Comment

Potholes in the road for business taxation

Speed read

The Spring Budget provides some semblance of the road ahead for business taxation but several 'potholes' remain. The short-termism of UK politics is still at play; we are still some way off having a fully integrated industrial policy; and the tax system contains a number of distortions and cliff edges yet to be tackled.

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Immediately after the chancellor stood down last Wednesday, I got together, as usual, with my tax policy experts to try to work out what we'd just heard and what it meant. Instant reaction to Budgets is a mug's game: they always sound good on the day but it's over the next 48 hours as the details sink in that the true meaning of what was (and was not) announced starts to become clear.

I commented on social media on Wednesday afternoon that the road ahead for business taxation – for there is now some semblance of a road ahead, more than for some time – looks rather heavily potholed.

At its heart were two quite radical changes: a hike in the headline rate of corporation tax to 25% combined with a new full expensing regime for plant and machinery investment, and a package of measures aimed at expanding workforce participation, the biggest tax measure being the abolition of the pensions lifetime allowance (LTA) and raising of the annual allowance to £60,000 alongside the huge expansion of free childcare. These, together with a reboot of Truss's investment zones in 12 regions, mark a further shift to a much more interventionist posture. Industrial strategy is back: we are picking winners again, and we're using fiscal policy to influence business investment and the jobs market.

So where are the potholes? I've identified three areas where the Budget leaves our tax system incomplete to the extent it may undermine the government's core policy priorities.

1. Policy stability

The UK is crying out for a stable tax system that allows businesses to make long term investment decisions, beyond the duration of one parliament. The crazy volatility of 2022 is now behind us, but the short-termism of UK politics is still at play. Full expensing, a measure designed to encourage long term capital spending, sunsets after three years. It's another cliff edge thanks to the tyranny of meeting fiscal rules.

Pensions have been messed around with multiple times in recent years. Now the LTA is being lifted but the Labour party has already promised to reintroduce it if it wins the next election. The CT rate remains subject to constant will-they-won't-they speculation.

The UK remains one of the hardest jurisdictions in which to get formal up-front certainty of tax treatment or access to incentives. The practice of getting clearances or rulings from HMRC almost ceased outside transfer pricing sometime ago. It means even when there is a well understood regime in place, like the RDEC, the benefit too often as a post-facto windfall.

It is a little easier this week to articulate where the UK's system is going, but the ride remains rather bumpy.

2. Going all-in

We are seeing the beginnings of an industrial strategy with targeted support in the investment zones and freeports and measures designed to boost industries like life sciences, quantum computing and CCUS. But over everything hangs the long shadow of the US Inflation Reduction Act (IRA) and its competitive sibling the EU green deal industrial plan. The investment zone tax reliefs, including SDLT and business rates relief and enhanced structures and buildings allowances, are welcome but alongside the seemingly tiny £80m announced funding per investment zone these feel like a drop in the ocean. The tax component of the incentives in the IRA is $270bn.

There is a hint at some fiscal devolution too, but no evidence the country is ready for the sort of truly federal tax model that allows regions and cities to choose their own priorities and compete for investment.

It's perhaps a little early to judge. By the end of this month, we will have 'green day' when the government sets out its proposals in response to the Skidmore review, including how it plans to respond to the US IRA. There is still the opportunity for a future of integrated industrial policy supported by regulatory and planning reform, targeted tax incentives and meaningful regional devolution, but we're not there yet.

3. The too difficult pile grows taller

Many of the changes needed to reform our increasingly creaking tax system remain somewhere in the long grass. The UK's legislation resembles an ever more layered palimpsest of legacy provisions whose original intention is long-forgotten, distortions and cliff edges that affect taxpayer behaviour in unexpected ways. Among the most commonly bemoaned are the VAT registration threshold, the many high marginal rates in the personal tax system (one of which – at income over £100k – was compounded by the free childcare announcement in this Budget), the business rates system and the rather archaic non-dom regime that incentivises the super-rich to keep money out of the country. The only cliff edge dealt with in the Budget was the pensions LTA. The fact this quickly became the most politically controversial of all the announcements says something about how difficult it is to resolve these distortions. There will always be losers or 'undeserving' winners. But these anomalies do need dealing with because some of them have serious real world consequences.

Final thoughts

What connects all these three potholes and turns them into a major water hazard? It's a sense that our tax system remains less than the sum of its parts. I still think last week's Budget was a decent effort. We've had enough abnormal fiscal events recently to appreciate something closer to normality. I would like to see a future UK tax system that is: stable in its underlying infrastructure across parliaments and administrations; in alignment with the big national priorities facing the country; as free as possible of anomalies and distortions; and easy to articulate to curious multinationals who just might consider placing their next big investment here in the UK. We are not there yet. ■

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