

ICAEW TAX FACULTY REPRESENTATION

TAXREP 35/10

AUTUMN FINANCE BILL: AN INFORMAL CONSULTATION

Comments submitted in September 2010 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales in response to the invitation to comment on draft clauses published on 12 July 2010 by HM Treasury

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INTRODUCTION

1. In this document we present the response of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) to the invitation to comment on thirty two draft clauses published by HM Treasury (HMT) on 12 July 2010 at http://www.hm-treasury.gov.uk/finance_bill_autumn_consult.htm
2. We are pleased to have the opportunity to respond to this invitation. We would be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. Information about the Tax Faculty and the ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals to change the tax system.

WHO WE ARE

4. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
5. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
6. 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, and a free weekly newswire.

COMMENTS ON SPECIFIC CLAUSES

Interest: corporation tax and petroleum revenue tax

Schedule 1, Interest: corporation tax

Paragraph 7, inserting new 2A/B into Sch 53 of FA 2009 (Late payment interest)

7. Where a company has a profit in an earlier period and a loss/non-trading deficit on loan relationships in a later period that is carried back, interest on the earlier period profits will continue to accrue if in the absence of a claim late paid CT would have been due (up to nine months after the end of the later period). We would welcome formal confirmation that this mirrors the existing rules.
8. These rules perpetuate the existing differences between the interest rules where losses are carried back and offset against profits of an earlier period. Under existing rules, where losses are carried back against profits and where additional corporation tax would be due, interest will run from nine months after the end of the first accounting period. However, in cases where losses are carried back resulting in a repayment of corporation tax, repayment interest will only run from nine months

after the end of the later period. We would have expected that in a genuinely harmonised regime, late paid interest and interest on overpaid tax would run from the same date.

Para 10, inserting New Part A1 of Sch 54 of FA 2009 (Repayment interest)

9. These are the opposite provisions to those in new 2A/B above. Again, please confirm our understanding that the new rules mirror the existing rules.

Para 11

10. As per above, please confirm our understanding that these special rules (eg franked investment income, loans to participators) mirror the existing provisions.

Para 12

11. This inserts a new Sch 54A and makes two further changes to the general rules that were introduced in the FA 2009.

New paras 1 and 2

12. Subject to certain conditions HMRC can recover as late payment interest amounts of repayment interest that have been paid, but which ought not to have been paid. However, this provision does not apply in cases where the whole or part was a result of HMRC error.
13. Please confirm that it is intended that these new paras will have the same effect as those currently set out in s 826(8A), s 826(8B), s 826(BA) and s 826(8C) of ICTA 1988 and that the latter provisions will be repealed when these new rules come into force?

New paras 3 and 4

14. Where there is an underpayment of corporation tax for one accounting period and an overpayment of corporation tax for another accounting period, neither late payment interest nor repayment interest will arise during a common period. We understand that this provision is intended to give statutory effect to HMRC's existing practice but we would welcome confirmation.

Penalties for failure to make returns etc

General comments

A new Taxes Management Act

15. Now that the outcome of the powers review is reaching a conclusion, we recommend that the various new powers provisions are consolidated with the remaining existing provisions into a new Taxes Management Act.

Start dates

16. The draft legislation provides for start dates to be introduced by way of Statutory Instrument. Please confirm when it is expected that these new provisions will be introduced and that draft commencement orders will be laid in advance.

VAT penalty structure

17. We remain concerned that penalties could mount up very quickly where businesses are submitting monthly VAT returns, for example in VAT repayment cases or where monthly returns are submitted at the request of HMRC. Small businesses are unlikely to have an in-house accountant: they are much more likely to have a part-time bookkeeper, so it would be easy for deadlines to be missed and for the business to struggle to escape out of the penalty cycle.
18. In the light of these concerns we request that the penalty structure is subject to regular monitoring and review to ensure that any penalty remains proportionate.

Specific comments

Para 1

19. This includes what now appears to be the standard approach of giving HM Treasury a wide power to amend the rules. Please confirm:
- the circumstances in which these powers will be used;
 - that they will not be used to amend the rules so as to put taxpayers at a disadvantage; and
 - that there will be suitable reassurances on this point when the Bill passes through its Committee stages.

Schedule 1

Para 4

20. We understand that this change, which does not relate specifically to the extension of the FA 2009 changes under consideration, is designed to clarify the operation of the existing FA 2009 penalty provisions in para 6 of Sch 55 where a person deliberately withholds information in respect of occasional and annual returns. We welcome this clarification. We think that the clarity of para 6 of Sch 55 would be improved further if sub-para 6(5) were moved so that it follows after 6(1). If it was moved the opening words in sub-para 6(5) 'In any other case' would then need to be deleted.

Para 5

21. Para 5 makes a similar clarification in respect of returns due under the construction industry scheme as that made by para 4 above. Again, please confirm that our understanding of the purpose of this amendment is correct.

Penalty for failure to make payments on time

Para 5 of Schedule 2

22. This para rewrites para 6 of Schedule 56 which applies for PAYE and the CIS scheme. It appears to extend the scope of the late payment penalty provisions to include late payment of NIC and also student loans. We understand that the existing wording of the FA 2009 was considered to include NIC and student loans but it was decided to add these to put the matter beyond doubt. Please confirm that our understanding of this is correct.

Settlor to return excess repayment to trustees etc

23. The problems with this clause that we identify below arise only because of the change to make trusts pay income tax at 50% which we continue to think is wrong in principle. The aim of the tax regime for trusts should be to maintain equality between income and gains of trusts and non-trusts. To tax trusts at a 50% rate when the majority of settlors pay tax at other rates cuts across this.
24. We note that the scope of this clause is limited to repayments in respect of trust income deemed to be that of the settlor rather than reductions in the settlor's liability. This is probably correct, because with a reduction in liability the income to which it should be attributed is not always clear. For the avoidance of doubt, we should welcome confirmation that the settlor need not repay anything to the trustees where the settlor has miscellaneous income (formerly Case VI) losses of his own brought forward which he has to use against the trust income.
25. In sub-ss 646(1) to (3) ITTOIA 2005 dealing with a settlor recovering his excess liability from the trustees, it is provided that he may require HMRC to certify the amount of any such recoverable excess. We recommend that there should be a similar requirement the other way, ie in the case of a settlor having to let the trustees have any repayment. We are aware that some have raised Data Protection Act arguments against this but we are of the view that that the legislation should be able to deal with this as trustees will not object to the principle.

26. We also have concerns about the costs and administration burdens on trustees, settlors and HMRC of implementing this albeit well-intentioned measure due to a large number of tax repayments now having to be made for small amounts and the need for all settlors to be brought into self assessment.

Venture Capital Schemes

Paragraphs 1(4) and 2(8) of Schedule 1

27. The draft s 180B (EIS) and s 286B (VCT) inserted into ITA 2007 introduce a 'financial health' requirement, ie. preventing tax reliefs for investment in a 'firm in difficulty'.
28. Draft s180B (3) states that the issuing company is in difficulty if it is reasonable to assume that it would be regarded as a firm in difficulty for the purposes of the Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty (2004/C 244/02)'. However, the Guidelines would appear no longer to have effect. 2004/C 244/02 states (at para. 102) that 'the Commission will apply these Guidelines with effect from 10 October 2004 until 9 October 2009'. This implies the Guidelines have now lapsed. Please clarify therefore whether the Guidelines are still effective.
29. Assuming the Guidelines remain effective, it is not clear how they will actually affect companies raising money under the EIS or VCT legislation. For instance, para 9 of the Guidelines states:

*'for the purposes of these Guidelines, the Commission regards a firm as being in difficulty where it is unable, whether through its own resources **or with the funds it is able to obtain from its owner/shareholders** (our emphasis) or creditors, to stem losses which, without outside intervention by the public authorities, will almost certainly condemn it to going out of business in the short or medium term'.*

30. This implies that, for as long as a company is able to raise funds from its existing shareholders or creditors (but presumably not from new external investors), it does not fall within the definition of a firm in difficulty. Please confirm this interpretation is correct.
31. Paragraphs 10 and 11 of the Guidelines go on to clarify particular circumstances when a firm is regarded as being in financial difficulties. These appear to be subsidiary to the primary condition at para 9 so that, if the company is able to raise funding from existing shareholders or creditors, paragraphs 10 and 11 do not come into play. Please confirm this interpretation is correct.
32. Paragraph 12 of the Guidelines states:

'For the purposes of these Guidelines, a newly created firm is not eligible for rescue or restructuring aid even if its initial financial position is insecure. This is the case, for instance, where a new firm emerges from the liquidation of a previous firm or merely takes over such firm's assets. A firm will in principle be considered as newly created for the first three years following the start of operations in the relevant field of activity. Only after that period will it become eligible for rescue or restructuring aid...'

33. We understand that the effect is that a newly created company will not be regarded as falling foul of the 'firm in difficulty' provisions for three years after the commencement of operations. However, we would welcome clarity on how this would apply in a group context; for instance, whether the three year rule will apply to a new holding company or to a new operating subsidiary which will employ the EIS funds.

The point in time at which the financial health requirement is viewed - EIS

34. Draft s 180B (1) states that 'the issuing company must meet the financial health requirement at the beginning of period B' (ie. the period beginning with date of issue of the shares). However, it is not clear how HMRC will approach the matter in practice.

35. The logical interpretation would be that the issue should only be considered at the time an application for formal EIS approval is made on Form EIS 1. If HMRC can use the benefit of hindsight and withdraw EIS relief retrospectively after formal approval has been given and certificates EIS 3 have been issued, this would create considerable difficulties for companies (and their professional advisers). It could also ultimately undermine the ability to attract EIS investment, as there is likely to be considerable uncertainty that EIS relief is available at all.
36. We would welcome confirmation on how HMRC will approach this matter and that it will be considered at the time the application is made.

The point in time at which the financial health requirement is viewed -VCT

37. The corresponding VCT provision (s 286B(1)) is that 'the relevant company is not, at the time of the issue of the relevant holding, in difficulty'. Again, there would appear to be scope for uncertainty, particularly as there is no formal approval process for investee companies at the time a VCT subscribes for eligible shares.
38. There will always be cases where a VCT will invest without there being a contemporaneous EIS share issue that might provide some level of comfort that HMRC accept the company is not in difficulty. It would be unfortunate if a view were taken that was reasonable at the time the shares were issued, but HMRC subsequently took a contrary view with the benefit of hindsight.

Schedule 1

Paragraphs 1(5) and 2(12), meaning of Permanent Establishment

39. Draft ss 191A(7) (EIS) and s 302A(7) (VCT) inserted into ITA 2007 state:

'A company is not regarded as having a permanent establishment in the United Kingdom by reason of the fact that it carries on business there through an agent of independent status (including a broker or a general commission agent) acting in the ordinary course of the agent's business.'

40. This implies a company employee who makes sales in the UK on behalf of the company would mean the company has a permanent establishment in the UK. There would appear to be no requirement for the employee to be resident in the UK, and a visitor carrying on business on behalf of the company would seem to qualify. Please confirm whether this interpretation is correct.

41. Draft s 191A 2(b) states:

'an agent acting on behalf of the company has and habitually exercises there authority to enter into contracts on behalf of the company'.

42. It is suggested for clarity that this definition follows that already established in s 148 FA 2003:

'an agent acting on behalf of the company has and habitually exercises there authority to do business in behalf of the company'.

43. However, we can see that difficulties will arise where there are groups with a holding company, as the draft legislation requires the issuing company (the holding company) to have a permanent establishment and not the subsidiary company that has the trading operation in which the VCT or EIS funds will be employed.
44. In many groups, the holding company is a 'pure holding company' and does not carry on any activity other than the holding of shares in its subsidiaries. This is unlikely to constitute 'a business'. Consequently, to require the company to have a permanent establishment, through which 'the

business' is carried on or indeed if the existing proposed definition is maintained 'to enter into contracts', could be seen to run counter to commercial reality. We would welcome further clarification of how such arrangements would be treated for these purposes.

Overseas holding companies

45. It is likely that many groups will have overseas holding companies some of which might be resident in tax havens. We would appreciate guidance on HMRC's interpretation of s 178 ITA 2007 in such circumstances.

FJH

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E: frank.haskew@icaew.com

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.com/index.cfm?route=128518>).

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