

TAXREP 9/10

BUDGET 2010: THE KEY TAX ISSUES

A memorandum dated 18 February 2010 from the ICAEW Tax Faculty to the Chancellor of the Exchequer setting out the key issues to be considered ahead of the 2010 Budget.

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BUDGET 2010: THE KEY TAX ISSUES

IMPROVING HOW TAX LAW IS MADE

- 1 The current approach to formulating tax law provides little opportunity for detailed Parliamentary scrutiny. The Finance Bill process should be reformed to improve the quality of tax law and provide greater clarity. Further, in order to provide greater certainty to taxpayers, the formulation of tax law should take place within a set timetable.
- 2 In order to ensure that taxpayers have reasonable certainty before the start of the tax year, government should commit to introducing a clear timetable for the annual Finance Bill process.
- 3 More time needs to be allowed for proper consultation with stakeholders and for detailed scrutiny of provisions, both by reference to the practicality of proposals and the costs of implementation. Policy decisions often appear to underestimate the true implementation and compliance costs.
- 4 Consultation should start at an early stage so that government policy objectives can be achieved in a way that minimises any unintended or damaging consequences. Consultation should therefore take place with bodies such as the ICAEW when the policy options and possible technical details are still being discussed. We appreciate that there may be times when consultation is not practical, eg the need to counter tax avoidance schemes, but this should be the exception rather than the rule.
- 5 A complicated tax system that changes regularly is putting the UK at a competitive disadvantage. We appreciate that HMRC is working on a tax simplification agenda and we recognise that tax simplification can create winners and losers. However, we think that more needs to be done. We recommend that an independent tax simplification commission should be established to oversee a comprehensive tax simplification programme.

6 Policy recommendations

- The Pre-Budget Report (PBR) should be held no later than the end of November. The Budget should be held no later than the end of February and the Finance Bill should be published before 31 March.
- Except in extenuating circumstances, for example to tackle identified tax avoidance schemes, tax changes should be announced only at the PBR or Budget.
- The Government should commit formally to improving tax policy formulation by engaging in consultation with key stakeholders on proposed tax policy changes. This should be undertaken as a matter of course unless there are exceptional circumstances, in which case reasons should be given.
- Consultation on potential tax policy changes should take place at an early stage and before major decisions are made. This process should include detailed, accurate and realistic analysis of the practical considerations and the costs of implementation. Adequate time should be allowed for consultation responses to be analysed and changes to be considered.

- The UK tax code needs to be simplified and an independent Tax Simplification Commission should be established to oversee this work.

HMRC'S SERVICE STANDARDS

- 7 We remain very concerned that the 'Change programme' at HMRC has resulted in a decline in the standards of services that taxpayers have a right to expect. Whilst we appreciate that HMRC has made progress in some areas, our members continue to report problems across a range of HMRC's activities. Key concerns of our members are:
- significant numbers of errors in PAYE coding notices which appear to be exacerbated by the coming online of the new NIC and PAYE service;
 - continued problems in making contact with HMRC to resolve issues due to the reliance on telephone contact, with calls not being answered or returned promptly;
 - difficulties in resolving problems first time with HMRC's contact centre staff;
 - long delays in dealing with post, including the processing of paper returns, tax repayment requests and VAT registrations which are subject to further checks even though they do not appear to be high risk;
 - that when things go wrong, HMRC needs to communicate earlier with taxpayers and agents.
- 8 In 2007 we recommended that HMRC should work with the professions to develop a better set of service delivery indicators that had the confidence of stakeholders. Similar recommendations were made by the Treasury Committee (HC 483-1, published on 23 July 2007). We believe that a set of reliable and meaningful service measures would be of public benefit and help drive improvements in service standards. For example, the last NAO report into HMRC's handling of telephone enquiries suggests that 35% are avoidable. This is because many calls are made to HMRC as a result of HMRC errors or delays. Greater emphasis needs to be placed on ensuring that HMRC gets it right first time, thereby reducing the need for contact afterwards. We believe that in order to reduce errors and ensure that processing is right first time there is a need for more staff training and supervision and better IT and procedures.
- 9 Incorrect PAYE coding notices remain a problem area and result in considerable wasted time and costs not just for agents but also for HMRC. HMRC needs to explore more innovative ways to improve standards and in the process help themselves. We have suggested in meetings that in appropriate circumstances agents could be given the ability to 'self-serve' PAYE coding notices. We have suggested that a pilot study be undertaken to identify the merits of this option and we hope that HMRC will take this forward in 2010.
- 10 We believe that there are a number of improvements that can be made but recognise that they will require further investment in IT systems. For example, most taxpayers now use email to communicate, but HMRC still relies on the telephone and post. Handling large numbers of letters promptly needs large numbers of staff, which in some offices is simply no longer possible. We appreciate that HMRC has been trialling the use of email and 'shared workspace' solutions but progress is very slow, with security issues being cited as the reason for a lack of progress. Given HMRC's drive to compulsory electronic filing, the lack of progress on

developing electronic means of communication is not good enough. HMRC needs to prioritise the provision of email/shared workspace solutions as a matter of urgency.

11 **Policy recommendations**

- HMRC needs to work with stakeholders to develop service delivery indicators which are robust and transparent and then use these to help prioritise improvements to its service delivery.
- Staff training and supervision, IT and procedures should be improved to reduce errors which create more work for HMRC staff, taxpayers and their agents. HMRC also need to adopt a clear communications policy which gives taxpayers and agents an early warning of developing problems and any systems changes that are likely to impact on users.
- HMRC should undertake a pilot study on allowing authorised agents to 'self-serve' PAYE Coding notices.
- HMRC needs to prioritise the development and roll out the use of email/shared workspace solutions so that taxpayers and agents can communicate electronically with HMRC: in the short term this could be restricted to tax agents but in the longer term the facilities should be rolled out to all taxpayers.

BUSINESS TAX ISSUES

12 We said in our 2009 PBR submission that the UK now has a tax code that is one of the longest and most complicated in the world. Further, the UK tax code is subject to significant changes year on year. This makes it difficult for businesses to plan with certainty. The Government should limit policy changes to provide for a period of stability and only make changes that are essential to maintain and build the UK's competitiveness.

13 **Policy recommendation**

- Government should commit to a period of stability and limit policy changes to those that are essential to maintain and build the UK's competitiveness.

Large business taxation

14 We appreciate that the Government is anxious to ensure that the UK remains an attractive location for businesses. Nevertheless, when all factors are taken into account, we are concerned that the UK has lost competitiveness and that other tax jurisdictions are actively seeking to exploit this. Whilst relatively few companies have decided to relocate to other jurisdictions, we know that many of the UK FTSE companies now examine this issue regularly and would consider relocating if the circumstances are right.

15 Whilst the attractiveness of the UK as the base depends upon many factors, tax issues are crucial and key factors in any assessment include not just headline rates but complexity, certainty and ease of administration. In 2008 the Chancellor established a Forum on Tax and Globalisation (the Forum) and we understand that HM Treasury is working on a tax framework for multinational companies with the aim to complete this work by the time of the 2010 Budget.

16 Now that two years have elapsed since the Forum was created, we believe that the forthcoming Budget: provides an opportunity to provide a detailed report on the Forum's activities to date, its plans for the future and that HM Treasury publish the promised tax framework for multinational companies. In addition to the work of the Forum and HM Treasury, we believe that the Chancellor should also announce an independent study to assess the relative importance of these issues to multinational businesses, where the UK stands relative to other jurisdictions and make recommendations for improving the UK's competitiveness. The study should report back in the 2010 PBR.

17 **Policy recommendations**

- A detailed independent study should be undertaken of the UK's competitiveness relative to other competing jurisdictions and detailed recommendations made for improvements.
- HMRC should publish (even if in draft) its tax framework for multinational businesses.
- Budget 2010 should include a detailed report of the work of the Forum to date and its future work programme.

E-business and iXBRL

18 We have supported the move to online filing of corporation tax returns and accompanying documents using the iXBRL standard and we will continue to work with HMRC to ensure that operational issues are resolved in advance of the proposed start date of 1 April 2011. We welcome the announcement of the two year 'soft landing' for businesses which seek to comply but fail. We requested this in our 2009 PBR submission and continue to see this as vital. From what we have seen so far, iXBRL enabled products will (at least in the early years) still require a reasonable amount of manual processing by staff proficient in understanding financial reporting and iXBRL coding. At the time of writing, there is only one accounts production tool available commercially. Until a proper market is established, implementation cannot be certain and the full extent of the administrative burden on business cannot be quantified.

19 We have been working with HMRC to educate our members about what is needed and what changes may need to be changed to their businesses processes. We will be delighted to continue this education process with HMRC in the run up to April 2011.

20 We welcome the HMRC and Companies House proposal for a joint filing facility. Whilst it may be true that both departments could be served by a single filing by a company, it is important to remember that the data required by Companies House and HMRC may not always be the same. For example HMRC may require a detailed profit and loss account for all companies whereas not all companies need to submit even full accounts to Companies House. To ensure that the maximum benefit is gained from this initiative HMRC and Companies House need to ensure that wherever possible their individual iXBRL filing requirements are standardised.

21 We believe that small companies could be relieved of the burden of filing their accounts in iXBRL format if they could provide the key figures from their accounts in their corporation tax return instead, as small unincorporated businesses do on the self employment pages of the self assessment tax return. It seems to us illogical that an unincorporated business with turnover below the VAT threshold need only report around twelve key figures in its tax return, whereas a company of the same size will have to provide iXBRL tagged accounts. This is an unwelcome

additional burden for the smallest businesses and of questionable value to HMRC or the businesses themselves.

22 **Policy recommendations**

- HMRC needs to work with stakeholders to improve the level of knowledge of the CT filing requirements and in particular iXBRL.
- HMRC and Companies House need to work closely together to ensure that the proposed joint filing facility maximises the potential that e-filing offers to joined up government and minimises the costs to business.
- The potential for taking an alternative approach to reporting by very small companies should be examined.

Small business taxation issues

23 An issue which we highlighted in our 2009 PBR document is the difference between the tax treatment of incorporated and unincorporated businesses. The ICAEW recognises that there have always been some differences in treatment but, in recent years, the differences have grown rather than reduced and this is now becoming a critical issue in view of the proposed increases in the rates of income tax/NICs.

24 From April 2010 we will have an effective top rate of tax (income tax and NIC) of 51% (and higher effective marginal rates for income of £100,000 to £112,950) as compared to a maximum corporation tax rate of 28% (and more likely only 21%) and a flat rate capital gains tax of 18%. We are concerned that the proposed increases in income tax and NIC rates in 2010 and 2011 will increase the gap between the tax treatment of employment income and dividend income, further encouraging small businesses to operate through companies unnecessarily.

25 **Policy recommendations**

- HM Treasury and HMRC need to work with stakeholders to reform the business tax system as it affects smaller businesses. This should involve reinvigorating the small business review.
- As part of this review, further consideration should be given to:
 - closing the gap between accounting and tax profits by reducing the number of tax adjustments that are needed; and
 - considering how the differences between the tax treatment of incorporated and unincorporated businesses can be minimised.

PERSONAL AND TRUST TAX ISSUES

Restriction on tax relief for pensions

26 As announced in the Budget 2009 legislation will be introduced to restrict pensions tax relief for high earners from April 2011. The restriction will apply to contributions to pension schemes by the employer as well as the employee. For defined contribution schemes the amount of tax that will be payable may be reasonably easy to estimate during the tax year. For defined benefit schemes such as 'final salary' schemes, the amount of the deemed benefit cannot easily be

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calculated until after the end of the tax year. In both cases, individuals may unexpectedly fall within the legislation as the result of higher than usual income in a tax year as a result of redundancy or other one-off events. They may also face paying large tax charges with no cash to do so where the offending contributions have been made, or deemed to have been made, solely by the employer.

27 Given that the amount of the charge can be unexpected, very high relative to net income, may be unknown until after the end of the tax year, may relate to money that the employee can never access and will be increased by payments on account due for the following year, we believe that there should be more flexibility over the timing and method of payment of the charge. Furthermore, a charge may be payable in respect of a scheme which subsequently fails and therefore from which the member never draws benefits. We therefore recommend that taxpayers should be given the option of spreading payments where unexpected charges arise.

28 **Policy recommendations**

- Taxpayers who face a charge of more than £5,000 should be allowed to pay by instalments over, say, five years.
- Employees should be allowed to ask for an adjustment to their PAYE code to collect some or all of the charge in year.
- Taxpayers whose pension schemes collapse should be able to reclaim any charges paid.
- HMRC should not rely on affected taxpayers being aware of guidance in its website and notes to the tax return – it needs to provide targeted publicity on these changes.

Statutory residence tests

Personal residence

29 Residence is fundamental to the UK tax system, but the existing rules for individuals and trusts are confusing and unclear and there is a need for clear statutory tests. We remain committed to working with HMRC to develop a residence test for individuals that is based on objective measures and is reasonable and competitive with other jurisdictions when it comes to attracting business and investment into the UK.

Trust residence

30 We are concerned about the impact of the FA 2006 trustee residence rules on the UK's competitiveness as a global financial centre. Despite HMRC recently publishing their 'Trustee Residence Guidance', there are still many areas of uncertainty in the law and guidance. Further, the use of 'permanent establishment' in determining residence is not appropriate for trusts and we believe that the rules need to be changed. We, jointly with other professional bodies, are meeting the HM Treasury shortly to discuss the need for policy changes to the rules. We have also submitted a paper on the problem areas to HMRC for their comment with a view to publishing a joint bodies' guidance note agreed by HMRC.

31 **Policy recommendations**

- The Government should again reaffirm its commitment to introducing a clear and reasonable statutory residence test for individuals based on objective measures so that a person's residence status can be established easily.

- The Government should clarify by amendments to the law the rules for trust residence and ensure that the rules do not put the UK at a competitive disadvantage for international trust business.

HMRC AND THE TAX PROFESSION

Working with tax agents

32 A key issue for agents and the tax profession was the publication in the 2009 PBR of the latest consultation document *Working with tax agents: the next stage*. We will be responding fully to the consultation shortly but we have had a number of concerns about the direction of this consultation, particularly in the light of the draft legislation published on 8 February 2010. We remain unconvinced that a compelling case has been made for some of these measures. This is too important an issue to get wrong and we think more time is needed to ensure that the proposals, together with any necessary legislation, are fit for purpose and fully supported by tax agents.

Deliberate wrongdoing by tax agents

33 We are concerned particularly about the proposed measures to tackle 'deliberate wrongdoing' (in other words fraud) by agents, particularly following the publication of the draft legislation on 8 February 2010. We have stated consistently that we support HMRC's efforts to tackle evasion and that HMRC should pursue rigorously the tiny minority of agents who engage in fraudulent behaviour.

34 The consistent message from the profession at HMRC's workshop on 6 October 2009 was that fraudulent behaviour by agents should be rooted out by HMRC and that greater emphasis should be placed on investigation work and pursuing criminal prosecutions. The perception of many tax agents is that HMRC is loading further civil penalties and sanctions on tax agents in the hope that they will discourage fraudulent tax agents. We are not convinced that fraudulent agents will change their behaviour if more civil penalties are introduced, but instead the new powers and penalties will be used against honest agents who make errors.

35 The draft legislation on deliberate wrongdoing published on 8 February 2010 brings these concerns into focus. There is a wide definition of 'tax agent', and 'deliberate wrongdoing' appears to include any tax saving advice. Thus, it appears that a tax adviser giving straightforward tax advice could be subject to a financial penalty of £5,000 or more. Whilst we understand that this is not the intention and that these provisions should only apply in cases where an agent has been involved in fraudulent/dishonest conduct, the fact remains that as drafted the legislation appears to be a major attack on all tax advisers.

36 There is a real danger that unless the many concerns that have been raised are recognised and addressed in the legislation, the proposals, far from being supported by honest tax agents, will be actively opposed.

Disclosure to professional bodies

37 We support increased use of the 'gateway in s 20 of the Commissioners for Revenue and Customs Act 2005 (CRCA 2005) to enable HMRC to report possible misconduct by members to their respective professional bodies. HMRC needs to hold detailed discussions with the relevant professional standards departments in the professional bodies.

38 HMRC needs to address to what extent it has confidence in the work of tax agents who are not members of a professional body and how poor or non-compliant work of this sector should be dealt with. HMRC should have some experience of this issue given the requirement under the Anti-Money Laundering Regulations for certain service providers who are not registered with professional bodies to be registered with HMRC.

39 HMRC must ensure that it has procedures and sanctions in place for unaffiliated agents and that its risk assessment procedures properly reflect the fact that members of a professional body have a duty to comply with their professional body's codes of conduct whereas unaffiliated agents have no such duties. Given the important role of the professional bodies in setting and maintaining standards, any proposals in this area should seek to encourage agents to belong to a professional body, not the other way around.

40 **Policy recommendations**

- The proposed measures on deliberate wrongdoing need more consultation over a longer time period so that any proposals have the full support of the tax profession. There should be a formal public statement that these measures are only aimed at fraudulent agents and that they will not be used to penalise honest agents who make errors.
- The draft legislation on deliberate wrongdoing published on 8 February 2010 needs to be rewritten to ensure that it is properly targeted, in particular that it can apply only to fraudulent agents.
- HMRC needs to engage in detailed discussions with the professional bodies on the precise procedures that will be followed for reports to professional bodies under the s 20 CRCA 2005 gateway so that only appropriate cases are notified.
- HMRC needs to decide how to improve poor and non-compliant work by agents who are not members of professional bodies – any decisions should build on intelligence gained by HMRC from its role under the Anti-Money Laundering Regulations.

Legal professional privilege

41 We said in our 2009 PBR representation that the Government should announce a consultative body to review legal professional privilege (LPP) as it affects tax advice so as to end discrimination and establish a level playing field for all taxpayers and their advisers. We also said that this body should represent the views of all those who provide tax advice, with particular emphasis on those who are not qualified lawyers, and should report back by the PBR 2010.

42 We understand that the *Prudential* case is going to appeal, but the current position on LPP in relation to tax advice is far from satisfactory and from press reports it is now clearly a matter of concern of HMRC. This is a matter of public concern and needs to be addressed as we believe that the current position is not sustainable.

43 **Policy recommendation**

- The Government should announce a consultative body to review LPP as it affects tax advice and make recommendations for extending LPP to all appropriately qualified tax advisers.

PROTECTING TAX REVENUES

- 44 As we said in our 2009 PBR submission, we support much of the approach the Government has adopted as regards tackling tax evasion and encouraging greater transparency. However, whilst we welcome in principle efforts to encourage errant taxpayers to come forward and make a full disclosure, we are concerned that the proliferation of 'disclosure facilities'. We believe that they may be counterproductive, particularly given that the latest disclosure opportunity given to health professionals appears to be the first in a number of such initiatives.
- 45 We are concerned that these initiatives appears to be being used as a substitute for HMRC undertaking detailed investigation of taxpayers suspected of tax fraud. The perception is that HMRC no longer have the resources to undertake detailed tax investigations and that the chances of HMRC catching up with tax fraudsters is low.
- 46 We understand the rationale for such an approach given the pressure on HMRC's budget and the reduction in staff, but in the long run believe it may be a false economy as they may discourage tax evaders from coming forward. Given these disclosure facilities and that the chances of being caught appear to be very low, many tax evaders may prefer not to come forward and hope that a disclosure facility will become available in due course which would enable them to come clean at a low penalty rate.
- 47 **Policy recommendation**
- Whilst we support the principle of HMRC encouraging tax evaders to come clean, HMRC needs to ensure that the disclosure initiatives are backed up by properly resourced investigation teams and a prosecution policy that sends out a clear message that tax evaders will be caught and punished.

FURTHER CONTACT

- 48 For any further enquiries please contact:

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18 February 2010

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 130,000 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, Innovation and Skills 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.

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 www.icaew.co.uk/index.cfm?route=128518.