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A Pro-Growth Roadmap for Business-Tax Reform

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Contents

01

Executive Summary

The difficult choices taken by the chancellor for last month's Spring Statement were a clear reminder of just how tight the UK's fiscal position has become. With further tax rises ruled out in what was deliberately framed as a non-fiscal event, the chancellor was forced to cut spending – particularly on welfare – just to undo the damage to the public finances caused by five months of disappointing economic news.

Faster growth is the only sustainable route out of this bind. But in a more geopolitically volatile world – with President Donald Trump having fired the opening shots in a global trade war– the UK's economic outlook looks more likely to worsen than improve in the run-up to the next Budget – creating yet more headaches for the chancellor.

The Spring Statement also laid bare just how hard it is for the government to generate growth: its flagship supply-side policy on planning reform is expected to raise GDP by just 0.4 per cent over the next decade – the equivalent of less than six months of growth at today's anaemic rate.

To stand a chance of reigniting growth, the government must reinvigorate business investment and restore business confidence. Here, it faces an uphill battle. The Autumn Statement's bumper tax rises have cast a long shadow over sentiment and, according to the British Chambers of Commerce, tax is now the top concern for UK firms.

To win back the trust of the business community, the government needs a new plan. Its Corporate Tax Roadmap, published in the autumn, was a plan for stability. The hope was that this would remove uncertainty, calm nerves and encourage investment. But stability alone now looks insufficient. What is needed is a clearer sense of direction: a strategy for how the system will evolve – and how it can do more to support growth within tight fiscal constraints.

The state of the public finances means that large business tax cuts are off the table for now. But it is possible to design a revenue-neutral package of reforms that recalibrates the business-tax system to be more growth-friendly. This paper sets out such a blueprint for reform, based on a three-pillar strategy.

Pillar 1: Pro-Growth Business Tax Reform

We recommend introducing more generous capital allowances in corporation tax and replacing business rates with a commercial-landowner tax to deliver a 0.75 per cent boost to GDP – almost twice the expected long-run impact of the government's planning reforms. Specifically:

- **Corporation-tax reliefs:** Businesses should be able to deduct the full cost of all capital investment from their taxable profits from April 2026. This would extend the full expensing policy announced in November 2023 to cover all remaining asset classes, while increasing the generosity of capital allowances for buildings. This would provide a clear and consistent incentive to invest, while also simplifying the tax treatment of capital across the board. Higher business investment would raise GDP by an estimated 0.3 per cent by the end of this parliament, and 0.5 per cent in the long run.
- **Business-rates reform:** Business rates should be replaced with a commercial-landowner tax from April 2028. Rather than taxing both land and building improvements, the new system would assess only the underlying land value and remove the current penalty on developing or upgrading property. This would encourage landowners to make more productive use of their sites and support a wave of investment in commercial property. The resulting boost to economic activity is expected to increase long-run GDP by a further 0.25 per cent.

Pillar 2: Better-Targeted Business-Tax Reliefs

We recommend eliminating business-tax reliefs that have demonstrated little measurable benefit to growth and recycling the savings to help fund the pro-growth tax changes in Pillar 1. These changes could free up £9.3 billion by the end of this parliament. Further reliefs could also be phased out in the next parliament once tax-modernisation efforts outlined in Pillar 3 are complete. Specifically:

- **Short term:** The government should abolish the Patent Box and National Insurance employment incentives for young workers and apprentices from April 2026, both of which have shown limited evidence of success in driving innovation or employment outcomes. From April 2027, Business Asset Disposal Relief in Capital Gains Tax should also be withdrawn, given the lack of evidence that it significantly increases entrepreneurial investment. In total, these short-term changes would free up £4.7 billion.
- **Medium term:** Once business rates have been replaced with a commercial-landowner tax, sector-specific business-rate reliefs for small businesses and retail, leisure and hospitality should be abolished. These reliefs largely benefit landlords by inflating rents and provide little sustained benefit to the businesses they are intended to support. In total, this would allow £4.6 billion to be allocated elsewhere.
- **Long term:** Once the tax-modernisation programme described below is complete, the case for blanket reliefs for small businesses on tax compliance grounds falls away. Early in the next parliament, reliefs linked to the VAT-registration threshold, the small companies' rate of corporation tax and the NICs Employment Allowance should be phased down. This could raise up to £11.1 billion a year, which should be recycled into targeted support for growing firms or used to fund broader pro-growth tax measures such as cutting the main rate of corporation tax.

Pillar 3: Tech-Enabled Modernisation

The UK's tax system remains too complex, too costly to comply with and too easy to defraud – placing a heavy compliance burden on businesses, particularly smaller firms. We recommend adopting a modern, digital-first approach to tax administration to cut costs for businesses, improve enforcement and create the infrastructure for more targeted support. Specifically:

- **Accelerating the Making Tax Digital (MTD) programme:** To win back trust in this programme, the government needs to complete the rollout for both income tax and corporation tax swiftly. But to be effective the system must be tweaked to be less burdensome and more accessible. The government should remove onerous requirements such as the forthcoming quarterly reporting requirement for income tax. It should also provide more tailored support for businesses to help make the digital transition, including better access to free or low-cost software, and practical help for firms with limited administrative capacity.
- **Introducing a digital ID for business:** Each firm should be provided with a unique identifier and single digital access point for government services by 2030. This would reduce administration costs for businesses by reducing data-entry duplication, help detect fraud and help join up services across government departments to deliver higher-quality support. For example, a digital ID could enable a more tailored support service for firms by highlighting eligibility for grants and issuing reminders for tax-filing deadlines or nudges to prompt action – particularly useful for small businesses that often miss out on support simply because they don't know it exists. It could also reduce compliance checks between businesses, which could save £1.7 billion a year in the financial sector alone.
- **Launching a national e-invoicing programme:** The government should initiate a phased rollout of e-invoicing – mandating its use for all business-to-government (B2G) transactions from 2027 and extending it to business-to-business (B2B) and business-to-consumer (B2C) transactions for all VAT-registered businesses by 2030. From 2030 to 2035, the transaction threshold should be gradually lowered to bring smaller firms into the system as the cost of compliance falls. This would result in faster invoice payments and hence improve cash flow for firms, while also helping to reduce error and fraud in the tax system. Automating value-added tax (VAT) reporting at the point of transaction could reduce the VAT gap by up to 50 per cent, raising up to £4 billion a year in additional tax revenue.

Tax reform will not be easy. Each relief will have its own group of defenders who will resist change. But by setting out a clear direction of travel and showing the size of the prize at stake, the government has a chance to deliver some long-overdue reforms and kickstart economic growth.

FIGURE 1

Timeline of proposed tax and tax-technology reforms

02

Pillar 1: Pro-Growth Business Tax Reform

The UK is in a bind. As the Office for Budget Responsibility (OBR) forecast in March made clear, a combination of slow growth, falling productivity in the public sector and the spiralling cost of public services have paralysed the UK in a state of high spending, high taxes and declining service quality. Successive crises over the past two decades have added to these troubles, causing national debt to triple from 31 per cent in 2003–04 to 98 per cent in 2023–24, and limiting the government's room for manoeuvre.

These pressures are set to intensify in the years ahead. The UK's ageing population will push up health and pension spending, while rising geopolitical risk will drive defence spending higher. Unlike in previous decades, when a "peace dividend" allowed rising social spending to be funded by lower military budgets, the UK now faces rising pressure on both fronts.

The chancellor knows that there are only three ways out of this bind. 1) Faster growth, to generate stronger tax revenue; 2) shrinking the size of the state by no longer providing certain services that do not represent good value for money or could be better provided by the private sector; and 3) smarter government, using technology to lower the cost and improve the quality of public-service delivery (as we have argued extensively in our paper *The Economic Case for Reimagining the State*).

These three principles are the foundation of the three-pillar strategy for reforming the tax system: pro-growth business-tax reform, better-targeted business-tax relief and tech-enabled modernisation.

A Strategic Approach to Business-Tax Reform

Business taxes are ripe for reform. The current system holds back investment, misallocates resources through poorly targeted reliefs and imposes high administrative costs on firms. Having promised not to raise taxes on “working people”, the chancellor raised business taxes in the Autumn Budget. But this has hit business confidence. In a survey by the British Chambers of Commerce, 63 per cent of businesses reported that tax was a concern for their business, the highest level since 2017.[1]

The Corporate Tax Roadmap published last autumn offered stability, but little direction. The government hoped that providing stability would boost business confidence, but that seems to no longer be enough. To win back the trust of the business community, the government should embark on a much more ambitious programme of business-tax reform aimed at fixing the problems with the current system.

As taxes have increased over the past 15 years, policy has too often moved in one direction only to be suddenly reversed at a subsequent fiscal event. The uncertainty that this has created has only added to the economic damage caused by rising taxes. It is no surprise that the UK has had the lowest investment in the G7 for 24 of the past 30 years.[2]

There have been attempts at strategy in the past. Under George Osborne and Philip Hammond there was a clear direction: lower headline corporation-tax rates offset by less generous capital allowances.[3] But since 2021, policy has reversed. The main corporation-tax rate has risen from 19 to 25 per cent, while temporary incentives – first the 130 per cent “super-deduction”, then 100 per cent “full expensing”[4] – have been used to encourage investment in plant and machinery. (Full expensing for most plant and machinery was subsequently made permanent.) While both approaches have merit, the absence of a clear, consistent long-term strategy has made the system harder to navigate and less effective. Investors rightly question whether policy is being made with growth in mind or simply patched together for the next fiscal event. Meanwhile, many ineffective tax reliefs for business remain in place, complicating the tax system and doing little to support the economy.

Business rates – the tax that businesses pay on the estimated rental value of the property they occupy, including land, buildings and improvements – have similarly seen many minor changes over the past 15 years. “Temporary” reliefs for certain sectors have been introduced, repeatedly extended and sometimes made permanent, and revaluations delayed. But there has been no significant reform of the system as a whole, despite clear evidence that it penalises the development of commercial buildings and widespread recognition that delayed revaluations make life difficult for businesses that are locked in to leases on their premises.[5]

Given the government's stated goal of boosting economic growth, the business-tax system must be ruthlessly reorientated towards raising revenue in the most growth-friendly way. Since many tax reliefs intended to support growth are ineffective, a key part of this strategy must be to recycle revenue spent on these reliefs in areas that have proven growth-enhancing effects.

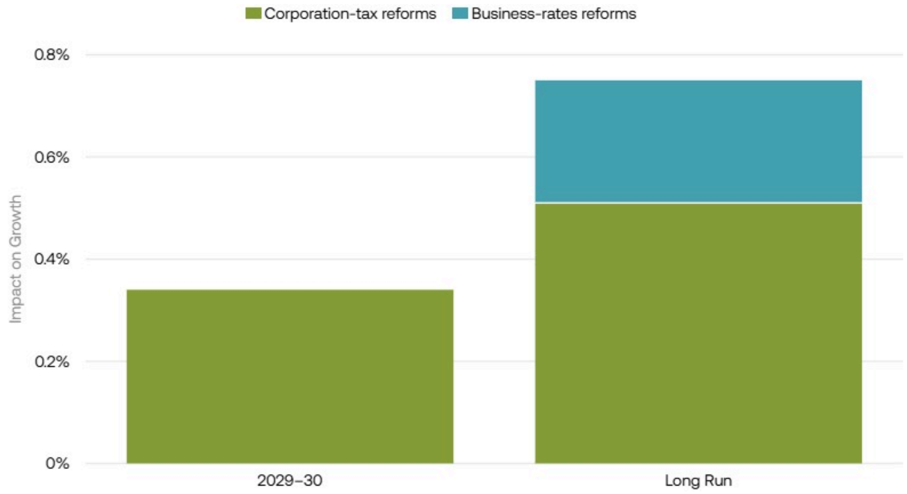
However, many big-ticket options for business-tax reform would have minimal impact on growth. Using the OBR's own methodology[6] – based on how tax changes affect firms' cost of capital[7] – we estimate that a four percentage-point cut in the corporation-tax rate, halving business rates or reversing the recent rise in employer National Insurance contributions (NICs) would each raise GDP by just 0.1 per cent in the long run. These are expensive policies with limited economic payoff.

But there are reforms that would be far more effective at boosting investment and growth. We recommend two substantial reforms:

- **Extending full cost recovery in the corporation-tax system** through full expensing for investment in all plant and machinery, vehicles and intangibles, as well as the introduction of neutral cost recovery for investment in buildings. This would cost £14 billion and raise GDP by 0.3 per cent by the end of this parliament and by 0.5 per cent in the long run.[8]
- **Replacing business rates with a commercial-landowner tax,** to remove one of the most distortionary taxes on investment in buildings. This would raise GDP by a further 0.25 per cent in the long run and could be achieved at no cost to the Exchequer.

FIGURE 2

Impact of recommended reforms on economic growth



Source: TBI calculations

Expanding Full Cost Recovery

The full expensing reform announced in the 2023 Autumn Statement is an example of full cost recovery in practice. It allows firms to deduct the full cost of qualifying investment up front when calculating their corporation-tax liability – just as they already do for day-to-day expenses. Businesses had called for this reform in the lead-up to the fiscal event.[9] It was not a cheap reform, at least in the short term,[10] costing £9 billion in 2028–29 according to the OBR.[11] But the OBR also estimated that it would have a significant positive effect on the economy, raising investment by £15 billion over the forecast period, and GDP by 0.1 per cent by 2028–29 and 0.2 per cent in the long run.[12]

However, full expensing currently applies only to most plant and machinery, mainly due to the cost of expanding it to other areas. Other forms of investment – including in long-lived plant and machinery, vehicles, intangible assets and buildings – remain subject to capital allowances that do not fully cover the cost of the investment.[13] In practice, this means that some marginal investments that would be viable in the absence of tax are not made. Put simply: the tax system is holding back investment.

To address this, we recommend two reforms – both analysed in more detail in the box below:

- **Expand full expensing to cover all plant and machinery, vehicles and intangible assets.** Under this reform, firms would be able to deduct the full cost of these investments up front when calculating corporation-tax liabilities. As well as improving investment incentives, this would represent a simplification of the tax treatment, particularly in relation to intangible assets, where multiple regimes currently exist.
- **Introduce neutral cost recovery for buildings.** For buildings, which have a longer lifespan than other assets, capital allowances should continue to be paid over the lifespan of the asset. At the moment, the total cash cost of the investment is paid out over the lifetime of the asset at a rate of 3 per cent per year (so £3 per year for 33 years for a £100 investment). But because these deductions are received gradually rather than upfront, their value is eroded by inflation and the time value of money (i.e. interest payments). The present value of £3 per year for the next 33 years is significantly less than £100 today. To ensure that the total value of capital allowances was the same as the value of receiving the money up front, under neutral cost recovery the outstanding balance would be increased each year to account for inflation and the time value of money.[14] Since buildings are the major area of investment that is not eligible for full cost recovery already and capital allowances are relatively ungenerous, the largest boost to investment would come here: of the £45 billion of extra investment over the five-year forecast period, £36 billion would be in buildings.

We recommend that this reform be announced in the 2025 Autumn Budget and introduced in April 2026 so that the growth impacts start to occur by the end of this parliament. It is also worth being clear that the OBR methodology we used to calculate the growth impact of this policy reform is conservative. Other studies suggest the gains could be significantly larger.

For example, analysis by the Tax Foundation estimates a similar reform would raise GDP by 1.8 per cent.[15] Even on the OBR's assumptions, however, the growth impact is material. By the end of this parliament, GDP would be 0.3 per cent higher – £9.6 billion higher in today's terms – and would generate an additional £4 billion in tax revenue annually. This would partially offset the £14 billion static cost of the policy, leaving a remaining gap of £10 billion, which we propose funding through the removal of ineffective tax reliefs, as set out in the chapter on targeting business-tax reliefs below.

The Impact of Full Cost Recovery on Effective Tax Rates on Investments

The investment-boosting potential of full cost recovery can be demonstrated by examining its impact on two measures that indicate the impact of the corporate-tax system on different types of investment decision made by firms:[16]

- The Effective Average Tax Rate (EATR), which measures the proportion by which taxes reduce the rate of return on investment.
- The Effective Marginal Tax Rate (EMTR), which measures the proportion by which taxes reduce the rate of return on a marginal investment. In other words, it is the EATR for a marginal investment. It measures how much lower the rate of return required by investors for an investment to be viable would be in the absence of taxation.

Ensuring that all investments that are viable pre-tax are also viable post-tax implies that the EMTR should be zero for all types of investment. But it does not imply that EATRs should be zero. More profitable investments will still go ahead even if some of the excess profit is taxed. Nevertheless, lower EATRs are still desirable because empirical evidence shows that firms respond to tax rates when deciding where to locate investments.[17]

Figure 3 compares the impact of our proposal to expand full cost recovery with that of reducing the headline corporation tax rate to 21 per cent.

FIGURE 3

EMTRs and EATRs for different assets under different reforms

Note: Assumes depreciation rate of 17.5 per cent for general plant and machinery, 8 per cent for long-lived plant and machinery, 3.1 per cent for buildings and 25 per cent for intangibles. Real interest rate is 5 per cent and inflation rate 2 per cent. For EATR, pre-tax rate of return is 20 per cent.

Under the current system, EMTRs are zero for equity-financed investment in plant and machinery. This is because the UK already has full expensing for these investments. But for other types of investment the EMTR is positive, as other forms of investment do not receive full cost recovery.

But EATRs are still positive for all types of investment. (These are calculated for a profitable investment with a 20 per cent annual rate of return.) Note, however, that they are less than the statutory tax rate of 25 per cent, as capital allowances provide some relief.

For debt-financed investments, EMTRs are negative. This is because firms can deduct both the cost of the investment and debt-interest costs when calculating taxable profits. As a result, investments that would be unprofitable in the absence of taxation become worthwhile. EATRs for a more profitable investment are still positive though, albeit lower than in the equity-financed case.

Turning to compare the impact of the two policy reforms – expanding full expensing to cover all plant and machinery, vehicles and intangible assets, introducing neutral cost recovery for buildings and reducing the main corporation tax rate to 21 per cent – they both have similar effects on lowering EATRs. There is a consensus in the literature that foreign direct investment (FDI) increases by 2.5 per cent for each percentage-point reduction in the average EATR.[18] Since both full expensing and a 4 percentage-point reduction in the main corporation-tax rate reduce the weighted average EATR across investments by about 2 percentage points,[19] we would expect FDI to increase by about 5 per cent as a result of either of these reforms.

The difference between the reforms is that full cost recovery has the desirable effect discussed above of reducing the EMTR to zero for equity-financed investment. Removing this tax-induced distortion to investment decisions should have the largest impact on investment and the capital stock.

Business-Rates Reform

Business rates have long been a bugbear of the business community. They are a distortionary tax that discourage investment and penalise the productive use of land. The current system has ancient roots, first formalised in the Vagabonds Act of 1572. The tax applies to all commercial properties in England and Wales, with each assigned a rateable value based on its estimated rental value in the open market. The headline tax – or "poundage" – in 2024–25 is 54.6 pence per pound of rateable value, or 49.9 pence for smaller properties.

In recent years, debate has focused on the retail sector, where high-street businesses feel unfairly disadvantaged relative to online retailers.[20] But the issues with business rates are more fundamental and widely recognised among economists. Nobel laureate William Vickrey observed that: "The property tax is, economically speaking, a combination of one of the worst taxes – the part that is assessed on real-estate improvements – and one of the best – the tax on land or site value."[21]

Under the current system, any improvements to a building – whether replacing an existing structure with a larger building, adding solar panels to a roof or putting electric charging points in a car park, or even adding some plant and machinery that is deemed integral to the building – can increase the property's rateable value, and thus its tax bill. That means business rates actively discourage investment in commercial property. Even with full expensing in corporation tax, the overall EMTR on investment in buildings remains above zero (see The Impact of Full Cost Recovery on Effective Tax Rates on Investments above). According to a poll by the manufacturers' organisation Make UK, 42 per cent of manufacturers would invest more if plant and machinery integral to buildings were excluded from business-rates calculations.[22]

The solution to this issue is well known. As the Mirrlees Review advocated,[23] business rates should be replaced with a tax on the unimproved value of land – a land-value tax that removes buildings, utilities and physical capital from the tax base.[24] Taxing land values is attractive, as the supply of land is fixed and does not respond to taxation. And by removing property upgrades from the tax net, the reform should boost investment and lead to a higher-quality capital stock better matched to the needs of businesses in the UK.

This solution isn't just conceptual. Commercial land-value taxes are already successfully used in several Organisation for Economic Co-operation and Development (OECD) countries including Denmark, Estonia and Australia. Denmark has recently introduced a reform similar to the one we propose. Having long had a land-value tax for non-residential property as well as an equivalent to business rates (*dækningsafgift*), the country has recently shifted from a tax based on the overall property value to one based on land values.[25] The practicalities of how to implement the reform in the UK context have also been well set out by the Liberal Democrat Business and Entrepreneurs Network.[26] Our proposed commercial-landowner tax would:

- **Shift the formal liability for paying business rates from tenants to landlords.** This aligns formal liability with economic incidence (who is made worse off by the tax) and studies have consistently shown that landlords ultimately bear the burden of business rates through lower rents.[27] Shifting formal responsibility would spare more than half a million small and medium-sized enterprises (SMEs) the administrative burden of managing property tax, which would reduce red tape and simplify compliance. It would also reduce administration costs for businesses and local authorities by reducing the number of taxpayers from 2 million tenants to 800,000 landowners.[28]

- **Reassess land values annually.** This would replace the current system of infrequent, disruptive revaluations with a more responsive and predictable framework, giving businesses greater certainty, especially during periods of economic volatility. It would also ensure that the tax reflects current local economic conditions. The Valuation Office Agency should begin work on a land-only revaluation using land values as of 1 April 2026 – a year earlier than the next scheduled revaluation exercise.
- **Reduce tax liabilities in most areas outside London.** Given the tight fiscal situation and the relative efficiency of land and property taxes, this reform would need to be revenue neutral. Since land values are estimated to make up 75 per cent of commercial property values in England and 60 per cent in Wales,[29] the headline tax rate would need to be commensurately higher than current business rates to raise the same level of revenue. For individual properties, this would of course lead to changes in tax liabilities: properties in areas where land values represented a lower share of property values – principally those outside London – would see lower tax liabilities, and vice versa in and around the capital. This would mean lower average tax liabilities in 92 per cent of local authorities.[30] Among those who would see lower rates liabilities would be high-street shops across most of the country, albeit with some shops in expensive areas seeing tax increases (though this would mostly benefit landlords rather than tenants). This reform would also impose larger tax liabilities on sites that are underdeveloped, encouraging landlords to build to take full advantage of the potential of the sites that they own. This increase in the supply of commercial property would increase the availability of premises and reduce rents for businesses.
- **Introduce the new system in a phased manner.** The new land-value system would come into effect in April 2028. Formal liability for the tax would shift to landlords at the next rent review or lease renewal after that date, ensuring the change is introduced in a way that reflects existing

contractual arrangements. For those facing higher tax bills under the new system, increases would be phased in over four years, giving both landlords and tenants time to adjust.

Given the long lead times involved and the need to provide early clarity to the business community, the government should move quickly to enact this reform. A consultation on the design of a new Commercial Landowner Tax should be launched this summer, with full details announced in the Autumn Budget. This timeline would allow the new system to come into force by April 2028 – a year ahead of the next scheduled general election.

While the growth impact of this reform would not materialise until the next parliament, it would still be effort well spent. Applying the OBR's methodology for assessing business-tax changes, we estimate that replacing business rates with a commercial-landowner tax would reduce the weighted average cost of capital for investment by 3.5 per cent. This would stimulate commercial-property investment and increase GDP by about 0.25 per cent in the long run. Combined with our proposed reforms to corporation tax, the full business-tax reform package would raise GDP by about 0.75 per cent in the long term – equivalent to £21 billion per year in today's terms – a material impact, and around twice the impact that the OBR estimates for the government's flagship planning reforms.

03

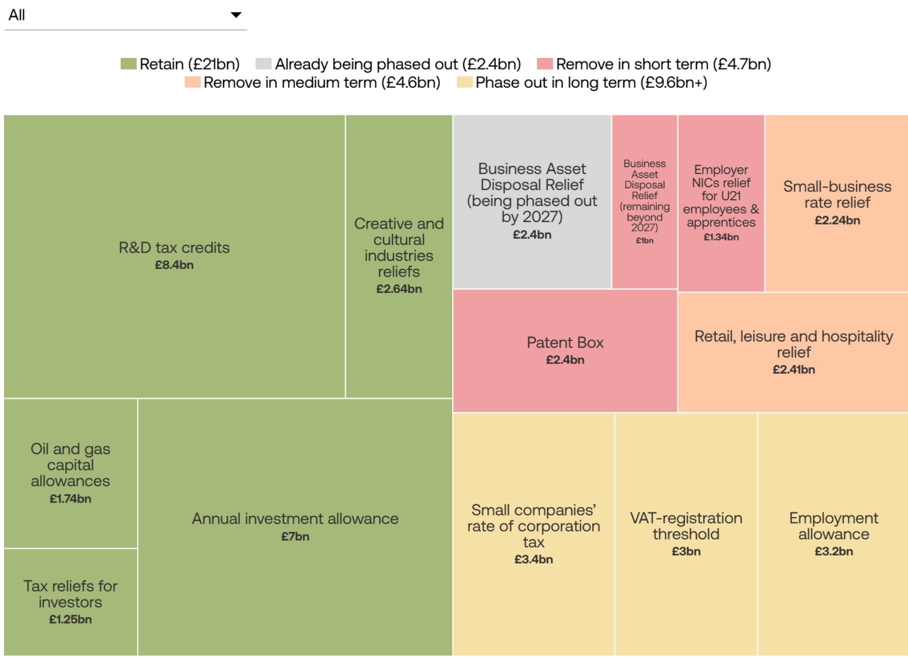
Pillar 2: Better-Targeted Business-Tax Reliefs

The UK spent £42 billion on tax reliefs aimed at supporting business growth in 2024–25. Many of these reliefs are well targeted and show evidence of positive impact, even if there is room to refine their design and improve their effectiveness further:

- R&D tax credits have been shown to increase the amount of innovative activity performed by firms.[31]
- The Annual Investment Allowance and First-Year Allowances for oil and gas both encourage investments that taxes would otherwise make unviable, while also simplifying the tax system, particularly for small firms.[32]
- Creative-sector reliefs for film, television, video games and orchestras have been shown to increase the amount of content made in the UK.[33]
- The Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Venture Capital Scheme are all important in ensuring that startup businesses have the capital that they need to grow.[34]

FIGURE 4

2024–25 business-tax reliefs aimed at supporting growth



Source: TBI calculations using HMRC statistics and Department for Levelling Up, Housing & Communities (DLUHC) non-domestic rate statistics.

By contrast, we estimate that about £20 billion is currently spent on reliefs that are poorly targeted. Reforming or phasing out these reliefs would free up resources for policies with greater economic impact and could help fund pro-investment reforms elsewhere in the system. We group these into three categories, based on how quickly reforms could be implemented:

- **Short term:** Reliefs such as the Patent Box, NICs exemptions for young workers, and Business Asset Disposal Relief could be abolished within the next two years, saving £4.7 billion, with limited economic impact.

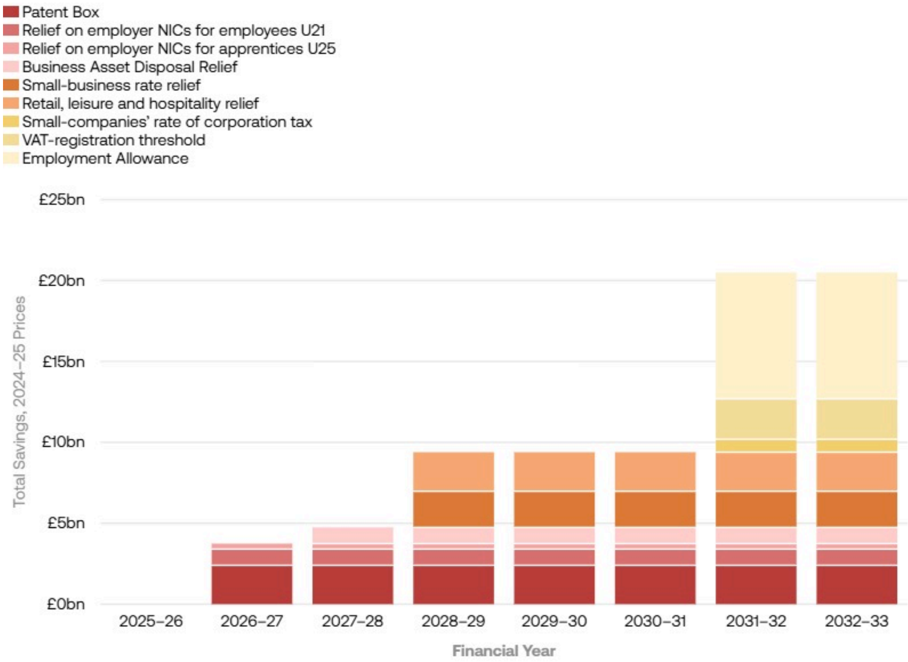
- **Medium term:** Replacing business rates with a Commercial Landowner Tax as described in the previous chapter could unlock a further £4.6 billion of savings from 2028 onwards, by enabling special reliefs for retailers, hospitality, leisure and small businesses to be removed.
- **Long term:** A further £11 billion is spent on blanket support for small businesses in the form of exemptions from VAT, the small profits rate of corporation tax and employment allowances in NICs. These could all be scaled back once the tax system is sufficiently digitalised, as described in the next chapter, to reduce the tax-compliance burden on SMEs and remove the prime justification for such reliefs.

Taken together, the short- and medium-term reforms would be sufficient to cover the remaining cost of the full-cost-recovery policy proposed in the previous chapter – making the reform fiscally neutral by the end of this parliament. Any additional savings from long-term reforms to small-business relief could be reinvested in targeted support to growing businesses or used to finance broader tax reductions.

FIGURE 5

Savings from abolishing select tax reliefs, 2025–26 to 2032–33

Note: Forecasts on the expected cost of each relief are not available, therefore chart shows the value in 2024–25 terms. The cash cost of each relief would likely increase in line with nominal GDP over time.



Source: TBI calculations using HMRC statistics and DLUHC non-domestic rate statistics.

Short Term: Remove Ineffective Business-Tax Reliefs Within Two Years – £4.7 Billion

There are a number of tax reliefs that are ineffective in boosting growth, where there is good reason to abolish them quickly - doing so could save £4.7 billion.

PATENT BOX – £2.4 BILLION

The UK offers two main corporation-tax reliefs to support innovation: R&D tax credits, which subsidise R&D expenditure directly, and the Patent Box, which applies a lower rate of corporation tax to income derived from patents. The theoretical case for the Patent Box is weak. While there is strong evidence that R&D activity generates positive local spillover effects that benefit other firms,[35] this is not the case for patent income since patents do not need to be registered in the same country as the original research took place.

In practice, the Patent Box is more likely to encourage firms to shift where patent income is booked rather than where research is carried out. Moreover, a patent box is targeted at the types of innovation where there is least concern about a firm's ability to capture the benefits of its discoveries. By definition, patentable innovations cannot be freely used by other firms. A patent box may therefore encourage firms to prioritise development of innovations that can be easily patented rather than those that will add the most social value.

Empirical evidence supports these concerns. Some studies find an impact on R&D expenditure[36] but it is much smaller than that associated with R&D tax credits, with each pound of revenue foregone only leading to an additional 50 pence of R&D expenditure.[37] The main effect found in the literature is a transfer of patenting to countries that have patent boxes, at least in countries where there is no requirement for further development domestically, but no increase in patents registered by inventors who are actually living in the countries in question.[38] Although many European countries have a patent box – including 13 of the 27 European Union member states, as well as non-EU countries including Switzerland, Turkey and the UK[39] – the tide now seems to be turning against this type of support for innovation. Italy, along with Andorra and San Marino, have abolished their patent boxes in recent years to replace them with more effective R&D tax credits.

EMPLOYER NICS RELIEF FOR YOUNG WORKERS – £1.3 BILLION

Employees aged under 21 and apprentices aged under 25 are exempt from employer NICs up to the Upper Earnings Limit, currently £967 a week. These reliefs are designed to increase employment among these groups and are expected to cost £1.3 billion in 2024–25. However, the available evidence largely suggests that they are not successful in achieving this objective. Two evaluations by HM Revenue & Customs (HMRC) in 2018[40] and 2023[41] provide qualitative evidence that the reliefs have not affected hiring decisions and quantitative evidence that they have not affected earnings.[42] Since these reliefs are not achieving their stated objectives, they should be abolished.

BUSINESS ASSET DISPOSAL RELIEF – £1 BILLION

Business Asset Disposal Relief (BADR) allows small-business owners to pay a reduced 10 per cent rate of capital gains tax on up to £1 million of lifetime gains from the sale of qualifying business assets. It is intended to incentivise entrepreneurship and reinvestment.

In practice, there is little evidence that this relief is having any positive effect. Encouraging business owners to retain capital in their businesses does not appear to lead to higher investment.[43] Moreover, qualitative research by HMRC indicates that only one in six small-business owners had even heard of this relief or its predecessors and only 2 per cent said that it had an influence on their decision whether or not to invest in their business.[44]

The relief has already been cut back – the maximum amount of gains that are subject to the lower rate was reduced from £10 million to £1 million in 2020, and the 2024 Autumn Budget increased the tax rate on disposals from 10 per cent to 18 per cent – but given the lack of evidence that it boosts entrepreneurship and investment, BADR should be scrapped altogether. Reforms have already been announced that will reduce this relief's £3.4 billion cost in 2025–26 and 2026–27. Scrapping it altogether from 2027–28 should save a further £1 billion a year from then on.

Medium Term: Replace Ineffective Business-Rates Reliefs With a Commercial-Landowner Tax – £4.6 billion

As discussed in the previous section, business rates are paid by the occupiers of business property but it is generally recognised that in the long run, the true cost of business rates is borne by landlords rather than tenants.[45] There is a maximum amount that tenants are willing to pay in both rents and rates to occupy a property, so if rates increase, landlords will be forced to reduce the rent they charge. Rate reliefs will generally therefore be offset by higher rents and be of little benefit to businesses occupying the property.[46] We therefore argue that the following reliefs be abolished, alongside the wider reforms to business rates that we advocate in the previous chapter.

RETAIL, LEISURE AND HOSPITALITY RELIEF – £2.4 BILLION

During the Covid-19 pandemic, the government – understandably – sought to support businesses that had been forced to close through the business-rates system. Retail, leisure and hospitality businesses were given a 100 per cent rates relief in 2020–21. However, this relief has proved difficult to remove . It was reduced to 66 per cent in 2021–22 and 50 per cent in 2022–23, with a £110,000 cash cap introduced. But it was then increased again to 75 per cent in 2023–24, before being reduced to 40 per cent in 2025–26. Alongside this final extension of the relief, the chancellor announced in the Autumn Budget that from 2026–27 there will be a permanently lower business-rate multiplier for these businesses if they have a ratable value of less than £500,000 (that is to say they will pay a smaller percentage of their ratable value in tax).

Clearly these reliefs were of value to businesses during the pandemic. But, given that changes in rates have been shown to lead to offsetting changes in rents, they are much less likely to benefit from a permanent relief. Thus, permanent business-rate reliefs will simply be offset one-for-one with higher rents, leaving no benefit to the tenant. The relief is therefore not likely to have its intended effect and should be replaced with other forms of support that will do more to spur growth.

SMALL-BUSINESS RELIEF – £2.2 BILLION

Businesses occupying premises with rateable values of less than £12,000 do not have to pay business rates at all, and those with a rateable value between £12,000 and £15,000 receive partial relief. But as with other reliefs, because this is a permanent feature of the tax system it is likely to have been offset by increased rents for these smaller properties and therefore largely be benefiting landlords.

The way in which the relief is designed also has undesirable effects. It is withdrawn sharply when the rateable value rises between £12,000 and £15,000, providing a strong disincentive for landlords to make improvements that would take the rateable value above £12,000. Above that level, £2,495 of rates relief would be lost for each £1,000 that rateable values increase. This is a particularly severe example of how badly designed features of business rates can discourage valuable improvements to businesses.

As we discuss below, higher compliance costs for small businesses might justify lower tax rates for small businesses, so that the tax system overall does not tilt the playing field in favour of either large or small businesses. But this rationale does not apply in the case of business rates. Unlike other taxes that require detailed reporting of sales or income to HMRC, businesses simply have to pay the amount they owe. Indeed, operating reliefs such as this only adds to compliance costs. In any case, with the reforms to business rates we outline in Chapter 1, responsibility for remitting taxes would shift to landlords, removing compliance costs from businesses completely.

Long Term: Retarget Reliefs for Small Businesses When Tax-Compliance Costs Fall – £11.1 Billion

The UK tax system offers several reliefs for businesses that are in some way "small":

- The small-profits rate of corporation tax for businesses with taxable profits of less than £250,000 costs the Exchequer £3 billion per year. Although there is a case for redistribution from high-income to low-income individuals, the same rationale does not apply to companies. To ensure that owner-managers of incorporated businesses do not pay more tax because of this reform, and that the overall effective tax rate paid by this group is the same as that paid by the self-employed, the basic rate of income tax on dividends should be reduced from 8.75 per cent to 1.45 per cent at the same time. This would cost about £2.2 billion, leaving a net yield from the two policies of about £800 million.[47]
- The VAT-registration threshold exempts businesses with a turnover of less than £90,000 from paying VAT, costing the Exchequer £3 billion per year. This is actively harmful to business growth, discouraging businesses from growing as they would see a big increase in their tax liability as soon as their turnover exceeds the VAT-registration threshold. This causes businesses to bunch below the threshold to avoid this sharp jump in tax liabilities.[48] Although a *de minimis* threshold would have to remain, this should be significantly lower so that all of those making a living from their business would have to register. All 27 EU countries already have a lower VAT threshold than the UK, and most are substantially lower.[49] We conservatively allow a much lower VAT threshold to cost £500 million, so would expect to raise £2.5 billion from this change.
- The employment allowance in NICs, which reduces employer NICs liability by £5,000 for businesses that pay less than £100,000 in employer NICs, cost the Exchequer £3.2 billion in 2024–25. But this cost is expected to rise by a further £4.6 billion on average over the next five years, as the Autumn Budget included an announcement on the expansion of the scheme to larger businesses, and an increase in the amount of relief to £10,500.[50] There is little reason to think that this relief will have a positive impact on employment – a fundamental insight from economics is that

incentives matter at the margin: only policies that reduce the cost of hiring an additional employee should be expected to boost labour demand. Consequently, a flat-rate reduction in employer NICs liabilities would not be expected to have any impact. Empirical evidence confirms this result: an HMRC evaluation of the employment allowance found that few claimants reported that they had taken on more staff or made additional investments as a result of the scheme.[51] Scrapping this relief could save £7.8 billion per year.

The theoretical justification for blanket support for small business in this way is weak. Any economic argument for favouring small businesses over large ones must rely on a market failure causing the playing field to be tilted in favour of larger businesses. Even then, a blanket relief favouring small businesses may not be the best way to address these concerns: difficulties accessing capital are best addressed through measures such as the Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs), or the provision of loan guarantees.[52] Similarly, distributional objectives targeting low-income business owners are best achieved through more general means-tested benefits or income-tax progressivity rather than favouring a particular group of businesses. And arguments that small businesses are a key driver of growth do not stand up to scrutiny – the "scale-ups" that employ 3.2 million people and make up 55 per cent of the total output of SMEs number only 34,000, just 0.6 per cent of the total number of SMEs.[53] Targeted support for these growing businesses would surely be a much better use of taxpayer resources.

The strongest justification for these reliefs is the regressive nature of tax-compliance costs. Multiple studies have confirmed that the costs of complying with tax obligations are higher for SMEs than for larger businesses.[54] Ideally, the tax system should neither favour larger nor smaller businesses so a lower tax rate may be used to offset higher compliance costs to create a more level playing field. But as we argue in the next chapter, developments in technology are already reducing the costs of compliance for small businesses, with the potential to go even further. Once these are in place, the justification for these reliefs will diminish further and we would argue that these reliefs should be abolished early in the next parliament.

04

Pillar 3: Tech-Enabled Modernisation

Several of the reforms proposed in this paper – particularly the removal of poorly targeted SME tax reliefs – rest on a simple principle: to promote growth, tax policy should reward investment and productivity, not firm size. However, many small-business representatives argue that blanket support for SMEs is justified, primarily due to the fixed costs of tax compliance, which fall disproportionately on smaller firms.

This concern is not unfounded. Businesses in the UK spend an estimated £15 billion to £25 billion each year on meeting their tax obligations.[55] Since many of these costs are fixed, they impose a much greater burden on small firms: one Europe-wide study found that the smallest firms faced compliance costs nearly 20 times higher as a share of turnover than large enterprises.[56]

These burdens matter not just for fairness, but for fiscal efficiency. In 2022–23, small businesses accounted for 60 per cent of the UK's total tax gap – equivalent to £23.9 billion in lost revenue.[57] Lowering compliance costs would therefore not only support growth but also improve tax collection.

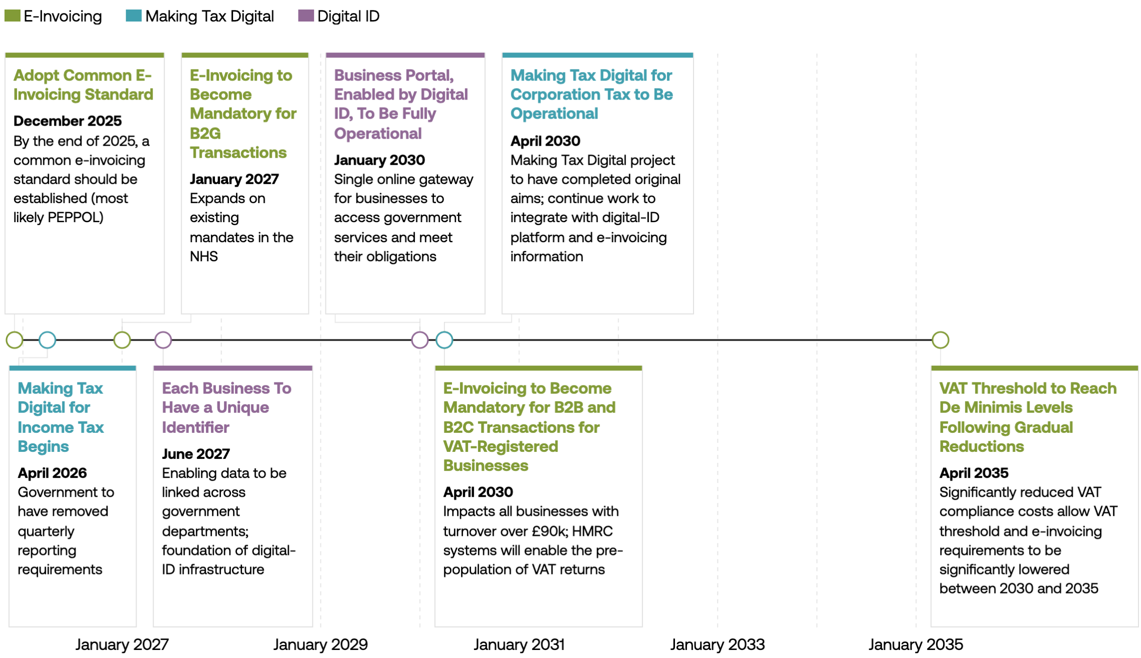
The good news is that technology can help solve this problem. By integrating data already collected across business systems – such as invoices, payroll and payments – tax liabilities could be automatically calculated or pre-populated, greatly reducing the effort required to pay the correct amount of tax. Done well, this shift could unlock a double dividend: enabling the phase-out of inefficient SME reliefs while also making life easier for businesses. This chapter sets out a roadmap for realising that opportunity. It focuses on three core digital tools that together could reshape how businesses interact with the tax system:

- **Making Tax Digital (MTD):** modernising record-keeping and tax reporting

- **A business digital identity:** consolidating fragmented data to simplify access to services and improve fraud prevention
- **E-invoicing:** enabling real-time reporting and pre-filled tax returns through secure, machine-readable invoices

FIGURE 6

Proposed timeline for building a digital-first business-tax system



Making Tax Digital

Launched in 2015, MTD was designed to modernise tax administration by requiring businesses, the self-employed and landlords to keep digital records and submit tax data via compatible software.[58] Initially set for completion by 2020, the aim of MTD was to digitise tax reporting for income tax, VAT and corporation tax to reduce fraud and errors, cut compliance costs and streamline interactions with HMRC.

Some progress has been made. MTD for VAT was introduced in 2019 and fully rolled out by 2022. By reducing manual data entry and linking digital records directly to HMRC systems, the scheme has delivered benefits to both the Exchequer and to businesses themselves. It has been a win-win, at least according to official estimates. An HMRC evaluation found that MTD for VAT raised £185 million to £195 million in additional tax revenue in its first year[59] and saved 26 to 40 hours on average for each company using fully functional software – a time-saving worth £603 million to £915 million across the economy.[60]

However, these headline figures obscure a more mixed reality – many businesses report that MTD has increased their compliance costs. Indeed, more than half of businesses surveyed by HMRC reported experiencing financial costs linked to the transition to MTD, with 52 per cent recording that they spent the same or more time on VAT returns than pre-MTD.[61] These concerns are most stark among small businesses, with a 2021 Federation of Small Businesses (FSB) report finding that 71 per cent of its members had experienced rising costs, averaging more than £1,500 per year.[62]

Implementation delays have compounded the frustration. Originally due to be completed by 2020, the rollout has slipped repeatedly.[63] MTD for income tax[64] will now begin in April 2026 for businesses with qualifying income over £50,000, while MTD for corporation tax has no confirmed start date. These delays make business planning difficult and limit the benefits of integrating digital systems across taxes.

There are also practical challenges. While MTD has not imposed new reporting requirements, the mandatory use of software has nonetheless added costs and complexity for many firms. Smaller firms often need help to make the digital transition but HMRC's phone lines are under pressure, with average waiting times exceeding 20 minutes in 2023–24.[65] Many calls are abandoned and those who do make it through are often referred to HMRC's software provider for help.[66] Firms adopting MTD then face an unhelpful choice between free software with no customer support or paid software with better usability but high costs.

There is a strong case for the government to encourage wider adoption of digital tools – especially among small firms that have historically lagged in technology uptake and contributed to the UK's long tail of low-productivity businesses. But while MTD is delivering benefits for the Exchequer, it is not yet clearly doing so in a way that also delivers for business. With better support, a clearer long-term roadmap and more flexibility in its requirements, MTD could still achieve its original goal: making tax compliance simpler, not harder.

To restore confidence in the MTD programme and unlock its full potential for businesses and the Exchequer, the government should:

- **Remove unnecessary reporting burdens.** The government should drop the planned quarterly reporting requirement under MTD for Income Tax Self-Assessment, which is due to come into force in April 2026. Unlike VAT, where quarterly filing supports cashflow management, the benefits of more frequent reporting for income tax are far less clear. Experts at the Institute of Chartered Accountants in England and Wales (ICAEW) have warned that quarterly updates could impose significant costs on taxpayers with limited benefit to HMRC.[67] Moving to annual reporting by default, with quarterly updates optional, would avoid this extra compliance burden.
- **Complete the rollout of MTD across all major business taxes.** To maximise its benefits, MTD must be rolled out fully and made consistent across tax types. Businesses currently face a patchwork of new and legacy tax-compliance systems, creating dual reporting burdens, reducing efficiency and increasing the risk of errors. Completing the rollout of MTD to include self-assessed income tax and corporation tax, as well as integrating MTD with other digital services – such as e-invoicing and digital ID for business, discussed below – would allow businesses to realise the full compliance benefits of the programme through automated reporting, pre-filled forms and real-time prompts.

- **Provide more support to help businesses transition to digital tax filing.** Many businesses – particularly smaller firms – continue to face barriers to adopting MTD, because the transition is either costly, poorly supported or both. Free software is often hard to use and lacks customer service, while better-quality options can be expensive.[68] Without targeted help, smaller firms risk facing higher compliance costs rather than the intended efficiencies. To address this, HMRC should:
- Work with free-software providers to improve usability and support, including co-developed video tutorials, step-by-step guides and webinars tailored to smaller firms.
- Foster a diverse and competitive software market – both free and paid – by engaging with developers, offering clear technical guidance and maintaining open access to its APIs.[69]
- Explore targeted financial support, such as a UK version of Singapore's Productivity Solutions Grant, which helps cover the cost of pre-approved digital tools.[70]
- Improve support services by building on HMRC's existing AI chatbot pilot[71] – either refining it or developing a new version specifically designed to support digital tax filing.
- Develop an AI-led triage system over time, to handle routine queries automatically and free up HMRC staff to deal with more complex cases – reducing waiting times and improving overall service quality.

Digital ID for Business

For many businesses – especially small firms – interacting with government feels more like an obstacle than an enabler of growth. The government systems that businesses depend on – such as those for tax, licensing, reporting and company registration – are often characterised by three persistent problems: complexity, opacity and fragmentation. Together, these issues undermine trust in government, drive up compliance costs, create space for fraud and make it harder for the government to target support to the firms that need it most.

- **Complexity:** Meeting even basic regulatory obligations often involves navigating a tangle of disconnected processes. A newly formed business must register separately with Companies House, HMRC (for VAT, corporation tax and PAYE) and potentially other bodies for sector-specific licences or trade permissions. These overlapping systems are inefficient for all firms and disproportionately burdensome for smaller ones. The National Audit Office estimates that UK businesses spend £15.4 billion a year on tax compliance alone.[72]
- **Opacity:** Poor coordination and data-sharing between departments creates serious vulnerabilities. For example, Companies House filings are not automatically cross-checked against HMRC records, allowing false or misleading information to go undetected. This has enabled several high-profile fraud cases, including a purported multi-billion-pound mining company that never actually existed,[73] and £4.9 billion in losses linked to the Bounce Back Loan Scheme, much of it involving "ghost" firms.[74],[75] In the absence of joined-up systems, the burden of due diligence increasingly falls on the private sector, where businesses must duplicate checks such as Know Your Customer and anti-money laundering.
- **Fragmentation:** Business data are dispersed across siloed systems, making it difficult for government to respond quickly or tailor support effectively. As a result, policy too often relies on broad, poorly targeted tax reliefs that fail to reach the firms most in need. When more targeted schemes are attempted, delivery is often delayed. For example, after Storm Henk in January 2024, most affected farmers had not received compensation more than eight months later.[76] As economic shocks become more frequent – from extreme weather to global supply disruptions – this lack of agility and coordination will carry an increasing economic cost.

To address the fragmentation, duplication and inefficiency of the current system, the government should commit to introducing a digital ID and portal-access system for every UK business, to be delivered in two phases by 2030. This would provide the backbone for a more streamlined, secure and joined-up relationship between firms and the state.

This is no longer a novel idea. Singapore's CorpPass system already gives businesses access to more than 130 government services through a single login, tied to a verified business identity.[77] It has reduced administrative burdens, improved service delivery and contributed to Singapore's consistently high global rankings as a place to do business. In the EU, the Digital Identity Framework Regulation will require member states to provide businesses with a unified digital identity by 2026, reflecting a growing international consensus that this kind of infrastructure is now essential to modern government.[78]

The UK is not starting from scratch. The OneLogin programme is beginning to simplify sign-in across government services,[79] and reforms to Companies House – including new identity-verification requirements – will help improve the integrity of the company register.[80] But these measures do not address the underlying fragmentation of data and services, nor do they equip government with the tools it needs to interact with businesses in a joined-up, efficient and proactive way.

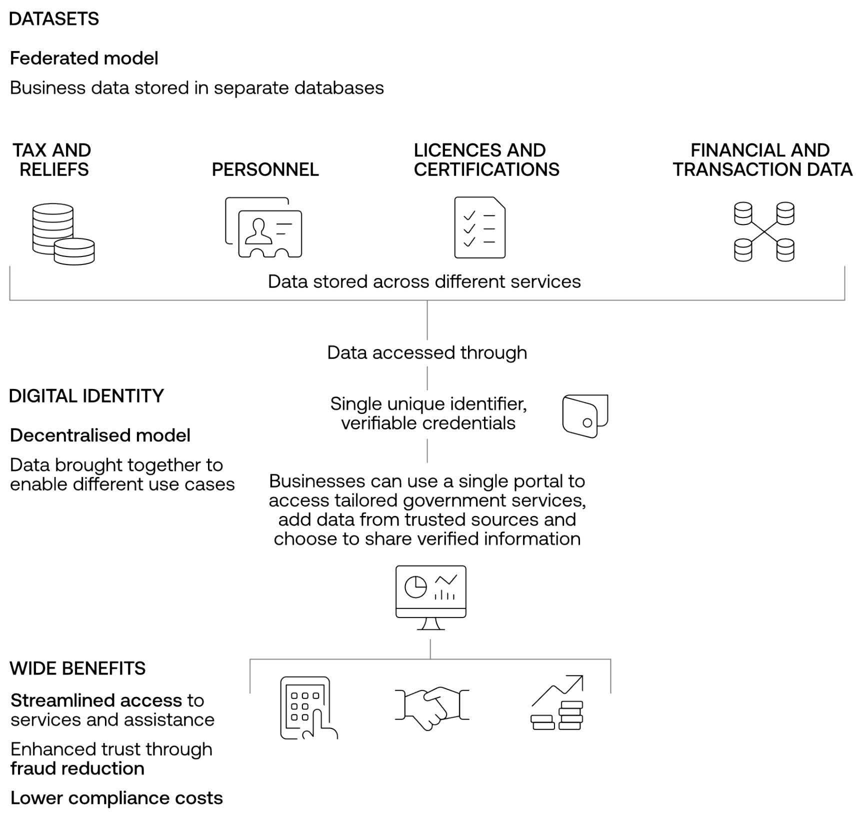
A digital ID for business would enable data to be pulled together across sources and operationalised by government for tax and business-support purposes. It would also enable businesses to streamline compliance processes. The proposal consists of two linked components:

- **Digital-ID infrastructure,** to be developed by 2027, would assign each business a single, verified identifier. This would allow data already held by government – across HMRC, Companies House and other departments – to be linked securely, without centralising them. Data would remain in departmental systems but become interoperable, enabling more accurate compliance checks, fewer duplicated processes and the ability to draw insights across data sets. It would also reduce the administrative burden on firms, which would no longer need to repeatedly submit the same information in slightly different formats to different departments.
- **A business-facing digital portal,** to be launched by 2030, would provide a single, secure interface through which firms could manage their obligations and access services. This would include filing tax returns, renewing licences, checking deadlines, updating business records and applying for support. It would replace the current patchwork of

fragmented systems with a coherent and accessible user experience, particularly important for smaller firms without dedicated administrative capacity.

FIGURE 7

An operational model for a business digital identity in the UK



Source: TBI

The system should also allow for permissioned data-sharing. Businesses could choose to share verified information – such as environmental, social and governance credentials, emissions data or financial indicators – with third parties such as lenders, supply-chain partners or regulators without revealing full internal records. This would support privacy-preserving data exchange, reduce friction in business-to-business (B2B) compliance processes and unlock new digital services.

The proposed implementation timeline is ambitious but achievable. The EU's legislation gives member states two years to deliver their digital-ID systems and Estonia successfully implemented its own national digital-identity system for individuals between 2000 and 2002.[81] TBI proposed a similar timeline in *The Economic Case for a UK Digital ID*. Given that most of the necessary data already exist in UK systems, a two-year window to build core infrastructure – followed by a further period to integrate services into a digital portal and onboard users – is achievable with the right political and administrative focus.

A secure, joined-up digital-identity and portal system would generate significant benefits for both businesses and the state:

- **Better access to government services and better-targeted support:** A unified portal could provide businesses with personalised prompts, reminders and recommendations – surfacing relevant funding schemes, licensing renewals or regulatory updates based on the firm's individual characteristics. This may be particularly beneficial for smaller businesses, which often lack the resources to stay on top of available schemes: recent research found that more than 60 per cent of SMEs report a very poor or below-average understanding of the government tax reliefs available to them.[82] Richer, integrated business data would also allow support to be targeted more accurately at firms with growth potential, rather than relying on blunt size-based thresholds.
- **Improved fraud prevention:** By linking data across departments and verifying business identities more effectively, a digital ID would significantly strengthen the government's ability to detect and prevent abuse. One major vulnerability it would help address is mini-umbrella-company fraud, in which thousands of short-lived companies are created

to exploit tax incentives or labour regulations. Between 2016 and 2021, an estimated 48,000 such companies were set up in the UK, costing the Exchequer hundreds of millions of pounds.[83], [84] A digital ID would make this harder by enabling authorities to spot anomalies, map networks of related entities and flag suspicious patterns in real time. It would also help close the loophole exploited by so-called muppet directors, whereby unrelated individuals are registered to conceal the true beneficiaries of fraud.[85] As Tax Policy Associates has noted, this risk persists even after recent Companies House reforms. Tying business identity to verified individuals – and restricting access to key functions, such as opening bank accounts, to those with verified credentials – would provide a powerful additional layer of protection.

- **Reduced compliance costs:** The current system places a high administrative burden on firms, particularly small ones, that face repeated form filling, duplicated processes and complex onboarding requirements. A business digital ID would help reduce this friction across both public and private interactions. In the financial sector alone, which spent an estimated £34.2 billion on regulatory compliance in 2022–23, a proof-of-concept trial by the Centre for Finance, Innovation and Technology found that a digital-identity system could cut onboarding and verification costs by up to 50 per cent, potentially saving £1.7 billion per year in that sector alone.[86] It could also help tackle the growing issue of late filing, for which related fines more than tripled between 2019–20 and 2023–24.[87]

A business digital ID would not only help the government achieve its target of reducing business compliance costs by 25 per cent, it would also lay the foundations for a smarter, more joined-up relationship between business and the state.[88] It would reduce friction, improve targeting and close loopholes in the system. And it would send a clear signal that government is moving from being a barrier to an enabler of business growth.

E-Invoicing

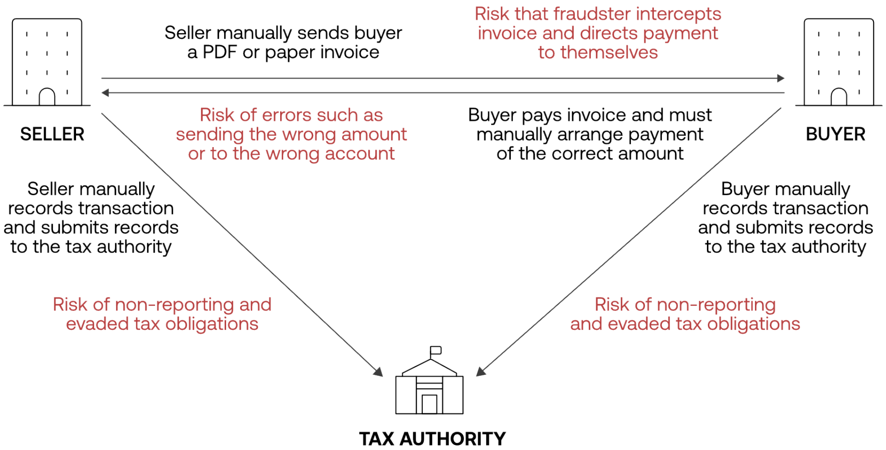
Without action, the UK's invoicing system risks becoming outdated and inefficient compared to other leading nations. Most businesses still rely on paper or PDF-based invoices, which must be actively processed by both sender and recipient. This typically involves manually generating invoices, entering payment details into accounting and banking systems, and checking that VAT is correctly calculated and recorded. The result is a system that imposes unnecessary costs and risks on firms:

- **Bureaucratic:** Manual invoicing processes consume valuable time and staff resources. Businesses must duplicate data entry, reconcile payments and manually verify VAT obligations – often across disconnected systems. These tasks divert attention from more productive work and create a compliance burden, particularly for smaller firms with limited administrative capacity.
- **Prone to error and fraud:** Traditional invoicing leaves both businesses and the Exchequer exposed to manipulation and misreporting. In 2023, UK businesses lost more than £50 million to invoice fraud, typically involving altered payment details on otherwise legitimate invoices.[89] HMRC estimates that the Exchequer missed out on £8.1 billion of VAT revenue in 2022–23, a substantial share of which can be linked to errors in recording and reporting transactions, and to undetected fraud.[90]
- **Slow:** Invoicing delays contribute directly to late payments and cashflow issues. Inconsistent formats, manual approval chains and poor visibility all slow the payment process. Late payments remain a persistent challenge for UK SMEs, costing an estimated £22,000 per business annually and contributing to the closure of up to 50,000 otherwise viable firms each year.[91]

These problems undermine efficiency, increase financial risk for businesses and weaken the integrity of the tax system.

FIGURE 8

The traditional invoicing model



Source: TBI

E-invoicing offers the potential to address many of the problems with the UK's current invoicing system. It represents a fundamental shift in how transactions are recorded, processed and reported. Instead of relying on static invoices that must be manually entered into accounting software, e-invoicing enables suppliers to send machine-readable data directly to buyers' systems. This removes the need for manual data entry, significantly reduces the risk of errors and allows payments to be processed at the push of a button.

The potential efficiency savings are substantial. Studies suggest e-invoicing can reduce invoice processing time by 44 per cent, freeing up staff to focus on higher-value activities.[92] Surveys of firms already using e-invoicing show a four-day reduction in average payment times and a 20 per cent drop in late payments, improving cashflow and reducing financial stress – particularly for SMEs.[93]

E-invoicing is already delivering results overseas and will be made mandatory across the EU by 2030.[94] Several countries have seen notable success:

- Italy mandated e-invoicing for all businesses in 2019, through its central platform *Sistema di Interscambio* (SDI). By 2022, the system was processing more than 2 billion invoices a year, and had driven an €8 billion increase in detected VAT fraud and a reduction in reporting errors.[95],[96] Italy's VAT gap fell from 21.6 per cent in 2018 to 10.6 per cent in 2022, representing a compliance gain worth €15.4 billion.[97] If the UK achieved a similar reduction in its VAT gap – from 4.9 per cent of potential revenue to 2.5 per cent – it could raise an additional £4 billion in revenue annually.
- In Peru, a national e-invoicing system introduced from 2010 (with mandates from 2014) led to a 64 per cent reduction in invoice-processing costs compared with paper-based systems, easing the administrative burden on businesses.[98],[99]
- In Colombia, e-invoicing has improved access to finance. Fintech lenders can now use e-invoice data to assess creditworthiness based on a transparent and verifiable transaction record.[100] This has expanded financing options for SMEs, potentially reducing borrowing costs in the process.

In the UK, progress has so far been limited but, in February 2025, HMRC and the Department for Business and Trade launched a joint consultation on e-invoicing – an important first step.[101] To realise the full benefits, including pre-populated VAT returns and lower compliance costs, this consultation must now quickly be followed by a clear implementation plan.

That plan must be built on an ambitious but credible timeline – for three reasons. First, to maximise the fiscal and administrative gains as early as possible. Second, to support wider tax-reform efforts already outlined in this report. And third, to ensure UK businesses are not left behind as e-invoicing becomes the global norm.

We believe the core infrastructure and bulk of the rollout could be achieved by 2030. Italy, for example, moved from initial mandates to pre-filled VAT returns in just over six years. With the right ambition and coordination, the UK could do the same – or better.[102]

Done well, e-invoicing can reduce processing costs, accelerate payments and simplify tax compliance. But the rollout must also learn from MTD: smaller firms will need clear guidance and accessible support to transition smoothly and with confidence.

The government should now commit to a phased rollout, with full integration with HMRC by 2030. By that point, larger businesses should be mandated to use e-invoicing for all transactions. The goal should be an interoperable, accessible e-invoicing ecosystem, with voluntary adoption supported early on, and a phased mandate to establish critical mass and lay the groundwork for VAT return pre-population. A 2030 deadline allows time for robust system development while keeping pace with international peers.

STEP 1: AUTUMN 2025 – ADOPT PAN-EUROPEAN PUBLIC PROCUREMENT ONLINE (PEPPOL) AS THE DEFAULT E-INVOICING STANDARD

In the absence of a common standard, e-invoicing in the UK remains fragmented. Businesses currently use a variety of formats – many of which are not interoperable –making it difficult to automate processing or exchange invoice data between trading partners. This lack of consistency adds friction to business transactions, limits the benefits of e-invoicing and creates barriers to wider adoption.

To enable scale and support early adoption, the government should move quickly to establish a single, national standard. The strongest candidate is PEPPOL, which is already mandated for transactions with the NHS and which is familiar to many UK software providers.[103] Expanding its use across the economy would build on existing infrastructure, reduce costs for developers and make it easier for firms to adopt e-invoicing.

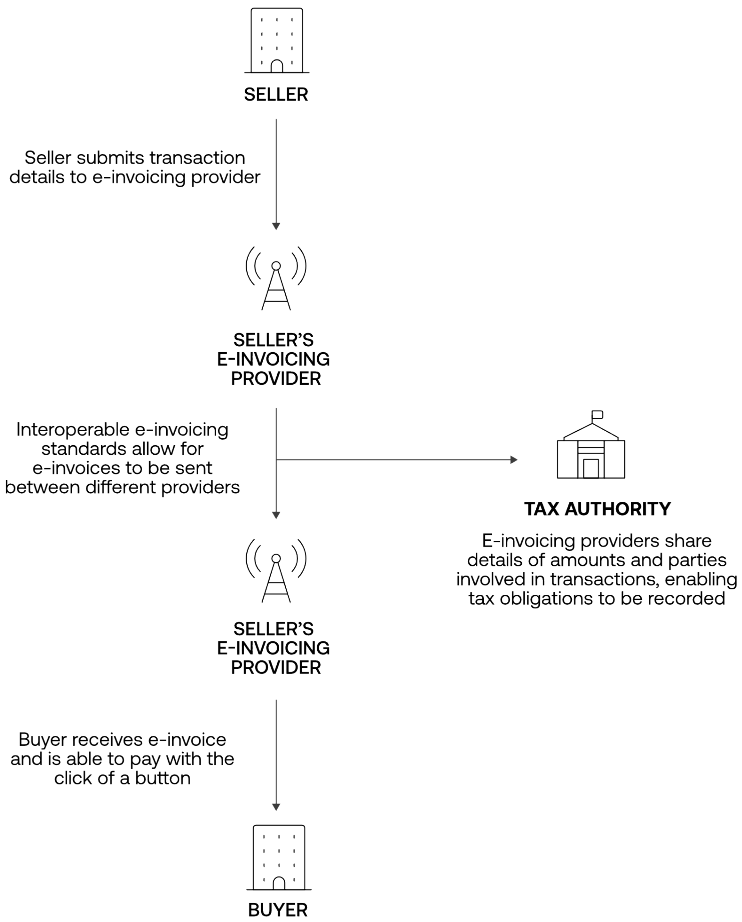
PEPPOL also offers global interoperability. It is fully compatible with EU e-invoicing standards and has been adopted by public authorities in countries such as New Zealand, Japan and Singapore.[104] Businesses in other jurisdictions – including South Africa, the UAE and the United States – also use PEPPOL to support cross-border trade. Adopting it as the UK's default standard would not only accelerate domestic rollout but also improve the international readiness of UK firms.

STEP 2: 2025 TO 2027 – ADOPT A FIVE-CORNER E-INVOICING MODEL AND SUPPORT BUSINESS ADOPTION

To ensure the e-invoicing system is flexible, scalable and resilient, the UK should adopt a five-corner model. Unlike the centralised three-corner model used in countries such as Italy, where all invoices pass through a single government platform, the five-corner approach allows businesses to choose from certified e-invoicing providers, which exchange invoice data directly with each other. HMRC acts as the "fifth corner", receiving real-time transaction data for tax purposes.

FIGURE 9

The five-corner e-invoicing model



Source: TBI

This model has key advantages: it promotes competition and innovation, avoids a single point of failure and is widely regarded as the international gold standard. It is already in use or being adopted in France, Belgium and Singapore, balancing public oversight with market-driven delivery.[105]

To deliver this model successfully, HMRC will need to develop the technical capability to receive and process real-time invoice data. It should also ensure that certified providers operate using interoperable standards, such as PEPPOL, and that clear technical guidance is available to software providers and businesses. Alongside this, HMRC should play an active role in monitoring the provider market, ensuring that free or low-cost options remain available, particularly for SMEs, so that cost does not become a barrier to adoption.

Crucially, HMRC must also address non-cost barriers to adoption. The experience of MTD showed that free software alone is not enough – many small firms need hands-on help to adopt new systems. Italy recognised this and supported its e-invoicing rollout with tools such as mobile apps, video tutorials and simplified onboarding for SMEs.[106] The UK should take a similar approach, offering proactive, accessible support tailored to smaller firms. A tax-specific AI chatbot could also play a valuable role, helping firms understand and implement e-invoicing processes, particularly those with limited administrative capacity.

A key design choice is whether HMRC should also develop its own free-to-use public e-invoicing service platform. Here, the UK can learn from France's experience.[107] More than 70 private providers registered under the national regime, prompting the government to drop its original plan to develop a public platform. Given the UK's mature tax-software market, a similar outcome is likely, provided that active steps are taken to prevent cost or complexity from excluding smaller firms.

STEP 3: 2027 – MAKE E-INVOICING MANDATORY FOR ALL B2G TRANSACTIONS

The UK should begin its transition to mandatory e-invoicing with business-to-government (B2G) transactions in 2027. This mirrors the approach taken in Italy, where e-invoicing was first mandated for central government bodies in 2014 and extended to all public entities by 2015 – a strategy that proved successful in building familiarity and momentum across the economy.[108] The UK is well placed to follow a similar path. Public bodies are already required to accept e-invoices, and e-invoicing has been mandated for all NHS transactions since 2022.[109] These provide a solid foundation for broader rollout across central and local government.

Making e-invoicing mandatory for B2G transactions in 2027 would help establish a critical mass of users and drive uptake among suppliers, many of which also operate in the private sector. If implemented well, it could act as a catalyst for voluntary adoption across B2B markets, helping more businesses access the benefits of e-invoicing sooner.

To support the transition, HMRC should work closely with other departments and experienced providers to share best practice, facilitate webinars and workshops, and build online forums to help businesses and public bodies navigate the shift. Smaller suppliers should be given targeted support to ease onboarding, and implementation should be closely monitored to identify and resolve early challenges. This phase will be essential not only to build confidence in the system, but also to demonstrate the practical advantages of e-invoicing – speed, simplicity and reliability – in a real-world setting.

STEP 4: 2027 TO 2030 – USE E-INVOICING DATA TO PRE-POPULATE TAX RETURNS AND INTEGRATE WITH MTD AND DIGITAL ID

Between 2027 and 2030, HMRC should focus on building the technical and operational capability needed to fully leverage e-invoicing data for tax administration – most importantly, to enable the pre-population of VAT returns and, in time, other returns such as corporation tax.

This integration will be critical to unlocking the long-term benefits of e-invoicing for businesses. By using invoice data to automatically fill in tax returns, HMRC can significantly reduce compliance costs and minimise administrative burdens, particularly for smaller firms.

To achieve this, e-invoicing data must be made interoperable with the MTD infrastructure and tightly integrated with the rollout of the proposed business digital-ID system. Coordination across these programmes will be essential to deliver a seamless, unified experience for businesses and to maximise the value of real-time transaction data in supporting a more accurate and lower-friction tax system.

STEP 5: 2030 – MANDATE E-INVOICING FOR ALL B2B AND B2C TRANSACTIONS BY VAT-REGISTERED BUSINESSES

To fully realise the benefits of e-invoicing, particularly in reducing compliance costs and improving VAT enforcement, it will be essential to capture the vast majority of transactions, including all B2B and most business-to-consumer (B2C). While voluntary adoption should be encouraged in the years leading up to 2030, international experience shows that mandates are ultimately necessary to unlock the full compliance and efficiency gains.

From 2030, e-invoicing should become mandatory for all VAT-registered businesses in the UK. This would mirror the approach taken in Italy, where B2B and B2C e-invoicing became compulsory for firms above the flat-rate threshold (equivalent to €85,000 turnover) in 2019.[110] The UK's current VAT registration threshold of £90,000 offers a similarly generous exemption for smaller firms.

As in Italy, special arrangements should be maintained for high-volume, low-value retail transactions, where traditional invoices are not typically issued. In these cases, businesses should be allowed to report gross daily takings, rather than issuing e-invoices per transaction. To support this, HMRC should work closely with electronic point-of-sale (EPoS) and payment-software providers to ensure automated daily reporting and reconciliation with VAT records.[111]

Waiting until 2030 to introduce this mandate provides HMRC with time to build its role as the fifth corner in the e-invoicing system and gives businesses the opportunity to familiarise themselves with the process. Since all VAT-registered businesses are already required to use MTD-compliant software to submit tax returns, the transition to e-invoicing should not be unduly costly or disruptive.

STEP 6: 2030 TO 2035 – GRADUALLY LOWER THE VAT AND E-INVOICING THRESHOLDS

The full potential of e-invoicing lies in its ability to automate VAT record-keeping and calculations, dramatically reducing the cost of compliance. As these administrative costs fall, it becomes more feasible for smaller firms to operate comfortably within the VAT system. This creates the conditions to lower the VAT-registration threshold and extend e-invoicing coverage, removing a long-standing barrier to business growth.

Italy again provides a useful precedent. After mandating e-invoicing for larger firms in 2019, it gradually lowered the threshold, extending the requirement in 2022 to firms on the flat-rate regime (€25,000–€85,000 turnover) and to micro-businesses below €25,000 in 2024.[112], [113] A similarly phased approach in the UK between 2030 and 2035 – lowering the VAT and e-invoicing thresholds in tandem – would support a smoother transition for smaller businesses.

Crucially, this change would benefit small firms, not just extend their obligations. By joining the VAT system and adopting e-invoicing, these businesses would be able to reclaim input VAT, access faster payments, reduce invoicing errors and participate more easily in trade – both domestically and internationally – through improved interoperability with other systems. With the right support, e-invoicing could shift the VAT system from being a burden to a benefit for small enterprises.

Towards a Digital-First Business Tax System

Harnessing technology in the UK tax system – through MTD, a business digital ID and e-invoicing – offers a transformational opportunity to reduce compliance burdens, raise revenue and unlock wider economic gains. By moving to a data-driven model, the UK can design a tax system that works better for both government and business.

While digitalisation has often been met with scepticism by small firms, a system that goes beyond compliance – delivering simplicity, well-targeted support and secure data-sharing – could make those firms among the greatest beneficiaries. A proactive, tech-enabled approach would support a more efficient, transparent and business-friendly environment, allowing firms to spend less on administration and more on innovation, investment and growth.

05

Conclusion

The business-tax system is a barrier to growth in the UK. Poor tax design has led to an over-complicated system that reduces investment, with many expensive reliefs that have little positive effect on growth.

The business-tax strategy presented here aims to maximise growth effects while maintaining revenue at the current levels. Reforms to corporation tax should ensure that all profitable investments before tax are still profitable after tax. Business rates should be converted into a tax on land values paid by landlords. Numerous tax reliefs that are failing to support growth should be abolished. And technology should be utilised in the administration of the tax system to ensure that compliance costs for business are as low as possible. This will be beneficial to all businesses, but particularly smaller ones who bear the heaviest burden of compliance costs at the moment. It will also have consequences for the design of tax policy: linking data across government databases will allow support to be better targeted on growing businesses, rather than providing blanket support for small business that results in little benefit for economic growth.

Following this strategy will not be easy and there will always be a cohort of defenders who will resist reform. But by setting out a clear direction of travel and highlighting the size of the prize at stake, the government has a chance to deliver some long-overdue reforms and kickstart economic growth.

Endnotes

1 https://www.britishchambers.org.uk/news/2025/01/budget-tax-hike-bursts-business-confidence/

2 https://www.ippr.org/media-office/revealed-investment-in-uk-is-lowest-in-g7-for-third-year-in-a-row-new-data-shows

3 https://www.gov.uk/government/publications/the-corporation-tax-road-map

4 Full expensing was subsequently made permanent for most plant and machinery.

5 https://committees.parliament.uk/writtenevidence/101223/html/

6 https://obr.uk/docs/dlm%5Fuploads/The-economic-effects-of-full-expensing.pdf

7 Economic theory suggests that profit-maximising firms will invest in capital until the expected rate of (post-tax) profit from an investment no longer exceeds the cost of capital, that is the financing cost plus depreciation. Business taxes lower the benefits of investment, but not the cost. They therefore increase the minimum rate of return for investments to be worthwhile. Some investments therefore may not be made as a result.

8 The OBR's methodology examines the impact of policy reforms on the cost of capital, weighted across different investment types. The recommended reforms would lower the weighted average cost of capital by 7.4 per cent. This would raise the optimal level of the capital stock by 3 per cent as the OBR uses a long-run user-cost elasticity between the increase in the cost of capital and the decrease in the optimal net capital stock of 0.4. The OBR assumes that two-thirds of this change would occur in the five years of the forecast period. Investment during the forecast period would thus be £45 billion higher, raising the broader gross capital stock by 1 per cent by the end of the forecast period. Given a Cobb-Douglas production function with an output elasticity of one third, this increases GDP by 0.3 per cent by the end of the forecast period.

9 https://www.cbi.org.uk/media-centre/articles/more-than-200-companies-and-trade-associations-join-cbi-and-make-uk-call-on-full-capital-expensing/

10 Though as the Institute for Fiscal Studies (IFS) has pointed out, the cost is lower in the longer term as the government is now paying capital allowances on new investment up front rather than over the lifespan of the investment. See https://ifs.org.uk/publications/full-expensing-and-corporation-tax-base.

11 https://obr.uk/efo/economic-and-fiscal-outlook-november-2023/

12 Note that this is a smaller impact than obtained by expanding full cost recovery to other assets. This is because capital allowances for plant and machinery were relatively generous (much closer to full cost recovery) in the first place, so the move to full expensing represented a smaller change.

13 For intangibles and buildings, capital allowances are paid over the lifetime of the asset on either a declining balance or straight-line basis. Declining balance means that a certain proportion of the remaining balance is offset against taxable profits each year; for example, for a £100 investment with a 25 per cent declining balance capital allowance, £25 is deductible in the first year, then £18.75 (25 per cent of the remaining £75) and so on. The straight-line basis deducts a fixed

percentage of the original investment each year. For buildings this is 3 per cent, so for a £100 investment, £3 is deductible from taxable profits each year for 33 years. Crucially though, these calculations do not take into account inflation or the time value of money, so the total value of capital allowances is less than the cost of the investment, as £1 received at some point in the future is less valuable than £1 today.

14 As set out in footnote 13, buildings are currently subject to capital allowances with a 3 per cent straight-line basis. This would continue, but the remaining balance would be increased in line with nominal interest rates each year. So, for a £100 investment, in the first year the capital allowance paid would be £3 as before. But in the second year, it would be 3 per cent of the remaining £97 plus interest – for example, if interest rates were 5 per cent, it would be £3.0555 (= £97 x 1.05 x 3%) – and so on.

15 https://cps.org.uk/wp-content/uploads/2022/09/After-the-Super-Deduction-Assessing-Proposals-for-the-Reform-of-Capital-Allowances.pdf.

16 https://link.springer.com/article/10.1023/A:1023364421914

17 https://academic.oup.com/oxrep/article-abstract/24/4/680/547862?redirectedFrom=fulltext

18 https://oxfordtax.sbs.ox.ac.uk/article/what-will-the-budget-do-for-corporate-investment

19 Weights for different investment types are taken from the Oxford Centre for Business Taxation's analysis: https://oxfordtax.sbs.ox.ac.uk/files/cbt-tax-ranking-appendicespdf.

20 https://commonslibrary.parliament.uk/how-could-the-government-change-the-business-rates-system/

21 William Vickrey, "Simplification, Progression, and a Level Playing Field", in ***Land-Value Taxation*** (Routledge, 1999).

22 https://committees.parliament.uk/writtenevidence/102480/html/

23 https://ifs.org.uk/sites/default/files/2022-08/16.%20The%20taxation%20of%20land%20and%20property.pdf

24 Note that the tax base would be otherwise unaffected. Land exempt from business rates at present – including agricultural land, forests, parks, public roads and religious buildings – would continue to be exempt from the Commercial Landowner Tax.

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for-R-D-Quasi-Experimental-Evidence-44786

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33 https://www.gov.uk/government/publications/creative-industry-tax-reliefs-evaluation

34 https://coadec.com/wp-content/uploads/2022/07/2022-Startup-Manifesto-Final.pdf

35 https://arxiv.org/abs/2306.17412

36 https://academic.oup.com/oxrep/article-abstract/33/1/141/2972709?redirectedFrom=fulltext

37 https://www.sciencedirect.com/science/article/abs/pii/S0048733399000852

38 https://ifs.org.uk/publications/should-there-be-lower-taxes-patent-income

39 https://taxfoundation.org/data/all/eu/patent-box-regimes-europe-2024/

40 https://assets.publishing.service.gov.uk/media/5bffc7a2ed915d1193085c11/Employer%5FNICs%5FReliefs%5FU21%5FApprentices%5FU25%5F-%5FHMRC%5FResearch%5FReport%5F514.pdf

41 https://www.gov.uk/government/publications/evaluation-of-employer-national-insurance-contributions-reliefs-for-employees-under-21-and-apprentices-under-25

42 Quantitative evidence on employment levels is more mixed. The 2023 study found some evidence that the proportion of those aged under 21 in employment had increased as a percentage of the labour force but not as a percentage of the population as a whole, suggesting that these results should be treated with caution.

43 https://ifs.org.uk/publications/intertemporal-income-shifting-and-taxation-owner-managed-businesses

44 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment%5Fdata/file/663877/HMRC%5FReport%5F456%5FCGT%5FER.pdf

45 https://ifs.org.uk/journals/who-pays-business-rates, https://wedlakebell.com/business-rates-who-pays-and-why-it-matters/, https://webarchive.nationalarchives.gov.uk/ukgwa/20080727055859/http://www.hmrc.gov.uk/research/report42.pdf

46 This is a simplification – higher rates may lead to fewer business properties being constructed or business premises being converted to other uses. This would dampen this effect, but any reduction in the availability of business property is likely to be small. It is generally recognised that construction in the UK is unresponsive to changes in rents received by landlords and changes of use are restricted by the planning system (https://www.oecd.org/en/publications/the-price-responsiveness-of-housing-supply-in-oecd-countries%5F5kgk9qhrnn33-en.html). Another exception to this rule comes when relief is given for certain activities or businesses but not others, and particular properties can be used for different purposes or by different users. In this case tenants may gain advantage from a relief that benefits one use or user but not another. Again, however, restrictions on changes of use through the planning system may make it more difficult for a property to be used for different purposes.

47 Source: TBI calculations using HMRC statistics.

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54 https://op.europa.eu/en/publication-detail/-/publication/70a486a9-b61d-11ec-b6f4-01aa75ed71a1; https://papers.ssrn.com/sol3/papers.cfm?abstract%5Fid=3727120

55 The lower bound represents the estimate produced by HMRC, https://www.nao.org.uk/wp-content/uploads/2025/02/the-administrative-cost-of-the-tax-system.pdf, while the Federation for Small Businesses (FSB) argues that the burden may be much higher: https://www.fsb.org.uk/resources-page/small-firms-losing-25-billion-a-year-to-tax-admin-as-budget-nears-new-study-shows.html

56 1.9% of turnover on average for micro firms vs 1.9% for large enterprises –https://www.europarl.europa.eu/RegData/etudes/STUD/2023/642353/IPOL%5FSTU%282023%29642353%5FEN.pdf

57 https://www.gov.uk/government/statistics/measuring-tax-gaps/1-tax-gaps-summary

58 https://commonslibrary.parliament.uk/research-briefings/cbp-7949/

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61 https://www.gov.uk/government/publications/impact-of-making-tax-digital-for-below-threshold-vat-customers/impact-of-making-tax-digital-for-below-threshold-vat-customers-executive-summary#time-saving-as-a-result-of-making-tax-digital-for-vat

62 https://www.fsb.org.uk/resource-report/a-duty-to-reform.html. It is worth noting the limitations of the methodology undertaken by the FSB, which failed to control for the fact that, as larger firms were mandated to use MTD, firms using MTD were often larger than those not using it, as larger firms may have more complicated tax affairs. We would expect them to have higher compliance costs even in the absence of MTD.

63 https://www.xero.com/uk/programme/making-tax-digital/making-tax-digital-timeline/

64 Previously known as Making Tax Digital for Income Tax Self Assessment

65 https://www.nao.org.uk/press-releases/taxpayers-let-down-by-poor-hmrc-customer-service/

66 HMRC guidance issued here offers little in the way of useful support for how to comply with the scheme; no FAQs or video tutorials for example: https://www.gov.uk/guidance/use-making-tax-

digital-for-income-tax/help-and-support

67 https://www.icaew.com/insights/tax-news/2024/oct-2024/budget-makes-changes-to-how-the-tax-system-is-administered

68 It is worth noting that tax software qualifies as a business expense and is therefore tax deductible for corporation-tax purposes. This will not, however, benefit many smaller businesses that are not incorporated, such as sole traders or partnerships.

69 https://www.gov.uk/guidance/find-software-thats-compatible-with-making-tax-digital-for-vat

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80 https://committees.parliament.uk/publications/46578/documents/238041/default/

81 https://ec.europa.eu/digital-building-blocks/sites/display/EUDIGITALIDENTITYWALLET

82 https://smallbusiness.co.uk/small-businesses-unaware-of-potential-tax-relief-2517971

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84 A recent court ruling confirmed that mini umbrella companies are not entitled to use the VAT flat-rate scheme or claim the Employment Allowance, thereby strengthening HMRC's enforcement position. However, effective enforcement depends on first identifying these companies – a process that could be supported by the use of digital ID. https://www.hive360.com/hmrc-landmark-mini-umbrella-company-ruling/

85 https://taxpolicy.org.uk/2025/02/13/how-criminals-use-muppets-to-commit-corporate-fraud-and-how-to-stop-them/

86 https://cfit.org.uk/digital-verification-coalition

87 https://www.ft.com/content/1d6a7d0b-1761-49c8-8c90-ef6bd4d3ef4d

88 https://www.gov.uk/government/speeches/pm-remarks-on-the-fundamental-reform-of-the-

british-state-13-march-2025

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106 https://ec.europa.eu/digital-building-blocks/sites/display/DIGITAL/eInvoicing+in+Italy

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111 To increase compliance and reduce fraud risk, consumer-facing incentives – such as receipt lotteries or whistleblower rewards – could also be trialled. This would encourage the issuance of (digital) receipts and discourage unrecorded payments.

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113 https://www.itaxa.it/blog/en/faq/what-are-the-requirements-for-applying-the-flat-rate-tax-regime-regime-forfettario-for-foreign-self-employed-individuals-in-italy/?

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