



**HM Revenue
& Customs**

Many are called, few are chosen: The dilemma of taxing SMEs and the costs of taxing them less.

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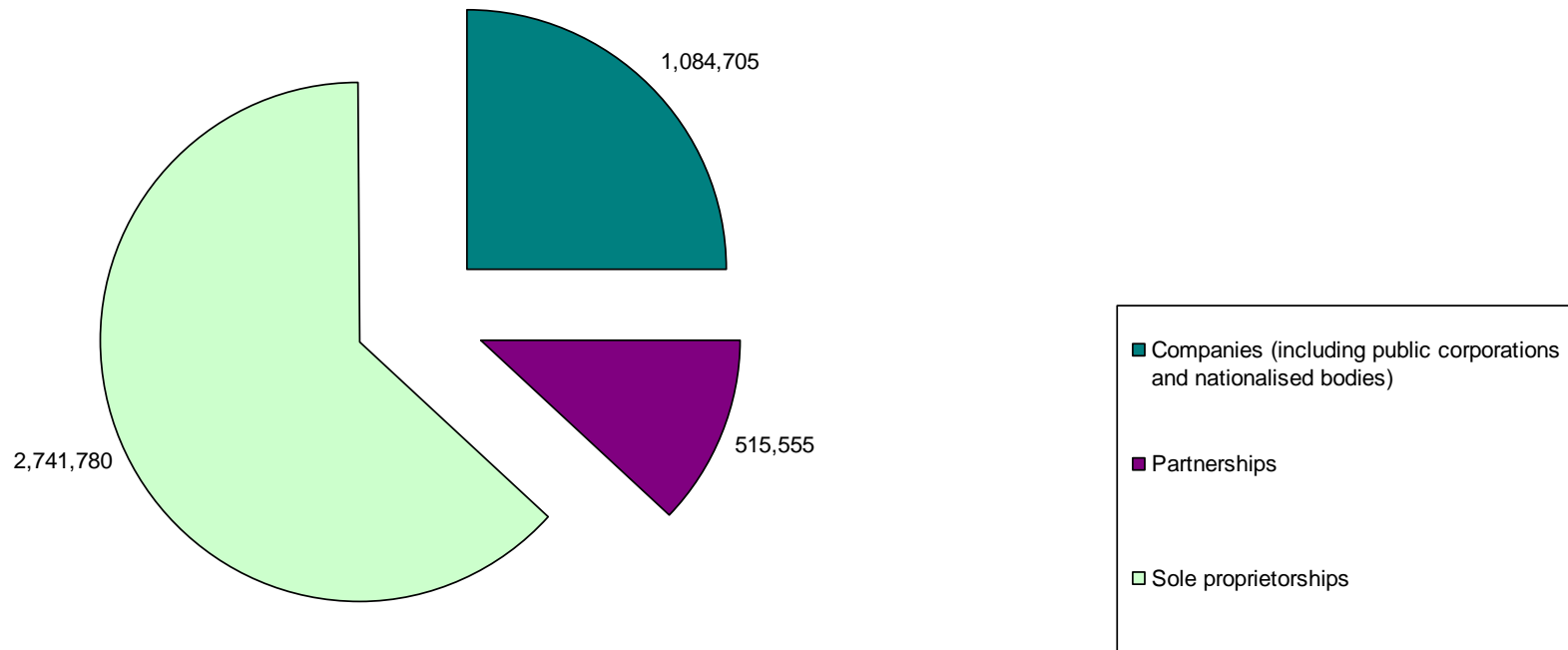
Issues to be discussed

- The characteristics of SMEs
- Choice of corporate form
- Tax avoidance and evasion
- Special tax measures and incentives
- Transparency about costs
- Conclusions

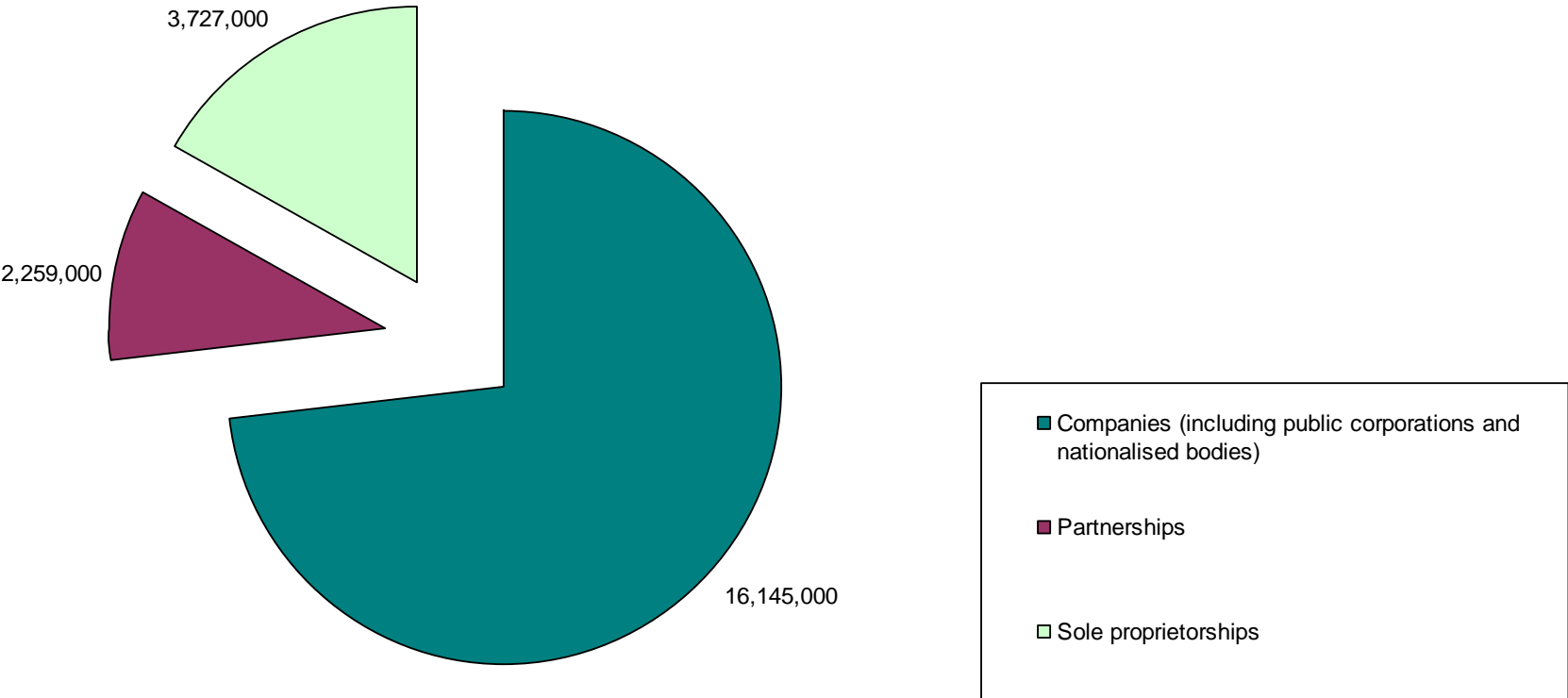
Many are called

- Discussion of SMEs tend to start with talk about importance of these firms for entrepreneurship and employment and economic growth (the motherhood and apple pie bit)
- followed by statistics on all small businesses
SO

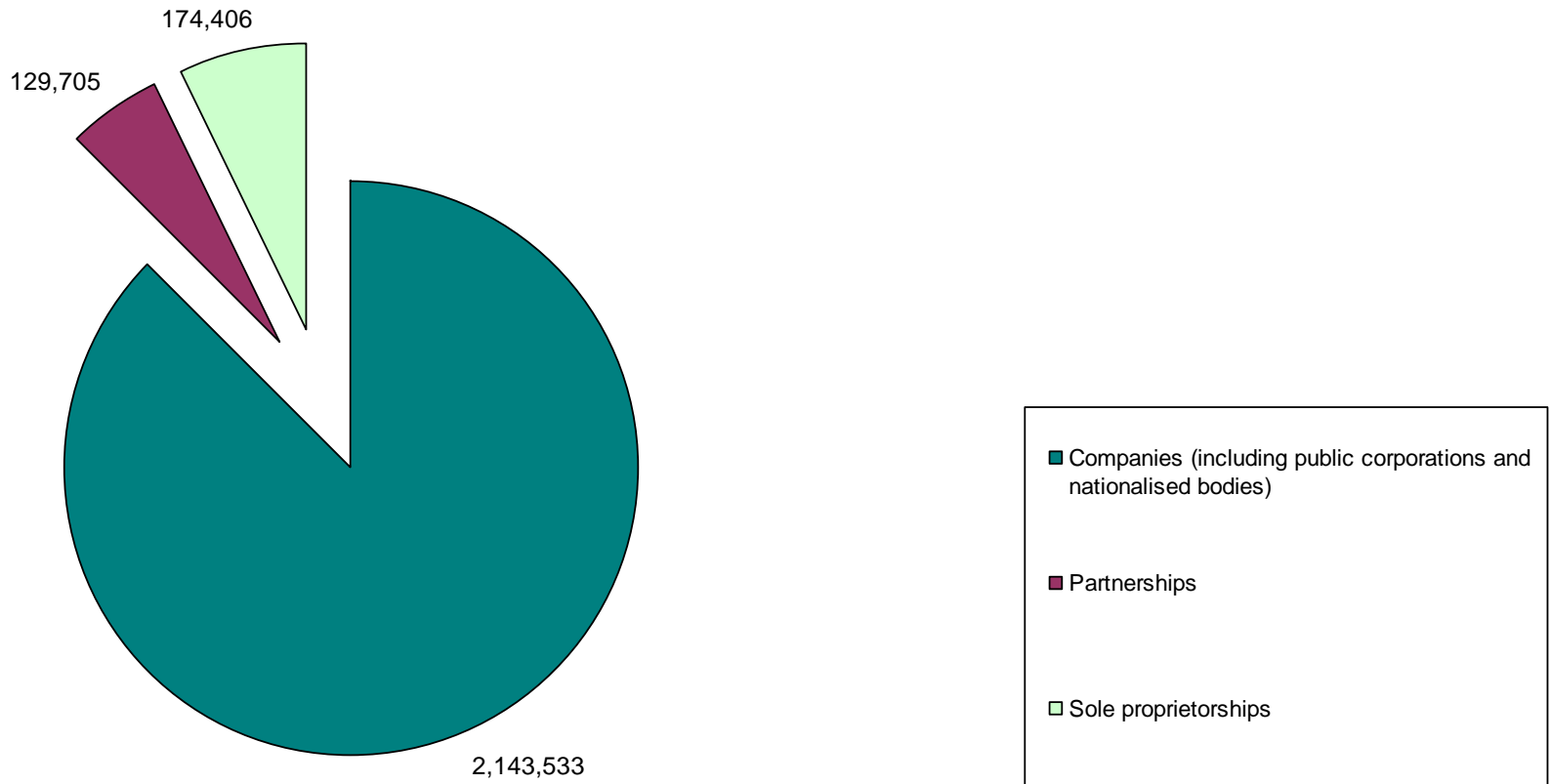
Number of enterprises in the private sector (including public corporations and nationalised bodies) by number of employees and legal status, UK, start 2005



Employment in the private sector (including public corporations and nationalised bodies) by number of employees and legal status, UK, start 2005 (/1000)



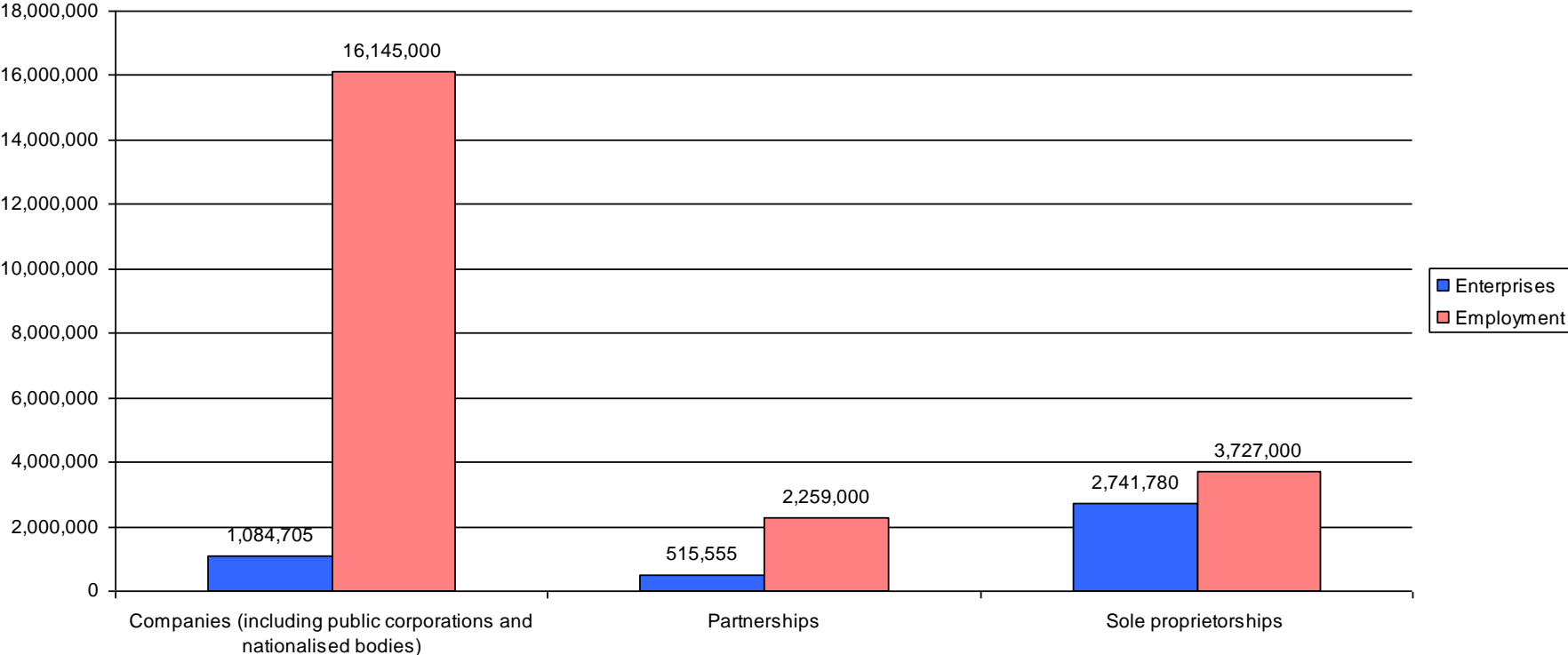
Turnover in the private sector (including public corporations and nationalised bodies) by number of employees and legal status, UK, start 2005 (£'s million)



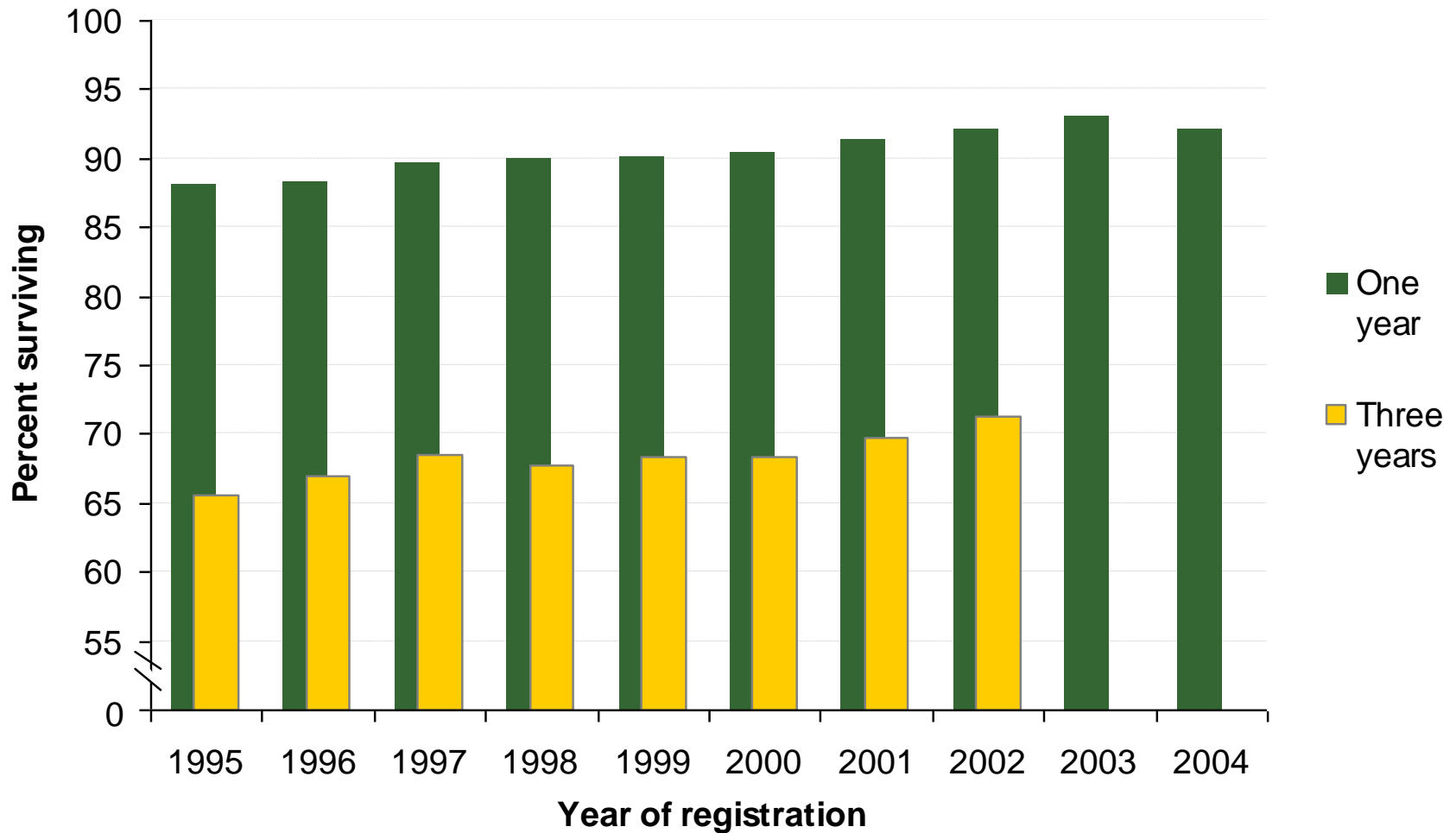
Statistics on "small" businesses in the UK in 2005, by legal form

	All	Number (%) with fewer than 10 employees	Number (%) with no employees
Incorporated (companies)	1,084,705	934,240 (86)	418,950 (39)
Unincorporated	3,257,335	3,214,290 (99)	2,743,650 (84)
Partnerships (including LLPs)	515,555	487,110 (94)	323,345 (63)
Sole Proprietorships	2,741,780	2,727,180 (99)	2,420,305 (88)
Total	4,342,040	4,148,530 (96)	3,162,600 (73)

Number of enterprises and employment in the private sector by number of employees and legal status , UK, 2005



Percentage of enterprises surviving one year and three years after registration, UK, 1995-2004



But few are chosen

- The number of SMES that are important for economic growth and job creation is of much smaller magnitude.
- Typically
 - Most small firms do not grow
 - Less than 4% of SMEs create around 50% of the jobs in small firms
 - Most do not survive a decade and create few additional jobs over and above those with which they started
 - Technologically advanced or innovative SMEs are very rare beasts
 - And therefore hard (impossible?) to find and target the economically important SMEs ex ante

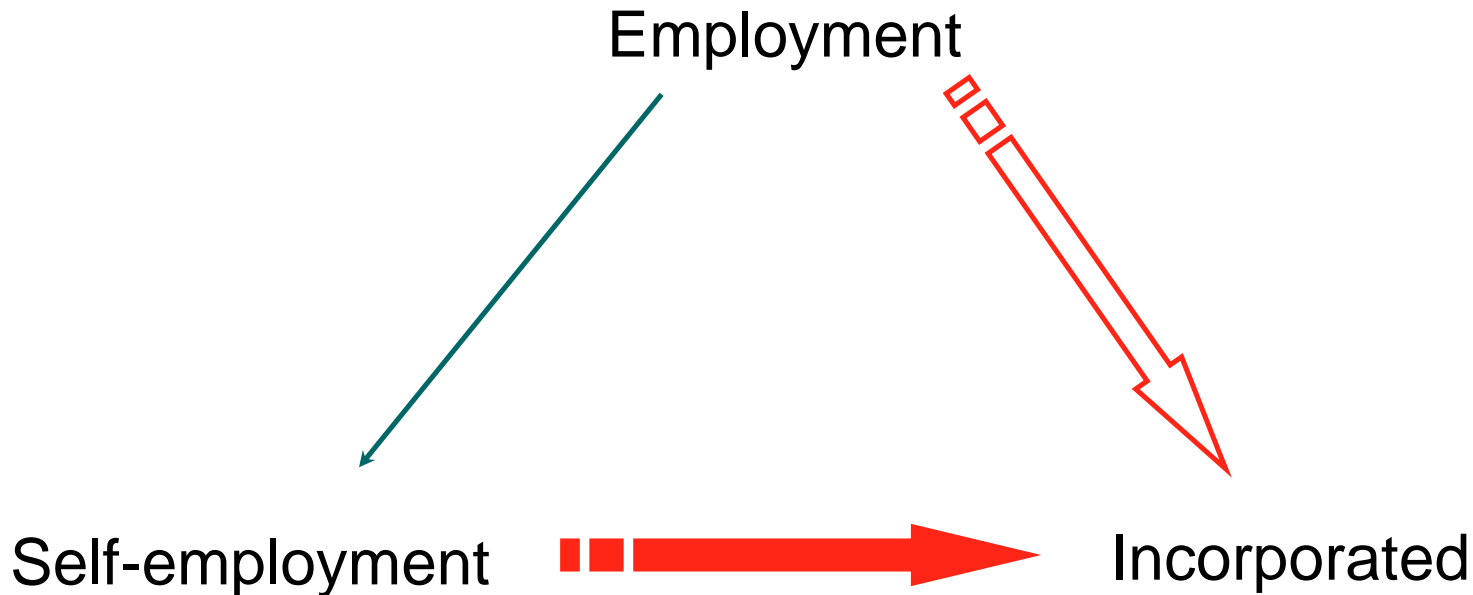
Policy Rationales for supporting SMEs

- Market failure – adverse selection, information costs, etc. Hard to distinguish genuine market failure from the market working and weeding out bad deals.
- Capital or equity gaps are difficult to define and measure because we cannot get at the counterfactual of what the “state of the world” would otherwise have emerged. EC state aid risk capital (SARC) guidelines put the upper bound of the equity gap at €1.5million. The UK’s Enterprise Capital Funds and tax-advantaged venture capital schemes (Enterprise Investment Scheme, Venture Capital Trusts, and Corporate Venturing Scheme) have a £2 million fundraising limit per year.
- Structural features – Admin burdens (e.g. first employee), complexity (e.g. incurring professional fees), and “cliff edges” of targeted SME tax incentives. A mixture of the unavoidable and the inevitable if you want to target assistance at SMEs. Aim should be for burdens and complexity to be minimised and proportionate.

The Choice of Legal Form

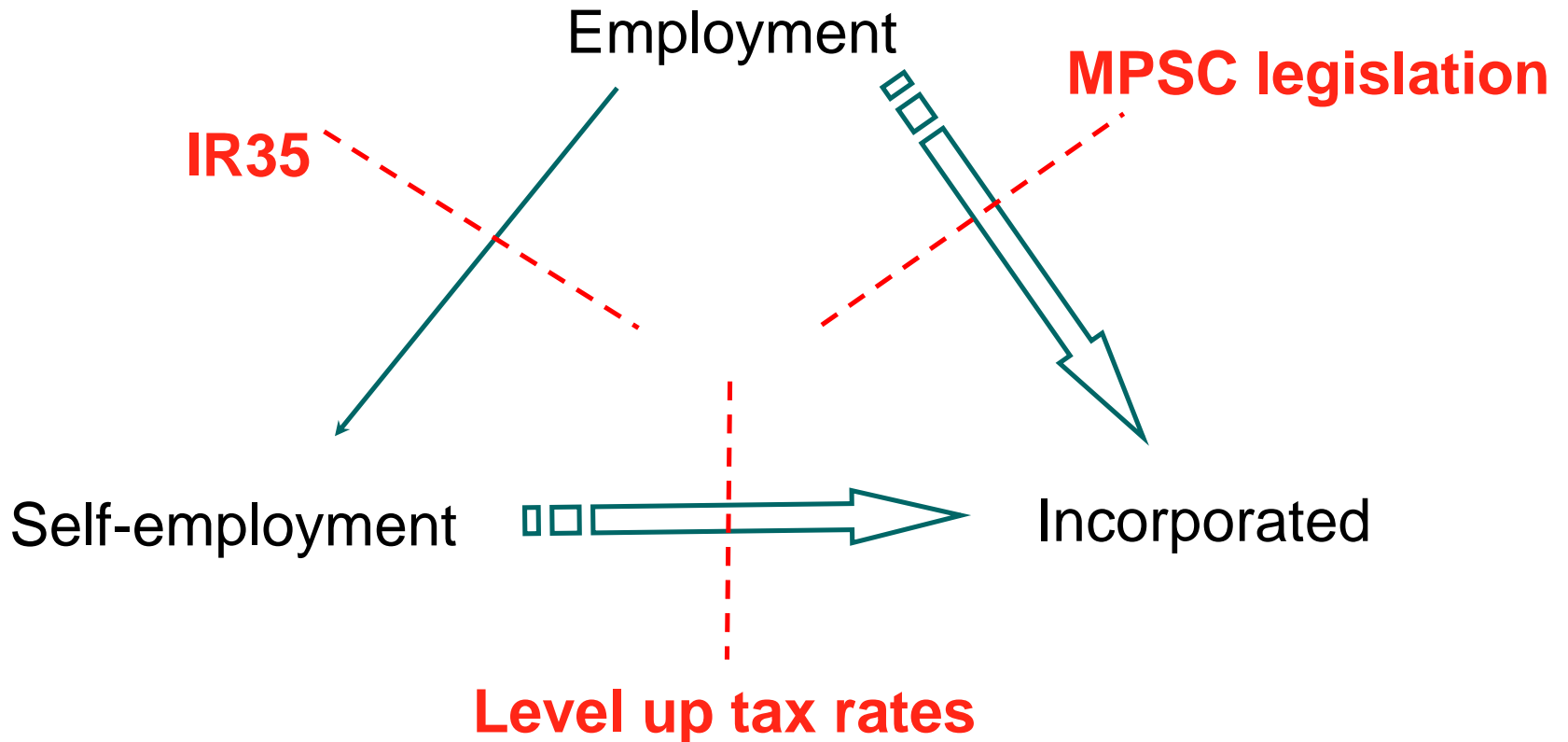
1. Employment - wages
[IT, NICs (class I)]
2. Self-employment - wages \approx profits
[IT_{SE}, NICs_{se} (class II and IV)]
3. Incorporated - wages, dividends
[IT, NICs (class I), CT]

Stylised Flow to Incorporation

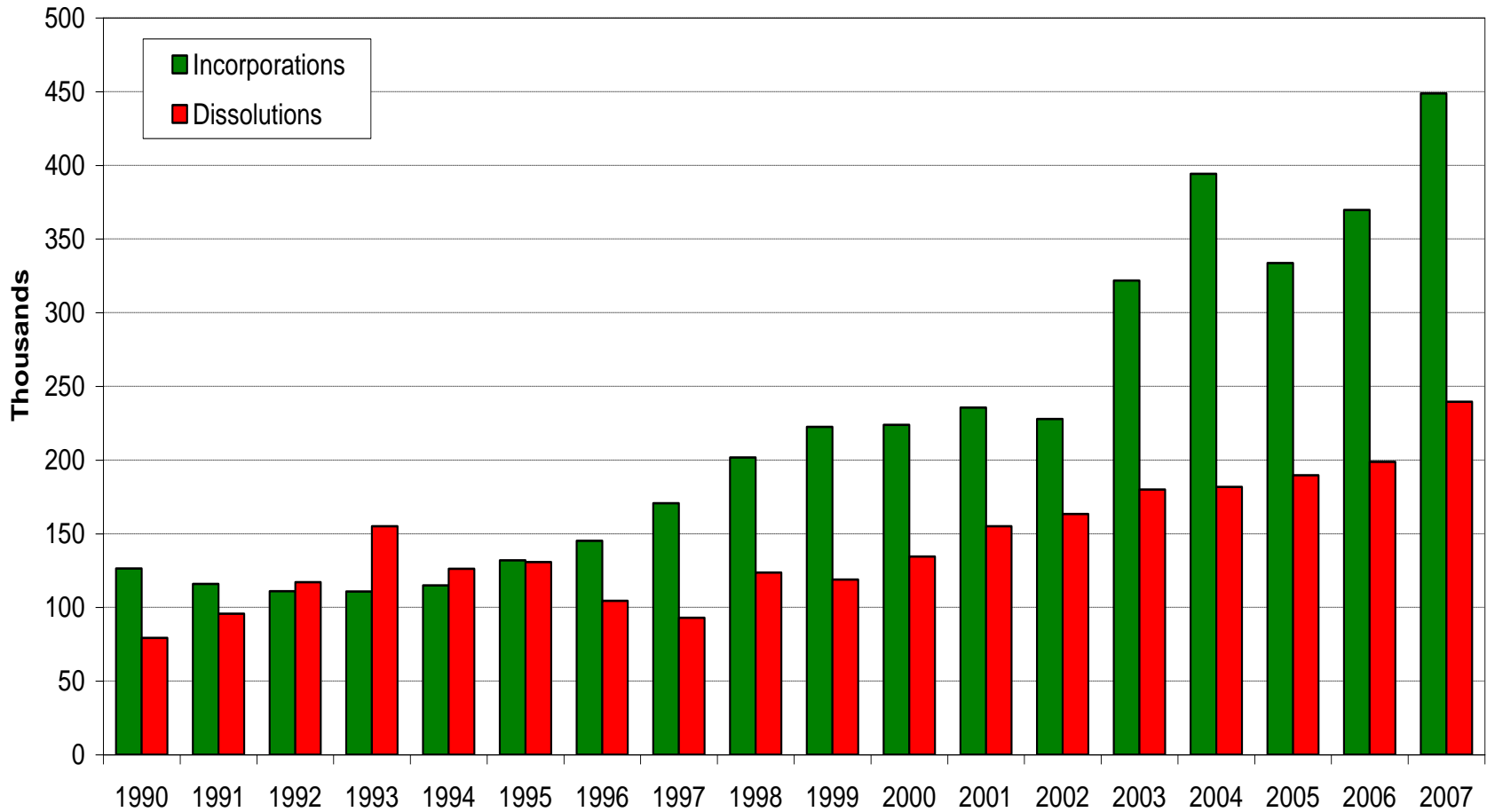


Tax-motivated incorporation (TMI)

Policy Responses



Annual Incorporations and Dissolutions - Tax Year Ending



Source: Companies House

Distortions to Employment vs. Self-Employment

- Lower National Insurance (lower rates) and more allowable expenses (narrower tax base) mean the UK tax system can encourage employees to become self-employed.
- Lower National Insurance only partly reflects less generous entitlements to state benefits for the self-employed. This is because the UK tax system implicitly makes allowance for the fact that self-employed income is the product of both capital and labour and the rates of tax on capital are lower than for labour.
- In theory, the existence of preferential tax treatment for some savings and investment vehicles should only have a negative marginal effect on SME creation. However, this will depend on the relative post-tax rates of return, the capital intensity of the business start-up and who owns the capital.

Tax Distortions to Unincorporated vs. Incorporated Business

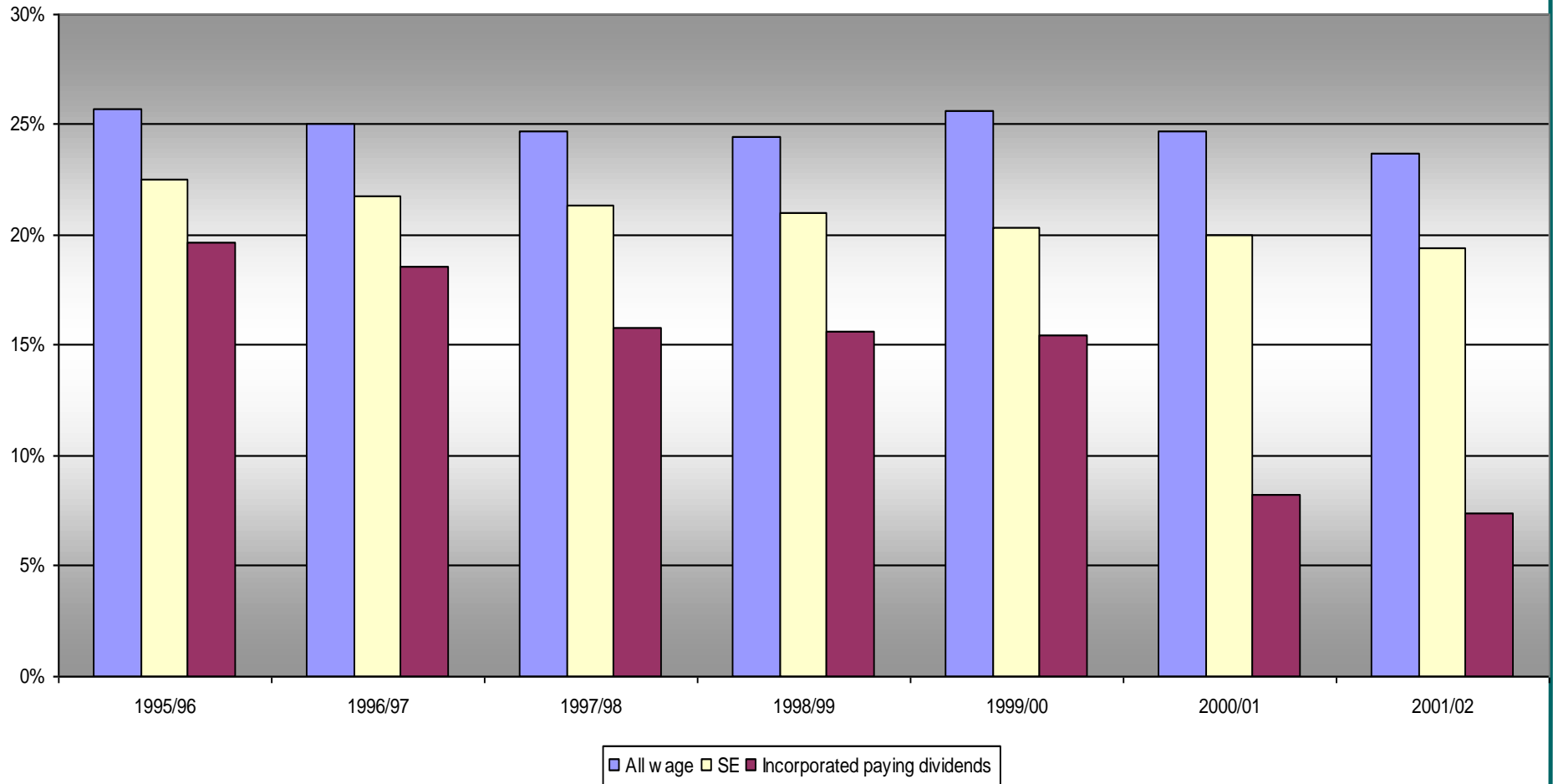
- If the combined corporate and dividend tax rates payable by the incorporated are lower than the combined income tax and National Insurance payable by the self-employed, then so-called tax-motivated incorporation will occur.
- Incorporation in the UK is very cheap (£20), it is available on-line, and there are no capital adequacy requirements to restrict the use of companies. It is so cheap and straightforward to incorporate here that we have seen sizeable numbers of foreign businesses registering as UK limited companies.
- Successive Governments have tried to encourage greater investment through low rates of tax for small companies. However, this can be taken advantage of by people incorporating with the aim of reducing their tax and National Insurance liability by extracting labour income as dividends.

Tax Avoidance or Legitimate Business Choice

- In the UK, tax-motivated incorporation became particularly apparent following the introduction of a 0% corporation tax band for the first £10,000 of profit in 2002-03. This was withdrawn after 3 years (2005-06).
- The latest Budget went further. The Chancellor of the Exchequer announced a phased increase in the small companies rate of corporation tax to 20% in 2007-08, to 21% in 2008-09, and 22% in 2009-10,

Average Tax Rate by Legal Form (1)

Average Tax Rates for an individual earning £15,000 depending on their status



SME Tax Evasion

- Considerations contributing to SME tax evasion are the ability to under report income (e.g. cash-in-hand) and over report business expenses (e.g. personal consumption of business assets).
- Measures to reduce tax evasion – targeted and random enquiry programmes (both direct yield and deterrence effects), providing information in a customer focussed way to reduce error, (different channels, website, help lines, etc), and tax evasion hotlines. Trade-offs: enquiries impose a high compliance burden so need to be targeted and proportionate to risk.

Awareness of Special Tax Incentives Amongst Small Firms: Recent Survey Evidence

- Survey carried out in July 2006 by PWC
- Awareness levels for incentives and reliefs limited. Average across nine named schemes of 41%
- Usage levels are low - average across schemes looked at was 11%
- If first year allowances on capital assets is excluded usage drops to 7%

Awareness of Special Tax Incentives Amongst Small Firms: Recent Survey Evidence

- Highest awareness (64%) was for first year allowances and R&D tax credits (57%)
- Lowest was 14% for corporate venturing
- A third of companies for whom R&D tax credits were relevant did not claim them as the process was perceived to be too difficult.
- Incentives don't appear to influence business decisions in most cases even where used, e.g. only 24% influenced by capital allowances.

Survey Results: Comparison of nine incentives and reliefs available to SMEs

Incentive	Awareness (%)	Overall usage (%)	Aware but not used- believed irrelevant	Used and influenced business decisions (%)
FYAs for capital assets	64	48	19	24
Tax deductions for employee share schemes	59	11	65	39
R&D tax credits	57	9	59	21
EIS and VCT	52	6	74	50
Capital Allowances on green technologies, flats over shops and contaminated land	45	10	55	23
Taper relief on sale of shares	45	8	69	40
Enterprise Management incentives scheme (share options)	18	3	73	----
Ability to sell subsidiaries tax free (SSE)	18	5	66	32
Corporate venturing scheme	14	1	76	-----

Why don't SMEs use reliefs available?

- Mainly because not relevant but:
- Perception that they are difficult to claim with detailed and complex criteria (which generally exist to deal with avoidance issues)
- Uncertainty as to whether claim would succeed
- Lots of SMEs unaware of their existence so questions over communication strategy used by government

Experience of Targeted Tax Relief for SMEs

- Incentives are often trying to target qualitative factors such as being “growth orientated” and so high deadweight use of the schemes is likely even with targeting rules. Targeting also creates “cliff edges” and can require anti-fragmentation rules. Allowing businesses that are “too large” into a scheme can mute the competitive gain the most needy users can derive from it (because barriers to entry are hardly lowered), while pushing up deadweight, etc.
- UK uses tax measures targeted both at businesses (enhance capital allowances & SME R&DTC) and investors to aid SME financing (venture capital schemes). There are none specifically targeted at institutional investors, although these and experienced individual investors tend to advise the business to exploit these incentives to aid growth and reduce the tax wedge on their expected rate of return.

Targeted Tax relief continued.

- Reducing compliance burden on self-employed – Trade-off between gathering enough information to assess risk and the compliance costs imposed on the business. One difficulty with most exemption schemes (like VAT exemption or possible simplifications that could be made to calculate expenses in a formulaic way) is that their existence can raise compliance costs for business as they recalculate each year whether it is worth being “in” or “out”. So take-up can end up being driven by whether the business can lower its tax bill, rather than simply reduce compliance costs.

Counting the cost

- Estimating the Exchequer effects of tax measures is an integral part of the tax policy making process. Tax costings are also an important source of public information and they contribute to the transparency of both the public finances and the tax system as required by the Code of Fiscal Stability.
- HMRC analysts are responsible for estimating the Exchequer effects of both actual and illustrative changes to the tax system together with the costs of existing tax expenditures and reliefs. These estimates are published in HM Treasury (HMT) Budget documents.

Background

- These estimates of revenue effects can be considered under three headings;
- Costings of Government proposals to change the tax system which are published in the Financial Statement & Budget Report (FSBR) and the Pre-Budget Report (PBR)
- The effects of a range of illustrative tax changes published in the ‘ Tax Ready Reckoner and Tax Reliefs ‘ at the time of the PBR
- Estimates of the cost of the main tax expenditures and tax reliefs published in both the ‘ Tax Ready Reckoner and Tax Reliefs ‘ and the FSBR

Background

- In principle the idea is that the TE and other information released in the autumn Pre Budget Report provides a basis on which others can contribute to the debate about what policies to adopt in the Budget that takes place the following spring.

Tax ready reckoner and tax reliefs

- The ‘ Tax ready reckoner and tax reliefs ‘ is published each year by HMT at the time of the PBR. It’s aim is to provide the public with costings information on various options to change the tax system together with the costs of the principal tax expenditures and structural reliefs. It contains the following tables in this context:

Published Tables : Potential Tax Changes

- **Table 3** The costs of indexation for income tax allowances and limits, Child & Working Tax Credits, inheritance tax and capital gains tax
- **Table 4** Direct effect of illustrative changes in income tax
- **Table 5** Direct effects of illustrative changes in other direct taxes & NICs
- **Table 6** Direct effects of illustrative changes in indirect taxes
- **Table 7** Estimated costs of principal tax expenditures and structural reliefs

Categorising Tax Expenditure

- TEs categorised as either
 - Tax Expenditures, e.g. relief for savings in individual savings accounts (ISAs)
 - Reliefs with Tax Expenditure and Structural Components, e.g. age related allowances for pensioners.
 - Structural Reliefs, e.g. personal allowance for income tax.

Tax expenditures and ready reckoners

- [Table 1.5 - Main tax expenditures and structural reliefs \(PDF 20K\)](#) also also [available in Excel format \(XLS 74K\)](#)
- [Table 1.6 - Direct effects of illustrative tax changes \(PDF 18K\)](#) also [available in Excel format \(XLS 35K\)](#)
- [Table B 1 - Minor tax expenditures and structural reliefs \(PDF 16K\)](#) also [available in Excel format \(XLS 60K\)](#)
- [Table B.2 - Tax allowances and reliefs in force in 2005-06 or 2006-07 costs not known](#)

1.5

Estimated costs of the principal tax expenditures and structural reliefs ¹

	£ million		£ million	
	Estimated cost for		Estimated cost for	
	2005-06	2006-07	2005-06	2006-07
Tax Expenditures				
Income tax				
Relief for:				
Approved pension schemes (2) *	14,300	16,300		
Share Incentive Plan*	250	280		
Approved savings-related share schemes (3)*	120	140		
Enterprise Management Incentives*	110	120		
Approved Company Share Option Plans*	170	190		
Personal Equity Plans*	450	475		
Individual Savings Accounts *	1,350	1,625		
Venture Capital Trusts (4)*	325	75		
Enterprise Investment Scheme (4)*	160	140		
Professional subscriptions *	80	80		
Rent-a-room*	100	100		
Seafarers' Earnings Deduction	100	100		
Exemption of:				
First £30,000 of payments on termination of employment*	800	800		
Interest on National Savings Certificates including Index-linked certificates*	110	150		
Premium Bond prizes*	170	200		
Income of charities (5)*	1,100	1,200		
Foreign service allowance paid to Crown servants abroad*	90	95		
Life assurance premiums (for contracts made prior to 14 March 1984) (6)	55	50		
Personal Tax Credits(7)				
4,400	4,600			
Corporation Tax				
R & D Tax Credits (8)*	440	450		
Income tax and corporation tax				
Small budget film tax relief (9)*	420	240		
Large budget film tax relief (9)*	280	240		
National Insurance Contributions				
Relief for:				
			Value added tax (12)	
			Refunds to:	
			Northern Ireland Government bodies of VAT Incurred on non-business purchases under the Section 99 refund scheme	
			300	350
			Local Authority-type bodies of VAT Incurred on non-business purchases under the Section 33 refund scheme (Includes national museums and galleries under the Section 33A refund scheme)	
			7,150	7,750
			Central Government, Health Authorities and NHS Trusts of VAT Incurred on contracted-out services under the Section 41 (3) refund scheme	
			3,900	4,750
Reliefs with Tax Expenditure and Structural Components				
Income tax				
			Age-related allowances (17)	
			2,400	2,400
			Reduced rate for savings (18)	
			200	210
Exemption of:				
			British Government securities where owner not ordinarily resident in the United Kingdom *	
			1,230	1,230
			Child benefit (Including one parent benefit) (19)*	
			1,090	1,130
			Long-term incapacity benefit(16) *	
			220	230
			Industrial disablement benefits*	
			60	60
			Attendance allowance*	
			120	120
			Disability living allowance*	
			360	370
			War disablement benefits*	
			60	70
			War widows pension*	
			30	30
Corporation tax				
			Small companies' reduced corporation tax rate (16,20)	
			3,970	4,500
			Starting rate of corporation tax	
			430	0
			Exemption for gains on substantial shareholdings	
			260	260
Income tax and corporation tax				
			Capital allowances (21)*	
			18,200	19,400
Of which:				
			First year allowances for SMEs *	
			380	620
			Enhanced capital allowances for energy saving technology	
			170	130

Share Incentive Plan *	170	190	Accelerated capital allowances for Enterprise Zones	120	40
Approved savings-related share schemes*	80	90			
Approved company share option plans*	50	60	Capital gains tax		
Employer contributions to approved pension schemes (10)*	7,900	9,000	Indexation allowance and rebasing to March 1982 (22)	300	250
Capital gains tax			Taper relief*	4,620	6,020
Exemption of gains arising on disposal of only or main residence (11)	13,000	15,000	Exemption of:		
			Annual exempt amount (half of the individuals' exemption for trustees)*	2,000	2,300
Inheritance tax			Gains accrued but unrealised at death (23)*	690	710
Relief for:			Petroleum revenue tax (24)		
Agricultural property*	210	220	Uplift on qualifying expenditure	80	110
Business property*	320	350	Oil allowance	790	860
Exemption of transfers to charities on death*	460	510	Safeguard: a protection for return on capital cost	40	50
Value added tax (12)			Tariff receipts allowance	80	50
Zero-rating of:			Exemption for gas sold to British Gas under pre-July 1975 contracts	40	60
Food	10,500	10,800	Inheritance tax		
Construction of new dwellings (Includes refunds to DIY builders) *	7,200	7,700	Nil rate band for chargeable transfers not exceeding the threshold*	10,400	11,300
Domestic passenger transport	2,200	2,250	Exemption of transfers on death to surviving spouses and civil partners (25)	2,000	2,200
International passenger transport (UK portion) *	100	100	Stamp duty land tax		
Books, newspapers and magazines	1,600	1,650	Exemption of transfers of land and property where the consideration does not exceed the £120,000 threshold	520	580
Children's clothing	1,200	1,250	In 2005-06 and the £125,000 threshold in 2006-07 and non-residential land and property where the consideration does not exceed the £150,000 threshold*		
Water and sewerage services	1,200	1,200	Exemption of all residential transfers in designated disadvantaged wards where the consideration exceeds £120,000 in 2005-06, £125,000 in 2006-07 but does not exceed £150,000(20)	50	50
Drugs and supplies on prescription	1,150	1,200	Transfers to charities	120	120
Supplies to charities (13) *	200	200	Group relief	1,510	1,530
Ships and aircraft above a certain size	600	650	Transfers to registered social landlords	60	60
Vehicles and other supplies to disabled people (13)	400	450	National Insurance contributions		
Reduced rate for: (14)			Reduced contributions for self-employed not attributable to reduced benefit eligibility (constant cost basis)	1,700	1,800
Domestic fuel and power	2,200	2,200			
Certain residential conversions and renovations	150	150			
Energy-saving materials	50	50			
Women's sanitary products	50	50			
Structural Reliefs					
Income tax					
Personal allowance	40,200	42,000			
Corporation tax					
Life companies reduced rate of corporation tax on policy holders' fraction of profits*	1,050	1,250			
Tonnage tax: a concessionary tax regime for shipping companies	75	85			

Income tax and corporation tax

Double taxation relief (15)*	10,000	10,000	Value added tax (12)		
			Exemption of: (26)		
National insurance contributions			Rent on domestic dwellings *	3,150	3,350
Contracted-out rebate occupational schemes.**			Supplies of commercial property *	150	150
Rebates deducted at source by employers	7,200	7,500	Private education*	300	300
Rebates paid by the Contributions Agency direct to the scheme	200	200	Health services *	850	900
Personal and stakeholder pensions(16)	2,400	2,200	Postal services*	500	500
			Burial and cremation	100	100
			Finance and insurance*	3,950	4,200
			Betting and gaming and lottery duties*	1,250	1,350
			Small traders below the turnover limit for VAT registration (20) *	900	950

* These figures are particularly tentative and subject to a wide margin of error.

Table updated April 2007

- 1) Costs are on an accruals basis unless otherwise specified and only reliefs with an estimated cost of at least £50 million are included. The costs of the personal income tax allowances do not cover individuals who are not on HMRC records because their income is below the tax threshold.
- 2) The baseline for calculation is unapproved schemes. The figure is the sum of the front-end relief on contributions plus the relief on the investment income of funds, net of the tax paid on current pension payments. Relief on capital gains made by funds is not included, due to lack of information about duration of holdings. The figure includes the CGT cost of deferral relief and exempting gains from tax.
- 3) Excludes the cost of the tax-free bonus or interest received under a SAYE contract.
- 4) These figures include the CGT cost as well as the income tax cost
- 5) These figures comprise the total sum paid to charities, certain heritage bodies and museums, and scientific research associations in respect of: tax credits on dividends paid up to 5 April 2004 (in the form of transitional relief on dividends paid from 6 April 1999) and income tax deducted at source from other investment income; basic rate tax relief on payments under deeds of covenant and donations under the Gift Aid scheme. Information is not available about income received by these bodies without deduction of tax, and no allowance in the figures is made for this. The figures also include an estimate of the following reliefs received by donors: higher rate relief on covenanted sums and donations under Gift Aid; basic and higher rate relief for donations of shares and real property; basic and higher rate relief on donations made under the payroll giving scheme.
- 6) Including the cost of deductions at source for non-taxpayers
- 7) These figures represent only the negative tax element of the tax credit payments. Negative tax is that part of the credit that is less than or equal to the tax liability of the family. Payments exceeding this liability are treated as public expenditure and are not included in these figures.
- 8) These figures represent only the negative tax element of R&D tax credits. Negative tax is that part of the tax relief due to the enhanced expenditure (i.e. amounts in excess of 100 per cent of the expenditure) which offsets liability to corporation tax. Directly payable tax credits are treated as public expenditure and are not included in these figures. The equivalent figures for the public expenditure element of R&D tax credits are £230 million in 2005-06 and £230 million in 2006-07.
- 9) The figures provided represent only the estimated cost of the tax relief and are on a receipts basis. These figures include substantial known avoidance that was closed down by anti-avoidance measures announced at the 2004 Pre-Budget Report.
- 10) The baseline for the calculation is employer contributions to unapproved pension schemes.
- 11) Calculated on the assumption that there would be no relief for gains when disposal proceeds were applied to the purchase of another house. The costs quoted do not represent the yield from abolition of the relief. Consequential effects on the housing market would substantially reduce the yield.
- 12) Some of these tax expenditures and reliefs are mandatory or permitted under the EC 6th VAT Directive and some are derogations from the Directive. These estimates are produced on a national accounts basis following the adoption of the European System of Accounts in autumn 1998.
- 13) Costs exclude the zero-rating of items appearing higher in the list and the reduced rate on domestic fuel and power.
- 14) The figures for all reduced-rate items are estimates of the cost of the difference between the standard rate of VAT and the reduced rate of 5 per cent.
- 15) This figure is illustrative only, showing the estimated cost to the Exchequer of the current double tax reliefs. It is based on provisional corporation tax assessment data for accounting periods ending in 2004-05 and the results of the 2004-05 Survey of Personal Incomes.
- 16) The data for these costs have been revised and updated.

17) These figures represent the cost of the excess of the age-related personal allowance over the corresponding allowances for non-aged taxpayers. For 2005-06 and 2006-07 respectively they include the cost of married couples allowance (MCA) which accounts for £540 million and £510 million and the cost of maintenance payments relief which accounts for £1.3 million and £1.2 million. The aged allowances include £35 million in 2005-06 and £40 million in 2006-07 for the cost of the higher age-related allowances for those aged 75 and over.

18) These figures represent the difference between the basic rate of 22 per cent and the basic rate on savings income of 20 per cent.

19) The figures assume that Child Benefit is paid to the mother or lone father.

20) The methodology for these figures has been revised and updated.

21) The figures for capital allowances are on an accruals basis, net of balancing charges and reflect the cost in the year investment takes place. Because enhanced capital allowances bring forward tax relief from future years, most of the first year cost will be offset by lower allowances claims in the future.

22) The estimated costs relate to gains of individuals and trustees only. Company gains are not included because of estimation difficulties.

23) These estimates assume deferral relief on transfer of assets between spouses would be available.

24) The figures are net of any consequential effect on corporation tax and represent the effect on calendar year accruals in 2005 and 2006. The cost of all types of expenditure relief (i.e. capital expenditure, including uplift, operating expenditure and exploration and appraisal expenditure) is £1,575 million in 2005-06 and £1,400 million in 2006-07. These figures reflect the fact that, in the case of petroleum revenue tax, no distinction is made between revenue and capital.

25) Includes civil partnerships. These costs are only in respect of transfers for which an account is submitted HMRC.

26) The estimates shown are net of any revenue loss that might arise from removing VAT exemption. Where an exempt trader provides goods or services to registered traders whose output is standard rated, there is likely to be some revenue gain to the Exchequer from the exemption. The taxable supply of the registered trader is likely implicitly to include an element in respect of the value added by the exempt trader and this element will be liable to VAT.

T1.6

Direct effects of illustrative tax changes (1)

	£ million cost/yield		
	2007-08	2008-09	2009-10
Income tax (2)			
Rates			
Change starting-rate by 1p (3)	880	710	710
Change savings rate by 1p (4)	100	140	140
Change basic-rate by 1p (5)	3,300	3,950	4,000
Change basic-rate in Scotland by 1p (5)	270	320	320
Change higher-rate by 1p (6)	880	1,490	1,430
Allowances and reliefs			
Change personal allowance by £100	880	880	710
Change age-related personal allowances by £100	85	75	80
Change aged income limit by £500	15	25	25
Change all personal allowances by 1 per cent	340	420	430
Change all personal allowances by 10 per cent	3,300	4,150	4,150
Limits			
Change starting-rate limit by £100	280	340	330
Change basic-rate limit by 1 per cent	180	270	270
Change basic-rate limit by 10 per cent:			
Increase (cost)	1,450	2,450	2,400
Decrease (yield)	1,850	3,050	3,000
Allowances, starting and basic-rate limits			
Change all main allowances, starting and basic-rate limits by 1 per cent	870	790	790
Change all main allowances, starting and basic-rate limits by 10 per cent:			
Increase (cost)	5,400	7,400	7,350
Decrease (yield)	6,150	8,450	8,400
Working Tax Credit			
Change basic element by £100	340	320	310
Change 30-hour element by £100	240	250	250
Change additional elements for couples and lone parents by £100	330	320	290
Child Tax Credit			
Change family element by £100 (7)	840	840	820
Change child element by £100 (8)	750	790	730
Common Features			
Change first income threshold by £100 (9)	120	120	120
Change second income threshold by £1,000	30	30	40
Other direct taxes and national insurance contributions			
Corporation tax:			
Change small companies' rate by 1 percentage point (10,11)	10	390	510
Change main rate by 1 percentage point (10)	850	1,350	1,400
Capital gains tax:			
Increase annual exempt amount by £500 for individuals and £250 for trustees	0	30	30
Inheritance tax:			
Change rate by 1 percentage point	40	85	110
Increase threshold by £5,000	30	70	80
National insurance contributions			
Rates			
Change Class 1 employee main rate by 1 percentage point	3,850	3,750	3,900
Change Class 1 employee additional rate by 1 percentage point	1,150	1,250	1,350
Change Class 1 employer rate by 1 percentage point (12)	4,850	5,150	5,400
Change Class 2 rate by £1 per week	175	185	190
Change Class 4 main rate by 1 percentage point	320	335	355
Change Class 4 additional rate by 1 percentage point	160	205	215
Limits			
Change employee entry threshold by £2 per week	245	255	265
Change employer threshold by £2 per week	265	305	320
Change lower profits limit by £104 per year (£2 per week)	20	20	20
Change upper profits limit by £520 per year (£10 per week) (13)	15	15	15
Change upper earnings limit by £10 per week (13)	180	160	170

Indirect tax rates (14)	Indicative level of duty on a typical item (15)			
One per cent change				
Beer and cider duties (16)	Pint of beer: 32p	40	45	45
Wine duties (18)	75cl bottle of table wine: £1.33	25	25	25
Spirits duties (16)	70cl bottle of whisky: £5.40	5	5	5
Tobacco duties (16, 17)	20 king size cigarettes: £3.35	5	5	5
Petrol (18)	litre of ultra low sulphur: 48.35p	120	110	110
Diesel (18)	litre of ultra low sulphur: 48.35p	120	125	120
Rebated oil (18)	litre of gas oil: 7.89p	5	5	5
Air passenger duty (18)	Economy flight departure: £10	20	20	25
Landfill tax	Tonne of waste: £2021	10	10	10
Climate change levy	100kWh of business electricity: 43p	5	5	5
Aggregates levy	Tonne of aggregate: £1.60	5	5	5
VAT				
VAT: change reduced rate by 1 percentage point (19)		175	190	200
VAT: change standard rate by 1 percentage point		4,520	4,025	5,055
Insurance premium tax				
Change standard rate by 1 percentage point		345	400	500
Change higher rate by 1 percentage point		10	10	10
Stamp duty land tax				
Change 1 per cent rate by 1 percentage point (20)		1,080	1,100	1,100
Change 3 per cent rate by 1 percentage point (20)		820	690	870
Change rental rate on leases by 1 percentage point (20)		290	310	340
Increase £250,000 threshold by £5,000 (20)		60	60	60

Table updated April 2007

£ million

Estimated cost for
2005-06 2006-07

Tax Expenditures

Income tax

Relief for:

Approved pension schemes (2) *	14,300	16,300
Share Incentive Plan*	250	280
Approved savings-related share schemes (3)*	120	140
Enterprise Management Incentives*	110	120
Approved Company Share Option Plans*	170	190
Personal Equity Plans*	450	475
Individual Savings Accounts *	1,350	1,625
Venture Capital Trusts (4)*	325	75
Enterprise Investment Scheme (4)*	160	140
Professional subscriptions *	80	80
Rent-a-room*	100	100
Seafarers' Earnings Deduction	100	100

Room for improvement?

- In principle reporting is comprehensive but in practice there may be minor gaps in area of national insurance (social security contributions) and because of staff resources.
- Reporting by individual tax as well as by relief across tax headings might be useful.
- Are judgements about what is a structural and what is a tax expenditure accurate/meaningful, e.g. are reliefs for approved pension schemes really a tax expenditure rather than structural?

Conclusions

- Lower CT rate for SMEs tend to be politically motivated
- Arguably no real economic rational for lower small companies rate
- Can cause distortions in terms of choice between employment, self employment and incorporation
- Need for associated companies rules to stop companies splitting into smaller entities to pay lower rate. Means even more tax complexity!
- But ... are tax incentives for SMEs better than subsidy programs despite deadweight costs which might otherwise take their place?

Conclusions

- Relatively few SME TEs account for most of the costs but apparently minor tax expenditures can explode when misused for avoidance
- Reporting system which is embedded as part of the budget process works fairly well
- System does seem to have provided some check on the proliferation of tax expenditures