

Rt. Hon Gordon Brown MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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16 March 2006

Dear Mr Brown

Appeal for tax simplification

It's that time of the year when quite a lot of people appear inclined to write to you. I trust you'll forgive me for joining the throng clamouring for your attention. I ask for your indulgence because the request I have to make is simple. It's also likely to be cost effective. Better still, it might win you the votes of up to 2 million people.

What I'd like you to do is make life a lot simpler for small businesses when you introduce your budget this year. I stress, not just a little bit simpler, but a lot simpler.

Let me give you some background. There are about 3.45 million self employed people in the UK at the moment. There are also about 1.8 million VAT registrations. I'm reliably told by people who should know that up to half of these are made voluntarily by businesses that need not be registered because they turnover less than the £60,000 registration limit. This means there are about 1.6 million businesses that are not VAT registered in the UK and about 900,000 that are registered but turnover less than £60,000 per annum. That's about 2.5 million very small businesses in all.

Some of those businesses are run through limited companies. Let's suppose that might be 500,000 in all (and that's the top end, I expect). They have special responsibilities to prepare accounts because they enjoy the benefits of limited liability. What I refer to below should not apply to them for that reason. That still leaves 2 million people in the UK who put all they own on the line to run small businesses, most of which only engage one person, and that is the owner.

Despite that every one of those businesses is expected to maintain a full set of accounting books and records showing all their income and all their expenses, and everything they've paid themselves from the business. When you're working all the hours God gives you (and maybe one or two more), are stretched to your limits

financially and have no training in accounting at all that's asking a lot. Can you imagine the stress of recording every small expense, from paying for the car park, to buying a newspaper to check your ad is in the right place, to ensuring that the bank charges for the month are correctly recorded? This takes time, effort and simple organisation on top of the hassle of making a living. It's a big strain, I can tell you.

So I have a suggestion to make. It's simple. So simple I hope you like it. It's this. I'd like you to let all those 2 million businesses stop recording the details of any expenses they incur. I mean they'd need to keep no records of expenditure at all. None whatsoever. Instead, if they wished (and this would be optional) they could simply elect to have a flat rate deduction of a proportion of their sales income to cover all the expenses they incur, with the proportion being pre-set for the business sector they are in.

Why should you do this? Because I can think of nothing that would so easily reduce the burden of administration on small business. It would mean they only needed to keep records of their sales, whether cash or invoice. Sales records usually represent less than a quarter of the total accounting most small businesses undertake.

It would also save small businesses real cost. Maybe half the small businesses affected will have an accountant. Each might be charged about £300 plus VAT (and maybe more). They probably won't need that help if this change were made. That's a saving to this sector of £300 million a year (and a loss of VAT of £52 million a year to you, I should add out of fairness).

This scheme is possible. It is, after all, only an extension of the VAT flat rate scheme. The ratios used there are deemed to give a fair VAT payment (and appear to do so in my experience, remarkably accurately). This suggests you've got all the data you need to set normal expense deduction rates for any type of business. Those rates would have to be different from the VAT scheme though for two reasons. The first is that the VAT ratios are based on VAT inclusive turnover, and the ones required here are on VAT exclusive sales. In addition allowance will be needed for non VAT expenses such as accommodation, insurance, bank charges and interest. I really don't see this as insurmountable. Given all the data you have normal rates for these must be easy to determine. I would add though that the ratios would have to assume staff no staff were employed. But that's fair. For well over 90% of these businesses that is true. And the scheme would be optional, which would mean that if anyone did have higher expense ratios they could always submit accounts.

So why should you do this? Well, I think there's a real win in this for the Revenue. First of all, it would save masses of work for you. Second it would massively increase goodwill amongst a group who need to have that re-established (rightly or wrongly). Thirdly, if the allowances are set appropriately then this should stop many excessive claims for expenses, and the investigations that go with them. Fourthly, it will make any investigation easier and quicker to conclude because its scope would be limited to just two things namely whether the person was actually self employed and whether they had recorded their sales properly.

You could even anticipate many such enquiries by asking anyone who opts for the scheme to submit one of two things with their tax return. The first would be a list of the top ten clients by value. The alternative would be a list of takings by month for cash based businesses. Reviewing just this data would allow most enquiries to be heavily focussed on unlikely self employments and unlikely patterns of disclosure. That might well increase the effectiveness of Inspector time. It would also allow concentration on the bigger issue in this sector – those who don't declare at all.

Is there a risk to this? I doubt it. As I note, the VAT scheme seems to work well, and fairly. I see no reason why a scheme for income tax shouldn't, again if the intention is to get a fair result. Inherently there is an anti avoidance mechanism built into the scheme. If people try to abuse it by failing to keep records as they progress to higher turnovers they're likely to lose out as they will be much more likely to have staff and higher rents for which relief will not be given. Those who try to creep in with £59,000 turnovers should be rumbled by the sales listings. Excess relief is unlikely therefore, on average.

And let's be clear. We're talking about very small business. A lot of people who run such businesses are part time. Many accounts will show turnover of no more than £30,000. Average earnings may only approximate to the UK median income, of about £24,000. That means a tax bill of approximately £4,000 a head in this group (and NIC of about £1,500). The total tax bill of all 2 million people affected is therefore just £8 billion. That's less than the tax avoidance industry costs at HMRC's estimate of £10 billion and much less than the cost of evasion of income tax and VAT.

Doesn't it make sense to make life easier for yourself, this group of people who do declare their income and your department and concentrate on the big picture?

I hope so. And think of all those votes that might be influenced by this. Enough, I should think to swing any marginal constituency for whoever is brave enough to take this on. It's a strong incentive for change. So, if there is anything in this letter you'd like to discuss, please do call me.

Yours sincerely

Richard Murphy

cc George Osborne MP
Vincent Cable MP
David Hartnett, Director General, HM Revenue & Customs
Tax Reform Commission

nb This letter was first published on www.accountingweb.co.uk, of which I am a contributing editor, as a pre-budget submission and the style used reflects that fact.