Tax Representation

ICAEW TAX FACULTY

TAXREP 26/09

FINANCE BILL 2009: ICAEW PRIORITY ISSUES

Briefing submitted on 11 May 2009 by the ICAEW Tax Faculty setting out high level issues arising from the Finance Bill 2009.

FINANCE BILL 2009: ICAEW PRIORITY ISSUES

INTRODUCTION

1 Set out below are the key issues identified by the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW).

2 Details about the ICAEW and the Tax Faculty are set out in Appendix 3. Our Ten Tenets for a Better Tax System which we use as a benchmark when analysing new legislation are summarised in Appendix 4.

INCOME TAX CHANGES: REDUCTION IN PERSONAL ALLOWANCES AND THE PROPOSED ADDITIONAL 50% RATE
CLAUSES 4 AND 6 AND SCHEDULE 2

Introduction

3 Tax rates are properly a matter for government to decide. Nevertheless, the ICAEW is concerned that the proposed changes to the income tax rules to take effect in 2010/11, namely:

- the withdrawal of personal allowances for those earning over £100,000 (creating a marginal 60% tax rate); and
- the new 50% tax rate (replacing the 45% rate proposed in the 2008 PBR and now to be introduced in 2010/11 rather than 2011/12);

create unhelpful anomalies and do little to address the budget deficit.

4 The 2009 Budget Red Book states that the above two measures will yield £1.23bn in 2010/11, rising to £1.99bn in 2011/12. This compares with predicted budget deficits for 2010/11 and 2011/12 which are now estimated to be £173bn and £140bn respectively. It is inevitable that action will be needed to bring the UK's finances back into balance and that this is likely to require a mixture of much more broadly based tax increases than have been proposed, together with cut-backs in public expenditure.

5 However these changes, together with measures such as the proposed restrictions on tax relief for pension contributions (see our comments on this further below) are likely to create a disincentive for high earners to work and invest in the UK, thereby hitting business and competitiveness.

Clause 6 and Schedule 2, the proposed 50% tax rate

6 The Institute for Fiscal Studies (IFS) expressed doubts before the Budget as to whether the 45% tax rate would result in a net increase in revenues and suggested that the optimal maximum income tax rate was 40%. We suggested in our 2009 Budget submission (TAXREP 14/09)[1] that a detailed economic analysis should be made of the proposed change before any final decision is made to proceed with the increase. We also note that, in evidence to the Treasury Committee following the Budget, an HM Treasury official stated that their calculations assumed that the measure would only yield 31% of the proposed

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[1] See http://www.icaew.com/index.cfm/route/164119/icaew_ga/Faculties/Tax/Publications_and_technical_guidance/TAXREP_14_09_2009_Budget_submission/pdf

maximum based upon the number of taxpayers affected (see page 42 of the Treasury Committee's *Budget 2009*[2], published on 6 May 2009).

7 The present higher rate of income tax is 40%. In order to encourage equity investment, there is a separate rate of 32.5% on dividends. Since companies pay tax on profits and shareholders pay tax when those profits are distributed to them, the tax system prevents complete double taxation of the profits to shareholders in two ways. The first is by providing a tax credit to shareholders of 10% of the dividends. The second is by taxing the dividend and credit at a lower rate than other income. The result is an effective rate of tax of 25% on dividends for higher rate taxpayers.

8 It is proposed to increase the top rate of income tax by 25% from 40% to 50%. But the proposed increases in the rate of income tax on dividends are much higher. An increase in the dividend rate from 32.5% to 42.5% raises the effective rate by over 44% from 25% to 36.1%. Such a change will discourage equity investment. The proposed higher dividend rate should be 38% to give to give an effective rate of 31.1% which is 25% higher than the present effective rate of 25%.

9 The proposed increase in the trust rate of tax to 50% and the trust dividend rate to 42.5% also create the following problems.

- The introduction of a 50% trust rate is likely to result in the majority of trust beneficiaries needing to file repayment claims. Whilst this will create more work for beneficiaries and their advisers, it will also create more work for HMRC. This is because whereas a trust rate of 40% reflects the marginal rate of tax paid by most individuals on high incomes, currently only 2% of taxpayers are in the £100,000-plus income bracket (according to paragraph 2.48 of the PBR 2008) so we would expect significantly fewer than this will be in the 50% marginal rate band which starts at income of £150,000.
- The proposals may also result in a cash flow disadvantage for HMRC. This is because many beneficiaries, for example minor children, vulnerable beneficiaries and all those not liable at the new 50% higher rate who receive payments of trust income, will be able to apply for tax refunds before the trustees have necessarily paid all of the higher rates of tax on the income.
- Where amounts are paid out to beneficiaries, the detailed operation of the trust tax pool provisions means that where those amounts include dividend income the actual effective tax rate on dividends is considerably more than the rate for dividends received directly. Whilst this problem already exists, these proposals will make the problem worse and will again discourage trustees from holding equities.

ICAEW recommendations

10 Given the weight of evidence that such rates may not be effective in raising revenue we remain of the view that the Government must make a detailed economic analysis of the impact of the proposed 50% tax rate before implementing any such policy.

11 The dividend upper rate and the dividend trust rate should be reduced so that the net effective tax increases are the same as that for other non-dividend income.

[2] See http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/438/438.pdf

Clause 4, Reduction of personal allowance for those with incomes exceeding £100,000

12 The way in which the personal allowance is withdrawn does not result in a progressive tax system. Withdrawing the personal allowance at a rate of £1 for every £2 of income above £100,000 results in an effective marginal income tax rate of 60% (61½% with NIC) on income between £100,000 and £112,950 (using the 2009/10 personal allowance of £6,475).

13 Aside from this concern, these proposals introduce considerable complexity into the income tax system and associated tax calculations.

14 There is a major practical problem with the proposals where the taxpayer is within PAYE which results in additional costs for both HMRC and taxpayers. At taxable income of over £100,000, the precise amount of the allowance depends upon the level of income in the tax year. This figure will not be known until the after the end of the tax year. The PAYE system relies on estimates of income in these circumstances and will have allocated the personal allowance accordingly. Where an individual usually has income well below £100,000 but receives a one-off bonus which takes income up to above £113,000, that taxpayer will face an unexpected underpayment of in excess of £2,590 simply because the PAYE system cannot deal with this situation. That taxpayer will have expected PAYE to be collecting the right amount of tax during the year and will no doubt want an explanation from HMRC staff.

15 The result will be more HMRC staff dealing with enquiries, the issue and processing of further forms or returns as well as making the associated payment/repayments or coding adjustments. This will add to the administrative burden and costs for many taxpayers and HMRC.

16 We recognise that a similar situation happens at present for the less well off elderly taxpayers within age allowance taper but this is a source of irritation and upset to those taxpayers. We therefore consider that such a poor precedent should be avoided.

ICAEW recommendations

17 There are alternatives which could give a less burdensome result. For example, setting aside for the time being our observations above about the ineffectiveness of increased tax rates, a more straightforward option would be to continue to give personal allowances in full but to increase the rate of tax applying to taxable income over £100,000 to an appropriate percentage. This would have the benefit that PAYE would then be able to deal effectively with bonuses because no estimations are required for income levels and underpayments of tax would be rare. This would also have the advantages that (i) tax would be collected earlier through PAYE rather than several months after the year end through assessment and (ii) the costs of making the changes to the manuals and guidance and of dealing with enquiries from taxpayers would be very much reduced.

18 Some analysis will need to be done to identify an appropriate rate of tax and we recognise that it would create winners and losers as compared to the current proposal in the Finance Bill.

VAT – EXTENSION OF REDUCED STANDARD RATE AND ANTI-AVOIDANCE PROVISIONS
Clause 9 and Schedule 3

Date when VAT rate reverts to 17.5%

19 Clause 9(1) confirms that the date when the standard rate of VAT reverts to 17.5% is 1 January 2010. In our 2009 Budget submission, we expressed concern that changing the VAT rate back to 17.5% on 1 January 2010 is a highly inconvenient time for businesses, particularly retailers. In addition, we are concerned that 1 January 2010 is also the start date for the proposed changes to the VAT place of supply rules for services (see below for our comments on these proposals). Businesses will therefore need to deal with a major change in the VAT system and a change in rate at the same time and this will impose burdens on many businesses.

ICAEW recommendation

20 We remain of the view that this date should be deferred although we recognise that it will have revenue implications. In our Budget submission, we suggested that the date that VAT reverts to 17.5% is put back to 1 April 2010 (ie a three month deferral). If this date will produce too large a loss in revenue, we suggest that the date is deferred by, say, one month to 1 February 2010. Even if the suggested date is not accepted, the change will be burdensome and we would welcome confirmation that HMRC will adopt a 'light touch' approach to any mistakes and errors that arise during the changeover.

Anti-avoidance provisions

21 Schedule 3 sets out anti-avoidance provisions designed to stop businesses entering into arrangements to pay VAT at the 15% rate on supplies which would otherwise occur after the rate has reverted to 17.5%. The proposals will only apply to businesses which cannot recover all of their VAT and, very broadly, where the supplier and recipient are connected and the supply is for more than £100,000.

22 These highly complicated provisions take up almost nine pages of legislation. They could apply in unexpected situations given the importation of the wide definition of connected persons as set out in s 839, ICTA 1988 and appear a disproportionate response to the problem given that any VAT saving will only be a maximum of 2.5%.

ICAEW recommendation

23 We recommend that HMRC engage in detailed discussions with the profession to see whether these rules can be simplified whilst ensuring that key concerns are addressed.

TEMPORARY EXTENSION OF LOSS CARRY BACK PROVISION
Clause 23 and Schedule 6

24 The ICAEW supports the tax-related changes announced by the Chancellor to help the cash-flow of businesses hard hit by the economic downturn, namely:

- the expanded debt management service and the ability to make in-year loss relief claims; and
- the extension of the loss carry-back rules to cover losses for a two-year period rather than a one-year period.

25 In our 2009 Budget submission, we proposed that the losses eligible for the extended three year carry-back proposed in the 2008 PBR should be extended from one to three years. Our rationale was that for many unincorporated businesses, the proposed operation of the relief would discriminate against unincorporated businesses in that the relief was likely to be available in the wrong year, although we recognised that it may have revenue implications.

26 The proposal set out in Schedule 6 is that losses arising in a two-year period can be carried back for three years, up to a limit of £50,000 per year.

27 Whilst the extended two-year loss period is welcome, given the difficulty in forecasting exactly when the economy may move back into growth we consider that these rules should be kept under review and that they may require greater flexibility, particularly in respect of unincorporated businesses. Whilst the Government expects growth to resume later this year, many commentators are forecasting that the UK could experience negative growth in 2010, and it is only now that many businesses are beginning to experience serious problems. An unincorporated business with a year end of, say, 30 April may find that it makes losses in the year to 30 April 2010. This would be outside the proposed extended two-year time limit which is for accounting periods ending in the tax year 2009/10.

ICAEW recommendation

28 We recommend that this area is kept under review and if necessary the proposed relief is extended for income tax purposes to include claims for carry back of losses arising in the tax year 2010/11.

FSCS PAYMENTS REPRESENTING INTEREST
Clause 33

29 In our 2009 Budget submission, we recommended that as a temporary measure any interest credited in a tax year which cannot be withdrawn due to the illiquidity or insolvency of the financial institution should not be taxed until actually received. We also requested clarification of how payments received under the Financial Services Compensation Scheme (FSCS) would be taxed and that payments from FSCS should be treated firstly as a return of capital and only amounts in excess of the capital contributed to the account should be treated as interest.

30 Clause 33 clarifies that where FSCS payments are received which include a payment representing interest, such interest will be treated as interest for the purposes of income tax. While this provides certainty in respect of such payments, we believe that further clarifications are still required. For example, it is not clear to us what will be the position if, say, an FSCS payment is received which is less than the original capital? If the FSCS stated that any payment nevertheless included an interest element, then taxpayers would be faced with an income tax charge even though they did not receive back their capital, thus exacerbating any loss.

31 We also recommend consideration of a temporary relief where any interest credited in a tax year cannot be withdrawn from the account until a later tax year due to withdrawals from the account being temporarily blocked by the financial institution.

ICAEW recommendation

32 The Bill should be amended to take account of these concerns.

FOREIGN PROFITS ETC
Clauses 34 to 37 and Schedules 14 to 17

Introduction

33 We welcome the broad thrust of these provisions and the extension of the relief to cover small companies. However, we 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

34 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.

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

35 We remain concerned about the introduction of the worldwide debt cap as currently proposed. The purpose of the world wide debt cap is to restrict tax relief for interest 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.

36 We appreciate the policy objectives but are concerned that the 32 ½ pages of the debt cap provisions will add considerable unnecessary complexity to the UK tax system which will affect the UK's competitiveness. We believe that there are other less burdensome ways to address these concerns.

37 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.

38 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.

39 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.

40 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.

ICAEW recommendation

41 As noted above, we believe that there are alternative approaches to address the problem of debt dumping without imposing such onerous burdens on UK businesses. HM Treasury should consult further with stakeholders on these proposals.

Clause 36 and Schedule 16, Controlled foreign companies

42 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.

43 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

44 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.

ICAEW recommendation

45 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.

PENSIONS – SPECIAL ANNUAL ALLOWANCE CHARGE
Clause 71 and Schedule 35

46 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.

47 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

48 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.

49 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.

50 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 Government during the passage of the FA 2004 which confirm these principles.

Anti-forestalling provisions

51 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.

52 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.

53 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.

54 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. As noted above, this discriminates in particular 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*.

55 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.

56 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

57 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.

PLACE OF SUPPLY OF SERVICES ETC

Clause 75 and Schedule 36

58 The proposed changes to the VAT place of supply rules for services is of fundamental importance and the most major change since the VAT Single Market rules were introduced with effect from 1 January 1993. In our 2009 Budget submission, we expressed a number of concerns about the proposals, namely:

- the complexity of the changes;
- the continuing uncertainty as to how certain services will be treated;
- the complex change to the time of supply for VAT purposes;
- the onerous reporting requirements; and
- the added risk to business of the joint and several liability proposals,

59 We appreciate that the proposed measures are being driven by the need to enact an agreed EU position and that HM Treasury has sought to identify the issues and how they should be resolved. The provisions in the Finance Bill address some, but not all, of the concerns that have been identified. Further the changes in the Finance Bill does not provide a complete picture because it does not include all of the proposed changes – some of these will be dealt with outside the Finance Bill process, for example the proposed changes to the time of supply rules.

60 We remain concerned that the changes, taken as a whole, will:

- deter some UK businesses, particularly SMEs, from supplying goods and services cross-border within the EU; and
- encourage others to re-route supplies, transferring business activity away from the UK.

61 Whilst we appreciate that these proposals have been agreed at the EU level, we remain unconvinced that the changes will combat cross-border (MTIC) VAT fraud. As we have

stated publicly on many occasions, MTIC fraud will only be halted when the obvious loophole in the VAT system, known to the Commission and to Member States since before 1993, is blocked, and VAT is charged on intra-EC cross-border supplies as it is on domestic transactions. However, Member States cannot agree on this and the result is that we continue with the faulty, fraud-prone 'transitional' system, but with the Commission and national tax authorities increasingly placing further costs on business to police it. In addition, by extending the range of services subject to the reverse charge, the Commission and Member States need to recognise that they have also extended the opportunities for cross-border VAT fraud.

ICAEW recommendations

62 Proposals in respect of the provisions in this package that are not in the Finance Bill need to be published as soon as possible (even if just in draft) so that taxpayers and their advisers can comment on these proposals in the light of the overall package of measures.

63 Given the complexity of the changes and the need for stakeholders to be given more time to examine them in detail, HM Treasury and HMRC need to work closely with stakeholders during the passage of this Bill so as to ensure that problems are identified and resolved.

HMRC CHARTER
Clause 91

64 We recommended previously that the proposed Taxpayer's Charter (now referred to as an HMRC Charter) should have statutory backing so in principle we welcome this clause. However, we cannot support this clause as it is entirely in the favour of HMRC: HMRC will set its own standards to which it aspires and will then report on its own behaviour and whether it met those standards. There is no independent oversight of whether those standards are reasonable in the eyes of taxpayers, no verification of whether those standards were actually reached and no sanctions against HMRC if they fail to reach them.

65 The purpose of the statutory backing is to enable it to be relied on in Court. If the Charter provides taxpayers with no substantive remedies or clarity on taxpayers' rights the Charter lacks real value. Statutory backing will also ensure that the Charter remains in existence and does not lapse as happened to the earlier Charters introduced in the 1980s.

66 In view of our rationale set out above of the need for statutory backing, we are very disappointed with the clause itself and the underlying draft Charter. We have always expected that any Charter should set out clearly taxpayers' rights: the dictionary definition of a Charter refers to 'a written grant of rights by the Sovereign or legislature'. However, this clause and the draft Charter bear little resemblance to what taxpayers have a right to expect and we are concerned that the Charter will be of limited use in protecting taxpayers' rights.

67 The confusion over what is the actual purpose of this Charter is reflected in the supporting material to the Bill. New s 16A(2) of Commissioners for Revenue and Customs Act 2005 will lay down that the Charter will 'include standards of behaviour and values to which HMRC will aspire when dealing with people in the exercise of their functions'. In other words, the clause makes it clear that the Charter is entirely aspirational on the part of HMRC about their standards. However the explanatory note to clause 91 the Finance Bill states that the new Charter is intended to 'set out the rights and responsibilities of taxpayers and other persons that HMRC deals with'. There is a world of difference between these two statements. If the new Charter is to achieve its intended purpose and have support outside HMRC, we believe that the provisions of new 16A(2) need to reflect the wording in the explanatory notes

68 In summary we do not think that this clause is good enough, particularly when compared to the detailed and onerous requirements being imposed upon ‘senior accounting officers in Clause 92 (see below). There needs to be a proper balance of powers, responsibilities and safeguards as between taxpayers and HMRC.

ICAEW recommendations

69 We believe that this clause needs to be redrafted to reflect:

- a clear statement on taxpayers’ rights;
- that HMRC must be required to act in accordance with independently determined standards of service levels;
- that there should be independent oversight of the Charter; and
- a regular review process that should be under the aegis of a Parliamentary Select Committee.

DUTIES OF SENIOR ACCOUNTING OFFICERS IN LARGE COMPANIES
Clause 92 and Schedule 46

70 Schedule 46 imposes new requirements and a personal liability on the senior accounting officer to verify that the company maintains appropriate tax accounting arrangements.

71 We are deeply concerned about this clause which imposes onerous new requirements whilst adding little new in terms of improved tax compliance. We are very disappointed that there was no consultation about this measure before it was announced in the Budget, especially given that the measure appears to have arisen out of the ongoing work on the review of HMRC’s powers and the ‘Tax in the Boardroom’ agenda. We have been very involved in the HMRC powers review, contributing to the discussions and responding to consultations, often on a confidential basis.

72 We think there should have been proper consultation on this measure beforehand which should have involved detailed discussions with the professional accounting bodies given that the measure:

- will apply a personal liability to many of our members who typically will be the nominated senior accounting officer;
- appears to impose potential further requirements on auditors; and
- is almost certain to impose considerable costs on business out of proportion to the expected yield.

73 The measure appears to reflect a Sarbanes Oxley style requirement on all large companies but which appears disproportionate to the likely risk and we would have thought largely unnecessary under existing tax rules. For example, for corporation tax a tax return must include a declaration that the return is correct and complete. It needs to be signed by someone authorised to do so, invariably a senior officer of the company. A corporation tax return cannot be correct and complete if the company does not have processes and internal systems that enable a correct and complete return to be made. The result is that under current rules a company would be liable to penalties for submitting an incorrect return.

74 Ultimately, it is the responsibility of the directors as a whole to maintain proper systems and it is their collective responsibility. It is right that the company should be liable to a penalty where it submits an incorrect return due to poor systems but we do not think that the senior accounting officer should then be personally liable to a further penalty.

75 This is a potentially wide and extremely onerous requirement, to which there appears to be no territoriality limit and which does not reflect the multinational nature in which large businesses operate. The senior accounting officer (who may not be based in the UK) could be held personally liable for any perceived infringements in arrangements (which includes not just for taxes but also duties albeit only in respect of the UK) by any subsidiary in any country. With the best will in the world, things can and do go wrong even with good accounting systems and problems may arise which are outside the effective control of the senior accounting officer. There is no 'de minimis' provision nor any recognition of risk or materiality. The measure is likely to result in increased costs on UK businesses for advisory and assurance work to provide protection which could well exceed the projected yield.

76 Paragraph 8 levies any penalty on the most recent accounting officer. This could operate unfairly on a new officer who may have inherited poor tax accounting arrangements but who nevertheless is taking steps to address them.

ICAEW recommendations

77 We believe that this clause and Schedule should be deleted from the Bill pending further consultation with the professional bodies. If HMRC is concerned about internal accounting systems, then we would have thought that a more targeted approach should be adopted rather than a blanket measure that applies to all large companies. For example, we would have expected HMRC's risk analysis procedures to identify the small number of large companies that do not have adequate accounting systems to prepare correct and complete returns. It might then be reasonable to target those companies with measures such as those set out in this Schedule, in other words that companies are first put 'on notice' and given an opportunity to put any perceived failings right.

78 An alternative approach would be to amend existing requirements, for example the existing declaration that is required on the corporation tax return could be extended so that it refers to the company maintaining records sufficient to enable a correct and complete tax return to be made.

PUBLISHING DETAILS OF DELIBERATE TAX DEFAULTERS

Clause 93

79 The ICAEW supports efforts to combat tax evasion and it is right that Government considers a variety of policy options. However, the proposal raises a number of serious issues and we are disappointed that there was no prior consultation on this proposal given the continuing review of HMRC's powers.

80 The proposed measure is based closely upon the approach that has been adopted in Ireland for a number of years. However, discussions with our Irish counterparts suggest that beyond the high profile reminder that tax defaulters are being pursued, it does not make much difference. Further, the measure could be counterproductive, not least because it may actually discourage people from coming forward to put their affairs in order.

81 We have a number of serious concerns with the proposal.

- We are not convinced that the measure is fully compliant with the Human Rights Act 1998 and believe that there is need for a detailed statement about this aspect. The proposal to list people's addresses and businesses appears even more draconian than corresponding disclosure in criminal prosecutions where it appears a person is only identified by name and place where they live (see for example the press release https://nds.coi.gov.uk/environment/fullDetail.asp?ReleaseID=399071&NewsAreaID=2&NavigatedFromDepartment=False).
- This measure is in the nature of a further penalty on the taxpayer and we think that there should be a separate right of appeal to the First-tier Tribunal. Under these proposals, a taxpayer is only allowed to make representations.
- In order not to be named, it appears that penalties would have to be fully reduced as set out in Sch 24 of FA 2007, ie the penalty would have to have been reduced by the maximum based upon the quality of disclosure. This introduces considerable uncertainty as to whether a full reduction would be achieved. This uncertainty leaves taxpayers exposed to being named even where they sought to put their affairs in order – it could therefore discourage taxpayers from coming forward.
- In the interests of fairness and the need to discourage fraud, we think that any 'naming and shaming' should also include false tax credit claims. Tax credit frauds are often for sums in excess of £25,000 - see for example the press release referred to above.

82 We note that in the past the Government has itself expressed similar concerns about this proposal. The Treasury Committee raised exactly this issue in 2002 when they conducted an inquiry into self assessment. The Committee questioned the then Paymaster General about the Irish proposals and her response (set out in Appendix 2) clearly states that she was not attracted to it. Whilst we recognise that times change, the fact remains that this measure has a number of difficulties and the Government needs to proceed with considerable caution.

ICAEW recommendation

83 We appreciate that the objective behind this measure is to cut down on tax evasion and are, and have always been, completely supportive of this objective. However, any measure adopted must be:

- proportionate - such that it does not infringe human rights and that there are adequate statutory safeguards for taxpayers; and
- appropriate - such that it achieves the stated objective.

84 In the light of the concerns expressed in our commentary above we think that this measure falls short of these standards and should, therefore, be dropped from the Bill and that there should be consultation about what would be a proportionate and appropriate approach.

FURTHER CONTACT

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Appendix 1

Pensions – special annual allowance charge

Comments by the Financial Secretary during the passage of the FA 2004

(see paragraph 50)

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

Oral evidence given by the then Paymaster General to the Treasury Committee on Wednesday 22 May 2002 in connection with the Committee's inquiry into self assessment (Eight Report,)
(Questions posed by David Ruffley MP)

(see paragraph 82)

368. On that point I have one specific question. I stress for anyone listening that I am not advocating this. In Ireland, which in very many ways is comparable to our own political system, it is a western, liberal, democratic, industrialised state, it is a member of the European Union, they actually has a system of naming and shaming. I think we were told that it is in the region of just over 12,000 in unpaid tax liability and after going through all the hoops and warnings and determinations you could end up named in a local newspaper, even a national newspaper. I just wondered, in the course of running an efficient tax system and I think we have heard a lot of empirical evidence that you as a Minister and your officials really do think through how the systems can be improved and all the evidence supports that you really are monitoring the operation of the British tax system closely, have you ever thought of that one? Have you considered it?

(*Dawn Primarolo*) I have to say that I thought it was interesting. Like you, I am not advocating it for a minute. I am a little bit worried and I wonder on closer inspection whether the Irish system could become a bit of a badge of honour. The other thing is that when we prosecute people they get named, but we also take a lighter touch approach on the basis that some people make genuine errors, nonetheless they are in the penalty system. I was intrigued with this proposition that we might name and shame. I am not attracted to it, but the principle of putting pressure on is something that we can look at. It would probably be a bit expensive on advertising as well.

369. [Not relevant].

370. There were differing views as to the efficacy of this system, the badge of honour point was also raised. I only mention it. If this were a system in Pinochet's Chile we would say of course it is ridiculous and we would never touch it. The fact that the Irish Government has operated it for in excess of 20 years or in that region made me just wonder whether it was something you were looking at. I stress that you do look at these issues and your officials are trying hard to look at new things and innovative things. Is this something you are looking at?

(*Dawn Primarolo*) Certainly you could not look at the Irish system without looking at the issue of naming and shaming, but I have to say that I am not at all attracted to it because of naming and shaming incorrectly or the consequences and the balance with taxpayer confidentiality. We operate in a slightly different way. It works for the Irish and it might not work for us. It is an interesting point to look at.
371. Fine. Your officials have not said, "This would be a brave decision, Minister".

(*Dawn Primarolo*) No. I do not think they would even try to do that. I would consider it in the "This would be a very, very brave and courageous decision, Minister" category. "You're out of your tiny head" approach.

For a copy of the transcript, see
http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtreasy/681/2052205.htm.

Appendix 3

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 +44 (0)20 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 4

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.