



ICAEW TAX REPRESENTATION

LEGISLATING EXTRA STATUTORY CONCESSION D33

ICAEW welcomes the opportunity to comment on the [Legislating extra statutory concession D33](#) published by HM Revenue & Customs (HMRC) on 31 July 2014.

This response of 15 September 2014 has been 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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For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

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MAJOR POINTS

Introduction

1. We welcome the opportunity to comment on the proposals in HMRC's consultation document of 31 July 2014.
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. A cut off time for submission of 3.30pm is bizarre; we can see no reason why a deadline of midnight on the specified submission date was not adopted.

Key point summary

4. Although HMRC suggest there will be little or no overall impact we cannot agree this is the case particularly in relation to professional indemnity (PI) premium. If compensation in excess of £1m is subject to CGT awards for significant losses for professional negligence will be grossed up by the Court (or in negotiations not reaching the Courts) to reflect that. Underwriters will of course take that possibility into account in assessing risk and thus PI premiums will increase.
5. There is a significant measure of inequality between individuals and non-natural persons in the proposed changes, the proposed changes favour individuals. It is unclear why this is the case given the relatively simple tax affairs of individuals and the compensation in question compared to the much greater complexity of actions for, in particular, corporates.

General comments

6. ESC D33 was put in place after the Zim case for various reasons including practicality, administrative ease, reducing the need for courts to consider tax when awarding damages, and generally to reverse the outcome of the case for most (capital) cases. These reasons presumably still continue to exist making a proposed change to the way that the concession operates somewhat curious.
7. The only risk currently to HMRC is if there is an imbalance between the tax treatment of the payment between the payer and the recipient, or if there is a failure of the recipient to declare taxable income. The proposed changes do not lessen this risk and may in fact increase the risk. The risk could be reduced by either a joint election (in line with s.198 CAA 2001), or a declaration by the payer that the payment was treated as non-deductible (in line with the surrender of losses via group relief) than by a one-sided adjustment of unclear technical nature.
8. Given that ESC D33 has to be legislated the preferred approach is to maintain the status quo and make no modifications. It is iniquitous to charge tax on damages awarded as compensation for a wrong.

RESPONSES TO CONSULTATION QUESTIONS

Q1: Is £1 million the right level of exemption? If not, what would be a more appropriate amount and why?

9. The limit is a purely arbitrary figure which has no apparent legislative grounding or basis. It may be sufficient to cover most personal claims but is likely to prove inadequate for trusts and corporations. However, even for individuals the limit will be eroded by inflation, and without a link to inflation the limit will cause issues for individuals.

Q2: Are you aware of any cases which would be taxable under the proposed changes which would result in hardship?

- 10.** The question is not hardship, which is not the purpose of the concession as is admitted in the consultation on page 9. The purpose of the concession is to exclude the need for the courts to consider tax when setting damages, and in similar out of court settlements, and remove anomalies arising from the Zim case. Hardship is not something that the tax system should seek to address, hardship is for the courts to address when setting the appropriate level of damages, it is not for HMRC to usurp the courts discretion in this matter by reducing compensation via taxation, or for HMRC to reduce any punitive element of court award damages by providing tax relief - which is the inevitable corollary to making the receipt taxable. HMRC's only input into the hardship debate is as regards their control and management of the tax system power which is quite limited in scope.
- 11.** If by "hardship" the question meant "administrative burden", there is already a burden (identifying whether the amount is revenue or capital is often unclear, identifying whether there is an underlying asset is often difficult) however this burden will clearly increase given the proposed legislation.

Q3: Should the exemption in section 51(2) TCGA include compensation paid for any wrong or injury suffered by an individual in their trade or employment?

- 12.** The exemption should apply to everybody, individual or otherwise; there seems no reason to exclude corporates who may not suffer personal injury but who can suffer all manner of other wrongs. If there is intended to be a difference in the tax treatment for receipts/payments between individuals and corporates how would the situation where the taxpayer (un)incorporated during a trial/settlement agreement be dealt with? Would this be challenged as tax avoidance (disincorporation to avoid a tax charge or incorporation to obtain a deduction)?

Q4: Should the exemption in section 51(2) TCGA include compensation paid

- **to a person other than the individual who suffered the wrong or injury, such as relatives or personal representatives of a deceased person?**
 - **to compensation for emotional distress caused by the death of another person**
 - **to compensation for loss of financial support?**
- 13.** Given the lack of any explained theoretical basis for the change, it is unclear what the purpose of the proposed legislation is. Any pay-out relating to an underlying asset, or replacement of business profits, is already taxable under existing case-law so why would any other compensation, which by default is not related to such an asset or business profits, be taxable? What benefit will arise from making it taxable? It is not clear why just a few types of compensation are highlighted. If the intention is to exempt individuals but leave corporates in charge then all individual payments should be exempt not just this limited list. Confusingly the bottom of page 13 implies that corporates should also be exempt on their awards which seems incompatible with the focus on personal injury in the proposed extension to 51(2) TCGA 1992.

Q5: Do you agree that section 49(1)(c) TCGA should include indemnities?

- 14.** There is a wider question regarding what happens where indemnities, contingent amounts, etc occur in the gains calculation, and they should be dealt with as part of a separate consultation to consider trapped losses, issues from estimated assessments, tax planning to structure deals as either ascertainable/unascertainable and contingent or not.

Q6: Do you have any comments on the assessment of equality and other impacts?

- 15.** It is questionable why a change with no expected benefits is proposed, much less one which is to a well-established practice, reasonably well understood and where the proposed changes cause so many questions to arise.

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)