

FINANCE BILL OF JUNE 2010

Memorandum on the Finance Bill of June 2010 submitted on 9 July 2010 to Government by the Tax Faculty of the Institute of Chartered Accountants in England and Wales.

Contents	Paragraphs
Introduction	1 – 6
Who we are	7 – 9
Detailed comments on the Bill	
Clause 1, Main rate of corporation tax for financial year 2011	10 – 12
Clause 2 and Schedule 1, rates of capital gains tax	13 – 40
Clause 3 and Schedule 2, Rate of Value Added Tax	41 – 42
Clause 5, Power to repeal high income excess relief charge	43 – 45
Clause 8 and Schedule 5, Amounts not fully recognised for accounting purposes	46 – 47
Further contact	48
The Tax Faculty's Ten Tenets for a Better Tax System	Appendix 1

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INTRODUCTION

- 1 We are writing to provide our comments on the provisions contained in the Finance Bill of June 2010.
- 2 We welcome the Government's commitment to improve the scrutiny of the Finance Bill and that a further Finance Bill will be published in draft shortly which will be subject to detailed debate in the autumn (the Autumn Finance Bill).
- 3 We understand that this Finance Bill is to be debated on the Floor of the House in its entirety in the week commencing 12 July 2010. In view of the limited time available for detailed consideration, we have therefore limited our comments to some of the key points that arise.
- 4 In view of the limited time for review, we would welcome confirmation that the Government will consider the points raised and that if further clarifications are required that cannot be included in this Bill, they could be included in the Autumn Finance Bill before it is enacted.
- 5 Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in paragraphs 7 to 9 below.
- 6 As in previous years, we have judged the Finance Bill of June 2010 by reference to our 'Ten Tenets for a Better Tax System'. These are the ten key principles that we believe should underpin a good tax system and they are set out in Appendix 1.

WHO WE ARE

- 7 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 132,000 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.
- 8 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.
- 9 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.

DETAILED COMMENTS ON THE BILL

Clause 1, Main rate of corporation tax for financial year 2011

- 10 Two of our ten tenets are that the tax system should be competitive and stable. We therefore welcome the commitment to a clear policy to reduce the corporation tax rate from 28% to 24% in 1% annual increments.
- 11 Although we appreciate that clause 1 reflects the proposal in Budget Note 2, in order to provide better certainty for businesses we think that consideration should be given to legislating as soon as possible for the proposed reductions in the main rate of corporation

tax. We note that in 1984, when a similar staged reduction in rates was announced, the proposed rates were all enacted by way of a table in Finance Act 1984. Consideration should be given to amending clause 1 to set out the proposed reduction in rates or, alternatively, the rates should be set in the Autumn Finance Bill.

- 12 In order to give certainty to businesses, we also recommend that similar provisions are included in respect of the proposed reduction in the small companies' rate of corporation tax as set out in Budget Note 3 and the proposed changes to the rates of capital allowances in Budget Note 4.

Clause 2 and Schedule 1, Rates of capital gains tax

General comments

- 13 We have said that we thought that the difference between the CGT 18% rate and the top rate of income tax was unsustainable and therefore understand the rationale for increasing the rate. We would like to highlight:

- the technical and practical issues thrown up by a mid-year rate change; and
- the need to address a number of policy changes.

- 14 On the first point above, although we can understand the pressure to increase the rate before 6 April 2011, we are not aware that there has ever been a mid-year change in the CGT rate since CGT was introduced in 1965. The mid-year change is likely to cause a number of practical problems in the 2010/11 tax year and we have particular concerns with respect to the changes to the CGT supplementary pages for the self-assessment tax return and filing on-line.

- 15 From a technical perspective the transitional provisions for 2010/11 are currently insufficient. We appreciate that further transitional provisions may be planned for the Autumn Finance Bill and would welcome the opportunity to discuss the technical issues with HMRC officials with a view to working collaboratively to ensure that the final legislation for 2010/11 covers all the issues thrown up by a mid-year change. We suggest that the CGT Liaison Group would be the appropriate forum for this discussion with the addition of HM Treasury officials as well as those from HMRC.

- 16 As a general policy point whilst we can understand why it was felt necessary to introduce this change we hope that this is a one off isolated incident. To send out the right message about UK competitiveness the tax system must be seen to be stable. Sudden changes to such fundamentals as the CGT rate are unhelpful as people's confidence is undermined.

Detailed comments

Tax on personal representatives of deceased persons

- 17 We believe that it would be appropriate to tax the personal representatives of a deceased person in the same way as basic rate taxpayers because it is a completely different situation to that subsisting with a trust.

- 18 This would require new s 4(2), TCGA 1992 to omit new sub-s 4(3)(b).

HMRC software to cope with all these capital gains complications in 2010/11

- 19 At the moment there is free HMRC software to deal with the CGT calculations in the tax return. It is essential that this is modified by HMRC to take account of the transitional and other complications in relation to the CGT calculations for this year and that it is ready and fully tested in advance of 6 April 2011. HMRC will also need to work with commercial software suppliers to ensure that third party software fully reflects the changes and that software suppliers have sufficient time to modify their products.

- 20 We are concerned that this may not be achieved by HMRC not least because the relevant Question & Answer issued by HMRC states that:

‘We will provide guidance in time for people to complete their returns for 2010/11 and we are looking at how we can automate the process *as much as possible*’ (our italic).

- 21 If taxpayers are expected to e-file, HMRC’s processes should fully reflect all necessary legislation and computational consequences. If this cannot be done then the 2010/11 deadline for paper returns should be extended to 31 January 2012. Furthermore, the transitional rules for 2010/11 are not simple and specific guidance will need to be made available to unrepresented taxpayers. We feel that it is vital that the needs of the unrepresented are addressed in detail.

Entrepreneurs’ Relief

- 22 We are concerned that paragraph 8 of Schedule 1 will make a fundamental change to the rules where gains subject to entrepreneurs’ relief (ER) are held-over into qualifying corporate bonds (QCB).
- 23 Under the ‘old’ s 169R, TCGA 1992 sellers could effectively take their ER relief in the held-over gain deferred under s 116(10), TCGA 1992 – the ‘held-over’ gain being subject to a 4/9ths reduction. Because of the way in which ER is now given (i.e. at a flat 10% rate), under the proposed new s 169R the seller has to elect out of s 116(10) to get their ER at 10% on the QCB gain and will have to pay CGT at the time of the disposal even though they still hold the loan note. They therefore have to choose whether to defer their CGT under the normal QCB rules or they will have to pay 10% tax without hold-over if they want to get their ER. This is the same treatment as the existing rules for share exchanges under section 169Q.
- 24 We believe that in the circumstances in order to encourage entrepreneurship it should be possible for the ER to be ‘embedded’ in the held-over gain as it was under the predecessor legislation. There is a similar issue with the change to the interaction of enterprise investment scheme CGT deferral relief and entrepreneurs’ relief (paragraph 9 of schedule 1) and again to encourage entrepreneurship we feel it should be possible for EIS deferral relief to be claimed and the 10% tax rate to apply when the deferred gain crystallises.
- 25 We are also concerned that gains that were deferred on the receipt of QCBs or through the making of an EIS deferral claim and which would, under the previous legislation, have crystallised at an effective 10% rate will now be charged at a higher effective rate, as the example below illustrates:

‘On 20 June 2008 Alice exchanged all her shares in her personal company; Wonderland Ltd for QCBs issued by Red Queen Plc. Alice had formed Wonderland Ltd and had been its sole director and shareholder for ten years. The gain accruing on the disposal of her shares was £990,000. This gain was fully deferred by the acceptance of QCBs and Alice elected under TCGA 1992 section 169R for the gain to be subject to entrepreneurs’ relief. This had the effect of reducing the deferred gain to £550,000.

On 20 July 2010 Alice received a cash payment for her QCBs, so the reduced deferred gain came into charge; being £550,000. Alice’s net taxable income for 2010/11 is £40,000, which exceeds the basic rate band, so the full gain of £550,000 is taxed at 28%. Alice’s CGT liability on the encashment of the QCBs is £154,000, (£550,000 x 28%), an effective tax rate of 15.6%, when she would have expected a CGT liability of £99,000 (10% x £990,000).’

- 26 In other words, Alice deferred her gain in the legitimate expectation that she would pay CGT at 10% when she cashed in the QCBs, but in fact she will now pay CGT at an effective rate of 15.6% (5/9ths of 28%).
- 27 There are similar issues with the changes to the FA 2008 transitional provisions where an election was made (or will be made) with respect to a first relevant transaction which occurred prior to 23 June 2010.
- 28 We believe that these rules should be amended so as to preserve taxpayer's legitimate expectations, or if this is not accepted that taxpayers are allowed to continue with the old treatment for a reasonable transitional period.

Gains of non-resident settlements

- 29 There are two main, existing, provisions which tax UK residents on gains of non-UK resident settlements. Section 86, TCGA 1992 taxes a UK resident settlor for a tax year on the net gains less losses of such a trust from which he, or specified relatives, can benefit. Section 87, TCGA 1992 taxes UK resident beneficiaries who are not settlors by reference to capital payments received in the year which are matched with the net trust gains.
- 30 Both the above provisions work by reference to the net gains of the tax year. Paragraph 21 of Schedule 1 provides that all s 86 gains are treated as accruing before 23 June 2010 and so will be taxable at 18%. This seems reasonable as until the end of the tax year there will be no net gains and it will be simpler to treat the aggregate as arising at the one tax rate and fairer for this to be the 18% rate.
- 31 For s 87 (also s 89 and Schedule 4C) the position is exactly equivalent as it will not be until 6 April 2011 that the trustees will know if they have any net gains. The existing matching works only on the basis of net gains of a year and total capital payments of a year. So it seems wrong that paragraph 22 of Schedule 1 proposes to charge CGT at 28% on capital payments received after 22 June 2010. Such payments could well be matched with gains before 23 June and if the gains all arose before then they would need to be taxed at 18% to avoid retroactive taxation.
- 32 Indeed if the gains arose in previous years then there will be a 10% surcharge for each of those years under s 91, TCGA 1992. The maximum surcharge is 60% so that if the full surcharge applies the rate of charge on the capital payment will increase from 28% to 44.8% (160% of 28%).
- 33 The transitional provisions do not address the more complicated situations that can arise with respect to the s 87 legislation. Amongst other issues, there are no rules for allocating capital payments which arise throughout the year (e.g. loans at favourable rates or the use of assets for no payment) to either the period ending on 22 June and to the period commencing on 23 June. As stated at the beginning we think that addressing these technical issues is something which could usefully be done collaboratively using the forum provided by the CGT Liaison Group.
- 34 For all these reasons we recommend that the principle of paragraph 21 is also applied to paragraph 22 gains under s 87 so that all gains are taxed at 18%.

The need for a review of the entrepreneurs' relief provisions

- 35 Entrepreneurs' relief was introduced in 2008 in what can only be described as hurried circumstances. Given the urgency with which the new legislation was required officials looked to the old retirement relief provisions as a model for the new relief. However, these provisions were targeted at a different audience and a different era and this means that the qualifying provisions for entrepreneurs' relief are in places inappropriate and/or very unfair. We raised these issues in 2008 and there was a welcome debate at Finance Bill Committee

Stage and Report Stage though rather than the required changes being made it was left that the operation of the relief would be reviewed at a later stage.

- 36 Having seen how the provisions work in practice our members have seen many cases where the rules operate unfairly. This was a significant problem before 23 June 2010 but now we have a higher rate of CGT we feel that these issues have to be addressed as a matter of urgency.
- 37 Employees/office holders with holdings of less than 5% will not qualify for relief even if for a significant earlier period they did have a holding of 5% or more (their holding may, for example, have been diluted by share options being exercised or by an injection of third party capital so the business could be expanded). There will also be no relief if the 5% condition is met but the individual leaves the employment or resigns as an office holder and has not disposed of their holding beforehand. We would suggest that the 5% holding condition is deleted and that the 12 month requirement be changed such that the conditions must be met in any continuous 12 month period in the 36 months prior to the disposal.
- 38 The situation is especially unfair for trustees where only interest in possession trusts can benefit from entrepreneur's relief and where shares are held not only must the life tenant be a qualifying employee/office holder he or she must personally hold at least 5% of the ordinary share capital, and personally be able to exercise at least 5% of the voting rights by virtue of that holding.
- 39 We would suggest that all trusts should be able to benefit from entrepreneur's relief where shares are held in a company of which a beneficiary is an officer or employee or (if the company is a member of a group of companies) the beneficiary is an officer or employee of one or more companies which are members of the trading group and the same change with respect to the 12 month holding period is made as suggested above for individuals claiming entrepreneur's relief.
- 40 There are a number of other issues and we would be happy to put together a report going into the detail which could then be discussed through the forum of the CGT Liaison Group with a view to recommending changes to the legislation.

Clause 3 and Schedule 2, Rate of Value Added Tax

- 41 Schedule 2 sets out detailed rules to prevent businesses seeking to charge VAT at only 17.5% when supplies span the change of rate and certain conditions are met.
- 42 While we understand the need for such rules, the Schedule appears to largely duplicate the rules that were set out in Schedule 3, FA 2009 and applied when the VAT rate reverted to 17.5%. It would potentially have been much simpler to have cross referred directly to the FA 2009 provisions, amended as necessary.

Clause 5, Power to repeal high income excess relief charge

- 43 We note that the government is introducing legislation to allow it to repeal s 23 and Schedule 2 to the FA 2010 (high income excess relief charge). This legislation was complex and would have been costly for taxpayers, pension administrators, employers and HMRC to apply and administer. In representations made previously we had urged the government to reconsider its proposals and we are pleased that it has done so. Any new legislation, which we note must achieve the same fiscal outcome, will need to be introduced within a very short timescale so that it will be operative from 6 April 2011.
- 44 Discussions with representative bodies are already taking place and we are keen to continue our involvement in these with a view to assisting government to arrive at a simple and fair solution.

45 Pension savings are a long term commitment and we urge government to provide more certainty to pension savers. In our view, the government should be working towards a public policy objective as regards pensions that:

- Encourages and supports long term pension savings
- Inspires confidence in pension savings by providing stability and consistency
- Is simple to understand
- Is easy to administer
- Can be relied on to provide the benefits saved for

Clause 8 and Schedule 5, Amounts not fully recognised for accounting purposes

46 This provision aims to combat a relatively narrow loophole and we do not have any observations on it. On 6 July HMRC published more wide-ranging proposals to amend ss 311 and 312, and ss 599A and 599B, Corporation Tax Act 2009.

47 These further proposals are likely to have more wide-ranging implications and we shall be considering the proposals and responding before the deadline of 7 September 2010.

FURTHER CONTACT

48 For any further enquiries please contact:

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APPENDIX 1

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>).