TAXREP 27/12

(ICAEW REP 103/12)

ICAEW TAX REPRESENTATION

FINANCE (No 4) BILL 2012 - BRIEFING

HIGH INCOME CHILD BENEFIT - CHARGE - CLAUSE 8 AND SCHEDULE 1

Briefing submitted in May 2012 by ICAEW Tax Faculty in relation to the provisions in Clause 8 and Schedule 1 of Finance (No 4) Bill 2012

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INTRODUCTION

1. ICAEW submitted Briefings to the Public Bill Committee on various clauses in Finance (No 4) Bill 2012. The present TAXREP reproduces the content of the Briefing on the provisions in clause 8 relating to the High Income Child Benefit Charge.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

BRIEFING

HIGH INCOME CHILD BENEFIT TAX CHARGE (HICBC)

(Clause 8 and Schedule 1)

Clause 8 and Schedule 1 introduce the new tax charge designed to withdraw child benefit from families where one partner has income in excess of £50,000.

As currently set out, the legislation is seriously flawed in principle and in practice. **Unless the government withdraws this clause and schedule with a view to tabling a more workable alternative in time for the Bill's third reading**, we believe the new tax charge could be an operational and reputational disaster for the government and HMRC.

- **HMRC will be using the tax system to claw back from one individual a benefit paid to another.** The tax system is based on individuals, while the benefits system is based on households. This undermines the principle of individual taxation.
- **Families in similar financial situations could be treated quite differently**, undermining the policy's 'fairness' objective, and creating very high marginal rates of tax for some.
- **Changed family circumstances could make it difficult or impossible to calculate the clawback, or who should pay** it. In the period between the benefit being paid and then clawed back, the couple could be separated, involved in an acrimonious divorce, or completely out of touch with each other.
- **Taxpayers could be penalised for failing to submit information they have no access** to, particularly if the relationship breaks down.
- **Taxpayers could find their confidentiality breached**, as HMRC may need to share information about one partner's (or former partner's) income and tax affairs with the other.
- **The deadline to notify HMRC that you're liable for the charge is 5 October, nearly one month before the self assessment deadline for submitting a paper tax return and four**

months before the online deadline of 31 January. If one or both partners is taxed under self assessment, they probably won't know their adjusted net income in time to meet the October deadline.

- **Collecting the charge through PAYE coding adjustment could lead to delays of up to 3 years and undermine the PAYE system's efficiency**. Any coding adjustment is an estimate, so HMRC would have to repeatedly re-estimate the code.
- **It could create 500,000 more self-assessed taxpayers**, because taxpayers will have to assess their own liability for the new charge – very expensive for HMRC to administer.
- **The extra admin burden could make it even harder for HMRC to improve service standards.** HMRC's processing and service standards are already poor, as identified by the Treasury committee last year. This charge may cause standards to fall further.
- **PAYE coding errors could leave tax payers with bills for thousands of pounds**, because **t**hose who don't have the charge coded out will have to pay the bill directly the following year.
- **It could breach the UK's EC Treaty obligations**; Couples with one partner who is an EEA migrant worker could be treated differently under EU rules, which renders the UK rule invalid because it is discriminatory.
- **The resulting poor confidence in the tax system could hit tax compliance.** Taxpayers could find their tax confidentiality breached and experience lower service standards while grappling with an even more complicated system. Their confidence in HMRC and the tax system will be undermined and there will be behaviour changes and planning to avoid the charge.

We would be happy to provide further information or meet to discuss these issues in more detail. For further information please contact Tax Faculty head Frank Haskew on 020 7920 8618 or Sarah Buckley, Public Affairs Manager, on 020 7920 8694.

Potentially unfair

The operation of the HICBC will lead to anomalies in treatment of families in similar financial circumstances and also to high marginal tax rates which undermine the intended basic fairness of the tax system.

For example, take a couple in receipt of child benefit who both work and who each earn £50,000pa. Although total household income is £100,000pa, there will be no HICBC as the income of each taxpayer does not exceed £50,000. However, a couple in receipt of child benefit where one partner works and earns £60,000 will face the full HICBC.

The HICBC introduces escalating marginal rates of tax on income between £50,000 and £60,000. For every £100 of extra income over £50,000, the liable taxpayer must pay 1% of the benefit recipient's child benefit for the year. This is on top of the 40% income tax and 2% NIC already due from someone earning £50,000 pa. The government briefing note on the measure focuses on a typical family with two children: £100 of extra income equates to extra tax of £17.52. This is £33.70 child benefit x 52 weeks at 1%. This means that the effective marginal tax rate on that £100 of income is 59.5%. This is income tax of 40% plus NIC of 2% plus HICBC of 17.52%. Another taxpayer with four children and exactly the same level of income will pay an extra charge of £31.46, a marginal rate of 73.5%. Once a family unit reaches eight children, (this situation might be rare but it could include, for example, two previously divorced or widowed parents, each with four children) the charge is £59.33 per extra £100, and the marginal rate of tax is 101.3%.

The charge can also create anomalies and perceived unfairness where the high earner is a cross-border worker. For example, a high-earner father who seeks work overseas may drop out of the UK tax system completely but be wholly supporting the family at home in the UK, who continue to receive UK child benefit. Although the high earner may earn well in excess of £60,000, the earner will have no adjusted net UK income and will not therefore be liable to the HICBC. That does not seem right.

Wrong in principle

Child benefit is a non-means tested state benefit. We believe it is wrong in principle to use the tax system to apply what is in effect a means test to claw back the benefit at a later date, often from someone who did not receive personally the original child benefit. This problem is compounded further by the fact that since 1990/91 the UK has operated a system of independent taxation for individuals, whereas state benefits look at the position of a household. Many of the problems with this charge stem directly from the violation of this principle.

The principle being introduced is that a tax charge will be imposed on a person by reference to a state benefit received by another person. Unlike some other state benefits, child benefit is not a means-tested benefit and the principle that a taxpayer can incur a tax charge based on the receipt of the benefit by another person will, we believe, undermine confidence in the tax system.

While this sharing of liability is appropriate in tax credit claims, where joint claimants are made aware at the point of claim that they may be jointly liable for overpayments made to the household, no such caveat precedes the claim to child benefit. It is likely that the ordinary taxpayer faced with such a charge would consider it objectionable. This is likely to undermine belief in the fairness of the UK tax system, which we believe is essential to its effective operation.

In principle, we believe that if the policy decision is taken to means test child benefit, then the usual rules for means testing state benefits should apply. The right amount of child benefit should be paid at the outset rather than paying the benefit in full and then seeking a repayment of the benefit from someone who may not have been the actual recipient of the benefit.

Breach of the UK's international obligations

There is a further and more fundamental problem with the EC Treaty's rules against discrimination. The government recently had to reconsider its policy on the treatment of EEA-resident seafarers under the rules for seafarer's earnings deduction (SED) because the effects of the Treaty had been overlooked when the SED policy was conceived. Another challenge cannot be ruled out if the current child benefit proposals go ahead. Taxpayers from different member states must be treated without discrimination in comparable circumstances. British taxpayers may, under EC Social Security Regulation 883/2004, receive child benefit, or its equivalent family benefit from another EEA state, because their social insurance falls under that other state's jurisdiction, but the HICBC only taxes the receipt of UK child benefit. Two UK-resident high earners working in the same grade of job for the same employer may therefore have different tax liabilities because one is a migrant worker and one is not. This is fundamentally incompatible with the UK's EC Treaty obligations.

It would also be virtually impossible to remove the discriminatory nature of the HICBC by extending it to family benefits received from other member states, partly because any legislation requiring sharing of information between family members is unenforceable outside the UK and partly because family benefits in other EEA states can be significantly more generous than in the UK, so any clawback through the tax system would automatically create a higher charge on the migrant worker, which would be discriminatory.

Fundamental defects in the legislation

Schedule 1 para 2 amends the Taxes Management Act 1970 so that a taxpayer will have to notify HMRC before 6 October after the end of a tax year if he or she is liable to the charge. The taxpayer faces penalties under Sch 41 Finance Act 2008 if he or she fails to notify HMRC by this date. It is reasonable to suppose that having notified a liability, the taxpayer would then be issued with a self assessment return on which to declare the amount of the charge or information to enable HMRC to calculate it.

In order for a taxpayer to establish whether he or she is liable to the charge, and therefore in order to comply with the requirement to notify, he or she must consider the tests set out in para 1 of the Schedule. This introduces a new section 681B into the Income Tax Earnings and Pensions Act

2003 and specifies that a person, P, is liable to the charge when P's adjusted net income exceeds £50,000 **and** either:

1. P himself is entitled to child benefit for a week in that tax year (known for certain), AND there is no other person who was a partner of P throughout that week who has adjusted net income for the year which exceeds that of P (not necessarily known), or

2. Q, a partner of P throughout a week is entitled to child benefit for that week (probably/possibly known), and P's adjusted net income for the year exceeds that of Q (not necessarily known).

So, the fundamental flaw in the legislation is that P has a responsibility to notify his or her liability, but is not able to determine whether or not he or she has a liability without knowing how much their spouse/partner earns and their child benefit receipts. Clearly he or she may be able to find this out, but they will have no right to this information, many couples keep their finances private, and in many cases may simply be unable to do so.

Breach of confidentiality

It is a basic and fundamental principle of the tax system (see s 18, Commissioners for Revenue and Customs Act 2005) that an individual's tax affairs are confidential. This legislation cuts across that principle by basing a charge to tax on knowledge about another taxpayer's affairs. It places a legal responsibility on a person (with penalties for non-compliance) who is not necessarily able to comply, and who may have no hope of securing compliance. HMRC officials are only allowed to breach confidentiality in very limited circumstances, and we do not think that s 18 gives HMRC officials such a power.

We do not consider that such a fundamental and far reaching change to the tax system should be introduced in this way, and in any event we believe that further legislation would be needed to ensure that taxpayers can comply with their obligations. Even if s 18 does give HMRC such power, any suggestion that a taxpayer could consult HMRC and be advised whether his or her partner's relevant income for these purposes is above or below a certain figure should be strongly resisted. Aside from the legal position, taxpayers will lose faith in the tax system if they consider that their financial information can be shared with anyone else, regardless of the reason.

It has been suggested that HMRC could just confirm whether a partner has income for these purposes of 'over £50,000'. We do not think that would be workable, as the tax charge is imposed on the partner with the higher net income, even if both have income in excess of £50,000. Any confirmation would have to be more specific if the taxpayer is to establish whether his or her own income is higher or lower than their partner's.

The draft legislation even caters for liability in those unusual households where there may be three partners in a relationship, but here too none has a right to access the financial data of the other two.

In summary, we believe that a tax law with which a taxpayer is unable to comply without relying on another party, with whom he or she may or may not share information, and may not still be in contact with, is fundamentally flawed and brings the law into disrepute.

The creation of a law that imposes an obligation with which it is impossible to comply, with concomitant penalty liabilities, will arguably fall foul of human rights legislation.

Practical problems

Availability of information

Where a taxpayer (A) is seeking to establish whether he or she needs to notify HMRC of their liability to the charge, the taxpayer will need to establish both his or her own and his or her partner's 'adjusted net income' as defined elsewhere in tax law. Even if we assume that the partner

(B) is willing to share information about income etc, we still face a practical problem. If B is taxed under self assessment, B's income and therefore adjusted net income may not be finalised until the tax return is filed in January. This means that A is not able to comply with the requirement to notify liability in October as, in spite of B's cooperation, the information is not available in time. This is a particular problem for self-employed people who often can't finalise their income until near 31 January, long after the 5 October deadline has passed. The couple will not know who is liable to the charge because they won't know which of them has the higher income.

Changes in family circumstances

One of the issues which we believe has not been properly considered is the issue of changes in family circumstances. In particular, as the charge cannot be established properly until after the end of the tax year (as it is based on income of the year) it is possible that by the time the tax is due to be collected (or indeed calculated) the couple are separated – and may be involved in an acrimonious divorce. Add in the fact that one partner is paying a charge in respect of money potentially received by the other partner (and possibly in respect of children that are not even his) and some of the difficult issues likely to be encountered start to become clear. When a divorce or separation is under way, the issue of confidentiality becomes even more crucial.

Problems with coding out

It is clear from the consequential amendments that HMRC intends to collect the charge through a coding adjustment for taxpayers within PAYE. This has some important limitations. Any coding adjustment for a tax year will, of necessity, be an estimate, pending the calculation of the taxpayer's net adjusted income for the year (and indeed the arrival of further children into the family or other change in the family's arrangements). We believe that this will lead to repeated iterations of amendments to the code to adjust the amounts collected in the previous year and to calculate a new estimate for the current year – and it may be that it could take up to three years' worth of adjustments to finalise a single year's charge for these taxpayers (because the calculations cannot be performed in time for the annual coding run for the second year). We do not have confidence that the resources are available for this task, and we believe that adding such complexity interferes with the efficient operation of the PAYE system, which is essential.

Electing not to receive child benefit

The Social Security Administration Act 1992 will be amended to allow a person who is entitled to child benefit to elect not to receive it where there is a reasonable expectation that it would be clawed back by a HICBC.

While this avoids the problems of the charge itself, such an election made by a person who isn't working and so who isn't paying NIC, could reduce that person's future State pension entitlement. This is because a period of time when a person is entitled to claim child benefit for a child under the age of 12 currently counts towards the 30 years necessary to qualify for the full pension.

Cost of administration, and effect upon HMRC's service standards

The proposed operation of the HICBC appears certain to impose considerable extra administrative burdens on HMRC at a time when its budget and headcount are being reduced. Budget reductions since 2005 have put a severe strain on HMRC's operational capability to deliver the tax system. HMRC's poor processing and service standards are already well known, see the report published in July 2011 by the Treasury Committee into HMRC's efficiency and effectiveness.

We have been working with HMRC since then to help try and improve standards, with some success, but we believe that the imposition of the HICBC will have a serious impact on HMRC's operational capability and will result in unacceptably high implementation costs. This comes at a time when HMRC is already struggling generally and is undergoing a major upheaval of the operation of the Pay As You Earn system as it moves to real time information.

In our view, the additional burden and implementation costs on HMRC in relation to the number of new self assessment taxpayers the HICBC will create (as the charge will be collected through the self assessment system) needs to be considered carefully. We understand that the imposition of the HICBC could result in a further 500,000 taxpayers being brought within self assessment. We set out below HMRC's own statistics of the number of self assessment returns submitted in the previous six years.

Year of receipt and filed by 5 April of that year	*Total returns received (online and paper)*	*Online returns received*	*Percentage of returns received filed online*
2005/06	8,856,552	2,025,425	23%
2006/07	8,832,105	2,948,983	33%
2007/08	8,837,932	3,853,227	43%
2008/09	8,963,661	5,949,510	66%
2009/10	8,988,029	6,625,382	74%
2010/11	9,248,160	7,127,072	77%

While we recognise that in the past three years the number of tax returns has increased and particularly so in 2010/11, the HICBC will result in a further increase of over 5% in the number of self assessment returns submitted. This is a considerable increase in the tax return base and, owing to the complexity of the HICBC already described, is likely to be proportionately much more expensive to service and administer.

As noted above, the operation of the HICBC is highly complicated and compliance with it is likely to require the taxpayer to knowing the income of another person. Such are the difficulties of this that HMRC are (as noted above) considering offering some sort of telephone assistance to taxpayers.

While we commend HMRC's desire to help, the likely resources and manpower requirements will be considerable. Further, given that HMRC's existing telephone service standards are a long way below industry norms, the HICBC is likely to place yet further strain on HMRC's already clearly overstretched resources.

Those taxpayers who do not have the charge coded out could suffer significant hardship when faced with a tax bill of potentially thousands of pounds, plus payments on account for the following year. We believe that HMRC will incur significant extra debt collection costs in these cases.

It seems highly likely that unless HMRC is given extra resources, the HICBC is likely to impose considerable administration costs on HMRC and is likely to result in further problems with its service standards.

Taxpayer compliance

Given the problems with the HICBC set out above, we are concerned that it will impose severe strains on the tax system and on its operation and is likely to bring the tax system into disrepute. This is likely to have a knock-on effect on taxpayer compliance. Given the fact that a large proportion of the tax population is likely to be affected by HICBC, we suspect that there will be widespread non-compliance. While some of this may be deliberate non-reporting, the scope for ordinarily compliant taxpayers to get this wrong and to not pay the charge appears to be considerable. We understand that HMRC's systems cannot cross-match child benefit recipients with partners and their income data, so a typical risk analysis approach to checking compliance will not be available.

Where taxpayers are aware of the potential charge, we suspect that there will be behavioural changes and planning to avoid the charge, not least because adjusted net income is determined after deducting pension contributions and Gift Aid payments. We saw earlier that the HICBC can result in high marginal rates of tax (which in some cases could be over 100%), so the incentive for tax planning where income is over £50,000 will be considerable.

Given the above comments, we question whether the measure will result in the expected receipts.

What should be done?

We believe the clause and Schedule should be withdrawn for a complete re-think and relaunch on 6 April 2013. We believe that the only possible way to achieve the policy objective is to use the social security / benefits system, where the concepts of household income and lack of confidentiality between couples are already established.

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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 icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)