TAXREP 31/15 (ICAEW REPRESENTATION 83/15)

BUDGET 8 JULY 2015 – ICAEW SUGGESTIONS

ICAEW responded to the invitation on the HMRC website to submit comments on Budget July 2015: have your say The comments were submitted to HMRC on 5 June 2015. The comments are now incorporated into the current TAXREP 31/15.

The comments, submitted on 5 June 2015, were prepared on behalf of ICAEW by the Tax Faculty.

Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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Introduction

1. We set out below the comments we submitted to HMRC in response to the invitation Budget July 2015: have your say in advance of Budget 2015 which takes place on 8 July 2015.

2. The present paper "picks up" earlier suggestions made in advance of the Autumn Statement 2014 and the March Budget 2015 to the extent that those earlier suggestions have, still, not been acted upon by government.

A Tax Vision for the new parliament

3. The present government has an outright majority in parliament and should seize this opportunity to set out the broad outlines of what it will be seeking to achieve in the tax area over the next five years.

4. We appreciate that deficit reduction is one of the government's key, fiscal, objectives but it has already announced, in the Queen's Speech of 27 May, a Tax Lock commitment not to raise the rates of income tax, VAT and national insurance over the 5 years of the parliament.

5. In 2010 the Coalition government published a corporation tax roadmap which had a very positive impact on business sentiment and allowed business to make its plans with a clearer understanding of the tax environment in which those business plans would come to fruition.

6. We urge the government to repeat the 2010 initiative and consider how it can announce further roadmaps to give a wider audience confidence that the government has a clear vision of the broad aims it has for the tax system and what it will be seeking to achieve through the tax system in its five years in office.

Progress since our earlier suggestions which were made in advance of Autumn Statement 2014 and March Budget 2015

7. In our suggestions prior to the Autumn Statement we asked the government to "Remove distortions and disincentives when property is purchased" and the Chancellor announced, in that Statement, that he would be replacing the SDLT slab system with a progressive tax.

8. SDLT was changed from the, previous slab system, to the slice system, for residential properties bought after 3 December 2014. The statutory provision is contained in a separate Act of Parliament Stamp Duty Land Tax Act 2015 http://www.legislation.gov.uk/ukpga/2015/1/contents/enacted

Our current areas of concern including those highlighted prior to the Autumn Statement and March Budget

9. We have added further areas of concern to those highlighted in our earlier submissions and the full list of current suggestions is set out below.

10. After the list below we have provided a detailed analysis of the problem we have identified together with our proposed solution:

- Put tax simplification at the heart of Government thinking
- Give greater certainty for larger businesses entering the quarterly payments regime
- Give new small businesses the right start in life
- Remove distortions and disincentives to work in the income tax system
- The Annual Investment Allowance
- Granny bonds - Tax deducted at source from the interest
- Removal of renewals basis for unfurnished rental property
- Use by non UK domiciliary of foreign income and gains as loan collateral

- Matching deficits and profits to give a sensible tax outcome
- Increase in inheritance tax threshold

Our detailed suggestions

1 Put tax simplification at the heart of Government thinking

The problem

11. We have one of the longest tax codes in the world and it continues to grow considerably with each year. There is little point in simplifying some areas of tax if at the same time huge complexities are being created elsewhere, for example the high income child benefit charge, transferrable personal allowances, the loss of the personal allowance where income breaches £100,000, lower rates of tax on savings income and so on. Such changes make it very difficult for most citizens to understand and budget for their tax, especially where actual income changes late in the tax year.

The solution

12. Government needs to commit to a real tax simplification programme and follow this through with policy. It is just too easy to add more pages to the tax code and it needs to be brought under control.

13. There should be a commitment that the tax code should not be increased further. If new rules are considered necessary, then a one in one out (or even better a one in two out) principle should be adopted. See our more specific comments below.

14. New policy ideas should be subject to a pre-implementation review to assess their practicability and the impact on the administrative complexity of the tax code.

15. ICAEW Chief Executive Michael Izza in his letter of 5 June to the Chancellor George Osborne laid down a red tape challenge for tax:

> **"Apply a red tape challenge to tax.** The 'one in, two out' principle for regulation should be applied to tax law. The UK has one of the longest and most complex tax systems in the world. Two of the three longest Finance Acts ever were enacted in the last Parliament. The complexity of our current code undermines confidence, acts as a burden on business, suppresses entrepreneurs and inhibits economic growth. The Office of Tax Simplification (OTS) was created at the beginning of the last Parliament; it's now time to give this body 'teeth' by placing it on a permanent footing as soon as possible. The Office for Budget Responsibility is an example of a similar body that operates independently within Whitehall. The OTS should be provided with resource to carry out an influential role in tax policy, with an obvious focus on tax simplification and deregulation."

Some more specific tax simplification ideas

16. We believe the following suggestions could simplify the tax system. Some of these would involve very little cost to the Treasury.

1. Allow smaller employers, with up to 50 employees, to make all RTI reports and payments just once per month, so reducing the burden of reporting to just once, for example on say the 19th of the month.

2. Make the RTI "on or before" easement for micro employers permanent.

3. Reform partnership tax reporting to remove burdens on small partnerships, for example, by providing free software for completing the self assessment tax return of small partnerships. This could possibly be achieved by working with software suppliers' existing products.

4. Simplify the auto enrolment process for smaller employers with up to 25 employees. Micro employers should be exempt. The current cost is totally disproportionate for small businesses, as are the penalties.

5. Increase the current rent-a-room relief to a more reasonable level, say £10,000 pa, This could be extended to cover all forms of "rent" of other personal assets.

6. Reinstate the SSP refund for SMEs. The present costs are disproportionate for micro employers.

7. Review the Construction Industry Scheme further to achieve more simplification, particularly for smaller businesses and employers.

8. Introduce a de minimis limit for VAT due on international services (VAT MOSS). We understand this is being discussed/negotiated, but it is not happening fast enough. This could be trivial eg £5,000 to apply to online businesses with only 1 or 2 clients in any given country or low value sales.

9. Introduce a £5,000 de minimis on loans to participators rules for corporation tax. Apply the new bed & breakfast rules only to larger balances, above say £50,000.

10. Replace Capital Allowances with depreciation for SMEs.

11. Medium sized businesses have said they need the following to enable growth: access to suitable funding, a shortage of skills and expertise, and excessive red tape.

    Apprentices are a good resource for MSBs looking to improve their productivity. A 2013 report by the National Audit Office and Cebr demonstrated that completing an apprenticeship raises the productivity of that employee by an average of £214 per week. We therefore recommend HM Treasury explore a National Insurance Contribution (NIC) exemption for apprentices of all ages (not just under 25s as we will have from April 2016) in MSBs (both employers and employee) for the duration of the apprenticeship.

12. We recommend finance initiatives enjoyed by smaller business are extended to medium sized businesses. Significant growth could be created if the government doubled the Enterprise Investment Scheme funding to companies that have 500 employees and gross assets of £30 million.

13. Improve cashflow by reducing the number of medium sized businesses caught within the corporation tax advanced payment system by raising the threshold for making quarterly payments from £1.5m to £5m. This is one ICAEW has been suggesting for a couple of years too and was one of our ‘Seven plain English suggestions’ pre Budget 2015.

14. Support medium sized businesses export ambitions through radically simplified transfer pricing and transfer of assets rules.

2 Give greater certainty for larger businesses entering the quarterly payments regime

The problem

17. Basing quarterly payments of corporation tax on in-year results causes considerable uncertainty and can result in cash flow difficulties for companies entering the system. This does not support the government’s growth agenda. While the system is intended only for the largest companies, the low de minimis and the operation of the associated companies rules mean that many more companies than might be expected are subject to these rules.

The potential solutions

18. A number of solutions could be adopted, including:

- increasing the £10,000 de minimis;
- in the first year a company is subject to the new rules there should be a better transition; and
- allow an election for the charge to be calculated on a prior year basis.

3 Give new small businesses the right start in life

The problem

19. New small businesses may find themselves in cash flow difficulties in the opening years as their first tax payment is not due until 31 January after the tax year that the trade started, and a payment on account of half this amount will also be due in respect of the following tax year.

The solution

20. Taxpayers should be encouraged to budget for tax payments earlier. Taxpayers should be incentivised to pay tax earlier than when it is due and to budget for monthly tax payments from the very beginning. Budget payment plans are not well publicised and a financial incentive for early payment of tax could make these more popular.

4 Remove distortions and disincentives to work in the income tax system

The problem

21. The method by which personal allowances are removed for income over £100,000 should be reformed. Taken together with the additional 2% NIC, this results in an effective tax rate of 62% on income between £100,000 and £120,000. Furthermore, because the threshold has not been increased since it was introduced, an increasing number of taxpayers are being affected by this measure. Those affected for the first time are usually unaware of this rule and so are caught unexpectedly. The lack of transparency and administrative complexity place an unnecessary burden on the tax system especially where taxpayers are liable to tax under PAYE. We note too that the policy encourages behavioural changes to reduce taxable income to below the threshold.

The suggested solution

22. The phased withdrawal of the personal allowance should be removed in favour of a transparent tax system based on progressive tax rates.

5 The Annual Investment Allowance

The problem

23. Partnerships which have a limited company or a trust as a partner are prohibited from claiming the Annual Investment Allowance (AIA). Modern partnerships are now much more likely to have mixed partners and we do not know why this prohibition remains in place.

The solution

24. We suggest that AIAs for partnerships are extended to include limited companies and if there are concerns about tax avoidance this should be dealt with by way of specific anti avoidance provisions.

Another problem

25. There have been too many changes to the allowance which creates uncertainty for business and gives rise to very awkward transitions.

The solution

26. In the letter of 5 June sent to Chancellor George Osborne by ICAEW Chief Executive Michael Izza the latter wrote:

> "The ICAEW Business Confidence Monitor shows that business investment has suffered in the wake of the financial crisis. Uncertainty around the general election and the UK's future in Europe has caused UK plc investment to slow, with businesses hedging their bets on whether to invest. It is now time to confirm a long term rate of AIA. Reaffirming the rate at £500,000 will provide stability and consistency to firms that like to plan and invest for the long term, and would kick-start the kind of investment needed to enable businesses to thrive."

6 Granny bonds - Tax deducted at source from the interest

The problem

27. The Chancellor announced the new granny bonds for those aged 65 and over in his 2014 Budget speech and they were first made available by NS&I in January 2015. They provide a 2.8% rate of interest for the one year bond and 4% for the three year bond. It has recently been announced that they will be available until May 2015.

28. The interest is paid net of 20% tax and for basic rate taxpayers no further action is necessary.

29. However non-taxpayers will have to reclaim the tax deducted at source using the HMRC Form R40 as NS&I are not part of the Form R85 scheme, which enables non taxpayers to be paid their bank interest gross. This is likely to affect many of the individuals applying for these bonds particularly as the new 0% savings income band of £5,000 comes into force from 6 April 2015. With a personal allowance of £10,600 and a 0% savings income band of £5,000 pensioners with total income below £15,600 will need to reclaim the tax deducted at source on their granny bond interest.

30. The concern is that many of the investors will not be aware that a tax reclaim can be made and those that are aware, may not be able to complete the claim form themselves. Professional fees may well exceed the tax reclaimable. In the past these pensioners could perhaps have called into their local tax enquiry centre to ask for help, but these were all closed in June 2014.

The solution

31. The problems we have highlighted need to be given appropriate publicity by the government and also by NS&I in all its publicity material. NS&I needs to liaise with HMRC so that HMRC can provide guidance, and assistance, to those non taxpayers who find themselves having to reclaim the tax deducted from the interest they receive.

32. The better solution will be for NS&I to be brought into the R85 scheme.

7 Removal of renewals basis for unfurnished rental property

The problem

33. Tax concession ESC B47 which allowed landlords of unfurnished properties to claim for the replacement of white goods, carpets and curtains in unfurnished property was withdrawn by

HMRC with effect from April 2013. The self assessment returns that had to be made by 31 January 2015 were the first when the effect of this change in the law had to be recorded.

34. We were unhappy after the withdrawal of the concession as, despite the assurance at the time, the existing law does not provide the same tax relief. Our correspondence with HMRC is published as TAXGUIDE 04/14

35. HMRC told us that it would review the impact of the change.

36. In the light of our concerns, we undertook a survey in January 2015, jointly with CIOT and the Residential Landlords Association, to find out if landlords generally were aware of the change in the tax rules, if the change would impact on the frequency with which they change white goods, carpets etc, and whether or not they would change their business from being unfurnished lets to being fully furnished or totally unfurnished

37. There were more than 600 responses to the survey. Of these, 75% were unaware of the change in the law, more than 50% were now going to change the frequency with which they changed the items for which there is no longer any tax relief, and more than 60% will either stop providing the relevant furnishings or will in future offer fully furnished lettings. Those landlords who change to being fully furnished will then be eligible for the wear and tear allowance calculated as 10% of rents received. This is likely to cost the exchequer more than allowing renewal costs for unfurnished lets.

The solution

38. HMRC needs to review the new situation and discuss with ourselves, and other interested bodies, how it can provided an appropriate tax regime for the unfurnished rental accommodation sector.

8 Use by non UK domiciliary of foreign income and gains as loan collateral

The problem

39. Prior to August 2014 for loans used in the UK where the loan was secured on unremitted foreign income and gains the collateral would not be treated as a remittance provided the loan was on commercial terms and it was regularly serviced by repayments from either already taxed funds or from unremitted income and gains which would then be taxed as a remittance. This change in view by HMRC has caused many problems which are exacerbated by the failure of HMRC to produce further guidance by way of FAQs 10 months after they changed their mind.

The solution

40. Allow arrangements that were in place at August 2014, including the pre-planned roll over of the loan onto new terms, to remain as they were under the previous interpretation of the statute by HMRC and just treat new arrangements under the new interpretation.

9 Matching deficits and profits to give a sensible tax outcome

The problem

41. If a person has not actually received any “profit” it is inequitable to charge tax on a “nothing”. Two examples, which illustrate the problem, are set out below:

1. The claw back of employee bonuses in a year after it was received. Where the gross bonus is clawed back in a year in which the individual has insufficient income to offset it against

there is an absolute tax and NI loss. It would be much fairer if the loss was matched with the income in the year of receipt, the tax could be repaid without interest to the payer of the bonus and the employee would then just have to repay the net bonus.

2. The Lobler case where a large chargeable event in one year remained in charge to tax despite a large loss a couple of years later on the same investment bonds that could not be used. The tribunal allowed the position to be corrected on the basis of restitution but the law should be changed to match the loss with the earlier gain.

The solution

42. Where a “profit” is taxed in one tax year it is frequently the case that a deficit on exactly the same source cannot receive tax relief in a later year. It would be more equitable if the deficit in the later year could be set off against the profit in the earlier year resulting in a tax repayment.

10 Increase in inheritance tax threshold

The problem

43. The nil rate band (NRB) has been frozen since 2009, had it increased at the same rate as UK average house prices it would now be £400,000 and £518,000 if it was linked to Greater London house prices. The increase in the NRB to take the average home out of the charge to inheritance tax is a good and necessary step but linking the proposed increase to just the main residence will encourage the elderly to stay in their large family homes rather than downsizing and freeing up the home for a young family. Empty houses will be retained when the owners are in a care home simply to protect the additional allowance.

The solution

44. The NRB has remained unchanged at £325,000 since April 2009. In the run up to the election a promise was made to add £175,000 to the nil rate band to be used against the main residence (no mention of this was made in the Queen’s speech) but to allow the increase to be used solely against the main residence is not sensible when there is a shortage of family homes. The increase in the NRB should not be restricted to the family home.

APPENDIX 1

ICAEW 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 via http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax).