Tax Representation

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

Tax Faculty

TAXREP 60/05

CHILD TRUST FUNDS

Text of a memorandum submitted in November 2005 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales in response to the invitation from the Treasury Sub-Committee of the House of Commons to give written evidence to their enquiry into Child Trust Funds

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CHILD TRUST FUNDS

INTRODUCTION

1. On 28 October 2005 the Treasury Sub-Committee of the House of Commons announced an enquiry into Child Trust Funds. This is the response of the Tax Faculty of the Institute of Chartered Accountants in England and Wales to this request for written evidence.

SUMMARY OF KEY POINTS

Financial education

2. We believe that one of the laudable principles behind the CTF is to encourage saving. It is not enough merely to give money in the hope that the person will save: indeed the result may be exactly the opposite. The Government has recognised that it is important to couple this proposal with education on the value and importance of saving. Any such financial education must necessarily include education about the UK tax system. The current complexity of the system with its plethora of rates, allowances and credits makes this a gargantuan task. Indeed, a more basic understanding of how investments work is needed to manage a CTF account: What are Equities? What is interest and how is it calculated? How does the charging system work? Why is a CTF account better than an ordinary savings account? Will the money in the CTF affect the parents' claim for benefits, or the child's claim once they are older? Why can't the child get the money until aged 18 when they can open an ISA from 16

Reliance on Tax Credit system

3. We are concerned at the extent to which the award of the additional CTF amount is reliant upon the Tax Credits (TC) system. We have already seen how complex Tax Credits have become and how easily mistakes are made.

4. In this respect, CTFs are most at risk where parents do not claim Tax Credits in time for their children to receive their full cash entitlement or where the household income is changed following an enquiry.

5. In 1999 the Tax Faculty produced a paper 'Towards a Better Tax System' (set out in the Appendix) in which we put forward Ten Tenets against which all new legislation should be judged. CTFs fail both on the grounds of simplicity and certainty. We believe that this is not because of the CTF rules themselves, but rather because of the Tax Credit rules on which they have been overlaid.

SPECIFIC COMMENTS

Qualifying for a CTF account and New Tax Credits

Protective claims

6. The basic entitlement to a CTF account is linked to entitlement to child benefit. Section 9(5) Child Trust Funds Act 2004 stipulates that the further amount (of £250) will only be available to children in families entitled to Child Tax Credit (CTC) and with a household income no greater than the CTC threshold for fast taper tax credits for the year in which the child benefit commencement date fell.

7. In order to ensure that children will not potentially lose this entitlement it is necessary for parents to consider making a protective tax credits claim. For example, Mr A runs his own business preparing accounts to 31 March 2006. Mrs A does not work but looks after their children. They have a baby on 1 January 2006. They have never previously claimed tax credits as their income averaged £80,000. In March 2006, the business suffers a disaster wiping out all profits for the year.

8. Not only will the family suffer a loss of many months' tax credits, but it is possible that they may not manage to claim their tax credits within the necessary three months (that is, within three months of the end of 2005/06, in order to establish a tax credit entitlement for that year). The new baby will lose out in 18 years time as a result.

9. The Tax Faculty has raised the problem of the interaction of the three-month back-dating rule and the annualised award of tax credits repeatedly during discussions on tax credits. The CTF rules base the new system on the problematic and highly complex TC system. We suggest that it is important to think again on this point.

Qualifying for a CTF account – Definition of household

10. One of the complicating factors of the TC system is the need to use annual income where the make-up of the household changes during the year.

11. The TC claim position on the date of the child's birth is relevant when considering the additional payment. This can be difficult to establish in practice and is a further reason for not retaining the link between the new CTF system and the TC rules.

Tax credit enquiries

12. A TC enquiry could result in the withdrawal or the increase of the TC award. Consideration must be given to the impact of this on the eligibility to the higher CTF payment. We are particularly concerned that an increased award may not send an automatic link to the CTF payment system because of the different tax years involved and the unreliability of the TC computer system. The CTF computer system is still too new for us to comment on its reliability.

Other issues

CTF Maturity

13. The CTF account is to be transferred into a tax-effective savings scheme on maturity. Assuming that the child and relatives have contributed the maximum sums, an amount in excess of £22,000 would be available. We should welcome clarification on the nature and extent of the anticipated 'tax effective' savings scheme. Will there be a cap?

14. Although not relevant for 16 years, consideration should also be given to the nature of the individual identification evidence, which will be required for 16 and 17 year olds to manage their accounts, and then for 18 year olds to gain access to the funds on maturity. Many teenagers do not hold a passport nor a driving licence. If we are all to be issued with identity cards in the future, then from what age will these apply?

Managing the account

15. Interaction implies two way involvement. We wonder how the Government's link with the school curriculum will enable children to have a real impact on their investment. It is likely to be parents who will manage the account and who are therefore most in need of education. Education for parents needs to happen now. According to the Nationwide Building Society over 1 million CTF vouchers issued to parents have not been used. See: http://www.nationwide.co.uk/mediacentre/PressRelease_this.asp?ID=732.

Children under 18 who are parents

16. In these situations, the grandparents will be in a position to make decisions about their own children's CTF accounts, but not that of their grandchildren. Rather than HMRC having sole responsibility, it would be easier if it could be possible for a claim to be made to pass responsibility to the grandparents (where they are in agreement) until the 'young parent' reaches 18.

Tax treatment of CTF accounts

17. We welcome the exemption of these accounts from the parental settlement rules and suggest that this should also be extended to funds in feeder accounts.

18. We would welcome clarification on how the inheritance tax exemptions would be applied to these accounts. For example, is the date of the gift when funds are placed into a feeder account or when they are place into the CTF. This is particularly relevant to the application of the inheritance tax exemption for normal expenditure out of income, s 21, IHTA 1984.

19. There should be a statutory commitment that the £1,200 annual limit should be raised annually in line with inflation.

Annual statements

20. Approximately nine million taxpayers currently receive self assessment Statements of Account from HMRC. Six million families receive tax credit award notices. Neither of these was developed with the needs of the customer in mind, but those of the issuer took priority. HMRC accepted this, and are re-designing both the Statement of Account and the Award Notice. We trust that lessons will be learned from this so that from the start, Annual Statements for CTF accounts will be more user-friendly and relevant to their audience.

21. We understand from earlier consultation that parents and children will be able to opt to receive these statements electronically. This implies that both will receive a statement, otherwise 'both' cannot request this option. Children frequently change email accounts and it will be easy to lose track of statements sent in this way to dead accounts.

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WHO WE ARE

22. The Institute is the largest accountancy body in Europe, with more than 123,000 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.

23. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Accountancy Foundation. 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 (which includes taxation).

24. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter ‘TAXline’ to more than 11,000 members of the Institute who pay an additional subscription.

ANNEX

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/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160