Tax Representation

ICAEW TAX FACULTY

TAXREP 14/09

2009 Budget submission

Memorandum submitted in March 2009 by the ICAEW Tax Faculty to the Chancellor of the Exchequer.

Contents	Page

Introduction: Dealing with the Credit Crunch

The single most important issue faced by the UK is the economic downturn**.** The speed of the downturn has been dramatic. A number of well know financial institutions have been swept away, amalgamated or nationalised. Governments across the world have been forced to underwrite failing industry sectors at a cost of many billions. Orthodoxies that governed economic behaviour over the last decade have been thrown into question. The real economy now faces a global downturn of indeterminate length.

The Institute of Chartered Accountants in England and Wales (*ICAEW) UK Business Confidence Monitor* (BCM, Q1, 2009)) shows that businesses are suffering, as the fall-out of the recent crisis in the global financial system spreads. The survey indicates that the outlook for business prospects for the next twelve months is negative. Turnover and profits are all expected to contract, while budgets for capital investments, R&D and staff training, as well as headcount, are forecast to fall.

Government has acted to support business through a number of policy responses, including the Working Capital Scheme and Enterprise Finance Guarantee Scheme. However, it is important that Government does not put unnecessary burdens and costs on business through taxation policy at this critical time. Continued work on ensuring certainty in the tax system and improving tax policy formulation is also crucial for maintaining productivity in the UK economy.

In this year's Budget Submission, the ICAEW highlights areas where the Government can act to help business and make the tax system more efficient. Key recommendations include:

- extending loss relief and clarifying payments made under the Financial Compensation Scheme;
- reconsidering proposed changes to income tax and national insurance contributions;
- deferring the date when the VAT rate reverts to 17.5% from 1 January 2010 to April 2010;
- putting business tax policy on hold pending a thorough review of business tax policy;
- improving tax policy formulation; and
- ensuring that the UK adopts rules for the taxation of foreign profits that encourage business and investment to be located in the UK.

Other immediate issues for the ICAEW are HMRC service standards, a statutory residence test and the taxpayer' charter, which are also addressed in this submission.

The ICAEW is a world leading professional body working in the public interest. Our strength and knowledge is drawn from the expertise of our members who hold world class finance qualifications. Because of chartered accountants, people can do business with confidence. Our members work in every sector of the economy, size of business and public body, from global company boardrooms and government departments, to high street practitioners, small businesses and charities. Their experience gives us an acute understanding of the dynamics which drive our economy from entrepreneurship and well-informed markets to efficient public services.

The ICAEW will work with Government and opposition political parties , in the public interest, to share its expertise, so that there is a competitive tax framework for UK business to help them through the downturn and build on the subsequent economic recovery.

1. Loss relief and the Financial Service Compensation Scheme Payments

The ICAEW supports helpful tax-related changes announced by the Chancellor in response to the credit crunch including:

- the new debt management service; and
- the extension of the loss relief rules.

Loss relief rules

The ICAEW would welcome the extension of the loss relief period from its current one year to three years, as it currently does not correspond with the time of most need for certain tax payers. We recognise that such a change would have revenue implications.

The provisions as currently set out also appear to discriminate against unincorporated businesses, for the reasons set out below.

- For many businesses unrelieved trading losses of the tax year 2008/09 will be the 'wrong year'. For example, those with a year end of 30 April 2008 would be less likely to have suffered a loss in that time period, since the impact of recession was still relatively mild for most at that stage. An alternative to extending relief to three years, that would help unincorporated businesses, is if they have the option of using either 2008/09 losses or 2009/10 losses.
- It appears that the set off for unincorporated businesses is to be restricted to profits arising from the same trade, whilst for companies it will be against all income. The ICAEW considers that the relief should be available to offset against all income.

Financial Services Compensation Scheme

Following the failure of some financial institutions, many individuals and small businesses will be compensated through the Financial Services Compensation Scheme (FSCS). It would be helpful if HMRC clarified how such payments will be treated for tax purposes. The ICAEW considers that any compensation payment received should first be treated as a return of capital.

In addition to the failure of financial institutions covered by the FSCS, investors are being affected by measures introduced by other institutions which prevent them from withdrawing funds, including interest credited to the account. Thus, interest credited to the account will be fully taxable whether or not the recipient eventually receives it.

In order to prevent possible hardship, the ICAEW recommends that as a temporary measure any interest credited in the current tax year, which cannot be withdrawn due to the illiquidity or insolvency of the financial institution should not be taxed until actually received. The measure could be temporarily extended if similar problems arise over the next few years.

Policy recommendations

- The ICAEW recommends that the loss relief period is extended from one year to three years.

- An alternative policy response to extending the loss relief period would be to allow unincorporated businesses to offset losses arising in either 2008/09 or 2009/10 and that the offset should be allowed against total profits.

- Clarification is needed of the tax treatment of payments received under the Financial Services Compensation Scheme.

- Consideration should be given to a temporary tax relief where any interest credited in the current year cannot be withdrawn from the account either due to insolvency or the account being blocked.

2. Income tax and National Insurance contributions

Increase in the NIC rates

It was proposed in the 2008 PBR that the main NIC rates should be increased by ½% in 2011. The ICAEW believes the rise in the rate of employers' NIC will increase business costs and act as a disincentive to recruitment at a time when we would hope that employment will start to increase.

The ICAEW is also concerned that the proposed increase will widen the gap between the tax treatment of employment income and dividend income, further encouraging small businesses to operate through companies for tax rather than commercial reasons (a concern highlighted by Government in the 2007 Budget Report, 5.113). The ICAEW is concerned that these policy changes will exacerbate the differences further and think that this proposal should be reconsidered.

Increase in the income tax rates and changes to the personal allowances rules

The ICAEW is also concerned about the proposed changes to the personal allowance rules in 2010 and the new 45%/37½% tax rate in 2011 for both individuals and trusts.

The Institute of Fiscal Studies (IFS) has expressed doubts as to whether the 45% tax rate will result in a net increase in revenues. We suggest that a detailed economic analysis of the proposed change should be made before any final decision is made to proceed with the increase.

In addition, we have three other concerns, as follows:

- the high *effective* marginal rates of income tax that have now been created;
- the proposed changes will result in added complexity and increased administrative costs; and
- there is a need for further clarifications about these changes.

Effective tax rates

The changes introduce distortions in the effective tax rates above the £100,000 and £140,000 thresholds (see Appendix 1 which sets out the effective tax rates at different levels of income). The tables show that marginal income tax rates of over 60% (61½% with NIC) have been introduced into the general structure of the UK tax system. The effective income tax rates are not progressive and at over 60% are likely to be perceived by many taxpayers as being not fair or reasonable, thus damaging public acceptance of the UK tax system. The IFS *Mirrlees Report* has suggested that the optimum revenue raising tax rate is 56.6% including consumption taxes, and estimated that the then effective UK tax rate was around 53%. This change puts the effective tax rate above the IFS figure and raises the concern as to whether the projected increased revenue will materialise.

Added complexity and administrative costs
The proposals will introduce considerable complexity into the income tax system and associated tax calculations. This increased complexity contrasts with the announcements in last year's PBR designed to simplify the tax system, in particular the introduction of a flat-rate of CGT.

The practical problem is that the proposed way in which the personal allowances are withdrawn lacks certainty, because the actual amount of the allowance depends upon the level of income and this will not be known until the after the end of the tax year. The PAYE system cannot deal effectively with such situations with the result that more taxpayers will be required to complete tax returns as they will have under or overpaid tax by the end of the year, which is what happens at present for the less well off elderly taxpayers within age allowance taper. This will increase the need for form filling, the issue and processing of which and having to make the associated payment/repayments or coding adjustments will increase the administrative burden and costs for many taxpayers and HMRC.

For trusts, the 45%/37½% proposal for trust rates of tax is likely to result in the majority of trust beneficiaries needing to file repayment claims, which will create more work for HMRC as well as the beneficiaries. This is because whereas a trust rate of 40% reflects the marginal rate of tax paid by a large number of wealthy people, the PBR proposal of a trust rate of 45% will equal the rate of tax paid by only a relatively small number of trust beneficiaries (according to paragraph 2.48 of the PBR 2008, only 2% of taxpayers are in the £100,000-plus income bracket, so significantly fewer will be in the 45% marginal rate) when one takes into account minor children, vulnerable beneficiaries and all those not liable at the new 45% higher rate.

Possible alternatives to tapering personal allowances include the following.

- Introduce the 45% income tax band for individuals at a lower income threshold. This approach would be transparent, simple and provide certainty.
- Give all taxpayers a tax reduction set at an amount of tax equal to the basic rate on the personal allowance. For example if the current personal allowance was £6,000, then all taxpayers would receive a tax reduction of £1,200 (£6,000 x 20%). This approach would treat all taxpayers equally and produce certainty. However, compared to the PBR proposals, tax charges would increase for those with earnings between the higher rate threshold and £100,000, whilst those with earnings above £146,475 would benefit, so adjustment to the 40% lower threshold would be needed to compensate those at the lower end of the 40% band.

As noted, these alternatives produce winners and losers as compared to the current proposals, and this would need to be factored in to any decision, but both are transparent, simple and provide certainty. Further, they do not involve increased processing and collection costs for taxpayers or HMRC.

The need for further clarification
With the introduction of the changes and the proposed 45% rate, there is a need to clarify whether tax relief for deductions such as pensions and charitable donations will be given at the highest rate of income tax. The Institute assumes that tax relief will continue to be available at the highest marginal rate but the PBR material was not clear.

Policy recommendations

- The tapering personal allowances proposal should be replaced by a higher rate of income tax, perhaps starting at less than that currently proposed to make it revenue neutral as compared with the PBR proposals for tax rates and personal allowances,

- Failing which, before a decision is made to implement the 45%/37½% individual and trust tax rates, the increased NIC rates and tapering personal allowances proposals announced at the 2008 PBR the following assessments should be undertaken:
  - a compliance cost assessment for taxpayers and HMRC (as happens for business tax measures), and
  - an economic impact assessment looking at exchequer revenues and taxpayer behaviour.

3. VAT - changes to the place of supply rules

The proposed changes to the VAT of supply rules for services is of fundamental importance and the most major change since the VAT Single Market rules were introduced with effect from 1 January 1993. However, whilst the changes should have produced a beneficial result for business, the actual proposals have turned this into what looks to be an expensive and risky compliance exercise.

The ICAEW responded to the HMRC consultation document in February 2009 (published as TAXREP 8/09) and highlighted a number of concerns about the proposals, namely:

- the complexity of the changes;
- the continuing uncertainty as to how certain services will be treated;
- the complex change to the time of supply for VAT purposes;
- the onerous reporting requirements; and
- the added risk to business of the joint and several liability proposals,

The Institute is also concerned that the proposals will increase the opportunity for cross-border VAT fraud. The HMRC has made considerable strides in bringing the problem under control, but these changes risk undoing that progress and increasing the compliance burden and risks on all businesses. The likely result is that, rather than facilitating cross border services, many businesses will now be deterred from providing such services.

The existing time of supply rule will be changed. The date of performance will become the main determining factor rather than the date of the invoice. This date is not tracked by accounting systems whereas invoice (and payment) dates are tracked in every accounting system. We do not think that businesses will be able to comply easily with this requirement, resulting in errors and increased costs.

Finally, due to the number of issues that still need to be resolved we do not think that businesses will have time to implement these changes before 1 January 2010.

Policy recommendations

- HMRC need to act quickly to resolve and clarify the identified problem areas, including making amendments to the law where necessary, and then giving business proper time to implement the IT changes, (re)train their staff and test their systems before going live.

- UK businesses will need to know not only the UK policy but also the view of the tax authority in the Member State of their customer. What is needed is a series of EC-wide statements on how business should treat the problem areas.

- There is a need at the EU level to reconsider the proposed time of supply rule and the proposed start date.

4. VAT - temporary reduction in the VAT rate from 17.5% to 15%

Deferring the 1 January 2010 date
Changing the VAT rate back to 17.5% from 1 January 2010 is a highly inconvenient time for businesses, particularly retailers.

The ICAEW is also concerned that (as mentioned above) the start date for the proposed changes to the VAT place of supply rules for services will also come into affect in January 2010, thus businesses will need to deal with a major change in the VAT system and a change in rate at the same time.

The ICAEW appreciates that the date of a change will always be inconvenient, but in view of the above problems we suggest that (assuming that the date of supply of services change remains 1 January 2010) the date that the VAT is increased to 17.5% is put back to 1 April 2010, i.e. to the beginning of the VAT year. We recognise that any savings will need to be balanced against the loss of revenue. The Government needs to make a decision on this shortly, as businesses are already raising concerns about how they will cope with the change-back.

The need for a light touch
The ICAEW has previously welcomed HMRC's reassurance that they will operate a 'light touch' in relation to errors or mistakes made in the first VAT return after the rate change. We hope that HMRC will take this approach throughout the whole of the VAT reduction period and after it ends and businesses adjust back to the higher 17.5% rate.

The ICAEW remains concerned that where traders adjust a subsequent VAT return to correct an error, for example due to VAT being undercharged following the resumption of the 17.5% rate, this will not be regarded as an 'unprompted disclosure' under the new penalty rules. If this was the case significantly higher penalties would be in point. The 'light touch' should therefore apply when considering the imposition of any penalties.

Policy recommendations

- Consideration should be given to deferring the date when the VAT rate reverts to 17.5% from 1 January 2010 to 1 April 2010.

- A light touch will be needed throughout the whole of the VAT reduction period and thereafter as businesses adjust back to the 17.5% rate. This should extend to any subsequent adjustment of errors where penalties might be in point.

5. Small business tax and simplification

The ICAEW has previously said that priorities for simplification of the UK tax system need to be decided and a timetable for delivery agreed.

In the 2008 PBR, the Government published a consultation document *Corporation tax calculations and returns for smaller companies.* The ICAEW is not convinced that the proposals in the consultation will result in a considerable improvement for smaller businesses (the ICAEW response was published as TAXREP 11/09). In principle, the Institute has always taken the view that the tax treatment should follow from the accounting treatment. We recognise that in recent years, accounting changes have often been controversial and that the move to a 'mark to market/fair value model' may not always be an appropriate measure for tax purposes.

For smaller businesses, alignment of the tax rules with the accounting profit would appear more straightforward and the ICAEW believes that this is an option which should be re-explored. We understand from informal discussions that the total level of deductions which are allowed for accounts but disallowed for tax is relatively small. The cost of alignment may be modest for the administrative savings this would achieve.

Further, policy developments in this area are also subject to further change as a result of the consultation published by the EU on 26 February 2009. The EU proposals are that there will be no EU wide requirement for micro businesses to file annual accounts but it will be up to individual Member States to determine their own requirements. The ICAEW believes that the tax rules need to be reconsidered once the new, UK, accounting requirements have been decided on.

One of the key issues for businesses is the frequency of changes to the business tax system. Examples of major policy changes in recent years include:

- the change to the VAT rate and in particular the impact on those businesses using the flat rate scheme;
- the continuing drive to compulsory e-filing;
- capital allowances, in particular the extensive changes to writing down allowances and the introduction of the annual investment allowance have caused further divergences between the tax and the accounting treatment of transactions;
- research and development tax relief;
- propose changes to the tax treatment of company cars; and
- tax incentives for green energy saving equipment.

The ICAEW appreciate that many changes to the tax system, such as those set out above, are made for entirely reasonable policy objectives. However, the total effect of all the changes is that the business tax system has become very complicated and is caught in a culture of constant change. The result is increased costs for both taxpayers and HMRC.

The ICAEW believes that one of the key principles that should underlie a good tax system is that it should remain constant. Changes to the underlying rules should be kept to a minimum. We believe that this is particularly important in the current economic climate and we would urge the Chancellor to commit publicly to a period of stability.

Incorporated vs unincorporated businesses
A further issue which we have highlighted in previous representations 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 appear to have grown rather than reduced. The small business tax review, which was started in 2004 but now appears to have stalled, needs to be reinvigorated in conjunction with the professional bodies.

Policy recommendations

- UK proposals for business tax simplification should be put on hold pending a considered response to the latest EU proposals and a coherent strategy then developed for UK businesses that takes account of the EU proposals.

- HMRC needs to work with the professional bodies to simplify the business tax system, particularly as it affects smaller businesses. This should involve reinvigorating the small business review and giving further consideration to closing the gap between accounting and tax profits by reducing the number of tax adjustments that are needed.

- There should be a public commitment to ensuring a period of stability in the business tax system and further changes in business tax policy should be put on hold pending a review of business tax policy.

6. Ensuring certainty in the UK tax system – Improving tax policy formulation

The 2008 ICAEW PBR representation emphasised the need for further improvements in the certainty of the UK tax system. It stated that tax policy changes needs to start earlier, when the policy options and technical delivery mechanisms are still being discussed.

The Institute welcomes the improvements that have been made in consulting on the *implementation* of major changes to areas of the tax system, for example on the proposed implementation of the powers rules and the committee established to review the FA 2008 changes to the residence and domicile rules. However, we remain of the view that tax policy formulation would be improved by greater consultation at an earlier stage.

The ICAEW reiterates its recommendation made in the 2008 PBR submission that to improve tax policy formulation Government and policy makers should work with professional bodies, such as the ICAEW, and the private sector, at an early stage in the process. The ICAEW is able to draw on the experience of our highly trained members who work in all fields of taxation, in all sectors of the economy and have both a national and global reach. The purpose of engagement would not of course be to decide tax policy but, as the public interest guardians of the tax system, to help the Government so as to avoid any unintended or damaging consequences.

As part of this process of improved policy formulation, policymakers at HM Treasury need to ensure that HMRC are fully involved in designing tax policies that will work on the ground. The ICAEW welcomes the appointment of Dave Hartnett as a permanent secretary for tax and believe that his appointment will strengthen HMRC's input into tax policy formulation.

The ICAEW accepts that there are times when the Government may need to act swiftly and that consultation is not always advisable, for example where measures need to be announced to counter known tax avoidance schemes. Subject to this, however, the ICAEW believes that there should be a presumption that there needs to be proper consultation on all major changes of tax policy so that any measures introduced are workable and keep implementation costs to a minimum (an approach endorsed by the House of Lords Economic Committee in its report on the 2008 Finance Bill, published on 12 June 2008).

Improving impact assessments
Part of this process of consultation at an early stage should involve reviewing the assumptions and costings that underlie the impact assessments. The ICAEW would like to work with HMRC to improve the formulation of impact cost assessments.

For example, the 2008 PBR included an impact assessment in respect of the reduction in the VAT rate in which estimates of the total costs for the temporary reduction was £300m, based on businesses' time using standard cost model data. We remain concerned that the burdens on businesses, especially small businesses and retail businesses have been significantly underestimated.

Poorly considered impact assessments merely undermine the policy intention. For the future greater rigour is needed in quantifying compliance costs, and the underlying figures and assumptions used in impact assessments need to be based on realistic assumptions about the burdens placed on business. Ideally, this should be done in consultation with businesses.

At present, impact assessments are made only on business tax measures. The ICAEW recommends that compliance cost assessments are also undertaken as a matter of course on personal tax measures as well – for example the 2008 PBR proposals to taper personal allowances, and increase income and tax rates to 45%/37½% and increase NIC rates.

Policy recommendations

- The Government should commit 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.

- The consultation should be started at an early stage when policy options are being considered and before any formal policy decisions are made. Where necessary, for example if the issues are market sensitive, this could be done confidentially.

- Tax policy formulation should allow adequate time for consultation responses to be analysed and factored in to tax policy formulation.

- In order to avoid creating uncertainty, under normal circumstances tax changes should only be announced at the Pre-Budget Report or Budget.

- More consultation is needed when compiling impact assessments and greater rigour is needed in quantifying any associated compliance costs. The underlying figures and assumptions used in impact assessments need to be based on realistic assumptions and in order to do this businesses need to be consulted at an early stage.

- Impact assessments should be made for proposals affecting personal taxation as well as business tax.

7. HMRC Service Standards

The ICAEW remains concerned that HMRC's Change Programme has resulted in a fall in standards in a number of service areas. Our members continue to report:

- significant levels of error in PAYE coding notices;
- difficulties caused by the deployment of inadequately trained or experienced personnel at HMRC's call centres; and
- general delays in processing, with specific concerns about mounting delays in VAT registrations which are subject to further checks – when the cases involved do not appear to be high risk.

The result has been an increase in compliance costs for many taxpayers and their agents.

The ICAEW recommended in 2007 that HMRC should work with the professions to develop a better set of service delivery indicators that had the confidence of stakeholders following similar recommendations made by the Treasury Committee (HC 483-1, published on 23 July 2007). The

Institute has had a number of discussions with HMRC about taking this work forward, but progress has stalled. The Institute believes that developing a set of reliable measures would be of public benefit and that it should now be taken forward.

Policy recommendations

- HMRC's customer facing departments need to be recognised as a front-line service and ensure that they are resourced accordingly.

- HMRC needs to work with its stakeholders to improve its services, working to develop service delivery indicators which have robust and transparent means of measurement and which are published on a regular (eg monthly) basis.

- HMRC should take steps to reduce the time taken to deal with those VAT registrations which are separated and subject to further checking so as to ensure that applications are not being held up unnecessarily in cases where the likely risk appears low.

8. Review of HMRC's powers

The 2008 PBR recommended that oversight of the whole powers review and underlying policy would be improved if an independent oversight committee was established. In the 2008 PBR, it was announced that the implementation of the outcome of the powers review should be overseen by an Implementation Oversight Forum. Whilst this stopped short of the Institute's recommendation, it is nonetheless a welcome development and we look forward to participating in the Forum. The ICAEW also welcomes the publication in the 2008 PBR of a 'roadmap' of the direction of the powers review.

The ICAEW continues to push for each new or revisited power to be matched with an appropriate safeguard. The ICAEW also believes that HMRC's implementation of the new powers regime will be a significant issue over the next few years and the success of this project will stand or fall in the way that this implementation occurs.

For example, it is becoming clear that keeping track of the start dates and transitional provisions from the old rules will be very important for taxpayers, advisers and HMRC and we think that HMRC needs to provide more guidance on these aspects.

The ICAEW would de delighted to work with HMRC to deliver joint training and understanding as to how the new powers provisions should be applied in practice. The way in which the new powers are introduced is key if they are to receive the support of stakeholders and not become a major area of contention between HMRC, taxpayers and the profession.

Policy recommendations

- The ICAEW would welcome a statement on the future of the powers review group and an indicative timetable of its future work and when the group is likely to come to an end.

- HMRC needs to set out a clear timetable for implementation of the new powers provisions and any applicable transitional provisions.

- HMRC should work closely with the profession on joint training initiatives so as to ensure that the new powers rules are introduced successfully and are supported by all stakeholders.

9. A statutory residence test

The ICAEW welcomes the Government's commitment to examine the case for a statutory residence test and the formation of an advisory group on this issue. The ICAEW has contributed fully to these discussions.

The Institute believes that it is essential that the UK adopts a statutory residence test. The concept of residence is fundamental to the UK tax system, but the existing rules are confusing and unclear. The UK is a major international centre and trading nation, with the result that the number of people who come to and go from the UK is considerable. These individuals need to be able to understand their UK tax position and the UK needs to ensure it remains competitive with other jurisdictions when it comes to attracting talent.

The UK therefore needs a clear and reasonable residence test based on objective measures to enable a person's residence status to be established easily.

Policy recommendation

- The Government should reaffirm its commitment introducing a statutory residence test with a proposed start date no later than 2010.

10. Taxation of overseas profits

The ICAEW welcomes the Government's decision to introduce a participation exemption . In our view an exemption system is necessary given concerns as to whether the current UK double tax relief system is compliant with the EU treaty. The Institute also believes that, properly designed, an exemption should help the UK's competitive position.

However, the ICAEW is concerned that the detailed proposals now emerging are too complicated and could make the UK a less attractive place to locate businesses.

The ICAEW has made two detailed responses to the current proposals (published as TAXREPs 1/09 and 4/09). The key concerns are that:

- the proposed debt cap rules are far too complicated to apply in practice and the rules will apply in cases where they should not do so;
- it is not realistic to seek to introduce the package before 1 July 2009; and
- if the participation exemption is introduced from 1 July 2009, the ICAEW recommends that the debt cap provisions are introduced for periods beginning on or after Royal Assent, in order to allow time for existing structures to be unwound.

Policy recommendations

- Government should commit to reconsidering the proposals and in particular the operation of any debt cap rules so as to ensure that any rules are straightforward to apply and are not excessively onerous as compared to the benefits that should accrue from an exemption system.

- The debt cap provisions are introduced for periods beginning on or after Royal Assent so as to allow time for existing structures to be amended.

11. A Taxpayers' Charter

The ICAEW welcomes the publication of the latest consultation document on the proposed Taxpayers' Charter and that it will have statutory backing.

It is important from a public perception viewpoint that the Charter has the support of taxpayers and the tax profession. Further work is needed to ensure that there is a fair balance in the Charter between HMRC and taxpayers and that it reflects developing best practice, as outlined in the OECD work in this area and in the Charters of other jurisdictions.

Particular points that need to be addressed include:

- It should set out clearly the rights of taxpayers. As currently formulated important rights are omitted, such as the right to privacy (which is different from the 'HMRC protecting the information that it holds), or are not covered in sufficient detail, such as the right to pay no more than the correct amount of tax.

- It needs to cover substantive legal rights such as the recognition of the doctrine of legitimate expectation, ie that in normal circumstances legislation should not have retroactive effect and that where changes are made there should be reasonable transitional provisions.

- The Charter should not include emotive statements such as HMRC *will pursue relentlessly those ...that bend the rules.* Such loose wording is not helpful in delineating the sort of behaviour that can reasonably be expected from HMRC officials and the use of the word 'bend' does not imply that HMRC will necessarily respect the right that taxpayers have to organise their tax affairs within the law.

The ICAEW would welcome further discussions on the Charter so that these concerns are addressed and the UK will then be able to introduce a world-class Charter that is supported by all stakeholders.

Policy recommendations

- The proposed Charter should include all government departments that deal with tax.

- The latest draft Charter needs to be amended in consultation with the profession to strike a better balance between the rights of taxpayers and HMRC so that the UK has a Charter which commands support and sets a standard for other jurisdictions to follow.

12. Statutory payrolling of employer-provided benefits-in-kind and expenses

The ICAEW welcomes the announcement in the 2008 PBR that HMRC would investigate further the case for making employers account for tax and NIC on benefits-in-kind (BIK) and expenses provided to employees via payrolls (payrolling) rather than reporting via end-of-year returns with a view to a decision later this year. The ICAEW pleased to be participating in HMRC's discussions with stakeholders. Nevertheless, unless changes are made to the rules governing the charges to tax and NIC on employer-provided BIK and expenses, we consider that statutory payrolling (i.e. payrolling in accordance with the law rather than the law as adjusted by easements) of employer-provided BIK and expenses would create enormous burdens on employers, especially smaller ones, and the proposals should be abandoned,

Where some employers currently do voluntarily payroll certain benefits, this is governed by individual non-statutory agreements between employers and their local HMRC officers, which incorporate informal local arrangements to enable payrolling to work in practice.

While putting all BIK and expenses through the payroll would in theory ensure that the right amount of tax and national insurance contributions are paid without requiring the employer to complete end-of-year returns P11D and HRMC needing to issue code numbers, in most cases it is impossible to put the BIK and expenses figures through the payroll in the pay period for which the present law provides that tax and NIC should be charged without having to rely on easements. This is because payrolls have to be computed in real time in order that employees receive their net pay on the normal pay day. For many BIK and expenses, the BIK or the expense will not be known until after the payroll has to be processed, so employers have to make an adjustment to payrolls in a later pay period. Such difficulties arise where, for example:

- the law provides that the tax or NIC charge is calculated by reference to the amount of the benefits at, say, the end of the pay period; or
- the value of the benefit needs to be agreed with HMRC; or
- employees are statutorily chargeable to tax and NIC on expenses incurred during the pay period details of which do not reach payroll personnel until too late; or
- employees are entitled to set against their emoluments certain expenses incurred wholly, necessarily and exclusively in the performance of their duties.

Policy recommendations

- Compulsory payrolling on a statutory basis by all employers of employer-provided BIK and expenses should not be introduced.

- If the proposals for compulsory payrolling on a statutory basis by all employers of employer-provided BIK and expenses are not abandoned, or if it is decided that certain BIK and expenses have to be payrolled, then to obviate the need for employers subsequently to have to make corrections, the law governing the charges to tax and NIC on BIK and expenses that have to be payrolled should be changed so that the quantum of BIK and expenses to be charged to tax or Class 1 NIC for a pay period can be ascertained by the start of the pay period.

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Appendix 1

Effective marginal tax rates - top slice of Income

2010/11		Earned Income		Unearned	Dividend	
		Employment	*Self-*	*Income*	*Income*	
Income:			*Employment*		*(Gross)*	
£	£	%	%	%	%	
0	6,095	0.00	0.00	0.00	0.00	Limit estimated
6,096	6,475	11.00	8.00	0.00	0.00	
6,476	43,875	31.00	28.00	20.00	0.00	
43,876	100,000	41.00	41.00	40.00	22.50	
100,001	106,475	61.00	61.00	60.00	43.75*	
106,476	140,000	41.00	41.00	40.00	22.50	
140,001	146,475	61.00	61.00	60.00	43.75	
146,476		41.00	41.00	40.00	22.50	

2011/12		Earned Income		Unearned	Dividend
		Employment	*Self-*	*Income*	*Income*
Income:			*Employment*		*(Gross)*
£	£	%	%	%	%
0	6,475	0.00	0.00	0.00	0.00
6,476	43,875	31.50	28.50	20.00	0.00
43,876	100,000	41.50	41.50	40.00	22.50
100,001	106,475	61.50	61.50	60.00	43.75*
106,476	140,000	41.50	41.50	40.00	22.50
140,001	146,475	61.50	61.50	60.00	43.75
146,476	150,000	41.50	41.50	40.00	22.50
150,001		46.50	46.50	45.00	27.50

* assumes personal allowance utilised by other income

Notes

1 The above ignores the 10% savings rate and age allowances.
2 It also does not consider the implications of gift aid or pension contributions.

Appendix 2

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, 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 our 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.

Appendix 3

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.