

The Rt Hon Philip Hammond MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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20 January 2017

Dear Chancellor,

We write to you on behalf of the Federation of Small Businesses (FSB) ahead of the 2017 Budget with our proposals to grow the economy through boosting the productivity of small businesses.

This Budget comes at a time when small business confidence at the national level has rebounded back to the levels seen at the beginning of 2016. This improved confidence has been supported by other positive signs - rising employment, decreasing spare capacity and exports growth. These indicators are testimony to the resilience and adaptability of small businesses. Looking ahead, small business resilience will continue to be tested by a number of external challenges and economic uncertainties. Added to these are significant increases in costs from domestic policy interventions, including the National Living Wage (NLW), the ongoing rollout of pension auto-enrolment, and changes to the taxation of dividend payments.

We therefore view Budget 2017 as a critical moment, and an opportunity to continue to strengthen confidence levels within the small business community. FSB will be looking to the Government to send a clear signal that it is committed to supporting businesses, delivering long-term growth and driving productivity.

Small businesses are the engines of job creation. The introduction of the Employment Allowance has helped increase employment levels, with evidence showing smaller firms are using the allowance to generate more jobs and increase pay. Due to increases in the NLW and pension auto-enrolment, increasing numbers of small businesses cite labour costs as a challenge for their firms. We believe the case for extending the Employment Allowance from £3,000 to £4,000 is strong. This would be an important but moderate expansion of the work-based tax incentive brought in under the previous Chancellor as a response to our call, which has been a huge success. As labour pressures increase, it would show that the new Government will help small employers to cope with these, create more jobs, apprenticeships and boost pay.

Alongside the increase in the cost of employment, there have been a number of increases in both the cost and administration of business taxes. FSB has campaigned against the mandatory aspects of HM Treasury's planned quarterly digital tax reporting, which are deeply unpopular with the small business community. While accepting the benefits of the Making Tax Digital agenda, we are now pushing for a series of changes to the proposals to make them a success.

These include delaying the current implementation timetable to at least 2019, so that it is not rushed; increasing the threshold of the scheme to match the VAT threshold of £83k; and phasing in implementation from larger firms down to the smallest, learning the lessons of pensions auto-enrolment.

We welcomed the reaffirmed commitment to permanently increase business rates relief for small businesses at Autumn Statement 2016. This will be a welcome relief for thousands of businesses across the UK. We urge the Government to examine the most perverse incentives in the system, including re-examining the increase in rateable value for commercial solar panels which means that the tax system will now reduce our country's ability to reduce emissions and combat climate change. There have been significant increases to the Insurance Premium Tax (IPT), which has having risen from 6 per cent to 12 per cent in 18 months. To ensure that affordable insurance is not beyond the reach of those that may need it most, we urge the Government to freeze IPT.

Creating the right environment for business to innovate is crucial to driving growth and productivity across the UK. While the private sector is the driving force, the Government has a direct role to play. We welcomed the announcement in the Autumn Statement 2016 of reviews of R&D tax credits and the Small Business Research Initiative as well as the announcement of the Industrial Strategy Challenge Fund. We urge the Government to continue to incentivise small businesses to invest to drive productivity across the UK.

We welcomed the announcement at Budget 2016 to introduce a small business champion on every LEP board. This move signalled the Government's recognition that the voice of small businesses should be taken into account at all levels of local economic decision making. FSB has become concerned that many LEPs have not taken concrete steps to achieve this. We urge the Government to undertake a review on the progress LEPs have made as a matter of urgency.

The self-employed are the bedrock of the UK economy. FSB was originally established to champion their interests, and it remains a key part of why we exist to this day – our full title is the 'National Federation of the Self-Employed and Small Businesses'. Over the last 15 years, self-employment has grown significantly and now accounts for 15 per cent of the labour force. FSB has called for policymakers to recognise both the considerable risk the self-employed take on and the growing number of self-employed on the lowest end of the income spectrum. We therefore welcomed the announcement of the Taylor Review. This review provides an ideal opportunity to reform the social security system so it better reflects today's economy, makes Universal Credit more responsive to income fluctuations, establishes a new statutory definition of self-employment, and incentivises the self-employed to save for retirement through flexible access to pension pots.

We hope our submission provides helpful input to your thinking. We are very grateful for the opportunity to discuss our submission in more detail with you on 9 February.

Yours sincerely,

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1) Protecting the Self-Employed

The number of people who work for themselves has grown by 40 per cent since the turn of the century, approaching 4.8 million individuals, or about 15 per cent of the workforce. FSB welcomed the announcement of the Taylor Review, and believes the review provides an ideal opportunity to reassert the importance of the self-employed to the economy, to consider a statutory definition of self-employment and to reassess the approach to benefits, like Universal Credit, for the self-employed.

The self-employed are an essential part of the UK's economy. Their ingenuity and hard work creates the entrepreneurial culture that cultivates the seeds of economic growth and drives innovation. Without this army of the self-employed, our economic recovery would have been a jobless recovery. The tax system needs to encourage more people to start a business and incentivise them to take this risk. It is essential that the UK maintains a light-touch tax system that recognises the importance of the self-employed to the UK economy. In addition, any new tax proposals for the self-employed should come with a full *public* economic impact assessment, as any changes may restrict the record high self-employed population.

Statutory Definition of Self-Employment

Business groups including FSB have also long highlighted the problems caused by the current lack of clarity over employment status. We urge the Government to explore the introduction of a new statutory definition of self-employment that applies across all areas of law, particularly tax and employment. A legal definition would help to end uncertainty for the self-employed and contracting businesses alike and prevent bogus self-employment. It should also reduce enforcement activity and the high volume of case law in this area, cutting costs for the taxpayer.

One particular area where the lack of clarity over employment status has led to problems is the manner in which HMRC applies and enforces intermediaries (IR35) legislation. Individuals who are operating on a self-employed basis – either as an individual sub-contractor or through a Personal Service Company – but deemed by HMRC to be 'inside IR35' (i.e. employees) are subject to high penalties. Both the Office of Tax Simplification and the Deane Review have recognised IR35 as an issue, with the former recommending the merging of NICs and income tax as a way of combating the problem while the latter has called for a single self-employment definition to be considered for tax and employment law.

Self-employed Social Security Benefits

Finally, the UK's social security system needs to be retooled to accommodate the changing labour market. The Government has introduced several welcome changes in recent years in this area, such as reforms to the state pension system and the extension of the childcare tax relief to self-employed individuals.

At the same time, it is essential to address some of the glaring discrepancies between the self-employed and employees in the social security system. This includes bringing the Maternity Allowance in-line with Statutory Maternity Pay, as recommended by the Deane Review, and exploring the feasibility of providing Statutory Paternity Leave and pay to all eligible self-employed fathers.

The introduction of Universal Credit (UC) is set to radically overhaul the welfare system and should better accommodate recipients with fluctuating incomes. However in its current form, it will create a number of challenges for self-employed recipients. Under the new system, the self-employed will after a year see their UC award capped in line with a Minimum Income floor (MIF), which assumes they will be earning the equivalent of the minimum wage (or National Living Wage for over 25s) over a standard full-time working week. This fails to take account of the realities of running a business, where many self-employed people will actually earn very little or nothing in certain months, either because they need to reinvest profits back into their business or because of a genuine and unexpected dip in business activity. In many cases, this could make them financially worse off or cause their business to close. In addition, the accounting rules and reporting requirements under UC are onerous and fail to take account of standard business practices.

Government policy is creating a two-tiered labour market, where – for the self-employed - it is difficult to start a family, save for retirement or to have your basic needs met if you fall ill or need state support. It is time to pull these policies into the 21st century and provide self-employed people with a level playing field in the social security system.

2) Tackling the increasing cost of doing business

Making Tax Digital (MTD)

FSB recognises the significant potential and long-term benefits of HMRC's Making Tax Digital (MTD) programme for many small businesses. However, FSB continues to believe it is right that the smallest firms, which are often time and resource poor, should only move to quarterly tax reporting if they recognise the benefits and therefore chose to do so. We remain concerned that mandating quarterly tax reporting will be hugely disruptive for many small businesses and significantly increase administrative burdens. We also remain deeply concerned by the current implementation timetable for the current proposals and are keen to work openly and constructively with Government to support small businesses that fall within the scope of quarterly tax reporting to get it right first time.

We look forward to the publication of draft legislation as well as the long-awaited publication of a full and detailed MTD Impact Assessment. Alongside the vast majority of the business and accountancy community, we are looking to the Government to address the key concerns raised over the past 12 months.

Following the publication of draft legislation, we encourage the Government to continue engaging with the business community about what the true costs and benefits of MTD will be in order to make a success of the programme. Our evidence shows HMRC has significantly underestimated the transitional and ongoing costs for some small businesses. On top of the purchases some small firms will be required to make in new software and guidance, we anticipate an increased and ongoing use of tax agents and accountants. We expect HMRC's final Impact Assessment must account for these issues, as well as how seasonal businesses in particular will be affected.

Insurance Premium Tax (IPT)

In recent years small firms have experienced a series of significant increases in the Insurance Premium Tax (IPT), the latest of which came at Autumn Statement 2016. This was the third increase since November 2015 and means IPT will have doubled from 6 per cent to 12 per cent in just over 18 months making the standard rate of IPT in the UK now the 6th highest in Europe.

IPT affects all motor, home, travel and health insurance policies whether personal or commercial. Unlike VAT, businesses cannot claim back the cost of IPT. As well as directly impacting upon the cost of doing business at a time when levels of confidence amongst small businesses is low, FSB is deeply concerned that rises in IPT will disproportionately affect those at the greatest risk of lacking appropriate insurance protection. This is particularly the case for the thousands of small businesses who currently struggle to secure affordable car, premises, liability and flood insurance. If insurance premiums continue to increase, the impact on the take up of insurance may begin to be negatively affected.

Further, small businesses need a stable tax environment so that they can continue investing. Such increases not only disrupt progress towards boosting growth and productivity, they prevent small firms from taking the steps necessary to plan for the long-term. We therefore call on the Government to send the right signal to the business community and freeze IPT for the duration of this parliament.

Fuel Duty

Rises in the price of fuel, are adding to the cost pressures on businesses. In a recent survey, 93 per cent of FSB members said cars are important to their business. Small firms across the country are heavily reliant on roads for customers, staff, and suppliers, and affordable fuel has been a lifeline to those in rural areas. We urge the Government to freeze fuel duty at its current level, providing a significant boost to small business confidence and stability.

Non Domestic Rates (NDR)

FSB welcomed the revaluation in 2017 based on 2015 values, this has been long overdue and will bring business rates in line with the real value of business property. Although this is a welcome step for many that have been overpaying for

years, there is a significant number of businesses who will see sharp increases in their liability at a time when costs of business are already rising.

We are deeply concerned about the impact rates increases will have on small businesses in London, especially in the central London boroughs where, on average, rateable values are set to rise by 11 per cent, with some areas seeing even larger increases. To help alleviate this sharp increase in cost, we urge the Government to create an increased inner and outer London Small Business Rate Relief (SBBR) threshold. This will help address the problem of many small businesses facing rateable values that are too high to allow SBBR eligibility. . We also urge the Government to address perverse incentives in the system, including re-examining the increase in rateable value for commercial solar panels.

Employment Allowance

Small businesses are the engines of job creation. The introduction of the Employment Allowance, has helped grow employment levels with evidence showing smaller firms used the allowance to generate more jobs and increase pay. The Employment Allowance has benefitted almost 1.3 million employers by helping to cut the cost of employment. HMRC data shows that the majority (83%) of those claiming the Employment Allowance are micro businesses. FSB research shows small businesses are using the Employment Allowance to boost staff wages (29%); employ additional staff (28%) and invest more in resources such as staff training (24%).

Due to introduction of the National Living Wage (NLW) and the ongoing roll-out of pension auto-enrolment the cost of employment is rising rapidly. FSB found 41 per cent of small businesses now cite wages as the main contributor to the rising cost of doing business. Our analysis shows that the average FSB member will face in excess of £2,600 of additional costs in the 2017/18 tax year from increases in the NLW, the resulting rise in National Insurance contributions, and the requirement to comply with pension auto-enrolment. An increase in the Employment Allowance from £3,000 to £4,000 would help small businesses maintain hiring levels and increase pay.

3) Supporting innovation, growth and productivity

R&D Tax Credits

According to FSB's latest Small Business Index (SBI), the number of businesses operating with spare capacity is falling, although the proportion is higher than a year ago. Investment intentions also remain subdued, suggesting businesses are holding back on investment decisions, perhaps because of wider uncertainty. We therefore welcome the Government's review into the tax environment for R&D tax credits as a means of stimulating greater innovation amongst small businesses.

Whilst acknowledging the improvements in the uptake of R&D tax credits from small firms in recent year's further enhancements can be made. FSB would encourage this review to focus on raising awareness and simplifying the

application process. The current level of intermediaries completing applications on behalf of small firms demonstrates the complexity of the process. The review should also focus on addressing the regional imbalance of uptake. Currently 63 per cent of the total amount of R&D tax credits claimed continues to be in London, the South East or the East of England. This is essential if we are to drive regional growth and productivity across the whole of the UK.

In terms of design, as intangible assets become increasingly important to small businesses, FSB would be interested to see whether there are opportunities to further develop the scope of tax credits.

Small Business Research Initiative (SBRI)

FSB welcomed the announcement of the Government's Review into the Small Business Research Initiative (SBRI). We believe that the public sector has a key role to play in driving innovation in small businesses through its procurement spend. These businesses contribute significantly to UK productivity, growth and global competitiveness. There is still low awareness within the small business community of this initiative and FSB would welcome remedies which address the need for engagement and education with relevant firms. We would also be keen to explore how the benefits of programmes such as the SBRI can be spread to as many small businesses as possible.

FSB is keen to ensure SBRI's focus continues to explicitly support small firms rather than any broader cross-section of the business community. Therefore we would support the Review's close scrutiny of whether the goals and objectives of the body continue to be fit for purpose, and provide the appropriate platform to focus on the right target audience. We would also be interested to see how the SBRI could engage with regional bodies more effectively to ensure small firms are aware of the opportunities available for accessing funding.

Industrial Strategy Challenge Fund

FSB welcomed the launch of the Industrial Strategy Challenge Fund and strongly supports its aim of driving progress in technologies across the UK economy's industrial and research base. We hope the Fund particularly addresses challenges around regional investment and innovation, and believe the link between R&D spending and the Industrial Strategy is key to achieving this. FSB is keen to engage in the work of Innovate UK and Research Councils to ensure our 170,000 strong membership feeds into accurately identifying UK business capability.

Enterprise Investment Scheme & Seed Enterprise Investment Scheme

According to the British Business Bank, equity investment in UK small businesses continued to grow in 2016, with both deal numbers and investment amounts increasing year-on-year since 2011. FSB welcomes the growth of equity finance, which is of vital importance to companies looking to grow and scale up. We welcomed the changes in 2015, and we encourage the Government to continuing reviewing how the Enterprise Investment Scheme (EIS), the Seed Enterprise

Investment Scheme (SEIS) and others will operate in the future. Whilst changes were made in 2015, we encourage the Government to continue reviewing how the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and others will operate in the future.

We believe further stimulating the equity finance market with the future of certain EU funding streams now in question (particularly after 2020) is vital. In particular, the Government should consider whether there is an opportunity in the future for increasing the maximum amount of investment that a qualifying company can receive under both EIS and SEIS. Separately, we believe more should be done to promote awareness as well as the benefits of such investment schemes. Such activity should involve LEPs and Growth Hubs to ensure engagement is undertaken at a local level.

Digital infrastructure

FSB recognises that significant progress has been made in improving the provision of superfast broadband through both private and public sector investment. Both fixed and mobile coverage continues to cause problems for some small businesses, particularly those in rural communities.

We urge the Government to quickly make a decision on Ofcom's three options for delivering the USO, to ensure its successful delivery by 2020. The clear economic benefits of improving digital connectivity suggests the more ambitious option would deliver the greatest benefits. The Government should publish its Digital Strategy at the upcoming Budget, along with plans for both driving fibre deeper into the network and delivering 5G coverage. Now that the BDUK programme is coming to an end, it is critical that the Government sets out how they intend to unlock the next wave of investment in digital infrastructure.

Data disclosure – small business lending

The publication of lending and bank branch data is a powerful means of improving access to banking services. Greater transparency can help to support competition and innovation alongside developing targeted policy interventions to address financial inclusion issues. Gaining an understanding of where the most acute finance gaps exist at a regional level will be crucial to providing additional support for SMEs. There is currently a limited amount of publicly available data in the UK, particularly at a geographic level. With the implementation of the CMA's retail banking remedies underway, and the requirement on providers to publish rates for SME lending products, we urge the Government to build on this progress by launching a review into the benefits of small business lending data disclosure.

Local Enterprise Partnerships (LEPs)

Local Enterprise Partnerships (LEPs) are the primary mechanism for securing business engagement with regards to regional economic development. Business engagement must include the voice of small business, who are vital to driving local economic growth. We therefore welcomed the announcement at Budget 2016

to introduce a small business champion to every LEP board. FSB has become concerned that many LEPs have not taken concrete steps to achieve this. We urge the Government to review the progress LEPs have made in fulfilling this requirement as a matter of urgency.

LEPs can only make decisions on their growth strategies on the basis of accurate economic data covering their area. The number of current data sets on small and micro businesses often make the picture complex. The largest and most comprehensive data set on small businesses is the Business Population Estimate, currently only available at a local authority level and not at a LEP level. We urge the Government to provide LEPs with the disaggregated business count data.