institute of Directors has always – and continues to believe – that excessive government spending damages business, economic growth and employment prospects and, in the medium and long term, the financing and, indeed, the provision of essential public services.

- Accordingly, we strongly believe that the Government should seek to emphasise these linkages in a much more transparent and easier to understand manner.

- One area we consider should be revisited is whether a limited form of tax hypothecation should have a role for the provision of carefully selected government spending. Examples could include the NHS and the State Retirement Pension. The over-arching objective would be to emphasise that service or payment improvements can only be made through efficiency savings and an increased income taxation (or, preferably NICS) burden.

- We consider that this area merits an open consultation with the public with the intention of establishing during this Parliament whether there is a sufficient level of political support for its enactment in the next Parliament.

The IoD remain keen to discuss further. Please do use the below contact details.

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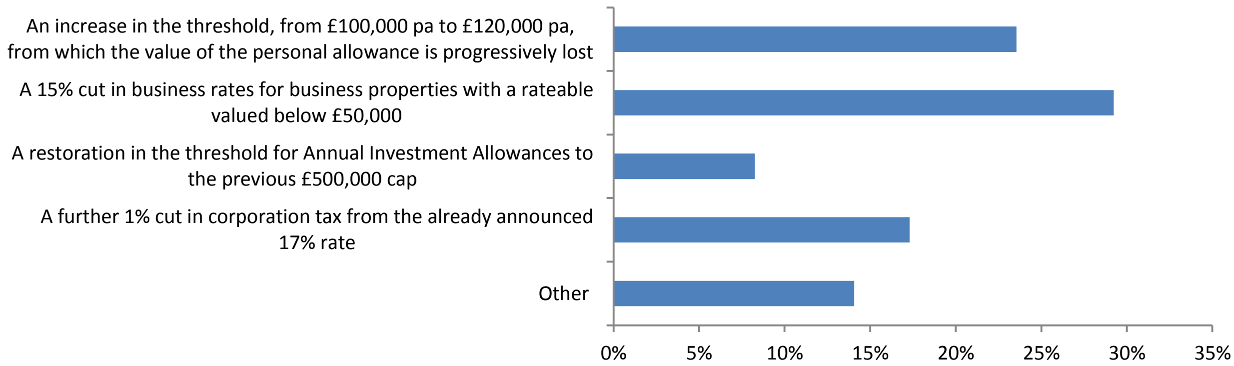
Appendix

Key IoD Survey Results (August)

Between 27 July and 10 August, around 900 IoD members provided responses to our Autumn Budget-related questions. The key results are listed below, and offer some context for our recommendations:

- 63% of respondents agreed the Chancellor should recommit to reduce corporation tax to 17% and raise the income tax higher rate threshold to £50,000 by 2020. 30% disagreed.

- Respondents were asked which of the following policies would be most favoured if the Chancellor could find £1bn for an additional tax cut in the Autumn Budget:



- 69% of respondents felt employers/employees should pay roughly the same level of national insurance contributions, while 26% felt employers/employees should pay more than the self-employed. 2% felt the self-employed should pay a higher level than employers/employees.

- 84% of respondents would like HMRC to create a list of acceptable tax planning measures – as distinguished from aggressive avoidance. 10% did not support it.

- 53% of respondents would 'slightly' or 'strongly' support tax 'hypothecation.' And if the government were to introduce such a policy, without increasing its tax take, 479 respondents would consider it suitable for tax to be hypothecated to the following areas: