Tax Representation

ICAEW TAX FACULTY

TAXREP 29/09

Submission to the House of Lords Economic Affairs Sub-Committee on the Finance Bill

Memorandum submitted on 11 May 2009 by the ICAEW Tax Faculty to the Economic Affairs Sub-Committee on the Finance Bill setting out initial comments on foreign profits, Real Estate Investment Trusts and pensions.

SUBMISSION TO HOUSE OF LORDS ECONOMIC AFFAIRS SUB-COMMITTEE ON THE FINANCE BILL

INTRODUCTION

1 We welcome the opportunity to submit evidence in response to the invitation published on http://www.parliament.uk/parliamentary_committees/lfinbill.cfm

2 Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Appendix 1. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Appendix 2.

FOREIGN PROFITS: CLAUSES 34-37 AND ASSOCIATED SCHEDULES

3 We welcome the broad thrust of these provisions in the Finance Bill, but remain concerned about the overall balance of the Foreign Company profit proposals and their impact on the UK's tax competitiveness. Headquartering a multi-national business in the UK, or inward investment into the UK, is likely to be less attractive in the future on account of these changes.

Clause 34 and Schedule 14, Corporation tax treatment of company distributions received

4 We welcome this clause and Schedule under which all distributions (both UK and foreign) will be exempt provided they fall within one of the five specified exemptions. We note that the related issue of the taxation of foreign branches has not yet been addressed. We note and welcome that these provisions will apply to dividends paid by overseas subsidiaries on or after 1 July 2009 while the introduction of the worldwide debt cap will be delayed until accounting periods beginning on or after 1 January 2010. This will allow time for further time for consultation on the worldwide debt cap provisions.

Clause 35 and Schedule 15, Tax treatment of financing costs and income

5 We remain concerned that the introduction of the worldwide debt cap, as currently proposed, will add considerable complexity to the UK tax system and affect its competitiveness.

6 The world wide debt cap attempts to restrict the quantum of the interest deduction against UK profits to an amount which is reasonable in the context of the worldwide activities of the particular group. In broad terms the amount of that UK deduction is limited by reference to the consolidated gross (external) finance expense of the particular group.

7 We believe that the same policy objectives, which are to prevent the 'dumping' of debt into the UK part of worldwide operations and the penalisation of upstream loans to the UK, could equally well be achieved by tightening up the existing thin capitalisation regime and introducing targeted rules against upstream loans.

8 We welcome the decision not to introduce the new worldwide debt cap rules before accounting periods beginning on or after 1 January 2010 so that international groups have time to reconsider their existing arrangements. This deferral provides an opportunity for further consultation so as to ensure that the identified problems with the debt cap are addressed.

9 The revisions to the December 2008 proposals, announced on 7 April 2009, will remove many of the practical difficulties that would have been posed by the original proposals, but the rules remain complex and it is anticipated that a significant proportion of companies,

including nearly all entirely UK based and UK headquartered groups, will still fall within the worldwide debt cap rules. This will add considerably to the UK tax compliance burden.

10 We note that HMRC has assessed the administrative burden of these rules at £8.7m per annum which we consider is likely to prove extremely conservative.

Clause 36 and Schedule 16, Controlled foreign companies

11 We believe that as part of the wider review of the existing controlled foreign companies (CFC) legislation there is merit in considering, as an alternative, a tightening up of the existing anti-avoidance legislation which has as its aim to prevent artificial diversion of profits from the UK.

12 We welcome the decision to retain the exemption for local holding companies which was to have been removed under the 9 December 2008 proposals.

Clause 37 and Schedule 17, International movement of capital

13 We welcome the abolition of the existing Treasury consents and their replacement by new reporting requirements. We welcome the extension of the time period during which companies have to comply with the new reporting requirements from 14 days of the end of the quarter in which the transaction took place, as proposed in the 9 December 2009 draft legislation, to the Finance Bill proposal of within six months of the transaction.

14 Further consideration needs to be given to these rules, in particular the debt-cap rules, so as to ensure that the identified concerns are addressed in ways that minimise UK compliance burdens and which do not harm the UK's competitiveness.

REAL ESTATE INVESTMENT TRUSTS (REITS): CLAUSE 65 AND SCHEDULE 34

15 We contributed to the extensive consultation that took place before the introduction of the REIT regime. We note that the regime is only just over two years old and, in spite of extensive prior consultation, the scheme continues to be amended. This is probably more a reflection on the difficulty in establishing a new taxation regime for property investment companies and ensuring that it caters properly for many different sets of fact circumstances rather than the fact that the original legislation was defective.

16 Whilst we appreciate that It takes time to fine-tune a new taxation regime, we hope that following these latest changes the REIT regime will now enjoy a stable framework which will provide an opportunity to analyse the success of the REIT regime.

17 REITs were only introduced with effect from 1 January 2007 and our experience of the effectiveness of the regime in practice is limited. We understand informally that about 16 existing property investment companies converted to REITs and that one or two new REITs have been established since then.

18 The above numbers suggest that the demand for REITs is quite low but as referred to above it is probably too early to assess the success of REITs. Further, given the current depressed property climate, it is perhaps not surprising if current interest in REITs is quite low.

PENSIONS: CLAUSE 71 AND SCHEDULE 35

19 It was announced in the Budget that from April 2011 tax relief on pension contributions will be restricted for those earning over £150,000. In addition, whilst existing pension arrangement are not affected, an anti-forestalling measure was announced aimed at limiting

tax relief for those with earnings of £150,000 seeking to make additional pension contributions in the period from 22 April 2009 until April 2011. Schedule 35 enacts the anti-forestalling provision.

20 We have a number of major concerns with these proposals, as follows:

- the proposed measures taken as a whole are likely to damage the pension industry and discourage saving for retirement using a pension; and

- the anti-forestalling provisions discriminate against the self employed and those made redundant who might top up their pension as part of any terminations arrangements.

Damage to the pension industry

21 The proposed restriction on tax relief breaches the fundamental principle which underlines tax relief for pensions, which is that tax relief is given on contributions at the marginal rate but is then taxed in full (including at higher rates of income tax, where applicable) when the amount is paid out as a pension.

22 The proposals will discourage long-term saving using pensions and are likely to damage confidence in the UK pensions industry. Many will consider that, given the relative inflexibility of pension savings (particularly extracting money on retirement), the return on net investment will be too low to make contributions worthwhile and will therefore stop saving for retirement using pensions. In addition, at the margins around £150,000, taxpayers may opt to reduce income by reducing hours etc rather than fall within the new regime.

23 This principle was confirmed most recently in the changes that were made to the pension rules in the FA 2004 and introduced on 6 April 2006, which included a generous annual limit specifically to enable top up contributions to be made. Set out in Appendix 1 are some comments made by the then Financial Secretary to the Treasury during the passage of the FA 2004 which confirm these principles.

Anti-forestalling provisions

24 The provisions effectively bring forward the restriction on tax relief by up to two years and as drafted discriminate against, for example the self employed. The provisions are also likely to apply in cases of redundancy, when taxpayers may receive termination payments which significantly increase current year income and often pay larger than usual contributions to improve their pension provision. In addition, it would appear that the provisions for 2009/10 and 2010/11 are more penal than the proposals for 2011 onwards, although in the absence of any detail for 2011 and beyond we cannot be certain on this point. For example, there are no tapering provisions prior to 2011 which give the 'cliff edge' effect mentioned below.

25 As currently drafted the provisions are likely to affect far more taxpayers than those at which we are told they are targeted and the provisions can result in marginal rates of tax far in excess of 100%. For example, we have calculated that a difference in income of just 1p between two individuals who otherwise have identical levels of income and pension contributions results in one paying £6,000 more tax than the other, a marginal rate of 600,000%. We therefore challenge the premise that the anti-forestalling rules will not increase tax take.

26 We are also very concerned by the level of complexity of the provision. One only has to look at the bulk of guidance which has already been issued to realise just how difficult are these

proposals, particularly for unrepresented taxpayers. As noted above, complex legislation leads to significant extra costs for HMRC.

27 The provisions apply to prevent higher rate tax relief for most pension contributions on or after 22 April 2009 other than where contributions 'are paid quarterly or more frequently'. We are unclear about the rationale for ongoing regular contributions being limited to quarterly or more frequently and consider that this is far too restrictive. In particular it discriminates against the self-employed. Pension contributions paid by self-employed individuals are often one-off or annual contributions made once the likely level of profits for the tax year is known. As currently drafted, many self-employed who make regular annual or six-monthly contributions face the possible immediate loss of higher rate relief. We note that in his Ministerial Statement on 22 April 2009 the Financial Secretary to the Treasury stated:

> *The Government recognise that those with less regular contribution patterns may be affected and would welcome views on whether there are ways of ensuring the contributions of this group are protected in the same way as those making more regular patterns, while continuing to meet the objectives above*.

28 The inclusion of pension contributions made by employers in taxable income (as defined for this purpose) is likely to result in the new provisions affecting those with incomes considerably below the £150,000 threshold being quoted. This is likely to result in compliance issues particularly for those taxpayers who do not believe that they will be affected by these changes. HMRC will need to undertake an extensive publicity campaign so that taxpayers understand the changes.

29 In the same way as mentioned above in connection with personal allowance withdrawal, dealing with the changes through PAYE and net pay arrangements is likely to be very cumbersome and difficult, resulting in extra costs for HMRC, employers and taxpayers and adding to the administration burden for employers and pension schemes.

ICAEW recommendation

30 Individuals who make regular annual contributions should be able to benefit from higher rate relief until the proposed changes in 2011. We therefore suggest that the proposed rules should be amended to cater for regular annual contributions. This could be done a number of ways. One approach would be to have a further test calculated by reference to average contributions made in, say, the highest two tax years out of 2006/07, 2007/08 and 2008/09 – perhaps indexed up by reference to the changes in the annual personal allowance.

FURTHER CONTACT

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Appendix 1

CLAUSE 71 AND SCHEDULE 35

COMMENTS BY THE FINANCIAL SECRETARY DURING THE PASSAGE OF THE FA 2004

The FA 2004 provisions, which came into effect in 2006, were the result of considerable consultation and when the changes were being debated in the Public Bill Committee the then Financial Secretary to the Treasury noted that:

> 'We are sweeping away the existing rules and regulations and replacing them with a single regime for all tax-privileged pension saving. That represents a hugely positive step for those saving or looking to save towards their retirement.
>
> Simplification will introduce greater individual choice and flexibility. For the first time, everyone will have the same opportunity to make tax-relieved pension savings over a lifetime. Our proposals will create a transparent, consistent and flexible system that is readily understood. That will make it easier for people to concentrate on things that matter, such as when and how much to save for their retirement, rather than on trying to understand anomalies between the different tax regimes.
>
> Simplification will reduce the administrative burdens and regulatory cost for pension schemes, their members, operators and sponsors, and will create opportunities for people to save more towards a pension and a retirement lump sum. The new rules will allow everyone to pay what they can afford when they can afford it.
>
> The pension simplification provisions represent the outcome of two formal consultations and extensive informal consultation. At every stage, we have had regard to the views of those who will be affected, whether individuals, employers or pension providers.
>
> The new regime will consist of two key controls: a lifetime allowance and an annual allowance for the amount of tax-relieved savings that can be made. It is important to recognise that the allowances will not prevent people from saving more in registered schemes if they wish to. The lifetime allowance will initially be set at £1.5 million and will rise to £1.8 million by 2010. The annual allowance will initially be set at £215,000 and will increase to £255,000 by 2010. **Those allowances represent very generous levels of tax-relieved savings. They are far in excess of what 99 per cent. of the population currently save or are ever likely to. However, they limit the amount of tax relief that very high earners can obtain, which is fair.[our emphasis]'**

These new (2006) provisions introduced both an annual allowance and a lifetime allowance so that that the tax relief obtained is restricted in a clear and transparent manner. Those taxpayers who took on board the message that the annual allowance was generous enough that they could make top up payments in later years should have time to re-arrange there affairs before the changes come in.

Appendix 2

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 130,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.

4. To find our more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

Appendix 3

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.

4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see http://www.icaew.co.uk/index.cfm?route=128518.