



Tax complexity: impact on UK competitiveness and growth

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Foreword

Competitiveness is a term that is much in the news: just how competitive is the UK economy? Can we become more competitive?

In truth, the UK's competitiveness (or lack of it) has been under the microscope for many years, with ways of improving the position eagerly sought. It certainly was back in 2013, when George Osborne, then Chancellor of the Exchequer, issued a challenge to the Office of Tax Simplification (OTS) in his Autumn Statement: could the OTS recommend how the UK's tax system could become more competitive and so assist UK businesses?

The main spark for what became the OTS's Competitiveness project was the UK coming 14th in the annual World Bank 'Paying Taxes' report. Could the UK climb higher – perhaps get to the top 5? As the World Bank methodology looked at all aspects of a business's tax burden, only major reductions in tax rates – really only possible for petro-economies and impractical for the UK – would get the UK into the very top echelons. But where changes to the tax system could make a difference was in reducing the administrative burdens placed on business: reduce the time to comply, increase certainty and generally leave businesses freer to focus on...well, doing business and generating growth.

The OTS's October 2014 report made 60 recommendations to improve the running of the UK's business tax system, all made with an eye to reducing admin burdens and so increasing competitiveness. Of those, 57 were accepted or taken for further study. But what has happened in the intervening years? Has the UK's tax competitiveness improved? What could be done in today's environment to improve the situation and reduce burdens on business?

This welcome report seeks to answer these questions. As the OTS is no more, a very commendable private initiative led to the formation of a small team, comprising academics and a former OTS senior policy adviser, to carry out the work. They followed a key part of the OTS's methodology by holding a wide range of meetings with stakeholders (business, advisers, representative bodies and HMRC) to gather evidence.

The resulting report ranges widely, covering areas that the OTS looked at but also new subjects including innovation and growth. There are recommendations on all areas which deserve serious study by tax policy makers. Progressing them could lead to a roadmap for reducing the admin burdens the UK's tax system places on business – and so improve the UK's competitiveness. And anyone doubting the importance of this work should have a look at the annex on the impact of complexity.

Great credit is due to the team who have taken on this project: Andy Richens, former OTS Senior policy adviser and a leading light of the 2014 Competitiveness project; Professor Peter Jelfs of Brunel, University of London; Professor Kevin McMeeking of the University of Bristol; and Sam Sherwood, PhD student at Brunel, University of London. The project team's thanks go to all the businesses, groups and HMRC teams who met with them and especially to the ICAEW for their financial support.

John Whiting

Tax Director, Office of Tax Simplification 2010-17

Executive summary

Introduction

This report revisits the Office of Tax Simplification (OTS) review of the competitiveness of the UK's tax administration, which was published in October 2014 and made 60 recommendations for improvement, of which 57 were either accepted or taken for further consideration. The original review was commissioned by the coalition government following the publication of the World Bank/PwC's Paying Taxes league table which ranked the UK in 14th position.

As part of this latest review, a series of 35 interviews were held with businesses, academics, industry organisations, tax professionals and their representative bodies and government policymakers, to assess what progress has been made, and we set out recommendations below for today's policymakers.

The annex to the report and feedback from stakeholders looks at the impact of tax complexity on taxpayers and the wider economy, and the **negative effect on innovation and growth**.

Academic studies show the tax compliance burden to be highly regressive, disadvantaging smaller businesses, giving rise to the recommendation below to **think small first** when introducing tax legislation.

A further cost of complexity is cognitive, with **its effect on tax morale and loss in confidence, exacerbated by the current HMRC culture encountered by business**.

Chapter 2 Innovation and growth

On research and development (R&D), the situation we find ourselves in is far removed from the original UK government policy rationale, to incentivise businesses to invest in R&D. On the contrary, some businesses, particularly SMEs, are fearful of a recovery claim and therefore may not reinvest the tax credit in R&D, while others may be hit unexpectedly, threatening the future of their business. The culture of the UK government through the gatekeeper, HMRC, in their workings with business is explored further in the HMRC chapter.

On the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS), there are multiple conditions the company must satisfy in order for investor relief in EIS/SEIS to apply, meaning errors can lead to loss of relief, which can occur several years later. We were told the maximum age requirement was the most common reason for failure by established promising firms to find a further tranche of funding, and its removal would help address the current lack of scaling up. Regarding the increased EIS/VCT limits from April 2026, we were told by Northern Ireland (NI) advisers that this does not apply in NI, as a result of the Windsor framework.

On capital allowances, it was suggested the complexity around choice of capital allowance reliefs was usually left to advisers, which may remove the incentivisation for the business itself.

Recommendations

1. We propose the expert panel is utilised in helping HMRC to draft cases studies within official guidance, from claims made across all sectors encountered. Sectoral webinars would be helpful as an addition. The guidance needs to be signposted at all stages of the claims process.

2. We were told the expertise and communicativeness of the HMRC officers was very hit and miss. Again, the expert panel could assist here in upskilling HMRC staff on sector specifics, increasing the number of officers experienced on R&D tax credits.
3. On conclusion of the advance clearance pilot, if it is found that resources allow, we propose the targeted advance clearance service be expanded to allow businesses to request clearance on 'Whether the project meets the definition of R&D for tax purposes' in addition to at least two of the other factors listed.
4. Where advance clearance has not been secured, we suggest the AIF is extended to ask all the information that HMRC specialists would need to determine whether the claim qualified, and HMRC could only subsequently revoke the claim where the business has acted carelessly or deliberately not provided full and complete information in the claim process.
5. The government should review whether it is possible to simplify the Patent box calculation, for SMEs, summarised in paragraph 3.44, to help smooth the transition from R&D credits to accessing the patent box thereby retaining the IP in the UK.
6. As part of the HM Treasury review following the call for evidence responses, we suggest work is carried out looking to simplify the conditions for EIS and SEIS reliefs to apply and remain permanent, in particular whether the maximum age requirement remains necessary.
7. Again following the call for evidence, work should be carried out on looking to improving administration processes on claiming the relief.
8. On the EU dimension, we recommend the government seek to obtain state aid or the equivalent necessary to enable Northern Ireland to secure the equivalent EIS/VCT easements as the remainder of the UK.
9. The range of plant & machinery accelerated allowances is seen as confusing, with full expensing being outside the pool, while AIA and FYAs are within. We recommend the government carry out a review on how best to allocate the 100% allowances, across both corporates and non-corporate entities. The review should set out the policy objective on relief for leased assets.
10. Identification of what constitutes plant remains a difficulty. Following the Gunfleet Sands decision, we suggest the government consider reviewing how plant can be better defined to incentivise investment, which in turn would reduce the number of queries and compliance checking for HMRC.

Chapter 3 Corporation tax or Income tax computation

This chapter looks at the adjustments that have to be made to the profit shown by the accounts in order to arrive at the profits for tax purposes. We were given examples of extensive admin work for no tax advantage. Usual suspects were movement in provisions, pension on cash basis, trivial legal expenses, and the lack of a de minimis size threshold for the anti-hybrid rules. Other problem areas raised were private use adjustments, entertaining, travel & subsistence, and in particular repairs and maintenance which were seen as a "large grey area".

There is little doubt that if designing from scratch, the schedules wouldn't be a part of the tax system and different forms of income matter less as we move further from April 2017, when the loss rules changed to allow sideways set off. Splitting and recombining takes considerable time and makes a difference in a vanishingly small number of cases. Farming businesses were raised as an

example where the schedular system was problematic, with bills spread across income streams. Diversification was now a fairly fundamental part of farm businesses – most unify the accounts and then have to separate out.

Recommendations

11. We would like the government to revisit the work initiated following the OTS recommendations on reducing the number of adjustments necessary between accounting profit and taxable profit, where there is no incentivisation or compliance rationale.

12. In particular, we would like work to commence on aligning the tax and the accounting definitions of capital and revenue, which would help considerably in deciding whether a replacement was a repair, or a capital acquisition, and on legal or professional transaction fees, for example.

13. For those businesses below the accounts auditing thresholds, we suggest a simpler statutory test for repairs is introduced. (See Small enterprises Chapter 5 for an outline of what the test could look like).

14. On the anti-hybrid rules above, now approaching 10 years since introduction, we propose the government carry out a review of the measure, with a view to introducing a de minimis limit in order to cut down on the disproportionate administrative time incurred chasing little or no tax adjustment.

15. We propose the government revisit the OTS recommendation from 2014 and 2017 to look at aligning the rules for as many of the schedular income sources as possible, and suggest looking initially at fully aligning trading income and property income. As part of this, we echo the OTS Property income recommendation from 2022 that the government work with DEFRA to look into a rural business unit for diversified agricultural businesses, enabling those agricultural businesses producing consolidated accounts with diversified activities which support the core agricultural business to make a single return, or in the case of making tax digital for income, the quarterly tax updates.

16. We propose the government look at aligning definitions used across the income schedules and capital taxes, for example having a unified meaning of ‘business’.

Chapter 4 Reporting and compliance

Making tax digital (MTD) for income tax was introduced for the self-employed and landlords with income over £50,000 (measured by reference to the tax year in 2024-25) from 6 April 2026, with a requirement to keep digital records and submit quarterly returns of income and expenditure (the first on 7 August 2026), together with a MTD self-assessment return by 31 January 2027. It is therefore too early to assess whether MTD quarterly reporting is working as intended, but we encountered fears that small businesses in particular would find the adjustment harder, would see that the same figures are being reported in a different format and in a way requiring them to go out and invest in software, and wonder what is in it for them.

On payroll, the durability of the government’s real time reporting systems was questioned, with a common theme of examples where a single error could result in the whole tranche of submissions being rejected. Calls were made to uprate the trivial benefits exemption (unchanged since its introduction), and it was questioned whether it best meets current practices such as employer reimbursements.

On employment status and the need for IR35, academics spoke of the need for an overall tax system producing equivalent results regardless of the legal form of the worker, facilitated by aligning and then merging income tax and national insurance.

On the theme of uprating, the Corporate Interest Restriction (CIR) de minimis limit was given as a further example of having remained at the same level since introduction despite interest rates increasing considerably over that time, and whether limits generally could be uprated automatically for inflation periodically.

Recommendations

17. We suggest a post implementation review next year of MTD quarterly reporting, to include an evaluation of whether recording and claiming by businesses has improved

18. Review whether the move to £20,000 turnover threshold should go ahead in April 2028, evaluating how many businesses with this level of turnover have profits in excess of the personal allowance.

19. The government should urgently review the durability of their back end RTI systems, particularly its ability to cope with the added pressure of compulsory benefit in kind payrolling from April 2027.

20. The trivial benefit exemption needs to be increased to take account of inflation since its introduction, and a review should be carried out whether it best meets current practices, for example whether reimbursements (in line with recent changes on eye tests and vaccinations) should be included.

21. Further to the issues and burdens we heard about on employer funded child care we suggest a review and consultation be carried out. Meanwhile, the proposed introduction of a cap on salary sacrifice seems unlikely to be workable in practice, and should be reconsidered.

22. Further to the OTS reports on alignment of income tax and national insurance, we heard recommendations for the government to revisit moving primary class 1 NICs to an annual cumulated and aggregated basis, which was identified by the government of the day as having potential advantages, but was not considered to be the right time for such a major change.

23. The government should review whether the 30 day deadline to notify liability to ATED could be extended, to say 60 days (in line with CGT return on disposal).

24. We propose the government look at uprating the Corporate Interest Restriction £2m de minimis limit, to help ease the burden on smaller groups and consider whether limits generally should be uprated periodical

Chapter 5 Small enterprises

For unincorporated businesses, the fixed rate expenses for motor vehicles, use of home and personal use of business premises were found to be very useful. The government has increased the mileage allowances from 6 April 2026, and calls were made to uprate the other fixed rates also.

It is disappointing that in the HMRC research and analysis paper published 24 April 2025, 'Understanding experiences of dealing with corporation tax'¹, the second most popular factor given for incorporation was 'don't know' (14%), suggesting HMRC's guidance in this area needs clearer signposting. The ability to pass the business back from limited company to sole trade or partnership status, known as disincorporation, without tax acting as a barrier, together with extending the use of the cash basis to one person companies, are raised for discussion.

Recommendations

25. The government has increased the HMRC approved mileage rates by 10 pence per mile, with effect from 6 April 2026, following the rise in fuel prices with a commitment to review again at Budget 2026, and we recommend the government also revisit the level of the other fixed rate expense allowances for unincorporated businesses (which have not been increased since introduction in 2013).

26. On companies, the overriding view was that a business needed to understand there were additional reporting and administration requirements following incorporation. We suggest the HMRC small business customer journey review², announced 23 June 2026, looks at the need for better signposting to HMRC guidance setting out the additional burdens of running a limited company, including at the point of incorporating a business.

27. In Chapter 3, we proposed that the treatment of revenue and expenses followed the accounts. For companies below the audit threshold, and unincorporated businesses, we suggest a simplified definition of repair be used, such as adapting that proposed in the OTS Property income report, published November 2022: 'Relief for all asset costs - other than where work is part of the capital cost of a building, such as the initial fit-out of properties bought in a dilapidated state or structural work such as extensions to the property'.

28. For those companies where the additional administration burdens outweigh the advantages of incorporation, we suggest the government review a reintroduction of Disincorporation relief, enabling assets to pass with no tax charge, without the asset level restriction that applied in 2013, to mirror the position on incorporating.

29. For one person companies, we consider the government carry out a review into whether a simpler cash based accounting scheme may be appropriate, in a similar fashion to unincorporated businesses.

Chapter 6 HMRC support

On communication with HMRC, delays around letters and telephone calls being answered were reported, although a membership organisation found HMRC engagement to be fairly straightforward. But there was a trend of feedback that businesses find HMRC adopt a penalty culture, rather than a growth culture.

The Customer Compliance Manager (CCM) model was generally very well received. There was an acknowledgement that small business tax makes up the majority of the UK's tax gap, but it was felt

¹ <https://www.gov.uk/government/publications/understanding-experiences-of-dealing-with-corporation-tax/understanding-experiences-of-dealing-with-corporation-tax>

² <https://www.gov.uk/government/publications/summary-of-tax-update-2026-simplification-modernisation-and-fairness/tax-update-2026-simplification-modernisation-and-fairness-summary>

that this was clearly linked to the difficulties such businesses had in being able to contact HMRC for guidance. HMRC were often felt not to be focussed on this particular part of the business community, with a claim that small businesses were underrepresented in internal HMRC discussions. It was thought that HMRC never seems to think small first, in terms of how they introduce tax legislation.

Regarding statutory clearances, we were given unfavourable comments on the ability to obtain rulings from HMRC, which left clients or businesses uncertain over the tax consequences of a transaction. VAT was identified as a particular area where clearances were sought but not given, echoing a finding in the 2014 OTS report.

It is noted that HMRC is open to consultation on policy development, which was welcomed, but that sometimes guidance was issued that was not fully developed and awaiting further update. It was questioned whether the practice of closed consultation with limited stakeholders fully satisfies HM Treasury's policy development framework.

Recommendations

30. HMRC are fully aware of criticisms made about the ability of taxpayers to communicate with them and receive an answer on a timely basis. Our respondents consider that the impact of such difficulties go far beyond the inconvenience caused to taxpayers and their advisers, and actually impact significantly upon confidence in the overall tax system and the tax gap in particular. We encourage HMRC to 'think small first' and continue to recruit, train and place compliance staff to deal with queries from small businesses in particular.

31. While HMRC's compliance role is critical, and in general on an international basis performs very well in terms of tax collection, there is genuine frustration by some taxpayers, particularly businesses who wish to invest and expand (including overseas businesses looking to invest in the UK) that HMRC's compliance focus sometimes impacts negatively upon their need for certainty. In the fields of tax incentives for innovation this can be a particular problem and go against the overall policy objective of the measure. We recommend that the government encourage HMRC to reflect on this internally and see whether, in certain focussed areas, consideration could be given to a different approach to assisting expanding businesses.

32. Both of the above recommendations form part of HMRC culture, and while we accept that this may be part of a longer term process given the length of time it will take to adjust the culture of a large and complex organisation like HMRC, we consider it important to highlight and call for serious consideration at this point.

Chapter 7 Other taxes

This chapter covers those taxes that were not listed in the World Bank's Paying Taxes survey, but were raised during the interviews we held as part of the wider picture of the competitiveness of the UK's tax administration, while acknowledging these areas deserve a full, separate study.

On VAT, as well as the difficulties in obtaining HMRC clearances, for the purpose of commercial certainty, in particular we heard there can be confusion surrounding the correct tax rate to be applied. On the theme of uprating, the capital goods scheme thresholds were cited as having not increased with inflation.

The issue of business rates and recent reforms were raised negatively, considering they adversely impacted small businesses over large, and high street over retail parks.

The Extended Producer Responsibility (EPR) levy was raised as an example of complexity, with the business not being told of the rate they would be charged before they needed to finalise pricing to customers. Annual monitoring of the recyclability of different packaging elements was raised as excessively complex. The Packaging Waste Recycling Note (PRN) was also identified as complex, given the need to liaise with various parties in the supply chain, leading to the need for external advice.

Recommendation

33. VAT should remain a key focus of tax simplification efforts. The UK's VAT system is complex at least in part by the actions of successive governments in reducing rates in certain areas for political reasons, although there is also significant underlying legislative complexity. We consider the suggestion to broaden the VAT base with a lower headline rate while removing certain lower rates as an area for HMRC policy teams to consider in more depth. One possible step might be a mechanism that challenged any tweak to VAT rates for some products in terms of whether the 'savings' are worth the additional complexity (and risk of error) caused.

Chapter 8 International comparisons

Many of our interviewees gave personal insights into tax policies in other countries that they considered favourable.

Estonia's tax system is clearly set within a very different context to that of the UK, and was raised as having an innovative corporation tax system, where profits are not taxed until distributed. It should be remembered Estonia and other ex-Iron Curtain countries largely started from scratch with their tax systems. They had the big advantage of learning from others, new IT systems, designing their tax systems to achieve what they wanted rather than being stuck with the legacies of many years of tax raising and associated IT systems.

The Netherlands were raised as operating an effective tax system, largely through the ability of business to obtain certainty. On technology, Sweden, Denmark and Estonia were praised. But arguably Singapore obtained the most favourable comments, with their approach of helpful engagement, of working with business rather than against business which was the perception raised by business in the UK, and brings us back to the recommendation for a change in culture raised in Chapter 6, HMRC Support.

Recommendation

34. We are aware that some HMRC staff interact with tax authorities in other countries. We would encourage HMRC to set up a more formal mechanism for information gathering and discussion internally, with the aim of recognising initiatives in other countries that could usefully be applied within the UK context to reduce tax complexity. This could be a formal role for someone (or a small team) to keep abreast with developments in other countries' systems in terms of innovations/ideas that could/should be considered for the UK.

1. Introduction

Context: The 2014 OTS Report

1.1 In October 2014, the Office of Tax Simplification (OTS) published a review of the competitiveness of the UK's tax administration.³ The Review made 60 recommendations for improvement, of which 57 were either accepted or taken for further consideration.

1.2 These recommendations encompassed both technical legislative changes and administrative simplifications across the tax system, including corporation tax, VAT, payroll, and HMRC administrative procedures.

1.3 While some of these recommendations were implemented, many more have failed to gain traction.

1.4 The OTS focused its assessment of UK tax complexity on the UK's ranking in the "time to comply" measure of the World Bank/PwC's annual Paying Taxes league table, a subsection of the World Bank's Doing Business report. The other two areas were total tax payable and number of tax payments, which were deemed outside the OTS's remit.

1.5 We have heard from former OTS staff members that a desire to move the UK up in these rankings was the motivator behind the introduction of the 2014 review.

1.6 If this was the report's goal, then it is one that remains unmet. The final edition of Paying Taxes, published in 2020, showed both a relative fall in the UK's rank (from 14th to 27th) and an absolute increase of almost 10% in time taken to comply with the tax regime from 2014 – 2018.⁴ Paying Taxes' replacement, B-Ready, records an even further fall, with the UK's time to file and pay ranked 48th of 94 measured countries - below the OECD average.⁵ In their 2014 report, the OTS observed that other countries were also attempting to move up the rankings, and therefore that reform would be necessary purely to stand still.

1.7 This increase in UK tax complexity is also present in the only academic attempt to measure levels of tax complexity across multiple years: the tax complexity index (TCI) of Hoppe et al.⁶ In the TCI, the UK has seen both absolute increases in complexity and relative decreases in country rankings since 2018, so that as of 2024 UK taxation is more complex than both the global and OECD averages.⁷ The main driver of these increases was the UK's growing code complexity, meaning complexity present in the tax code itself, since 2020.

1.8 The OTS was abolished in 2022, with the stated aim of embedding responsibility for tax simplification into existing Treasury and HMRC processes.⁸ While we are sure both departments can

³ Review of the competitiveness of the UK Tax administration: final report. Office of Tax Simplification (2014).

⁴ Paying Taxes 2020, World Bank/PwC (2020). PwC formerly hosted an interactive map at <https://www.pwc.com/gx/en/services/tax/publications/paying-taxes-2020.html> that made comparing performance between countries relatively straightforward. As of 2026 the map has been discontinued, but the raw data tables are available at <https://archive.doingbusiness.org/en/data/exploretopics/paying-taxes>

⁵ Business Ready (B-Ready) 2025, World Bank (2025). Country-by-country rankings for

⁶ The Tax Complexity Index – A Survey-Based Country Measure of Tax Code and Framework Complexity, Thomas Hoppe, Deborah Schanz, Susann Sturm, Caren Sureth-Sloane (2023)

⁷ The TCI's authors have created an interactive map, similar to that formerly hosted by PwC, available at <https://www.taxcomplexity.org/>

⁸ Paragraph 4.13, The Growth Plan 2022

see the benefits of simplification for all parties, this is not their primary focus and given the apparent rise in the complexity of UK taxation, this approach does not appear to be working. This report aims to fill the gap left by the OTS' abolition: for an independent and evidentially-rigorous champion of tax simplification.

1.9 In this report, we revisit the OTS recommendations put forward in 2014. We begin by assessing the position at the time of the original report, what progress or lack thereof we have seen since, and what we have heard during our investigation.

1.10 Our analysis is built upon a series of 35 interviews and roundtables, held in late 2025 and early 2026. In these interviews we heard from over 70 individuals; from businesses large and small, academics, policymakers, industry organisations, tax professionals and their representative organisations. This process was supported by a review of the academic literature on the impacts of tax complexity. A brief summary of the main findings in the literature, and selected bibliography, are included in the appendices to this report.

1.11 We acknowledge with gratitude the generous financial support of the ICAEW (Institute of Chartered Accountants in England and Wales) enabling the preparation of this report.

2. Innovation and growth

2.1 This chapter concerns the following tax initiatives, which aim to drive investment in innovation and grow the economy:

- Research and development (R&D) tax credits;
- Patent box;
- Enterprise investment scheme and Seed enterprise investment scheme income tax and CGT reliefs; and
- Capital allowances.

R&D

2.2 In May 2025, the European Parliament's official economic think tank published a study on the effectiveness of tax incentives in the EU, primarily those targeted at research and development (R&D).⁹ They concluded that there was strong empirical evidence for the efficacy of input-based R&D tax incentives – for example, the UK's Research and Development Expenditure Credit (RDEC) – in stimulating additional R&D investment, by reducing the cost of that investment to businesses.

2.3 The EU study's central projection was that the cost of input-based R&D credits to government in tax revenue is roughly equal to the amount of additional R&D spending produced by the credits. This projection was based on meta-analyses from the mid-2010s; the authors emphasise that more recent empirical evidence suggests that the UK's RDEC may generate anywhere from £160 to £410 in new R&D spend, for every £100 it costs in revenue.¹⁰

2.4 Accessing R&D tax credits was raised by stakeholders at virtually all meetings we held.

Position at the time of the OTS 2014 review of the competitiveness of the UK tax administration

2.5 In the OTS review in 2014, the issue was commented on by many businesses, but overall awareness of the relief and the government's desire to encourage R&D investment was found to be high. Approximately 16,000 claims were made by companies in 2012-13 and, based on a qualifying spend of over £13 billion, the support claimed under the credit had a value of £1.4 billion.

2.6 The review encountered some businesses reluctant to claim, either because of uncertainty of what qualifies as R&D, or reluctance to pay for specialist advice.

2.7 The OTS argued that much of this uncertainty was rooted in the fact there were three sources for defining what constitutes R&D: the accounting definition (under SSAP 13); the definition offered by the Department for Business, Innovation & Skills (BIS), which is now held by the Department for Science, Innovation and Technology; and the HMRC guidance, of which the HMRC definition was the most restrictive.

2.8 The OTS report recommended aligning the BIS and HMRC definitions, and to include in the official HMRC guidance more examples and case studies of successful claims, including in particular software, and examples of what costs do and do not qualify.

⁹ Tax Incentives and Investments in the EU - Policy Department of the Directorate for Economy and Growth (2025)

¹⁰ Ibid., p. 21

What has happened in the meantime

2.9 By 2014-15, R&D claims totalled £3 billion; equivalent to £4 billion in 2023-24, adjusted for CPI inflation. By 2023-24, annual claims had risen to £7.5 billion.

2.10 In the 2023 Autumn Statement, the government announced that it would merge the previous research and development expenditure credit (RDEC), and the small or medium sized enterprise (SME) R&D relief schemes, from April 1st, 2024. New provisions under the merged scheme (now, simply, the RDEC) included an enhanced rate for eligible SMEs, new rules on claims for subcontracted R&D, and overseas restrictions.

2.11 The early 2020s saw rising abuse of UK R&D credits, particularly of the SME scheme, with reports of successful R&D claims ranging from a restaurant introducing a vegan menu¹¹, to a construction firm converting an office to a bike shed.¹² There is a widespread perception amongst tax advisors that the growth in dubious claims was in part driven by “boutique” R&D advice firms, cold-calling small businesses to sell their services.¹³

2.12 This merger was preceded by further administrative provisions. From 2022, all CT returns containing an R&D claim, including amended returns, had to be submitted digitally through the HMRC tax return portal. Since April 2023 additional required disclosures include a description of the R&D undertaken, breakdown of qualifying costs, details of any agent who has advised on the R&D claim, and a sign off from a senior officer of the company. Companies making their first R&D claim in three years must now submit notification that they plan to claim in advance, by submitting a form within six months of the accounting period end. The form must include contact details of the senior internal R&D contact in the company, any agent who has given advice, and a summary of planned activities.

2.13 These modifications have had an impact on the numbers of claims. In 2021-22 the total number of claims was 83,240, reducing to 46,950 in 2023-24. SME claims fell from 71,905 to 36,885 during this period, accounting for almost all the reduction in the total figure.¹⁴ It would be convenient to say this fall entirely represents the removal of erroneous and fraudulent claims. But although just under half of the fall occurred in 2022-23, the actual policy changes mostly did not take effect until 2023-24. Much of the fall may be attributable to greater awareness of dubious R&D advice, or behavioural changes occurred in anticipation of the reforms. Our interview evidence suggests that much of the fall in claim numbers may represent genuine claims being deterred.

2.14 A further consultation¹⁵ ran from March to May 2025 on widening the use of advance clearances in the R&D tax reliefs, both to reduce error and fraud and provide certainty to businesses. Following responses, HMRC announced a pilot scheme from May 2026 for one year, whereby any SME may seek assurance on two of four issues:

- Whether the project meets the definition of R&D for tax purposes;
- Whether overseas expenditure qualifies for relief;
- Which party is able to claim relief for contracted out expenditure;

¹¹ ‘Free money from HMRC’: firms cash in on questionable tax credits – George Greenwood & James Hurley, The Times (2022)

¹² Bike sheds and other ridiculous R&D claims - David O’Keefe, AccountingWeb (2021)

¹³ ‘A horrible situation’: the entrepreneurs caught in R&D tax credit debacle – Emma Agyemang & Kieran Smith (2025)

¹⁴ Approach to R&D tax reliefs 2024 to 2025 - HMRC Corporate report (2024)

¹⁵ R&D tax relief advance clearances: Consultation outcome - HMRC (2025)

- Whether the company qualifies for exemption from the PAYE/NIC cap.

2.15 It was also announced HMRC has established a R&D expert advisory panel comprising six independent experts in scientific fields. While the panel does not assess individual claims, it will advise on guidance and provide insight across specific sectors, with a view to enhancing HMRC understanding of innovation and development in these areas. It is too early to have evidence on whether this is being achieved.

What we have heard

2.16 There was an understanding amongst interviewees that HMRC needed to act to prevent fraud, particularly given past exploitation of “fluffiness” involved in defining innovation, and the lack of policing of that definition’s boundaries. However, we were told repeatedly that SMEs are now being put off claiming due to the uncertainty of getting their claim approved. As a result, we were told by an academic that the UK R&D credit is “seen as a bit of a bonus, but doesn’t drive activity”. In other words, the incentive to invest in R&D shifts away from companies on the borderline of being able to afford it, and towards businesses with the administrative nous to confidently claim the credit, many of whom would have made that particular investment anyway.

2.17 An SME interviewee commented along the same lines: “if I can tell the business that they'll get 20% credit from doing [R&D] here in the UK, then that will tip the balance. It might not go the whole way. There'll be a range of other factors, but it's a very positive, it's a positive pull factor that would keep it here. But if you're doing that two years after the project's finished, then you're doing it in the week before the claim deadline comes true, then that's just, to my mind, the UK just writing a cheque for something that would have happened anyway”.

2.18 A major producer told us “R&D was the best example of a policy in place for a reason, but then trying to stop the policies being applied”.

2.19 If UK businesses are going to be incentivised to invest in R&D, they need certainty and clarity that what they are doing is R&D, and would qualify for the credit.

2.20 We heard a number of suggestions to help achieve this. Firstly, businesses and advisers told us they would prefer a doubling of the period before the claim is paid out (currently 40-50 days), if it allowed HMRC to pre-approve the claim – especially if once paid, approval could only be revisited if the business did not fully disclose, in line with the discovery provisions. In essence, interviewees were willing to trade-off a longer wait for payment, for the certainty that payment would arrive.

2.21 We were told by a regional firm of advisers that the current additional form when first submitting the claim just does not go far enough and needs to cover a minimum amount of detail necessary to make a valid claim; for example, the standard 12 questions currently being asked on enquiry, suitably updated.

2.22 There was a cautious welcome of the pilot SME advance assurance claim, but it was identified that it was only possible to seek clearance on two of four issues, so a business wanting certainty on more than two needed to choose which ones to seek clearance, and of course could still be picked up on the others. We heard the previous advance assurance service was too restrictive in terms of the £2 million turnover, and recently, claimants with experience of live enquiries were reluctant to use it given a lack of confidence in the current HMRC R&D team and the approach they were taking.

2.23 A possible challenge with pre-activity assurance identified was that companies may only have limited information to share at that stage, potentially leaving HMRC unable to give assurance without a further round being necessary later on, which would remove the intended value of providing certainty for business.

2.24 R&D models for large business were very different, and of course these have access to HMRC support through the CCM and large business directorate. Larger businesses were mainly supportive of the merged scheme, in particular the easing of subcontract rules.

2.25 We were told HMRC guidance on innovation is outdated, for example it still mentions DVDs. The guidance hasn't yet been updated for new developments, for example on AI coding. We were told of 'elephant traps in the PAYE/NI restriction and a less subjective UK activities restriction would be useful'. Software was mentioned as still difficult to work out its validity, as was the case at the time of the 2014 report.

2.26 It was repeatedly mentioned to us that HMRC needs more resources with specialist knowledge, with a suggested "analogy of Patent Office having PhD STEM staff". There needs to be more expertise on the frontline, such as in the Netherlands. The introduction of the independent panel was supported.

2.27 A tax adviser said "HMRC told one client they could not have done the R&D development as they googled [it] and found another manufacturer selling an identical product, but [the] client confirmed that was a supplier reselling one of their product they were making the R&D claim for".

2.28 Worryingly we were told HMRC had suggested to a small business that a small claim was unlikely to be R&D and therefore there was a strong chance of enquiry.

2.29 We had mixed feedback on the re-introduction of a minimum claim threshold. Although this almost certainly would free up HMRC time, the following quote was typical: "There's lots of smaller companies [that] will be doing things which are development and they may only spend £20,000 in total in labour and other costs".

2.30 The question was asked whether R&D could be extended to unincorporated business.

2.31 Some stakeholders queried whether the tax system was the right place for incentivising investment. HMRC, responsible for policing the UK tax system, would not appear to be a natural gatekeeper for incentivising business. One suggested using an agency such as Innovate UK as the gatekeeper, or even trusting tax advisers more, with HMRC now having the power to bar advisers in light of the new registration provisions. But equally we heard that "the benefit [of] the tax system versus the grant system is you know you are going to get it annually" and "most if not all the international territories largely derive the R&D incentives through the tax system, so there seems to be a consensus that that's the best way of doing it." Finally on this point, we heard business wants stability, and to be familiar with the system. We found little appetite for immediate significant structural changes. Indeed the absence of changes in the latest couple of Budgets was welcomed.

Conclusions

Policy rationale

2.32 The situation we now find ourselves in is far removed from the original UK government policy rationale, to incentivise businesses to invest in R&D. On the contrary, some businesses, particularly SMEs, are fearful of a recovery claim and therefore may not reinvest the tax credit in R&D, while others may be hit unexpectedly, threatening the future of their business. The culture of

the UK government through the gatekeeper, HMRC, in their workings with business is explored further in Chapter 6, HMRC Support.

2.33 The appointment of an expert panel and the introduction of a pilot advanced assurance system are welcome moves in the right direction. It is too early to say whether these will enable businesses to regain confidence that investment in qualifying R&D will give rise to the R&D credit, and we make the following proposals for improvement.

Guidance

2.34 A starting point in addressing the above shortfall is publication of useful guidance in determining whether expenditure incurred under the project qualifies for the R&D credit.

In the OTS 2014 report, it was suggested:

1. the official guidance would benefit from more examples and case studies of successful and unsuccessful claims;
2. this should include more guidance on software and AI development, where it can be particularly difficult to draw the line between qualifying and non-qualifying activity; and
3. there is scope for better guidance and examples on what costs do and do not qualify. The main uncertainties seemed to be around HR costs.

2.35 It is therefore disappointing that we continued to hear these issues being repeated. We understand the HMRC position that it is difficult to provide case studies, as every case is different and whether or not the expenditure qualifies will depend on the specific facts.

2.36 Our conclusion is that vagueness in the guidance helped to fuel 'fluffiness' in the wording of claims. In the absence of a full advance clearance service, specific guidance is a minimum requirement. Bringing examples of innovation up to date, including latest examples on AI coding for example, is essential.

Recommendations

- 1. We propose the expert panel is utilised in helping HMRC to draft cases studies within official guidance, from claims made across all sectors encountered. Sectoral webinars would be helpful as an addition. The guidance needs to be signposted at all stages of the claims process.**
- 2. We were told the expertise and communicativeness of the HMRC officers was very hit and miss. Again, the expert panel could assist here in upskilling HMRC staff on sector specifics, increasing the number of officers experienced on R&D tax credits.**

Providing certainty - Advance assurance service

2.37 The pilot scheme was planned for introduction in May 2026, as this report was being published. The main drawback for those SMEs making an application is that only two of four areas (see paragraph 2.14) could be asked for. So, a business wanting assurance on three or four, must choose two, and could still be taken up for enquiry on one of the others subsequently.

2.38 The nature of a pilot is that there should be a post implementation review of its effectiveness for SMEs, and how HMRC resources were able to cope.

Recommendation

3. On conclusion of the advance clearance pilot, if it is found that resources allow, we propose the targeted advance clearance service be expanded to allow businesses to request clearance on 'Whether the project meets the definition of R&D for tax purposes' in addition to at least two of the other factors listed.

Additional information form (AIF)

2.39 As identified above, some companies may not be in possession of sufficient information to make a pre-activity application.

2.40 Businesses told us they would prefer a doubling of the turnaround time, if that provided the certainty that the credit could only be recovered where full disclosure of the facts had not been made, carelessly or deliberately.

Recommendation

4. Where advance clearance has not been secured, we suggest the AIF is extended to ask for all the information that HMRC specialists would need to determine whether the claim qualified, and HMRC could only subsequently revoke the claim where the business has acted carelessly or deliberately in the claim process.

2.41 We do not suggest reimposing a de minimis threshold, as valuable R&D can be undertaken at lower levels, and longer term, suggest the government consider whether the scheme could be extended in some form to non-corporates.

2.42 But overall, what is required is a shift in culture, from 'let's see what you've done wrong' to 'how can we help you to invest in innovation UK'. This cannot happen overnight of course, but we suggest that the changes proposed would help provide business with certainty and in turn incentivise UK investment in R&D, while driving up compliance standards.

Patent box

2.43 The Patent box provides a lower rate of CT of 10%, having been introduced in phases from 2013 to 2017. It was therefore too early for comment in the 2014 OTS report.

2.44 The Patent box is designed to encourage companies to keep and commercialise intellectual property in the UK and is therefore a natural follow up to R&D tax credits.

2.45 During the course of our stakeholder meetings, we tended to hear about the bad news rather than the good. It is therefore pleasing to report the Patent box regime was seen as a bonus for the UK, and we heard of multinationals in the Pharma industry locating here partly as a result.

2.46 The calculations of the profits derived from the development carried out by the company itself can be complicated, with a R&D fraction calculated for each IP stream (comprising relevant in-house R&D + relevant subcontracted R&D to unconnected parties, with a 30% uplift applying on certain costs, divided by all all relevant R&D expenditure related to the qualifying IP). In exceptional circumstances, the company may elect to use a value fraction instead, arrived at on a just and reasonable basis where the standard R&D fraction would misrepresent the company's contribution. We were also told that there is plenty of innovation that qualifies for R&D but is not patentable, and passing on the tax benefit from a patented product can be complex.

Recommendation

5. The government should review whether it is possible to simplify the Patent box calculation for SMEs, summarised in paragraph 2.46 above, to help smooth the transition from R&D credits to accessing the patent box thereby retaining the IP in the UK.

Enterprise investment scheme (EIS) and Seed enterprise investment scheme (SEIS)

2.47 While we were conducting this review, HM Treasury issued a call for evidence on tax support for entrepreneurs¹⁶, seeking views on the success of venture capital schemes and tax-advantaged share schemes for scaling companies, seen by many of the stakeholders we interviewed as a sector needing further support.

2.48 We did not seek to duplicate this work, but inevitably we were given stakeholder views on the operation of these schemes.

2.49 We are pleased the government is seeking the views of stakeholders on ways the tax system can help unlock the UK's scale up potential, and will be assessing the range of options to improve the effectiveness, targeting and impact of tax incentives to support start ups and scale ups.

2.50 Following the announcement at Budget 2025, Finance Act 2026 doubled the company investment limits and gross asset tests for EIS and VCT eligibility (but see paragraph 2.54 below regarding Northern Ireland). But the call for evidence recognises too many promising firms feel compelled to look abroad for capital as they grow. Stakeholders we spoke to echoed that concern, that once limits for funding have been reached, the company has nowhere to go for the next tranche, meaning possible failure or sale overseas and a resulting loss of the IP paid for by the UK taxpayer.

2.51 The rule that the relevant investment must be made before the period of seven years (ten years for knowledge intensive company) beginning with the first commercial sale (subject to further round of investment allowed of at least 50% of average turnover amount, where employed for the purpose of entering a new product or geographical market), was introduced in 2015 following an EU directive. We were told this maximum age requirement was the most common reason for failure, and its removal would help address the lack of scaling up.

2.52 As identified in the CIOT response to the call for evidence, there are multiple conditions the company must satisfy in order for investor relief in EIS/SEIS to apply, meaning errors can lead to loss of relief, which can occur several years later. One such condition mentioned to us was that a share buy-back would disqualify the relief, even though this is very common when the founder leaves. The income tax relief given is then clawed back, and the accompanying CGT relief is also lost to the investor.

2.53 We have heard the advance assurance process is confusing, with founders and advisers not appreciating this is only a preliminary indication, with actual HMRC approval occurring later, which can cause misunderstandings between the founder and investor.

2.54 Regarding the increased EIS/VCT limits from April 2026, we were told by Northern Ireland (NI) advisers that this does not apply in NI, as a result of the Windsor framework.

¹⁶ Tax Support for Entrepreneurs: Call for Evidence – HM Treasury (2025)

Recommendations

6. As part of the HM Treasury review following the call for evidence responses, we suggest work is carried out looking to simplify the conditions for EIS and SEIS reliefs to apply and remain permanent, in particular whether the maximum age requirement remains necessary.
7. Again following the call for evidence, work should be carried out on looking to improve administration processes on claiming the relief.
8. We recommend the government seek EU clearance to enable Northern Ireland to secure the equivalent EIS/VCT easements as the remainder of the UK.

Capital allowances

2.55 Much of the discussion in the 2014 OTS report was around the adjustments necessary to replace the accounting depreciation with capital allowances, which is looked at in Chapter 3.

2.56 Areas seen as problematic at the time were identifying the expenditure qualifying for plant & machinery allowances, the lack of any relief for building and structures, and the need for stability in the level of the annual investment allowance (AIA).

What has happened in the meantime

2.57 A Structures and buildings allowance was introduced for qualifying expenditure incurred from 29 October 2018. The Corporate Tax roadmap¹⁷ published by the current government sets out a level of AIA of £1 million (including for non-corporates) for the life of this parliament.

2.58 For expenditure incurred from 1 April 2021 to 31 March 2023 by companies, in anticipation of an increase in the rate of CT, a super-deduction of 130% was introduced for assets that would enter the main pool, with a special rate allowance of 50% for assets that would enter the special rate pool. From 1 April 2023, the super-deduction was replaced by 100% full-expensing for main pool assets, with 50% on special rate assets.

2.59 Budget 2025 announced a decrease in the level of writing down allowance on main pool plant & machinery from 18% to 14% with effect from 1 or 6 April 2026 for companies and unincorporated businesses respectively. A hybrid rate applies if the accounting period spans the date of change. A new 40% first year allowance was introduced for expenditure incurred on or after 1 January 2026, with leased assets (other than overseas) being admitted.

2.60 Example

Palmer Ltd has an accounting period year end 31 December 2026 with a main pool tax written down value at 1 January 2026 of £68,000. It incurs expenditure of £200,000 on new plant on 1 June 2026. On 1 July 2027 the plant is sold for £50,000.

If a claim for AIA is made, the main pool computation would be::

1 January 2026 b/f		68,000	Allowances
1 June 2026	Acquisition	200,000	

¹⁷ Corporate Tax Roadmap 2024 – HM Treasury (2024)

	AIA	<u>(200,000)</u>	200,000
		68,000	
	WDA @ 15% (hybrid)	<u>(10,200)</u>	<u>10,200</u>
31 December 2026		57,800	<u>210,200</u>
1 July 2027	Sale	<u>(50,000)</u>	
		7,800	
	WDA @ 14%	<u>(1,092)</u>	<u>1,092</u>
31 December 2027		6,708	

However, if a claim for full expensing is made on the plant acquisition instead, the main pool computation becomes:

1 January 2026 b/f		68,000	Allowances
	WDA @ 15% (hybrid)	<u>(10,200)</u>	<u>10,200</u>
31 December 2026		57,800	
	WDA @ 14%	<u>(8,092)</u>	<u>8,092</u>
31 December 2027		49,708	

On the full expensing, £200,000 would be allowed for year ended 31 December 2026 (in addition to the writing down allowance £10,200) and a balancing charge would arise for year ended 31 December 2027 for £50,000 (with a writing down allowance of £8,092).

Both the results are correct, but with quite different outcomes.

2.61 The Supreme Court in the *Orsted West of Duddon Sands (UK) Ltd and others v HMRC* (previously known as Gunfleet Sands) issued their decision that pre-development surveys and technical studies did not constitute plant and machinery.

What we have heard

2.62 There was strong approval for the AIA.

2.63 Interaction with CGT was raised with us, with a simplified CA regime suggestion of deduction on acquisition, tax on disposal. This follows the corporate full expensing computations, and to fully expense everything was raised as a potential simplification measure.

2.64 There appeared to be no policy rationale for different treatments, assets bought versus leased for example, making the system complicated and distortionary, and a call was made for full expensing to include leased assets.

2.65 Due to its complexity, we heard the choice of capital allowance reliefs was usually left to advisers, which may remove the incentivisation for the business itself.

2.66 It was queried whether any work had been done looking at the administration time spent on disallowing 15% of leased vehicle charges (other than those with low emissions).

2.67 We spoke to university academics who noted that different answers can be obtained on capex depending which capital allowance relief is claimed, and experimenting with Artificial intelligence (AI) may result in different decisions to a human, resulting in different answers.

Recommendations

9. The range of plant & machinery accelerated allowances is seen as confusing, with full expensing being outside the pool, while AIA and FYAs are within. We recommend the government carry out a review on how best to allocate the 100% allowances, across both corporates and non-corporate entities. The review should set out the policy objective on relief for leased assets.

10. Identification of what constitutes plant remains a difficulty. Following the Gunfleet Sands decision, we suggest the government consider reviewing how plant can be better defined to incentivise investment, which in turn would reduce the number of queries and compliance checking for HMRC.

3. The Corporation tax (CT)/Income tax (IT) computation

3.1 Reforming the calculation of trading profit for CT or IT formed one of the flagship recommendations in the October 2014 OTS review of the competitiveness of the UK tax administration.

3.2 In 2014, the time taken to comply with tax obligations computed under the 'Paying Taxes' report was 37 hours per year. This was similar to Canada (45), Australia (37) and Singapore (32), but considerably longer than in Ireland (10), Switzerland (15) and Luxembourg (19).

3.3 Looking at one thing to improve competitiveness in the OTS report, it was found 'we are only going to make a real difference to the time taken on CT (or IT) administration by making significant reforms to the rules for the computation'.

3.4 The starting point in the calculation of trading profit for CT or IT purposes is the profit determined in accordance with generally accepted accounting principles (CTA 2009, s. 46(1) and ITTOIA 2005, s. 25(1)), unless the cash basis applies for income tax purposes (ITTOIA, s. 25A). It is then necessary to make adjustments to that starting profit, by adding back deductions made that are not allowable for tax purposes, and deducting allowances that are allowable but are not shown in the starting figure. Income included in the starting profit that is taxable under another schedule (see paragraph 3.18) must also be deducted and usually taxed elsewhere, and finally income that should be included for tax purposes but has not been credited in the starting profit needs to be added in (for example taxable lease premiums).

3.5 At the time of the above report, it was counted there were potentially 81 differences between taxable profit and accounting profit, falling mainly in two areas:

1. Those disallowed under the wholly and exclusively rule, and
2. The treatment of capital expenditure.

3.6 This gave rise to a key recommendation in the report: Align more closely accounting and tax profits and eliminate many sundry adjustments.

What has happened in the meantime

3.7 The trend for greater alignment between accounts and taxable profit had already given rise to CT relief for intangible assets and interests.

3.8 The alignment issues were carried forward into the OTS report on Simplifying the Corporation tax computation, published July 2017, on which the government agreed the need for reducing the number of adjustments from accounting to taxable profits, and align tax definitions, to help simplify the tax code for smaller companies.

3.9 The Chancellor additionally commissioned the OTS to explore accounting depreciation instead of capital allowances. The report was published in June 2018 and concluded the evidence did not support such a change, but looked at widening the scope of capital allowances, and from which a new Structures and buildings allowance was introduced.

What we have heard in our meetings

3.10 We were told Sweden, Germany and Australia have more closely aligned systems than the UK (see Chapter 8 for further detail on international comparisons).

3.11 We heard some academic suggestions that total alignment was not possible, nor desirable, as it would never be possible to change accounting standards to depreciate 100% in year one. It was suggested the only difference should be in order to incentivise, for example on capital allowances, or government policy decisions on non-deduction. Further to the OTS report from June 2018 on Capital allowances, it is clear the 100% capital allowances annual investment and fixed expensing regimes are popular and help encourage investment in plant and machinery. These are considered further in Chapter 2. From an accounting point of view, full first-year depreciation is unlikely to be either desirable as it reduces the value of accounts as a snapshot of the business, nor possible, as setting accounting standards are not within the remit of the UK government. For these reasons we do not recommend that alignment between depreciation for tax and accounting be pursued further.

3.12 A mid-sized accounting firm gave examples of extensive admin work for no tax advantage. Usual suspects were movement in provisions, pension on cash basis, trivial legal expenses, anti-hybrid rules' lack of size threshold (see paragraph 3.15 below).

3.13 Other problem areas raised were private use adjustments, with the comment that farming businesses faced complex adjustments, entertaining, travel & subsistence, and in particular repairs and maintenance which were seen as a "large grey area".

Anti-hybrid rules

3.14 The anti-hybrid rules were introduced from 1 January 2017 under the *Taxation (International and Other Provisions Act)*, [ss 259A–259NF](#) to neutralise the tax effect of hybrid mismatch arrangements in accordance with recommendations from the G20/OECD Base Erosion and Profit Shifting (BEPS) project. The measure sought to tackle aggressive tax planning where, within a multinational group, either one party gets a deduction for a payment while the other does not have a taxable receipt, or there is more than one deduction for the same expense. In addition, the measure neutralises the tax effect of hybrid mismatch arrangements involving permanent establishments.

3.15 We heard from partners of a mid-sized firm of accountants that several of these adjustments take a disproportionate amount of time compared to the value of the tax at stake. The work is challenging, and frequently necessitates dealing with the adviser's overseas team who may not appreciate why they were having to spend time extracting, translating and providing the information, especially given that often there is little impact on the tax due, but will still require a full re-analysis each year.

3.16 The resource demands of this work is likely to be beyond many smaller accounting firms, who may miss these rules, or need to refer clients to more specialised firms.

3.17 Further, there is no de minimis threshold, unlike the Corporate interest restriction (on which there are issues considered further in Chapter 4 on Reporting and compliance), and no anti-avoidance or intention test, thereby catching normal cross border commercial arrangements.

Recommendations

11. We would like the government to revisit the work initiated following the OTS recommendations on reducing the number of adjustments necessary between accounting profit and taxable profit, where there is no incentivisation or compliance rationale.

12. In particular, we would like work to commence on aligning the tax and the accounting definitions of capital and revenue, which would help considerably in deciding whether a replacement was a repair, or a capital acquisition, and on legal or professional transaction fees, for example.

13. For those businesses below the accounts auditing thresholds, we suggest a simpler statutory test for repairs is introduced. (See Small companies Chapter 5 for an outline of what the test could look like).

14. On the anti-hybrid rules above, now approaching 10 years since introduction, we propose the government carry out a review of the measure, with a view to introducing a de minimis limit in order to cut down on the disproportionate administrative time incurred chasing little or no tax adjustment.

The schedular system

3.18 The different schedules date back to the re-introduction of income tax in 1803. Although the Tax law rewrite process, resulting in the consolidated acts ITTOIA 2005, ITA 2007, CTA 2009 and CTA 2010, removed the lettered headings (schedule A, B, C, D, E and F), they retain the distinction, simply renamed as Property income, trading income, employment income, investment income and so on, each with their own particular tax rules applying.

3.19 In the 2014 OTS report, it was reported these rules could be very confusing for businesses. Managing the use of losses, and deciding whether or not to disclaim capital allowances took considerable time, not necessarily something they had to do in other countries. The report concluded the trading/investment distinction was outdated then, and did not fit with modern business practice which considers all their activities as a single enterprise.

3.20 The report recommended taxing businesses on their overall business profits and review the removal of the loss streaming rules that applied at the time. The report also called for a review into introducing a consolidated CT return for groups of companies, on the basis of a single business carried on by all members of the group, at least on an optional basis.

What has happened since

3.21 The proposals on schedular reform were also taken forward into the 2017 OTS report on Simplifying the CT computation. In his response, the Chancellor recognised the complexity of the existing schedular regime, and that reform would be a sensible long term objective, and would ask officials to gauge exchequer costs, risks and impacts on customer groups, but this has not progressed.

3.22 In the meantime, the loss streaming rules were removed for losses incurred post 1 April 2017 (CTA 2010, s. 45A onwards).

3.23 The OTS Property income report published in November 2022 proposed the introduction of a single 'rural business unit', to allow for agricultural diversified businesses to consolidate their income and expense streams.

What we have heard

3.24 Stakeholders told us that starting from scratch, the schedules wouldn't be a part of the tax system and different forms matter less as we move further from April 2017, when the loss rules changed allowing sideways set off.

3.25 We were told splitting and recombining takes considerable time and makes a difference in a vanishingly small number of cases. However, it was acknowledged removal may be difficult with overseas taxes, banking levies, patent box, so moving to fewer schedules may be a better way to look at it.

3.26 It was thought UK governments over many years like the ability to charge different sources at different rates, but that is a complication rather than simplification.

3.27 Farming businesses were raised as an example where the schedular system was problematic, with bills spread across income streams. Diversification was now a fairly fundamental part of farm businesses – most unify the accounts and then have to separate out. This was said to be: “time consuming and in many ways a little bit pointless”. We were told “businesses would prefer an option to report as a single trade, aligned with their VAT registration, following the Rural business unit approach which had gained some interest with HMRC”.

Recommendations

15. We propose the government revisit the OTS recommendation from 2014 and 2017 to look at aligning the rules for as many of the schedular income sources as possible, and suggest looking initially at fully aligning trading income and property income. As part of this, we echo the OTS Property income recommendation from 2022 that the government work with DEFRA to look into a rural business unit for diversified agricultural businesses, enabling those agricultural businesses producing consolidated accounts with diversified activities which support the core agricultural business to make a single return, or in the case of making tax digital for income, the quarterly tax updates.

16. We propose the government look at aligning definitions used across the income schedules and capital taxes, for example having a unified meaning of ‘business’.

4. Reporting and compliance

Making tax digital (MTD)

4.1 Although the 2014 OTS report references digital initiatives, publication was prior to the introduction of the government's plans for making tax digital.

4.2 Originally badged as Making tax easier: the end of the tax return in March 2015, the vision set out that by 2020, more than 50 million individuals and small businesses would have a secure personalised digital tax account, removing the need for millions to complete a tax return.

4.3 The word 'easier' was dropped from the heading in 2015-16, rebadged as making tax digital with a view to maximise tax revenues, make cost savings and improve customer service across three business taxes: VAT, Income tax self-assessment and Corporation tax. The self-assessment tax return has remained in place.

4.4 Digital VAT for large traders was introduced as planned in 2019, with smaller traders in 2022. On MTD for Self-assessment, following four changes to planned implementation, the self-employed and landlords with income over £50,000 (measured by reference to the tax year in 2024-25) entered the scheme from 6 April 2026, with a requirement to keep digital records and submit quarterly returns of income and expenditure, together with a MTD self-assessment return. Those with incomes over £30,000 will enter from April 2027 and £20,000 from April 2028. It is not known when partnerships will enter, and an announcement was made that MTD for Corporation tax will not go ahead¹⁸.

4.5 A promise was originally made by the government that free software would be available for those below the VAT registration threshold. Although initiatives by third party software providers, in collaboration with certain banks, mean it is possible for businesses or landlords to access free software, this could not have been behind the government's original promise.

What we have heard

4.6 We heard mixed views on a move to pre-population of returns - this was not thought to be ideal by some and added to compliance work by advisers attempting to reconcile and correct figures that were wrong, while software providers, unsurprisingly, called to increase pre-population. Although amending a pre-populated figure should be straightforward, the need to check and amend the figures does not reduce the admin burden.

4.7 A software provider told us people are getting things wrong because there is an assumption the software will make it right for them, a mindset that may be influenced by software providers implying they will get it right first time. It was acknowledged the software cannot act as an adviser, or correct information entered that was wrong.

4.8 It was accepted that the move to quicker recording would improve recordkeeping, but some thought that this would mean expenses that may have been missed or mislaid will now be reported, while the majority of sales now are dealt with by bank transfer, which could potentially result in a reduction of the tax take.

¹⁸ HMRC clarifies position on Making Tax Digital and cessations – ICAEW Insights (2026)

4.9 For VAT, there was already a quarterly payment system in place, and we were told the return is effectively created in the way it always was, and then exported to the MTD system. However, the business felt they “were on the hook for third party pricing”.

4.10 But we were told “quarterly reporting for income tax is so completely different [to annual reporting under self-assessment], it will be a big shock to people”. Smaller businesses were thought likely to find adjustment harder – “what you see as a business standing back is the same numbers being reported to HMRC in a slightly different format, and in a format that requires you to go out and invest in software – so what’s in it for me?”

4.11 While the easing of there being no in-year penalties for the opening year is welcome, businesses may not understand there are still year end submission penalties. And we heard on starting, there was a misunderstanding that registering for a software account doesn’t automatically enrol them into self-assessment.

4.12 It was noted there was an advertising spree by software providers, with some suggesting HMRC were appearing to allow this to happen in the absence of their own advertising budget.

4.13 We heard of difficulties for taxpayers if they were to try and change software providers as historical data is encrypted, so if HMRC raises an enquiry and the taxpayer hasn’t extracted their data after a switch, it can be quite laborious to re-obtain it from the previous software provider.

4.14 It was thought quarterly payments are likely to lead to a more pay as you go system. Otherwise our stakeholders couldn’t see the need from first principles. Seasonal business have particular problems here: “it is not going to be useful data for HMRC for farmers as some quarters will just show outgoings and in no way is it going to give an accurate picture of final taxable profit”. The problem is that farmers need multiple years to predict tax payments, and farmers’ averaging was excluded from the pilot. It was thought quite a number of farmers would be digitally excluded. And when partnerships are brought into MTD, agricultural businesses may need 5, 6, or 7 returns per quarter (see paragraph 3.27 on a rural business unit).

4.15 A Northern Ireland adviser summed up: “now these things are proposed by people who’ve never really worked properly in private industry, and then they’re designed by software engineers who are only following the instructions they’ve been given”. However, there was evidence of improved HMRC engagement with software providers to better understand the issues for business, one example being to allow the use of multiple advisers.

4.16 A further quote from a software provider: “I think they should have gone in at the other end and simplified the tax system and kept the once a year self-assessment filing, but made it a lot easier for somebody to fill in a tax return. My view is that it should be possible for an intelligent 6th former”.

4.17 We heard there was no logic to having to provide a NI number to register for MTD.

Conclusions

4.18 The National Audit Office report of 12 June 2023¹⁹ concluded HMRC did not fully assess the scale of work required at the outset of the MTD programme, or the additional complexity of introducing digital record keeping for business taxpayers at the same time as replacing its legacy systems, resulting in multiple deferment of the commencement date.

¹⁹Progress with Making Tax Digital - National Audit Office (2023)

4.19 Although there now appears widespread knowledge of its introduction from April, the first quarterly return date is not due until 7 August 2026, so a better picture will not be obtained until then. However, it is extremely unlikely that businesses will understand the hidden detail, such as the fact that although income may fall, a business remains in MTD until falling below the threshold for three years.

Recommendations

17. We suggest a post implementation review next year of MTD quarterly reporting, to include an evaluation of whether recording and claiming by businesses has improved

18. Review whether the move to £20,000 turnover threshold should go ahead in April 2028, evaluating how many businesses with this level of turnover have profits in excess of the personal allowance.

Payroll

4.20 Publication of the 2014 OTS report closely followed the introduction of Real time information (RTI) payroll reporting. The introduction of MTD for income tax self-assessment echoes what was heard following RTI's introduction, of employers incurring set up time and costs.

4.21 Although problems were rare, those encountered were significant, reported as:

1. Duplicate records being created in a limited number of cases, causing year to date figures being duplicated resulting in underpayments,
2. RTI appeared to have delayed the time when a leaver or starter is notified,
3. The tax dashboard not being immediately updated.

4.22 These issues were not always communicated to frontline HMRC staff, causing considerable frustration for employers and payroll bureaux.

4.23 The OTS report recommended a post implementation review, looking at whether on or before reporting was actually necessary to operate the Universal credit system, reduce the number of FPS and EPS submissions, to be able to set up an annual scheme by a structured email facility, and produce guidance to clarify the disparity between RTI and employment law on reporting date of leaving.

4.24 The OTS report recommended pushing forward with the proposals of the OTS Employee benefits and expenses (EBE) review, of allowing voluntary payrolling of benefits in kind, removing the £8,500 lower paid threshold, allowing reimbursed allowable expenses instead of the dispensation process and introducing a trivial benefits exemption.

4.25 Last but by no means least were the proposals to look further at aligning income tax and national insurance contributions (NIC) and employment status of a worker.

What has happened since

4.26 All the above recommendations from the OTS EBE review were introduced. Full compulsory payrolling of benefits in kind will be phased in from April 2027.

4.27 Further reviews were carried out by the OTS into Employment status and aligning income tax and NIC, but apart from changes made to the guidance and the Check employment status for tax (CEST) tool, little change has occurred. On income tax and NIC, a seven stage process in order to align class 1 primary contributions was outlined in the OTS reports published March and November

2016, some of which were introduced in part such as aligning the lower earnings threshold and the personal allowance, but a major hurdle is how to replace employer secondary class 1 NIC, which yielded £61 billion at the time of the review.

4.28 Changes to the salary sacrifice of pension contributions are planned from April 2029, with only the first £2,000 of contributions per employee to be exempt from NICs. Employer contributions will continue to be free of NICs.

What we have heard

4.29 Ten years on, it is disappointing to note there are still issues with RTI, and we were told of difficulties following an employee's departure with the need to provide an address. We heard new starter forms had increased recently which made the process "quite cumbersome". A payroll representative body informed us duplication of records was still a major issue, particularly when businesses merge and when switching payroll providers. A large industry representative told us there remain mismatches between payroll and HMRC records, and when speaking to HMRC, it is only the more senior people who are able to resolve issues in the longer term.

4.30 Reconciliation of payroll systems with HMRC backend systems proved difficult for all sizes of companies, with HMRC not always recognising that their own system is causing the problem.

4.31 A software provider told us there were examples of mislabelling the year to date figure as the month 11 figure and of HMRC closing schemes without notifying the employer.

4.32 A large accounting firm was sceptical on the accuracy of the tax gap figures quoted, given the large variations on larger pay as you earn schemes between the employer and HMRC records.

4.33 The RTI system was described to us as 'fragile', "all it takes is an employer to get the wrong reference on one payment and it all falls out of kilter as HMRC need to manually allocate those payments". And "if there is a fault with PAYE data at submission, the whole tranche of submissions are rejected, not just the erroneous ones." Payrolling benefits may produce more errors and the worry was the system would break.

4.34 We were told of the need for additional software on P11D benefits, but that the process may become simpler when full merger into the P60 payroll is introduced from April 2027.

4.35 We heard obtaining a visa for an inbound employee was possible under the non-dom regime, as a travel facility for the cost of a trip home (ITEPA 2003, s. 373), but per Employer Bulletin December 2018, the cost of the visa is now considered a benefit in kind, and this matter was being taken up with HMRC.

4.36 It was suggested to us that because offshore income is frequently reported per calendar year, that self-assessment should allow reporting on the basis of the tax year for the country it comes from.

4.37 A suggestion was made to loosen the exemptions around employer funded child-care which could take many out of the state funded tax free child-care scheme.

4.38 On salary sacrifice changes, it was suggested some employers would make a change to everyone's contract to have higher employer contributions, which is not a sacrifice, while smaller employers would not want to take the hit of an additional pension contribution, creating winners and losers, with the losers likely being the squeezed middle earners. The question was raised about what would happen in the case of part-years.

4.39 Calls were made to update the level and relax some of the conditions on the trivial benefits rule, which has remained at £50 since introduction. The removal costs exemption of £8,000 similarly has not been updated.

4.40 We were told auto-enrolment was an administrative burden for employers, but did not explore this further as it is not a tax issue. However, we consider any future government review on the pension system should encompass auto-enrolment and the burdens it imposes for business.

4.41 On employment status and the need for IR35, academics spoke of the need for an overall tax system producing equivalent results regardless of the legal form of the worker. This could be facilitated by merging income tax and NICs, and this was suggested by several participants. There are longstanding arguments the National Insurance system is distortionary.²⁰

Recommendations

19. The government should urgently review the durability of their back end RTI systems, particularly its ability to cope with the added pressure of compulsory benefit in kind payrolling from April 2027.

20. The trivial benefit exemption needs to be increased to take account of inflation since its introduction, and a review should be carried out whether it best meets current practices, for example whether reimbursements (in line with recent changes on eye tests and vaccinations) should be included.

21. Further to the issues and burdens we heard about on employer funded child care we suggest a review and consultation be carried out. Meanwhile, the proposed introduction of a cap on salary sacrifice seems unlikely to be workable in practice, and should be reconsidered.

22. Further to the OTS reports on alignment of income tax and national insurance, we heard recommendations for the government to revisit moving primary class 1 NICs to an annual cumulated and aggregated basis, which was identified by the government of the day as having potential advantages, but was not considered to be the right time for such a major change.

Other reporting issues

4.42 Annual tax on enveloped dwellings (ATED) was described to us as an anti-avoidance provision but brought in many more situations. The biggest problem was the 30 day deadline from acquisition which was described as “unrealistic for agents” and appears to be set up for companies to fail and become liable to penalties.

4.43 That said, the ATED return was praised for ease of registering as an agent, which contrasted with online Employment related securities registration which necessitated waiting for codes by post.

4.44 The lack of digitisation for form CT61 was raised.

Recommendation

23. The government should review whether the 30 day deadline to notify liability to ATED could be extended, to say 60 days (in line with CGT return on disposal).

²⁰ See, for example, “Reforming the Taxation of Earnings in the UK”, Chapter 4 in Tax by Design: the Mirrlees Review (2011)

Corporate interest restriction (CIR)

4.45 The CIR was introduced in April 2017 following the OECD BEPS project to address tax avoidance by multinational organisations, and therefore did not feature in the OTS UK Competitiveness review.

4.46 The administration burdens around the CIR was raised to us and the HMRC working group by stakeholders, and the following issues identified:

1. The de minimis limit of £2m net interest was introduced to remove the burden for small groups, but has not kept pace with inflation, nor in particular, the large increase in the Bank of England base rate since introduction²¹.
2. The requirement to nominate a reporting company within 12 months of the end of the period of account, with all information required on the reporting company nomination being repeated in the main interest restriction return (IRR), was seen as a pointless administrative burden, while submitting an incorrect appointment would make any subsequent IRR invalid.
3. A further difficulty arises with the IRR, in that although it is possible to amend a previous IRR (within 36 months of the end of receipt of the amended CT return), it is not possible to do so where the IRR was not submitted, for example where the group believed it was within the £2 million de minimis limit at the time, but a subsequent amendment of the group CT returns (within the self-assessment amendment period) meant the group find themselves above the threshold.

4.47 It is pleasing that changes introduced by Finance Act 2026 during the course of our review have addressed the second and third bulleted concerns above, allowing the reporting company to retrospectively appoint a reporting company, and the statutory obligation and time limit for reporting companies to file an IRR is removed, apart from the limited circumstances where HMRC appoint the reporting company.

Recommendation

24. We propose the government look at uprating the Corporate Interest Restriction £2m de minimis limit, to help ease the burden on smaller groups and consider whether limits generally should be uprated periodically.

²¹ The BOE base rate was 0.25% in April 2017, at the time of drafting it is 3.75%

5. Small enterprises

5.1 The OTS 2014 UK Competitiveness review included recommendations for HMRC to extend as much as possible the 'once and done' procedure, removing tax as far as possible from the day to day activities of the business, notably for returns and payments. It was considered a possible way of achieving this was to emulate Sweden and create a single tax account. The vision was for small businesses to make monthly returns of income and expenses, and receive a single bill covering as many taxes as possible, removing the need for multiple payments for different taxes. This is looked at further in Chapter 6.

5.2 The 2014 OTS review was preceded by the Small business review, with the final report published February 2012, recommending the introduction of a cash basis for small unincorporated businesses, fixed rate expenses for motor vehicles, use of home and personal use of business premises, and a disincorporation relief for small companies.

5.3 Disincorporation refers to a transfer of a business from a company to its shareholders, whether as a sole trade or a partnership. This would normally be followed by the striking off or liquidation of the company. Following the introduction of a nil CT rate in 2002, many small businesses took the decision to incorporate their business, but following the removal of the nil rate four years later, many of these businesses found the additional administrative burdens outweighed any remaining tax advantages with 14% wanting to return to unincorporated status. However, while there was no capital gains tax charge on entering a company (known as incorporation relief), there was no such relief from the chargeable gain that would arise on the company on disincorporation. Further, a capital gain charge would arise on the shareholders on striking off or liquidating the company. A disincorporation relief enabling the transfer of a business from a company to the shareholders at a deemed price producing no gain or loss was introduced from 1 April 2013, but was subject to a maximum market value of qualifying assets (including pre and post FA 2002 goodwill) of £100,000, which left the relief having little value and it was allowed to expire under a sunset clause in April 2018.

5.4 The concept of reducing the number of adjustments between accounts and taxable profit set out in chapter 2 was carried forward to the Simplification of the corporation tax computation, published July 2017, with further work carried out on 'Closer alignment of income tax and national insurance' published November 2016, and 'Accounting depreciation or capital allowances' published July 2018. A report on the concept of look-through taxation for small companies was published November 2016. A full list of the OTS reviews, with links to the reports and government responses is available on the gov.uk website²².

What has happened since

5.5 Meanwhile, of course, making tax digital for VAT and income tax has been introduced from April 2019 and April 2026 respectively (see Chapter 4).

5.6 Cash basis for unincorporated traders was introduced from 2013-14 and the default basis for unincorporated property landlords from 2017-18. It has proved extremely popular, with HMRC statistics indicating 1.1 million self-employed and landlords use the scheme. Cash basis became the default basis for the self-employed from April 2024.

²² Index of reports published by the Office of Tax Simplification – Office of Tax Simplification (2022)

5.7 Fixed rate expenses for motor vehicles, use of home and personal use of business premises were also introduced from 2013-14.

5.8 The number one reason for incorporating remains the advantage of limited liability, which was also the case at the time of the OTS small business review, although the need for personal guarantee on finance may impact this advantage. It is disappointing that in the HMRC research and analysis paper published 24 April 2025, 'Understanding experiences of dealing with corporation tax²³', the second most popular factor given for incorporation was 'don't know' (14%), suggesting HMRC's guidance in this area needs clearer signposting.

What we have heard

5.9 For unincorporated businesses, we heard the fixed rate expenses were really useful as it could be time consuming to make all the necessary adjustments. However, calls were made to uprate the amounts, along with trivial benefits, which have remained the same since introduction.

5.10 Similarly, we were told adjustments from accounts are time consuming, particularly for smaller businesses, finding the item as it may be within a number of software codes, and finally exercising a judgement on, for example repairs, where replacement with new materials counts as revenue although it is strictly capital. It was suggested anything under a de minimis limit, say £1,000, could be treated as revenue.

5.11 It was suggested enhanced education on tax would be a good thing, to help individuals better understand their tax affairs and budget for their payments, although with nine different rates of income tax from 2017 (plus those in Scotland) it will be complex to calculate and educate.

5.12 The consultation on Reporting company payments to participators – modernising the reporting framework was published (19 March until 10 June 2026) at the end of our period of stakeholder interviews, and we therefore did not have opportunity to fully gauge stakeholder views on these proposals, and as with the Entrepreneurs consultation, would not want to duplicate stakeholder input, other than to note that increased administration burdens act against business growth and competitiveness. The proposed additional disclosure requirements on directors' loan accounts for close companies were raised as an example of an increased administration burden, where even a micro company with £30,000 turnover could have 50 transactions on the account in a year.

5.13 The loss of the free software service for small companies (known as CATO) to file with Companies House and HMRC from 31 March 2026 created further difficulty and costs for small companies, particularly those self-filing.

5.14 While cash basis clearly works for certain unincorporated businesses, although there are complexities when moving from one basis to the other, we heard mixed views on extending to companies. Some thought that for small companies tax should be as simple as possible, and following the bank account under the cash basis is just that. Others felt that for a limited company, it was important that correct accruals-based accounting principles be followed to produce an accurate position.

²³ Understanding experiences of dealing with Corporation Tax – HMRC (2025)

5.15 The small company rate was seen as a complexity, particularly with associated companies, and may encourage incorporation for the wrong reason, with a call for a flat CT rate and a return to disincorporation relief being seen as a good thing.

Recommendations

25. The government has increased the HMRC approved mileage rates by 10 pence per mile, with effect from 6 April 2026, following the rise in fuel prices with a commitment to review again at budget 2026, and we recommend the government also revisit the level of the other fixed rate expense allowances for unincorporated businesses (which have not been increased since introduction in 2013).

26. On companies, the overriding view was that a business needed to understand there were additional reporting and administration requirements following incorporation. We suggest the HMRC small business customer journey review²⁴, announced 23 June 2026, looks at the need for better signposting to HMRC guidance setting out the additional burdens of running a limited company, including at the point of incorporating a business.

27. In Chapter 3, we proposed that the treatment of revenue and expenses followed the accounts. For companies below the audit threshold, and unincorporated businesses, we suggest a simplified definition of repair be used, such as adapting that proposed in the OTS Property income report, published November 2022: 'Relief for all asset costs - other than where work is part of the capital cost of a building, such as the initial fit-out of properties bought in a dilapidated state or structural work such as extensions to the property'.

28. For those companies where the additional administration burdens outweigh the advantages of incorporation, we suggest the government review a reintroduction of Disincorporation relief, enabling assets to pass with no tax charge, without the asset level restriction that applied in 2013, to mirror the position on incorporating.

29. For one person companies, we consider the government carry out a review into whether a simpler cash based accounting scheme may be appropriate, in a similar fashion to unincorporated businesses.

²⁴ Tax update 2026: simplification, modernisation and fairness summary – HMRC (2026)

6. HMRC Support

6.1 'HMRC administration' formed one of the flagship chapters and recommendations in the October 2014 OTS review of the competitiveness of the UK tax administration.

6.2 The review noted that 'HMRC administration has an important impact on the general competitiveness of the UK tax system' and that respondents had identified certainty and efficiency as 'two key requirements from a tax system and the authority that runs it'. Comments were received regarding customer service, the post-filing process, obtaining certainty, clearance procedures and HMRC guidance.

6.3 The review made a final recommendation for HMRC to consider implementing (in the longer-term) a 'single tax account for small businesses', with a monthly return of income and expenses and a 'single tax bill covering as many taxes as possible'. Sweden was cited as a country that had implemented such a system.

What has happened in the meantime

6.4 The introduction of a single tax account remains an objective for HMRC. In the Command paper released 23 March 2021, the government stated the investment in HMRC announced in the Spring 2021 Budget would in part be used to fund the development of a single digital account and customer record and are set to replace both the personal tax account and business tax account.

6.5 Since publication of the 2014 OTS report, there has been the introduction of topical webinars and videos, and HMRC has enabled agents to track client details via the Income Record Viewer.

6.6 The ICAEW and CIOT responded to the Public Accounts Committee inquiry into the HMRC customer service and accounts 2023-24 and published a report 'Tackling HMRC customer service challenge' on 11 December 2024.

6.7 The report's findings included that only 33% of contact attempts to HMRC resulted in the query being fully resolved, the average wait time across phone and webchat was 19 minutes, 88% of phone calls were connected to an adviser and nearly half (49%) of webchat attempts were connected to an adviser.

6.8 The bodies made the following 10 recommendations:

1. Introduce an external tracking mechanism
2. Review and improve internal tracking mechanisms
3. Ensure there are appropriate routes to escalate complex cases
4. Improve individual ownership of work
5. Improve education and training of HMRC staff
6. Invest in customer service staffing
7. Maintain investment in legacy systems
8. Identify and plug gaps in digital services
9. Increase the use of secure email for agent communications
10. Co-create and continually improve digital services

6.9 On 31 March 2025, following an announcement by the Exchequer Secretary at the ICAEW-CIOT conference on 11 March 2025, HMRC introduced a dedicated mailbox for agents to escalate and resolve PAYE and self-assessment queries outstanding from the agent dedicated line or the

HMRC digital assistant. The service can be used once at least 20 days have passed from the reply date given by the 'where's my reply' tool, and the agent has tried at least twice to resolve the query by contacting the agent dedicated line or the HMRC digital assistant. In response, HMRC will acknowledge within 48 hours, provide an update every 5 working days by telephone and aim to resolve or make an action plan within 20 working days.

What we have heard in our meetings

6.10 We received a wide range of views concerning interactions with HMRC. Unsurprisingly the feedback was mixed, with frustrations identified in dealing with HMRC across a range of sectors and size of business, interspersed with fewer comments about where HMRC have performed well. It should be noted that some observations were anecdotal or only covered a small number of cases. While this does not mean criticisms are invalid, HMRC should be given the right to respond, with data where available. We have identified some themes arising from our interviews.

Difficulties in communication with HMRC

6.11 Many respondents commented on delays in communication with HMRC, particularly around letters being answered and telephone calls being answered. In some cases delays led to the need to resubmit information which was inefficient. It was claimed by more than one respondent that, where a letter is not answered by HMRC within a certain time period, it is recategorized and no target for response time is then applied. This practice was compared unfavourably with HMRC's requests for information from taxpayers within a strict deadline. More than one respondent linked delays to lack of capacity in terms of numbers of HMRC officers available to take calls from businesses and agents, and one business commented that they had "sympathy" with HMRC in this regard. HMRC's drive to make interactions online was noted.

6.12 Most respondents felt that standards of knowledge and service had declined in recent years, with some linking this to less experienced HMRC staff being put on the front line to deal with queries from agents and taxpayers. This was felt to be a particular problem in the area of R&D tax credits by some respondents. In addition, one respondent identified mandatory payrolling of benefits as an area where HMRC no longer appeared to have the all-round knowledge to answer queries and resolve problems. One respondent noted that "the HMRC transformation roadmap promised more upskilling of query handlers" but felt this had not yet happened in a material way.

6.13 One respondent knew of someone seconded to HMRC who felt that HMRC staff often shared the frustrations of those taxpayers or agents trying to contact them.

6.14 Some respondents mentioned HMRC's unwillingness to deal via email to be problematic although some positive cases were noted where HMRC officers had allowed this, as well as use of functionality such as Dropbox, in the field of R&D tax credits.

6.15 One respondent identified delays in repayments as a particular problem for foreign workers, which seemed to form part of a downgrade of services for expat workers through the abolition of the expat forum.

6.16 Not all experiences of engaging with HMRC were negative. One membership organisation stated that HMRC engagement was "generally fairly straightforward for our members". In addition, one respondent had had good experiences of using webchat for Corporation Tax. One respondent was particularly appreciative of the online offering "It's far easier now to go on, find out, not just your self-assessment, you see your tax code, you can see the information about your open years. It's

all in one place, all kept together. And I think if you've got any queries, you can fast track it through there quite easily”.

HMRC culture

6.17 Respondents often raised the wider culture of HMRC across a range of business sizes and sectors. One business perceived HMRC’s culture to be “not working with business, we're working against business” which created fear amongst compliant businesses of being penalised financially in a “seriously punitive environment ... it's a penalty culture, not a growth culture”. Comparisons were made with certain overseas tax authorities and detailed in our international comparisons chapter.

6.18 One respondent felt that HMRC staff were excessively risk-averse and prone to deferring even straightforward decisions to managers, leading to inefficiency and delays in resolving queries, with a “lack of incentives within HMRC to offer solutions”.

6.19 HMRC’s litigation and settlement strategy was highlighted by one respondent as a problem with a current culture within parts of HMRC of an averseness to mediation which impacted upon tax morale amongst taxpayers. It was noted, however, that with a recent change in leadership HMRC may be more open to mediation rather than defaulting to challenging in court.

6.20 It was also noted that HMRC contains many talented people but, in line with general Civil Service culture, such individuals often change jobs very rapidly and are rarely employed in taxpayer-facing roles.

6.21 Some respondents felt that HMRC could do better in relation to communication with other government departments to overcome specific issues that businesses and individuals face; Companies’ House and DWP were among those mentioned.

6.22 In respect of venture capital schemes, one respondent considered HMRC’s culture as “quite guarded”, attributing this to staff members joining from the investigations directorate, and attributing this attitude to a “cultural leak” from the R&D tax credits area where fraud has been much more prevalent. Again, linking to the above point around helping taxpayers, “this is enabling legislation...let's incentivize HMRC to help here”.

Popularity of CCM model

6.23 The Customer Compliance Manager (CCM) model was generally very well received. One business about to enter the CCM model commented “then you can actually have an open [conversation]”. The link to the tax gap was again noted “of course small business tax gap is larger when small businesses have to wait 3 days to speak to somebody, whereas larger companies speak to their CCM directly”.

6.24 One respondent noted however that a CCM’s power was often limited citing a client issue with RTI that took a long time to resolve.

Small business specific issues

6.25 Some respondents acknowledged that small business tax makes up the majority of the UK’s tax gap, but felt that this was clearly linked to the difficulties such businesses had in being able to contact HMRC for guidance, as identified above. HMRC were often felt not to be focussed on this particular part of the business community, with one respondent claiming that small businesses were underrepresented in internal HMRC discussions.

6.26 One respondent stated “HMRC never seem to think small first” in terms of how they introduce tax legislation. This can be linked to the popularity of the CCM model, only available to large businesses, and similar sentiments expressed in the EU in response to the recent European Commission’s ‘Competitiveness Compass’²⁵, calling for additional compliance cost reductions for European SMEs, over and above those targets for businesses in general, as articulated by groups such as EFAA for SMEs²⁶.

Bad actors not seeming to be dealt with

6.27 Some respondents felt that bad actors appeared not to be dealt with promptly by HMRC, which could lead to undermining trust in the system. One respondent felt that HMRC carried out very few investigations compared to earlier years, particularly in the areas of VAT, PAYE and Corporation Tax.

6.28 One respondent noted in the field of VAT that there was “frustration in the sector that HMRC seems to crack down on honest retailers when they make a mistake, but not doing enough about imports with dummy VAT addresses”.

Lack of certainty and guidance

6.29 Views on HMRC’s published guidance were mixed. One respondent found guidance “generally helpful”, but most of the views expressed were less positive. It was claimed that HMRC are sometimes unable to prepare guidance for the gov.uk website in a helpful format, such as incorporating flowcharts, because of shortcomings in the government department responsible for publishing the information, namely the Government Digital Service (GDS).

6.30 Respondents were mixed on whether the provision of ‘nudges’ to guidance links when completing a form were effective. While the principle was generally reckoned to be sound, some found that links to inapplicable guidance were a problem.

6.31 A small number of respondents had come across cases where published guidance was out of date, unclear or could not be relied upon legally, but did not indicate whether they followed up on this with HMRC or a relevant professional body.

6.32 Regarding statutory clearances, several respondents commented unfavourably on their ability to obtain rulings from HMRC, which left clients or businesses uncertain over the tax consequences of a transaction. VAT was identified as a particular area where clearances were sought but not given, echoing a finding in the 2014 OTS report, with one advisor saying clients often had to “go through a fairly unhelpful kind of adversarial approach on it”.

Policy development

6.33 Respondents noted that HMRC was open to consultation on policy development, which was welcomed, but that sometimes guidance was issued that was not fully developed and awaiting further update. This was a particular problem for tax advisors who were unable to fully advise clients about potentially significant changes. One example was that of tax adviser registration which came in on 18 May but with only partial guidance, with full guidance not published until 1 June. One

²⁵ A Competitiveness Compass for the EU – European Commission (2025)

²⁶ EFAA for SMEs Response to call for evidence: Simplifying EU rules on direct taxation – European Federation of Accountants and Auditors (2026)

stakeholder questioned whether the practice of closed consultation with limited stakeholders fully satisfies HM Treasury's policy development framework.

6.34 One respondent felt that Tax Impact and Information Notices were not particularly meaningful, specifically in terms of impact and cost to taxpayers, with little consultation on obtaining relevant data to calculate impact quantitatively.

Irish comparison

6.35 The Irish revenue authorities and tax system have often been held up as something that the UK could learn from. However, our conversations with Irish tax advisers suggested that Ireland faces its own challenges in this area.

6.36 In terms of staff turnover, one respondent noted "Irish Revenue has had a lot of recent turnover - about 4k out of 7k since 2023. And unfortunately, an awful lot of wisdom and expertise has gone with them... with hybrid working setups and so on and so forth, they're not necessarily getting the hands-on supervision". However, it was not identified where the staff went to work, as movement of staff (and therefore practical experience) between a tax authority and practice or industry, within limits, may be regarded as beneficial and healthy for a tax system.

6.37 Delays in responses also appear to be commonplace in Ireland. It was observed "If it's a simple query, it will be dealt with fairly swiftly, but once there's any complications involved, it could be months, in some cases it could be years".

6.38 Irish Revenue does appear to be more accepting of email communications than HMRC "Encrypted email communications - Ireland has a "My Inquiries" section on Revenue Online Services portal, for both agents and taxpayers - UK's personal tax query by comparison is only for agents and it's very limited in terms of its capacity".

6.39 On phones, we were told "Irish Revenue has a system where they'll call back when you get to front of queue - but sometimes had to switch off at high load times".

Recommendations

30. HMRC are fully aware of criticisms made about the ability of taxpayers to communicate with them and receive an answer on a timely basis. Our respondents consider that the impact of such difficulties go far beyond the inconvenience caused to taxpayers and their advisers, and actually impact significantly upon confidence in the overall tax system and the tax gap in particular. We encourage HMRC to 'think small first' and continue to recruit, train and place compliance staff to deal with queries from small businesses in particular.

31. While HMRC's compliance role is critical, and in general on an international basis performs very well in terms of tax collection, there is genuine frustration by some taxpayers, particularly businesses who wish to invest and expand (including overseas businesses looking to invest in the UK) that HMRC's compliance focus sometimes impacts negatively upon their need for certainty. In the fields of tax incentives for innovation this can be a particular problem and go against the overall policy objective of the measure. We recommend that the government encourage HMRC to reflect on this internally and see whether, in certain focussed areas, consideration could be given to a different approach to assisting expanding businesses.

32. Both of the above recommendations form part of HMRC culture, and while we accept that this may be part of a longer term process given the length of time it will take to adjust the culture

of a large and complex organisation like HMRC, we consider it important to highlight and call for serious consideration at this point.

7. Other taxes

7.1 The October 2014 OTS review of the competitiveness of the UK tax administration contained a chapter on taxes that were mentioned during interviews but did not specifically contribute towards the compliance time factor in the 'Paying Taxes' survey.

7.2 As with the 2014 report, we include a similar chapter on the basis that such taxes are important to consider as part of the wider picture of the competitiveness of the UK's tax administration, and to illustrate some of the issues, while acknowledging that the area deserves a full, separate study.

What has happened in the meantime

7.3 Numerous changes have been made in the UK since 2014 with the introduction of 29 net new²⁷ taxes (according to a recent study by Tax Policy Associates) a noteworthy issue and one that might be considered to increase complexity of the overall tax system.

What we have heard in our meetings

Respondents commented on a range of other taxes:

VAT

7.4 Respondents identified VAT as a tax where advance clearance during a transaction is valuable, given the financial impact of making an incorrect assessment, but where, as noted in Chapter 6, HMRC are often reluctant to grant such clearances, which can lead to uncertainty for businesses and their advisors.

7.5 In addition, in line with comments above, some respondents considered that HMRC were opening fewer checks into VAT returns, especially where a repayment situation did not exist, which is likely to mean that transactions are being misclassified for VAT purposes. This was felt to be a particular issue in the construction sector.

7.6 Delays in the issue of VAT numbers were also noted as a problem, particularly in the context of VAT group numbers.

7.7 One respondent considered that VAT could be simplified and remove confusion surrounding the correct rate to charge by removing all exemptions and having a slightly lower headline rate to maintain fiscal neutrality.

7.8 The capital goods scheme was identified as an example of thresholds which are probably too low having not been increased with inflation.

Business Rates

7.9 The small numbers of respondents who spoke about business rates were all negative about the concept of business rates and recent reforms, considering that they adversely impacted small businesses over large, and high street over retail parks, implying complexity in designing a regime that is seen to be fair. However, there were few issues noted over complexity of administration. One respondent implied that recent revaluations were miscalculated in relation to government policy

²⁷ Why does Britain have more taxes than at any time since 1834? – Dan Neidle (2026)

aims and that there had been a loss of legacy knowledge over how the scheme actually works across government departments.

Extended Producer Responsibility (EPR)

7.10 One respondent considered the recently introduced EPR as an example of complexity, with the business not being told of the rate they would be charged before they needed to finalise pricing to customers. In addition, annual monitoring of the recyclability of different packaging elements was felt to be excessively complex. The respondent would also incur cost on engaging external advisers to help understand and pay the amounts owed.

We note that the EPR is already under review by the government given the impact it has had on food and drink prices.

Packaging Waste Recycling Note (PRN)

7.11 PRNs were also identified as an area of complexity by one respondent given the need to liaise with various parties in the supply chain, leading to the need for external advice.

Recommendations

33. VAT should remain a key focus of tax simplification efforts. The UK's VAT system is complex at least in part by the actions of successive governments in reducing rates in certain areas for political reasons, although there is also significant underlying legislative complexity. We consider the suggestion to broaden the VAT base with a lower headline rate while removing certain lower rates as an area for HMRC policy teams to consider in more depth. One possible step might be a mechanism that challenged any tweak to VAT rates for some products in terms of whether the 'savings' are worth the additional complexity (and risk of error) caused.

8. International Comparisons

8.1 The October 2014 OTS review of the competitiveness of the UK tax administration contained 'Annex D – Lessons from other countries' detailing brief findings from conversations with tax professionals from Ireland, Canada and Denmark (countries that ranked above the UK in the World Bank survey), as well as from New Zealand, whose tax system was 'often cited as an exemplar'. Reference was also made throughout the report where interviewees mentioned what they considered to be notable differences in tax systems in other countries compared to the UK.

8.2 It should be noted that it is notoriously difficult to compare tax complexity meaningfully between two countries given the lack of truly objective comparative metrics, the background and diversity of countries and tax systems and lack of tax professionals with detailed compliance knowledge of more than one tax system. It seems unlikely that there are any true outliers in a positive sense in the tax complexity field and many countries are undertaking essentially the same kind of reforms to improve their systems.

8.3 However, we still consider it worthwhile to consider tax systems in other countries, if for nothing else than to find 'simple wins' that could be replicated in the UK.

8.4 We therefore asked most of our interviewees for any personal thoughts about where other countries' tax systems were better (or worse) than the UK.

What we have heard in our meetings

8.5 Many of our interviewees gave personal insights into tax policies in other countries that they considered favourable. We have not performed any material exercise to explore the veracity of the statements, due to resource and time constraints, nor attempted to rank observations in order of importance, although we have focussed our output to considering only observations regarding complexity of tax systems rather than simply favourable tax policies implemented in other countries. We have attempted to group together key findings below to serve as further discussion points.

General tax environment

8.6 There were mixed views on whether the UK's tax system was more complex than other countries or useful lessons could be learnt. One respondent was sceptical about the possibility of the UK learning from other countries' systems given each system was "a product of very long history and a lot of political decisions". In a similar vein, another commented that "a lot of countries commonly held as exemplars for tax environments are younger and have not had time to accumulate complexity". Another was "not confident that many Western European countries are much simpler than the UK" and "you tend to find that tax rules are pretty complicated wherever you go" although another felt that "[companies] would probably point to the general complexity of the UK tax system".

8.7 In terms of the technology behind the tax system, one respondent felt that the UK compared poorly to certain other countries "UK is lagging behind in technology in tax - maybe because invested in legacy systems".

8.8 Expanding on this technology theme, one respondent noted "Sweden, Denmark, Estonia, even the VAT and tax systems that they've just implemented in Brazil are mind-blowingly good. But we would not be able to replicate those in the UK because we don't have the technology, we don't have the software, we don't have the digital infrastructure for those corporate tax systems to really,

really take off, unfortunately”. However, on a brighter and pragmatic note “the UK being slightly behind could allow us to learn from mistakes”.

8.9 One respondent identified an example of ‘joined-up thinking’ to note a possible simplification available for the UK to create for each company a “unified public business identifier to amalgamate e.g. VAT number and CRN – take the Australian ABN as an example”.

8.10 It was noted that the UK government is keen to promote the fact that the UK’s corporation tax rate is the lowest in the G7 but does not publicise the overall tax burden nor levels of complexity in the tax system. On the theme of investment, another respondent commented that “the UK’s overall tax offer needs to be communicated in a way that is both comprehensive but concise and intelligible - Singapore is a good example of this in terms of easily accessible information on estimated costs to bring employees to Singapore. You’ve got to take people on a journey”.

8.11 One respondent noted that cultural differences (and different legal environments) may also limit the UK’s ability to maximise efficiency in the tax system at times “Cultural difference with e.g. Singapore’s real-time info sharing, in UK too many privacy concerns”.

8.12 The UK and tax authority were identified by one respondent as being potentially more adversarial than other countries, including in the approach to overseas investors, who commented “In places like Singapore or Hong Kong you don’t have these sorts of things, it just doesn’t happen. They don’t suddenly come up with some whimsical new tax that we can sting you for and you’ve got to do loads of other things around it because they’re trying to work with you not against you. It’s a totally different environment.”

8.13 One respondent found Singapore’s approach in engaging early with a company planning to undertake R&D and claim tax incentives favourably compared to the UK: “if you want to do some R&D in Singapore you pick up the phone and they’ll be out and they’ll help you with that and they’re proactive and giving you solutions...the relationship here is you submit your form, right, okay, let’s see what you’ve got then. Then you bring us your report, bring us everything and woe betide you if... hold on guys the whole policy here was to try and stimulate growth in this country, and you’re acting as if I’ve done something wrong here”.

8.14 However, one respondent who dealt with multiple overseas tax authorities stated that their “relationship with the UK was very good...would hold up the UK as an example to other countries”.

Specific country tax systems

Some respondents identified specific countries and their tax systems in giving their evidence and we have collated these by country below.

Estonia

8.15 Estonia’s tax system was highlighted as one of interest from a complexity perspective by a number of respondents. One respondent considered that HMRC had actively looked at Estonia as an example to inform its own thoughts about complexity reforms. Another described Estonia’s tax system as ‘brilliant’.

8.16 However, respondents also clearly recognised that Estonia’s tax system is set within a very different context to the UK, as Estonia and other ex-Iron Curtain countries largely started from scratch with their tax systems. They had the big advantage of learning from others, new IT systems, designing their tax systems to achieve what they wanted rather than being stuck with the legacies of many years of tax raising and associated IT systems, which limits the extent to which ideas can easily

be transferred and implemented. One respondent criticized HMRC looking to Estonia (and Sweden) as examples to follow as their economies are 'smaller and less complex'. Another noted political differences as an issue "Estonia is "brilliant", but their system hinges on having [tax] IDs, which is politically suicide in the UK".

8.17 Another respondent commented regarding Estonia's innovative corporation tax system where profits are not taxed until distributed "I don't think that would ever work for the UK because I don't think you can be in a situation where you could have companies who could just roll up cash indefinitely and never pay any tax on it".

Netherlands

8.18 Some respondents identified the Netherlands as operating an effective tax system, largely through the ability of businesses to gain tax certainty through dialogue with the tax authority and binding rulings being given (Malta was also mentioned in this regard).

8.19 The Netherlands was also highlighted in the CIOT's publication Tax Adviser (April 2026) as being well-regarded by advisors citing as key reasons legislation that is short in length, the availability of binding rulings, strong relationships between highly qualified advisors and the revenue authorities, and an overall stable system with limited political tinkering.

Singapore

8.20 One respondent noted that Singapore appeared to be seen as amenable to foreign direct investment by providing clear information to potential overseas investors such as the cost of moving employees to work there. Other comments regarding Singapore are noted in paragraphs 8.10-8.13 above.

Ireland

8.21 Ireland has also been described as having a favourable tax system, although it is unclear whether this refers more to the rates of tax charged on businesses than the underlying complexity of the system. One respondent held to the former view "what they possibly mean is [Ireland's system is] less inefficient simply because it's a smaller pool of people. We're 1/10 the size of the UK, you know, and that has to be reflected". Other comments relating to the Irish tax system are noted in Chapter 6.

R&D tax incentives

8.22 The theme of complexity in dealing with HMRC specifically in the area of R&D tax incentives was a clear theme throughout our interviews, which are covered in Chapter 2. Respondents noted with approval certain attempts to offer novel approaches to incentivise R&D through the tax system, such as a Belgian initiative to allow some clawback of employer social security for R&D staff.

8.23 Pre-approval of claims such as that seen in Australia was considered a positive policy, giving companies certainty about their claims. HMRC's recent moves in this area should therefore meet with approval.

8.24 One respondent considered the employment of R&D specialists within the Netherlands' tax authority to improve the system. Again, HMRC have made some limited moves in this direction recently with the appointment of some sector experts.

OECD Report: Foundations for Growth and Competitiveness 2026

8.25 During the course of our interviews the OECD published the results of a study on the UK's tax system (among other areas of finance and consideration of a range of countries). The findings make interesting reading in terms of complexity of the UK tax system.

8.26 The OECD recommended in the field of taxation that the UK should 'Reduce distortions and close loopholes'. It commented:

'There is scope to improve the efficiency and fairness of the UK tax system. Parts of the tax system are complex, leading to large compliance costs. As a result, tax compliance has decreased, especially for smaller businesses with less capacities to navigate the system. VAT reliefs are largely inefficient and regressive and property tax is based on outdated valuations. Furthermore, distortions such as kinks in the income tax schedule weaken work incentives, and the deductibility of net interest payments against corporate income makes unprofitable investments viable'.

The OECD made a range of recommendations to the UK to resolve these issues:

1. Conduct an in-depth tax review to make the tax system more efficient and growth-friendly by reducing distortions, closing loopholes, and ending reliefs and exemptions that do not serve economic or social objectives (to which our work contributes)
2. Broaden the VAT base by phasing out exemptions and compensate low-income households through targeted transfers.
3. Regularly conduct tax expenditure reviews.

EU tax simplification

8.27 As the UK seeks to refresh its relationship with the EU post Brexit, and within the context of wider geopolitical uncertainty, it is important to note that the EU itself is giving serious consideration to tax simplification within its Member States, in line with the current Political Guidelines of the European Commission, which set an objective of making business easier and faster in Europe by cutting red tape and simplifying implementation.

8.28 One respondent noted that complying with the DAC (Directive on administrative cooperation) in the field of taxation was often onerous. Recent work is underway under the auspices of the European Commission to 'recast' or simplify the DAC.

Recommendation

34. We are aware that some HMRC staff interact with tax authorities in other countries. We would encourage HMRC to set up a more formal mechanism for information gathering and discussion internally, with the aim of recognising initiatives in other countries that could usefully be applied within the UK context to reduce tax complexity. This could be a formal role for someone (or a small team) to keep abreast with developments in other countries' systems in terms of innovations/ideas that could/should be considered for the UK.

Appendix 1

Theory of tax complexity

1.1 Although the academic literature on tax complexity is relatively small, it overwhelmingly finds that complexity has significant negative effects both on taxpayers and on the wider economy. These effects are often similar to those of headline rates.

1.2 We have categorised the major impacts found in the literature by sphere - into complexity's impact on: competitiveness and investment; compliance costs and cognitive costs.

Defining tax complexity

1.3 There is no settled definition of tax complexity in the academic literature (Schaffa, 2024; Snape, 2015; Heyndels and Smolders, 1995; Slemrod, 1989).²⁸ The most common approach is to define complexity as an aggregate of more precise concepts – in short, attempting definition by disaggregation. Approaches in this style can be categorised into two broad types.

1.4 First, those that disaggregate tax complexity into categories of tax system attributes. Paul (1997) describes complexity as consisting of complication (abundance & intricacy of rules and taxing authorities); intractability (the ease with which underlying concepts of tax law are understandable); and incoherence (the extent to which measures express incoherent policy purposes). Other examples of this approach include Swenson et al (2024), Milliron (1985) and Walker (2022).

1.5 The second approach is to disaggregate complexity by source, generally using either political or tax procedural categories. Examples include Tran-Nam & Evans' (2014) division by the relative extent of policymaker control, into policy, statutory, administrative, and compliance complexities, and McCaffery (1990) into technical, structural, and compliance complexities.

1.6 There are four attempts in the academic literature to construct alternative indices that measure tax complexity more directly. The OTS itself proposed one such index, with a view to discovering 'which areas of the tax system were most ripe for simplification.'²⁹ The OTS index divided the UK's tax system by area and applied a 'complexity rating', aggregated from ten metrics labelled under either 'underlying complexity' or 'impact of complexity' [on taxpayers]. Of these ten metrics, four were based on objective measures (all describing features of legislation such as number of reliefs and exemptions), and the remaining 6 were scored subjectively by OTS team members with a rating between 1 and 5, with 5 representing maximum relative complexity or impact on taxpayers.

1.7 Similar subjective scorings, which might be described as measures of perceived complexity, are used in two of the other four indices – specifically, those of Borrego et al (2016) and Hoppe et al (2023), with the caveat that both studies derive their index scores from large surveys of tax professionals. Tran-Nam and Evans (2014) is the only index of the four to attempt measurement by objective tax system features (as above, categorised by the relative extent of policymaker control). The index of Hoppe et al has the distinct advantage of being the only such attempt to take measurements across multiple years, or to form the basis for further academic studies.³⁰

²⁸ A bibliography, on which this appendix and other chapters draw, is included in Appendix 2

²⁹ Developing a Tax Complexity Index for the UK – Office of Tax Simplification (2014)

³⁰ A helpful map of the Hoppe et al index's findings, across years, is available at taxcomplexity.org

Competitiveness and investment

1.8 The Tax Complexity Index reports worldwide, country-specific indices for code complexity and for framework complexity – respectively, tax complexity arising from legislation and from implementation.

1.9 The German research group behind the Index found that framework complexity appears to depress GDP (Hoppe et al., 2020; Hoppe et al., 2023).

1.10 Tax complexity appears to depress foreign direct investment (FDI) comparably to headline corporate tax rates.

1.11 Lawless et al. (2013) find that complexity acts as a fixed cost, significantly predicting the existence of an FDI relationship between countries. Their estimates suggest that a 10% reduction in tax complexity can increase total FDI comparable to a one percentage point reduction in effective corporate tax rates.

1.12 Esteller-More et al. (2021) find that tax complexity differentials explain outward FDI flows from high-complexity to low-complexity jurisdictions. Between these jurisdictions, the difference in complexity appears to have a more significant effect than headline tax rates.

1.13 Complexity negatively impacts business growth and value. Braunerhjelm and Eklund (2014) find that tax administrative complexity – a concept comparable to Hoppe et al.’s framework complexity - reduces new firm formation, with an estimated effect of a similar order to corporate tax rates. Recent firm-level evidence indicates that tax code complexity depresses firm value (Braun et al., 2025), while Amberger et al. (2025) find that complexity dampens the sensitivity of investment to changes in statutory tax rates.

Compliance costs

1.14 Tran-Nam et al. (2000) and Evans (2012) emphasise that compliance costs are social costs. The time and money spent by taxpayers in complying with the system is fundamentally used in reallocating existing value, rather than producing further value.

1.15 The total social cost of tax compliance is higher than both the direct cost to taxpayers and administrative cost to the government.

1.16 The scale of these costs is significant. Evans (2004) places tax compliance costs in the range of 2% to 10% of revenue yield in a range of studies. Marcuss et al. (2013) estimate that, in the United States, compliance costs were around 10% of tax yield, with approximately two-thirds borne by businesses. Eichfelder and Vaillancourt (2014) similarly show that tax compliance costs can represent a material share of business revenue.

1.17 The tax compliance burden is highly regressive, disproportionately impacting smaller businesses and poorer individuals. This is one of the most consistent findings in the academic literature (Slemrod and Blumenthal, 1996; Evans, 2004; Chittenden et al., 2005; Lignier et al., 2014; Eichfelder and Kegels, 2014).

1.18 Stability matters. Complexity is particularly damaging when law, guidance, forms, or administrative expectations change frequently. Where rules are stable, compliance costs reduce over time as taxpayers and advisors become familiar with the system. Braun et al. (2025) find that some firm-value effects of additional tax code complexity dissipate over time as taxpayers adjust.

Lignier et al. (2014) and Hoppe et al. (2018) nevertheless show that ongoing instability and frequent change can prevent those learning effects from materialising.

1.19 Tax complexity exists not just in the existing stock of rules, which the OTS' remit was limited to, but additionally, the flow of new rules.

Cognitive costs

1.20 We understand these costs both as the behavioural impacts of tax complexity on the economy and policymakers, and the broader effects of a complex tax system on society.

1.21 Tax complexity makes it harder for taxpayers, who are unsure whether they have understood the law correctly, claimed the right relief, applied the right rate, or filed in the right way, to make optimal economic choices. This dynamic may partly explain the negative impacts of complexity on competitiveness and investment, as described in our first sphere. Giese et al. (2024) find that complexity is associated with greater variability in effective tax rates, suggesting increased risk and uncertainty. Krause (2000) links complexity to audit pressure, errors and administrative friction.

1.22 Tax complexity reduces transparency and imposes stress on taxpayers. During this project, we repeatedly heard from businesses that this stress is real, and has a significant effect on tax morale. Stress and tax morale are difficult to measure quantitatively, with Chittenden et al. (2005) constituting one of the only academic attempts.

1.23 But these cognitive effects matter for compliance behaviour. Complexity creates honest error as well as deliberate avoidance. We note that in 2024-25 about 60% of the tax gap as identified by HMRC was assigned to behaviours that we can assume to be driven strongly by tax complexity: error, failure to take reasonable care, and legal dispute.

1.24 The final cognitive cost of complexity is born by the government itself. Complexity can prevent tax policy from achieving the goals for which it was designed. The take-up of tax incentives can be undermined when eligible taxpayers do not understand or respond to them, as shown in Zwick (2021).

1.25 The same applies to major tax policy levers. If complexity reduces the responsiveness of investment to statutory rate changes, as suggested by Amberger et al. (2025), then complexity can blunt the effect of tax policy changes.

Appendix 2

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