Tax Representation

ICAEW TAX FACULTY

TAXREP 27/08

Finance Bill 2008: ICAEW priority issues

Parliamentary briefing submitted on 3 April 2008 by the ICAEW setting out high level issues arising from the Finance Bill 2008.

Contents **Page**

ICAEW Tax Faculty, Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ www.icaew.com/taxfac	T F E	+44 (0)20 7920 8646 +44 (0)20 7920 8780 tdtf@icaew.com

FINANCE BILL 2008: ICAEW PRIORITY ISSUES

1 CAPITAL GAINS TAX, CLAUSES 6 & 7 AND SCHEDULES 2 & 3

Purpose

Clause 6 and Schedule 2 enact the Government's proposal, announced in the 2007 Pre Budget Report on 8 October 2007, to reform the CGT rules and introduce a new 18% flat-rate of CGT. Clause 7 and Schedule 3 enact the new 'entrepreneurs' relief, which was announced on 24 January 2008. This relief, which is based upon the CGT retirement relief rules which were phased out beginning in 1999, provides that gains of up to £1m on the disposal of all or part of business are taxed at an effective rate of 10% rather than 18%.

ICAEW Issues

- The move to a flat-rate CGT is a potentially welcome simplification but will create winners and losers. In particular, many employee shareholders who previously would have qualified for the 10% CGT rate as their shares qualified as business assets will not qualify for entrepreneur's relief and will therefore be faced with an 18% CGT rate. In the light of these changes we are unclear as to the direction of tax policy in relation to encouraging employee shareholders and the interaction of the new rules with existing reliefs to encourage employee share ownership such as the enterprise management incentives (EMI) scheme.

- The new entrepreneurs' relief rules are based on the retirement relief rules as they existed before they were phased out in 1999. The rules for partnerships and companies are not identical, with the latter being generally more restrictive in that the shareholder must be an officer or employee and own 5% or more of the voting rights. The business world has moved on since 1999 and there is now an alternative business structure, the limited liability partnership (LLP), which combines some of the flexibility of a partnership structure but with an element of limited liability. Whilst LLPs are treated as partnerships for tax purposes, we question whether the new relief takes proper account of this new type of business vehicle and, in particular, whether the old retirement relief restrictions on personal holding companies are still appropriate given the advent of LLPs as an alternative business structure.

- The new entrepreneurs' relief will be a very useful and valuable relief for gains up to the £1m limit. We recognise that the £1m limit is a policy decision and understand the rationale for it. However, given that the new relief is aimed at entrepreneurs rather than business people looking to retire, we are concerned that the £1m limit will not necessarily encourage 'serial' entrepreneurs to reinvest in new businesses.

- The rules as drafted will operate to deny relief in circumstances where we think it should be available. The particular concern relates to cases where relief may be denied for associated disposals of assets which may not satisfy the 'relevant business asset' test because the asset may be held as an investment. The point is best illustrated by using an example which was set out in a document which was published on Budget Day providing examples of how the new relief would work in practice.

Example

Mr R has been a member of a trading partnership for several years. He leaves the partnership and disposes of his interest in partnership assets to the other partners, realising gains of £125,000, all of which qualify for entrepreneurs' relief. He also sells the partnership office building which he owned outright, but let to the partnership, realising a gain of £37,000. The disposal of the office building is "associated" with Mr R's withdrawal from the partnership business, and the £37,000 gain therefore also qualifies for entrepreneurs' relief (assuming there is no restriction on the amount of the gain qualifying for relief as a result of non-qualifying use).

Our understanding of the rules is that entrepreneurs' relief will only be available in relation to the office building if it was let 'rent-free' to the partnership for the whole of the period of ownership. We presume that the words in brackets at the end of the example are referring to this potential problem although the precise meaning of them is unclear because the restriction is not by reference to 'non-qualifying use' but instead whether the asset was held as an investment.

The problem is that even if rental arrangements are changed from 6 April 2008 and any property is let rent-free, the test of whether the asset was an investment is by reference to the complete period of ownership, which will include any period of ownership prior to 6 April 2008.

It therefore seems to us that the requirement to include the period of ownership prior to 6 April 2008 will restrict the availability of relief even if the taxpayer seeks to amend the position for the future.

ICAEW Finance Bill activity

- We will be requesting clarification in committee stage of the government's tax policy in relation to employee shareholder tax policy and for further consideration of the current restrictions on qualifying shareholdings in the light of the introduction of LLPs. We will also be requesting a further consideration of the proposed £1m limit and whether it will discourage serial entrepreneurs from reinvesting in new businesses.

- We will be requesting amendments to the entrepreneurs' relief provisions covering associated disposals of assets in order to ensure that a retiring partner disposing of property that was let to a partnership before 6 April 2008 are not disadvantaged. As a minimum we think that in applying new paragraph 169L(4), periods of ownership prior to 6 April 2008 should be ignored and ideally this include any period.

2 RESIDENCE AND DOMICILE, CLAUSES 22 & 23 AND SCHEDULE 7

Clause 22, Periods of residence

Purpose

The clause amends the legislation relating to the taxation of foreign income where the individual is in the UK for a temporary purpose. It amends the way in which days of presence are counted for determining the amount of time spent in the UK.

ICAEW Issues

- This appears a very narrow amendment but the issues it raises are of considerable importance to UK plc. Given the fundamental importance of establishing whether a person is resident in the UK for tax purposes, this change highlights the fact that the existing residence test, which is based primarily on old case law and HMRC practice, no longer provides a satisfactory basis for establishing liability to UK tax.

- It is a particular concern that the existing guidance is withdrawn and will not be published until autumn 2008.

- As the notes acknowledge, the issue of whether one is or is not resident in the UK is fundamental to the rest of the UK tax system. Current HMRC practice in this area is unclear, often ambiguous and highly uncertain in application. The result is that individuals can be present in the UK without knowing if they are or are not tax resident. The lack of certainty puts the UK at a disadvantage as compared to our competitors.

- The explanatory notes indicate that HMRC practice will be amended to reflect the new legislation. The amendment will therefore perpetuate an existing unsatisfactory situation that needs to be addressed properly, not least to ensure that the UK maintains an internationally competitive tax system.

- The explanatory notes indicate that the Finance Bill change was introduced because ‘the UK was out of step with …its international partners.’ However, the UK is now one of very few developed countries (if not the only one) that does not have a statutory test. It is for this reason that the UK is out of step and this issue must now be addressed.

- We believe that there are suitable models of statutory residence tests that the UK could use to develop its own rule. A suitable example is the Irish statutory residence rule, which was first introduced in 1994 (subsequently consolidated in 1997) and which we understand works well. We would be happy to assist in the drafting of a suitable test.

ICAEW Finance Bill activity

- A more detailed briefing on the benefits of a statutory residence test and suitable models will be provided for the Public Bill Committee debates.

Clause 23, Remittance basis- Withdrawal of the remittance basis

Purpose

Under existing rules resident taxpayers who are not domiciled in the UK are able to claim to be taxed on non-UK source income only to the extent that it is remitted to the UK, whereas UK domiciled taxpayers are taxed on their worldwide income wherever it arises and whether or not it is remitted to the UK.

With effect from 6 April 2008:

- non-domiciled taxpayers who have been resident in the UK for 7 of the last 9 years will only be able to access the remittance basis on payment of a £30,000 levy; and
- the remittance basis will need to be formally claimed and, if it is claimed, the taxpayer will not be entitled to claim the income tax personal allowance of the annual capital gains tax exemption.

In respect of the second bullet point, this will apply regardless of how long a non-domiciled person has been in the UK, ie it will apply to any non-domiciled person in a year in which they are resident in the UK, subject to the application of a £2,000 de minimis limit on non-UK source income.

Issues

- Whilst we appreciate the government's need to make changes to the rules, we remain concerned that the changes will result in a net loss of revenue to the UK. Whilst the Budget Red Book predicts that the changes will increase revenue, we remain concerned that no economic and sensitivity analyses have been prepared to support the change and that behavioural impacts will result in the opposite effect to that intended.

- As far as we know the £30,000 levy to access the remittance basis has no international precedent and there remain concerns that the levy may not be creditable in other jurisdictions for double tax relief purposes. It was recognised that this may be a particular problem for US tax purposes and the Budget Notes included a helpful opinion from a firm of US lawyers that the levy would be creditable for US tax purposes. Nevertheless, the fact remains that until the US revenue authorities have agreed to this treatment the issue is not free from doubt. This needs to be clarified.

- The focus of these changes is on extracting more tax from the 'super rich' but the need to formally claim the remittance basis and the loss of personal allowances and the CGT annual exemption will increase the tax rate on all non domiciles, for example migrant workers, many of whom will not be particularly well off and who may not even realise that they face an increased tax bill in the UK.

- In addition to the increased tax charges, the changes will also impose significantly higher administrative burdens and associated costs on many non-domiciles. This is because they will now need to take advice on their UK tax position and they may now need to complete a UK tax return whereas currently many non-domiciles do not need to do so. The raising of the de minimis limit from £1,000 to £2,000 announced in the Budget was a welcome announcement and this will help to alleviate some of the compliance burdens that this change introduces, but we remain of the view that the de minimis should be set at a higher level.

- We remain concerned that HMRC will also need extra resources to implement and monitor these changes and that the strains that will be imposed could be considerable at a time when HMRC's budget is being cut in real terms over a three-year period.

ICAEW Finance Bill activity

The ICAEW will be pressing during the Public Bill Committee debates for:

- a detailed economic justification for the changes;
- confirmation from the US revenue service that the £30,000 levy will be creditable for US tax purposes; and
- a further review of the de minimis level to see whether it could be raised further in order to minimise compliance burdens.

The abolition of the source ceasing rules – paragraph 49 of Schedule 7

Purpose

The provision disapplies the previous rule that an amount of income could not be taxed in the UK if the source of that income did not exist in the year of remittance. This is straightforward anti-avoidance legislation and we do not object to the policy purpose that the provision seeks to achieve, however we believe the current proposals are unworkable.

Issues

- HMRC had long recognised and accepted the previous position, with the result that it was used by a large number of taxpayers on many occasions over many years. There is, therefore, a potentially large practical problem in operating this provision.

- As drafted any sum which was, for example, income when it arose will be taxed as income in the year it is remitted. It will be very difficult, and in many cases next to impossible, to identify correctly and accurately these sums as they will have been treated as capitalised and assimilated into other funds or reinvested in other assets.

ICAEW Finance Bill activity

- The ICAEW will be pressing for an amendment to limit the application of this provision in respect of past transactions. We propose that the legislation is amended to reflect the fact that s 832(3) ITA 2007 should read '… whether or not the source ….exists when the income is remitted *where the source ceased after 5 April 2007'.* The italics are our words.

3 INFORMATION AND INSPECTION POWERS, CLAUSE 108 AND SCHEDULE 36

Purpose

These provisions make new powers for:

- the provision of information from taxpayers and third parties; and
- new powers for HMRC officers to inspect business premises.

The provisions follow a consultation process on aligning the powers of the former HM Customs & Excise and the Inland Revenue. Following their merger in 2005, it was announced that there would be a review of the existing powers and how they might be aligned in the new department (the Powers review). A consultation forum was established with external stakeholders in 2005 and there has been a series of public consultation documents.

These clauses relate to the reform of powers for compliance checks, on which a first consultation document was published in May 2007, followed by a further consultation document and draft legislation which was published in January 2008. Some changes to the draft legislation have been made as a result of the comments received.

Issues

- Although the provisions have been subject to consultation, we remain concerned about a number of aspects of these proposals. The consultation period ended on 6 March 2008 but the detail of the proposed changes was announced in the Budget on 12 March 2008. This has called into question whether all of the concerns expressed by stakeholders have been considered in the provisions set out in Schedule 36.
- The proposals enshrine protection from disclosure for documents that are legally privileged documents. Whilst we accept that this seeks to re-enact provisions which are similar (although by no means identical) to existing rules, the lack of protection for papers produced by a non-legally qualified tax adviser is an issue of national importance in that it entrenches the unlevel playing field between advice given by a legally qualified tax adviser and a non-legally qualified tax adviser as decided in the *Morgan Grenfell* case. We think that there should be a level playing field so that all taxpayers who seek tax advice are in the same position.
- There should be a right of appeal against HMRC's use of the power to see statutory records. Whilst we appreciate that taxpayers can appeal against a penalty for non-production, we do not think that this is satisfactory protection because it provides unfair pressure on the taxpayer to produce records even if he or she believes they are not relevant.
- There should be a right of appeal against the power to inspect assets and premises. The use of any statutory power to visit business premises ought to be a last resort and only where the taxpayer has refused to make his records available at some other place, where fraud is suspected or where a visit to the premises is the only realistic way to carry out the check that the officer perceives is necessary.

- We are opposed to HMRC using these powers to carry out pre-return checking of direct tax return. Whilst such provisions are reasonable in respect of PAYE and VAT due to the frequency with which returns need to be submitted, such powers are not appropriate for direct tax returns where the tax return in question has not been submitted. There is serious concern that these provisions give far too much power to HMRC and allow them to mount ‘fishing expeditions’ with no right of the taxpayer to object.

ICAEW Finance Bill activity

- A more detailed briefing will be provided for the Public Bill Committee debates.

4 RECORD-KEEPING, CLAUSE 110 AND SCHEDULE 37

Purpose

The Schedule seeks to align existing record-keeping requirements for the various taxes and also arises out of the Powers review of compliance checks (see comments above in relation to information powers). The Schedule amends the existing record-keeping requirements set out in s 12B, TMA 1970 and the corresponding rules for corporation tax (Sch 18 FA 1998) and VAT (Sch 11 VATA 1994).

The key change is that the amended provisions give HMRC the power to specify by way of regulations what records should be kept and preserved. For these purposes, the records extend to include supporting documents such as vouchers and receipts. Further, the regulations may make further reference to items specified in any notice published by HMRC.

Issues

- As far as we are aware the current requirements in s 12B, TMA 1970 (and the corresponding provisions for corporation tax found in para 21, Sch 18, FA 1998) which require a taxpayer to keep the records needed to make a correct and complete return, are readily understood and we believe constitute a reasonable generic statutory requirement and we are concerned about a blanket power given to HMRC to prescribe what record should be kept.

- We would be grateful for clarification as to what is proposed for secondary legislation. We would expect that such provisions would not seek to expand generally on the generic requirement but will be limited to specific areas such as the existing additional record-keeping requirements targeted at MTIC fraud.

- We understand that record-keeping requirements will be set out not just in legislation but also in HMRC guidance. We think it is unreasonable for a taxpayer to also have to refer to any HMRC guidance in case it might contain statutory requirements somewhere among the guidance. If guidance is intermingled with statutory requirements, taxpayers are likely to be uncertain as to where the guidance ends and the obligations begin.

- The concept of materiality should be applied in determining the degree of detail in which records should be kept for tax purposes.

ICAEW Finance Bill activity

- A more detailed briefing will be provided for the Public Bill Committee debates.

5 PENALTIES, CLAUSES 117 & 118 AND SCHEDULES 40 AND 41

Clause 117 and Schedule 40, penalties for errors

Purpose

These provisions also arise out of the Powers review. The Schedule extends the new penalty provisions that were introduced in Schedule 24 of the FA 2007 for the purposes of income tax, corporation tax, CGT and VAT to a further range of taxes, duties and levies, including inheritance tax, stamp duty land tax, stamp duty, petroleum revenue tax, insurance premium tax and a wide range of duties.

Issues

- While we favour alignment where this can be sensibly done, we do not agree with alignment for the sake of alignment, particularly if it gives rise to other problems. We are sceptical whether penalties based on underlying behaviour and which differentiate between prompted and unprompted disclosure are appropriate for one-off taxes such as inheritance tax and stamp duties.

- In relation to inheritance tax, we think that they are inappropriate for personal representatives who are often unpaid laymen and who may have to try to piece together historical information from inadequate records which the deceased had responsibility for creating. In such circumstances the penalty will not necessarily reflect the behaviour of the personal representatives – and may not even reflect that of the deceased, as records might exist of which the personal representatives are unaware.

Penalties for failure to notify, clause 118 and Schedule 41

Purpose

Again this provision arises out of the Powers review and provides a comprehensive framework for penalties. These follow a similar format to those in Schedule 24 FA 2007 referred to above and provide for stepped penalties based on the level of tax lost and the taxpayer's behaviour. Penalties range from 100% of the tax lost for deliberate or concealed failure to 30% for non-deliberate and non-concealed failures with further reductions depending upon whether the taxpayer made a prompted or unprompted disclosure about the failure.

Issues

- We do not think that these proposals will encourage a situation in which the deliberate non-complier can become compliant.

- We are concerned that the stepped percentages are too high and are therefore unlikely to encourage people to come out of the 'shadow economy' and regularise their tax position. Paying the tax plus interest plus a penalty may be just too much for some taxpayers who would otherwise come forward.

- In order to encourage non-compliant taxpayers to come forward and put their tax affairs in order, we recommend that there should be a system of suspended penalties similar to the regime which has been included in Sch 24, FA 2007. These provisions allow for a penalty to be suspended for up to two years subject to the taxpayer complying with any conditions. This system looks equally applicable to non-deliberate failure to notify cases and would allow HMRC to monitor future behaviour, such as whether the taxpayer submits returns on time and otherwise complies with his or her obligations, after the notification has been dealt with.

ICAEW Finance Bill activity

- A more detailed briefing will be provided for the Public Bill Committee debates.

6 PAYMENT AND ENFORCEMENT, CLAUSES 122 TO 124 AND SCHEDULE 43

Purpose

Again these provisions arise out of the Powers review and provide for an officer of HMRC to make a single action (clause 122 relates to England and Wales and clause 123 to Scotland) to seize goods to recover a tax debt.

Issues

- We are concerned that the provision in clause 122 refers to procedures in Schedule 12 of the Tribunals, Courts and Enforcement Act 2007 (TCEA 2007). Schedule 12 sets out procedures and powers for taking control of goods but these rules are subject to a number of areas where the precise procedures and powers are subject to regulations, for example what form of notice must be given to the debtor, the time when control of goods can be taken and what powers of entry and force may be used. As far as we are aware, none of these regulations have yet been published, thus making it impossible to determine whether these provisions are reasonable and appropriate in the circumstances.

- It is wholly unsatisfactory that such an important provision is introduced with such an unclear framework for enforcement. It is essential that the regulations under the TCEA 2007 are laid before these clauses are debated in Parliament so as to allow Parliament the opportunity for proper scrutiny of these provisions.

- We also think it important that a taxpayer should be able easily to understand his rights and relegating safeguards and detailed provisions to secondary legislation will make it difficult for a person to do so. We strongly believe that if statutory powers are to be subject to limits or conditions, then these safeguards should also be spelled out in statute.

ICAEW Finance Bill activity

- A more detailed briefing will be provided for the Public Bill Committee debates.

7 SET-OFF, CLAUSES 126 TO 127

Purpose

These provisions also arise out of the powers review and provide a statutory basis to allow HMRC to set-off sums payable to the taxpayer against sums owed to HMRC by the same taxpayer.

Issues

We are concerned that set-off is to be entirely within HMRC's power and exercisable at its discretion. There are inadequate safeguards for the taxpayer because:

- There is no right of appeal against HMRC's decision.

- The taxpayer does not have the right to opt for set-off himself.

- There are wide powers in the draft legislation, and few safeguards.

- Safeguards solely in the form of HMRC's operational guidance are not adequate.

- Set-off should not be used for liabilities which are under appeal, or which are the subject of a formal complaint which is being investigated.

- The order of set-off may make a considerable difference to taxpayers in terms of interest, surcharges, etc. The legislation should be amended to ensure that HMRC should be required to set-off debits and credits in whatever way is most favourable for the taxpayer.

- We understand that tax credits will not be used to reduce a tax debt. However, this is not stated specifically stated in the legislation. We also believe that tax credit overpayments should be excluded from any set-off.

- We assume that child benefit will also be excluded from set-off but again think that this needs to be set out in statute.

ICAEW Finance Bill activity
A more detailed briefing will be provided for the Public Bill Committee debates.

8 FURTHER INFORMATION

Please do contact the ICAEW if you require any further information:

Frank Haskew
Head of the Tax Faculty
Tel: +44 (0)20 7920 8618
Frank.haskew@icaew.com

Liz Stevenson
Public Affairs Manager
Tel: +44 (0)20 7920 8694
liz.stevenson@icaew.com