# TAXREP 17/13
# (ICAEWREP 21/13)

ICAEW TAX REPRESENTATION

## TRADE PROFITS: DEDUCTIONS ALLOWABLE AT A FIXED RATE

**Comments submitted in February 2013 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW) to HMRC in response to the draft legislation published in December 2012**

**Contents** | **Paragraph**




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## TRADE PROFITS: DEDUCTIONS ALLOWABLE AT A FIXED RATE

## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the draft legislation, Trade profits: deductions allowable at a fixed rate, published by HMRC on 11 December 2012 at http://www.hmrc.gov.uk/budget-updates/11dec12/fixed-rate-transitional.pdf

2. This TAXREP should be read in conjunction with TAXREP 16/13 which is made in response to draft legislation Cash basis for small businesses, also published by HMRC on 11 December 2012 at http://www.hmrc.gov.uk/budget-updates/11dec12/cash-basis-transitional.pdf

3. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

4. Information about the Tax Faculty and ICAEW is given below. We have also set out, in the Appendix, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

## WHO WE ARE

5. 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 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

6. 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.

7. 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.

## MAJOR POINTS

8. We were pleased that HMRC consulted on these proposals from an early stage. The considerable discussion these proposals have generated amongst our members and committees, as well as the considerable discussion we have been able to have with HMRC, shows the enthusiasm of our members for simplification and a reduction in the tax administrative burden, particularly for the smallest businesses.

9. Unfortunately, having now seen the first attempt at legislation, we do not think these proposals can be made ready for implementation from 6 April 2013. This should be delayed for a year if at all possible to allow more time for proper considered thought to be given to the legislation. Moreover, HMRC's guidance is being written concurrently with the design of the system, commercial software is not yet available let alone tested, and most potential users of this system, the small businesses themselves, remain totally unaware of its existence.

10. We have been told that this will be an iterative process which will be improved through practical experience. While we welcome this open approach and ready acceptance to make necessary

improvements going forward, we do not consider this to be the way to implement radical change to the tax system which it is estimated could affect 3m businesses in the UK.

11. We are increasingly concerned that this will not be the simplified system proposed by the Office of Tax Simplification (OTS), but rather will just be an alternative system.

12. We note too that the timetable is being driven to a large extent by the political imperative to implement Universal Credit (UC) from later in 2013 for some businesses. Although UC will not affect many self employed people initially, it could soon affect anyone who joins a household which has been transferred into UC.

13. We are broadly supportive of the proposals to allow a system of fixed rate deductions, but consider that:

    - The amounts specified for deductions are too low.
    - There should be only one rate for using a private car for business, being 45 pence a mile. This could more easily aligned with the Universal Credit rules which are based on monthly rather than annual usage.
    - The requirement to keep a record of hours spent using a home for business purposes represents an additional administrative burden, which cuts across the purpose of this proposal.

14. We welcome the decision to make using fixed rate deductions for expenses other than cars optional for businesses using the cash basis.

15. We consider that businesses should be able to use actual costs rather than fixed rate deductions for cars.

16. In relation to the cash basis proposals more generally, our key points remain:

    - We support tax simplification and the work of the OTS and the Administrative Burdens Advisory Board (ABAB).
    - We were broadly supportive of the proposals originally made by the OTS which suggested a turnover limit for the cash basis of £30,000. The Government's higher turnover limit changes significantly the nature of the OTS's proposal which was to allow very small (usually unrepresented) businesses to adopt the cash basis. We remain convinced that the turnover limits for any cash basis proposal should be in line with the recommendations made by the OTS. Many of the problems we have identified could be ignored if these rules were only available to very small businesses with income below £30,000.
    - Cash accounting cuts across one of the fundamental tenets of taxation, namely horizontal equity across taxpayers; all taxpayers in similar circumstances should be treated the same.
    - The ability to move from cash to accruals each year will
        - add further complexity to the rules
        - add to the administrative burden
        - increase the amount of tax lost through legitimate tax planning.
    - We do not support the use of the cash basis by a business of any size where that business has other than minimal levels of fixed assets, stock, debtors or creditors, nor for growing businesses.
    - Those using the cash basis will still need to prepare proper accounts to support mortgage or loan applications.
    - The reporting system which is being designed to accommodate UC will be incomprehensible to most small businesses, should be reassessed and aligned more closely with the income tax rules.

## GENERAL POINTS

17. We continue to advocate tax simplification and to support the work of the OTS and the Administrative Burdens Advisory Board (ABAB). We are pleased that HMRC has modified its proposals following earlier consultation, but consider that this legislation still misses its target. This proposes an alternative system for taxing small businesses, not just a simpler method.

18. This draft legislation will implement a cash basis for small business tax. The consultation described this as a simpler tax system for small businesses, its purpose intended to make life easier for the 3m smallest businesses in the UK. While we accept that few small business owners will ever attempt to read the legislation, the complex structure makes it difficult even for qualified tax professionals to use.

19. Experience shows that complex legislation leads to anomalies and requires complex anti avoidance provisions as it attempts to cover all possible situations. It also leads to a greater need for extensive guidance, which users rely on rather than the law itself.

20. As drafted, these clauses will be extremely difficult to use. This was an obvious time to make use of the tax law re write project style of more straightforward drafting and it is disappointing that this opportunity has been missed.

21. We think that the election to use fixed rate deductions should be more formal than a tick on the tax return. It will be difficult for many small businesses to be consistent in their approach to this.

22. We are broadly supportive of the proposals to allow a system of fixed rate deductions, but consider that:

    - The amounts specified for deductions are too low.
    - Set rates should be reviewed regularly to keep pace with inflation.
    - There should be only one rate for using a private car for business, being 45 pence a mile. This could more easily aligned with the Universal Credit rules which are based on monthly rather than annual usage.
    - The requirement to keep a record of hours spent using a home for business purposes represents an additional administrative burden, which cuts across the purpose of this proposal.

23. We welcome the decision to make using fixed rate deductions for expenses other than cars optional for businesses using the cash basis.

## SPECIFIC POINTS ON DRAFT LEGISLATION

### S94H The appropriate mileage amount

24. We disagree with the reduced mileage rate for the business use of a car in excess of 10,000 miles. Mini cab drivers and driving instructors and others whose businesses require extensive use of a car will be unfairly disadvantaged.

25. We are also concerned that as fuel prices increase rapidly on occasion, the fixed rates will not change quickly enough to keep pace.

26. When the initial mileage rate was increased from 40p to 45p for the first 10,000 miles a couple of years ago, no adjustment was made to the 25p rate. As a minimum, this should have been increased to 30p in recognition that the fuel element has increased and will continue to do so.

27. We consider that businesses should be able to use actual costs rather than fixed rate deductions for cars.

**S95J Use of home for business purposes**

28. Many small businesses are run by people who live in rented accommodation. The rent paid is likely to be very disproportionate to the fixed rates being suggested.

29. There is also an argument for considering regional variations in the fixed scale of rates.

30. We consider the issue of apportioning or otherwise splitting expenses for business/private is a difficult one and more thought needs to be given to it. Clear guidance will be needed to enable this matter to be dealt with in a way that achieves the intended simplification.

31. Many small businesses use their home for storage. An allowance should be available for this.

**S95K Premises used as a home and as business premises**

32. S94K (1)(b) The term 'mainly' needs definition.

33. These rates for the income tax to be charged seem disproportionate to the deduction allowed by S94J.

34. A single scale such as this cannot cater for the range of sizes of business and geographical variety with associated range of costs.

**New s240DA in ITTOIA 2005 - Cars with low carbon dioxide emissions**

*(1) This section applies if:*
*(a) a person carrying on a trade has incurred expenditure on a vehicle that is first-year qualifying expenditure by virtue of section 45D of CAA 2001 (expenditure on cars with low carbon dioxide emissions),*
*(b) the person has obtained a first-year allowance in respect of that first-year qualifying expenditure, and*
*(c) the person enters the cash basis for a tax year.*
*(2) An amount equal to the market value of the vehicle is to be treated as a receipt in calculating the profits of the trade for that tax year.*
*(3) The market value of the vehicle is determined at the beginning of the basis period for the tax year.*
*(4) If the first-year allowance obtained by the person was reduced under section 205 of CAA 2001 (reduction where asset used only partly for qualifying activity), the market value of the vehicle is to be proportionately reduced.*

35. If retained, we think that this provision needs to clarify that the vehicle is still owned by the taxpayer at the point of entering the cash basis.

36. However, Government policy has been to encourage expenditure on environmentally friendly cars. A simpler solution to previous relief having been given on cars through the 100% first year allowance, would be to deny further relief going forward under the cash basis, while then not needing the add back described in this clause.

**New s33A Cash basis: capital expenditure – ss11 non-depreciating assets**

37. (11) Head 7 is expenditure on acquiring, creating or improving any asset which, at the time of its acquisition or creation, could not reasonably be expected to decrease significantly in value with the passage of time.

38. 'Expected to decrease significantly in value' and 'passage of time' are both too vague to be workable. We suggest that there is a tie in with long life assets here and a period of, say, 25 years is considered instead. Businesses that make their own tooling and moulds will be affected by this.

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