

TAXREP 26/08

BUDGET 2008: SUBMISSION TO TREASURY COMMITTEE

Text of written evidence submitted on 17 March 2008 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation dated 6 February 2008 from the House of Commons Treasury Committee to comment on the Budget of 12 March 2008

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Submission to Treasury Committee on the Budget 2008

	Page
1. Introduction	3
2. Formulation of tax policy Adequate time for full consultation with a wide variety of stakeholders is vital to maintain UK competitiveness	3
3. Income shifting and small business taxation issues HM Treasury's small business tax review needs to be reinvigorated to develop a clear strategy for small business taxation	4
4. Capital gains tax reform We welcome the introduction of entrepreneurs' relief but are concerned that taxpayers should have been given more time to understand the impact before implementation	5
5. Residence and domicile These changes have highlighted the need for the UK to introduce a statutory definition of residence	5
6. Tax simplification We welcome the government's explicit commitment to simplification of the tax system but believe that an overarching strategy and core principles need to be agreed	5
7. HMRC service standards We remain concerned that HMRC appears to be under resourced for the wide range of tasks that the department undertakes	6
8. Review of HMRC's powers We are disappointed that measures relating to the Powers consultation have been announced in the Budget, six days after the closure of the consultation	6
Further contact details	6
Annex A – Who we are	7
Annex B – The Tax Faculty's Ten Tenets for a Better Tax System	8

Submission to Treasury Committee on the Budget 2008

1. Introduction

We welcome the opportunity to submit evidence in response to the invitation published on 6 February 2008 at

www.parliament.uk/parliamentary_committees/treasury_committee/tc060208pn23.cfm

Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B.

2. Formulation of tax policy

We welcome the measures in the Budget designed to improve on the original proposals in the 2007 Pre-Budget Report.

A key lesson that must be taken from the reaction to the tax reform announcements made in the October 2007 Pre-Budget Report is that the government must improve its tax policy formation process. It is critical that tax policy formation – particularly where simplification is the objective – must follow effective consultation, whether open or informal. The ICAEW Tax Faculty remains committed to assisting the government in creating good tax policy. As a body we represent the largest group of qualified tax advisers in the UK and can offer a unique assessment of the likely behavioural impacts and unintended consequences that a particular policy approach is likely to create.

In our submission to the Chancellor ahead of the Budget (see TAXREP 16/08 <http://www.icaew.com/index.cfm?route=154645>), we expressed concern that the major reforms proposed to the existing tax system in the 2007 Pre-Budget Report (PBR), namely:

- Income shifting;
- Capital gains tax reform; and
- Residence and domicile

had been announced without prior consultation, with inadequate transitional provisions and with a lack of appreciation of the likely behavioural impacts and compliance costs that they would impose. Further, we were concerned that insufficient consideration had been given to the potential damage that the measures would inflict on the international reputation of the UK as a place to live, work and invest.

Since the PBR proposals we have worked closely with HM Treasury and HM Revenue & Customs to clarify the policy objectives of the Government and to suggest improvements to the original proposals. We are pleased to see that in the light of the representations of the ICAEW Tax Faculty, and other representative bodies, organisations and taxpayers, the following major changes have been made to the original PBR proposals:

- Income Shifting – the proposals have now been deferred until 2009;
- CGT Reform – entrepreneur's relief was announced in January 2008; and
- Residence and Domicile – a number of relaxations have been announced in the Budget, which we reflect on below.

Notwithstanding these welcome changes, we remain very seriously concerned about the approach to policy formulation as shown by these recent developments and we repeat below what we wrote in our Budget Submission this year:

'...we believe that these highly controversial changes have been announced without proper prior consultation, inadequate transitional provisions and a lack of appreciation of the likely behavioural impacts and compliance costs they will impose. Further, the announcements showed a lack of appreciation of the potential damage they could inflict on the international reputation of the UK as a place to live, work and invest.

This whole process has seriously undermined confidence in the UK as a place in which business can plan for the future with certainty. Whilst we have been working with HM Treasury and HM Revenue & Customs (HMRC) officials since the PBR to help improve these proposals, this is far too late in the process and there is a pressing need to build in adequate consultation at a much earlier stage. It is essential that the views of taxpayers and other stakeholders with relevant experience, for example the ICAEW, are sought when policy ideas are being formulated rather than after the policy has been decided. If this had been done, we believe that policies in these areas could have been formulated that met the Government's needs but which also enjoyed the wide support of stakeholders.'

3. Income shifting and small business taxation issues

We welcome the Budget announcement to defer the implementation of the income shifting proposals. This should provide time for proper consultation and we think that this provides an opportunity to reconsider the underlying policy objective.

We believe that these proposals were fundamentally flawed and deferring the proposals for one year without a reconsideration of the underlying policy will merely defer the considerable implementation problems that will otherwise arise. We do not think the income shifting policy has ever been properly articulated and that the rules as drafted went further than the publicly stated position. The proposed legislation would have caused considerable administrative burdens upon businesses and a high level of uncertainty as to whether people were caught or not.

We welcome the opportunity for further consultation on this issue. We believe that this is an opportune time for a considered review of small business taxation. The proposed income shifting rules bore all the hallmarks of other recent measures in this area, namely IR35 and managed service companies, which are in the nature of 'sticking plaster' changes, in other words piecemeal changes being made in a reactive way rules that are merely papering over the underlying problems rather than providing a comprehensive solution and which are damaging confidence in a key growth sector of the economy.

We still believe the solution to the problem found in these areas is a reinvigoration of the small business tax review, launched in 2004. The only tangible outcome from this review that has been seen to date is to raise the small companies' rate of taxation. It could, however, be used as a constructive consultation process to identify some longer term answers to:

- how owner/managed businesses should be taxed;
- how this should interact with the taxation of – and social security (including tax credit) provision for – the family;
- how this might be achieved in a way which is workable in practice by, in many cases, unsophisticated taxpayers; and
- is framed in such a way that it is in accordance with our Ten Tenets for a Better Tax System (summarised in Annex B).

The ICAEW welcomes the publication of the Enterprise White paper, which sets out an impressive ambition. The central themes of the paper, in particular the recognition of the often acute burden of regulation on small businesses are an important step forward. However, we believe that a high level, pan-government commitment to delivery on the stated aims is vital.

4. Capital gains tax reform

We have welcomed in principle the Chancellor's move to make a significant simplification of the existing capital gains tax (CGT) regime but we still remain concerned that the initial announcement was made with no prior consultation and, even now, we believe that some of the detailed impacts of the proposed legislation are not well understood.

We welcome the introduction of entrepreneurs' relief but are concerned that taxpayers should have been given more time to understand the implications of this new relief before it is implemented. The announcement of the new relief was not made until 24 January, despite promises that this would be done before Christmas, and the delay meant that the detailed draft legislation was not finally available until 28 February 2008, when the new rules will come into force on 6 April 2008.

We remain concerned that the proposed changes have not respected taxpayers' legitimate expectations. To take just one example, there are a number of situations where under current rules disposals of business assets now will qualify for business asset taper relief but if they are disposed of after 6 April 2008 they will not qualify for entrepreneurs' relief. We believe that a fundamental principle of taxation is the preservation of legitimate expectations. We believe that the move to a flat-rate CGT would have been assisted by improved transitional rules, either by grandfathering existing reliefs and/or providing taxpayers with a longer period to reorganise their affairs.

5. Residence and domicile

We welcome the changes announced in the Budget to the proposed new regime for non-domiciled individuals and changes to the residence rules.

Similar comments in relation to legitimate expectations apply to the residence and domicile changes as they apply to CGT mentioned above.

We are also concerned that the new regime is highly complex, for instance the rebasing election available to trustees of non resident trusts.

We remain concerned that the new rules will impose considerable compliance burdens and costs on relatively low earning non-domiciled individuals. Such individuals are now much more likely to find themselves within the self assessment regime.

The residence and domicile changes have highlighted the need for the UK to introduce a statutory definition of residence. The UK is now out of line with international practice in maintaining a rule that is largely based on (often conflicting) case law and practice that does not deal satisfactorily with increased international mobility. A statutory definition of residence is needed to provide certainty to taxpayers, their advisers and to HMRC.

6. Tax simplification

We welcome the Government's explicit commitment to a radical programme of simplification of the tax system.

We are concerned that the Government has 'dived into the detail' without first articulating an agreed tax simplification strategy. The present approach looks like a 'change agenda' with many different initiatives, but we remain concerned about the overarching strategy and principles that we believe should underpin such a major work of simplification.

We believe that if simplification is to be successful, there also needs to be recognition that not only does it take time and thought if real progress is to be made but there should also be

some formal structure to guide the process and make sure that simplification remains an ongoing commitment for Government.

We have previously recommended that the Government set up a Tax Simplification body, similar to the Steering Committee of the Tax Law Rewrite Project, to bring together representatives of Government, business including employers, taxpayers and the tax profession. This idea has not been taken up but we remain of the view that the tax simplification agenda would be improved by strategic guidance and input from committees that considered specific areas of tax.

7. HMRC service standards

We remain concerned that HMRC appears to be under resourced for the wide range of tasks that the department undertakes.

Given that compulsory electronic filing is being extended to all taxpayers in some sectors, we continue to be concerned about HMRC's ability to deliver e-filing services that have sufficient capacity and robustness. E-filing around the deadline should be as easy and reliable as using a credit card on Christmas Eve. We believe that HMRC should reaffirm its commitment to the Carter principle that no new service should be launched until it has been fully tested and that the date of introduction should be deferred if the systems prove to be insufficiently robust and reliable.

8. Review of HMRC's powers

Three major consultations by HMRC on their powers ended on 6 March 2008.

We are disappointed that measures relating to these consultations have been announced in the Budget, a mere six days after the closure of the consultation period. We question whether this was sufficient time in which properly to consider all the responses received and make a series of suitable recommendations. The hasty issue of these decisions shortly after the expiry of the consultation period does little to encourage the perception of the tax profession and taxpayers generally that there has been proper consultation; rather, it suggests that Government has already made its mind up and is merely going through the motions of consulting.

Two particularly controversial issues which we consider need more careful consideration and continuing discussion are visits by HMRC to business premises and record-keeping requirements.

9. Further Contact Details

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ANNEX A

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 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.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. 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, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

ANNEX B

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/index.cfm?route=128518>.