Tax Representation

ICAEW TAX FACULTY

TAXREP 23/09

Submission to the Treasury Select Committee on the 2009 Budget

Memorandum submitted on 27 April 2009 by the ICAEW Tax Faculty to the Treasury Select Committee setting out initial comments on the 2009 Budget.

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SUBMISSION TO THE TREASURY SELECT COMMITTEE ON THE 2009 BUDGET

INTRODUCTION

1 We welcome the opportunity to submit evidence in response to the invitation published on http://www.parliament.uk/parliamentary_committees/treasury_committee/tc060208pn23.cfm.

2 Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Appendix 1. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Appendix 2.

DEALING WITH THE CREDIT CRUNCH – LOSS RELIEF AND THE FINANCIAL SERVICE COMPENSATION SCHEME PAYMENTS

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

- the expanded debt management service and the ability to make in-year loss relief claims; and
- the extension of the loss carry back rules to cover losses for a two year period rather than a one-year period.

Loss relief rules

4 In our 2009 Budget submission, we proposed that the losses eligible for the extended three year carry-back proposed in the 2008 Pre Budget Report (2008 PBR) should be extended from one to three years. Our rationale was that for many unincorporated businesses, the relief applied too early and the proposal discriminated against unincorporated businesses although we recognised that it may have revenue implications.

5 The 2009 Budget proposal is that losses arising in a two-year period can be carried back for three years, up to a limit of £50,000 per year.

6 Whilst the extended two year loss period is welcome, we remain of the view that greater flexibility is likely to be required, particularly in respect of unincorporated businesses. Whilst the government expects growth to resume later this year, many commentators are forecasting that the UK could experience negative growth in 2010, and it is only now that many businesses are beginning to experience serious problems. An unincorporated business with a year end of, say, 30 April may find that it makes losses (or makes further losses up to the £50,000 limit) in the year to 30 April 2010, which would be outside the proposed extended two year time limit which is for accounting periods ending in the tax year 2009/10. We therefore remain of the view that this relief should be extended for a further year.

Financial Services Compensation Scheme

7 In our 2009 Budget submission, we recommended that as a temporary measure any interest credited in a tax year, which cannot be withdrawn due to the illiquidity or insolvency of the financial institution should not be taxed until actually received. We also requested clarification of how payments received under the Financial Services Compensation Scheme (FSCS) would be taxed and that payments from FSCS should be treated firstly as a return of capital and only amounts in excess of the capital contributed to the account should be treated as interest.

8 Although some technical clarification is now being provided for the tax treatment of payments received under the FSCS, no provision is being made to provide relief where:

- any interest credited in a tax year cannot be withdrawn from the account until a later tax due to insolvency or withdrawals from the account being temporarily blocked by the financial institution; or

- the amount received by an investor from the FSCS is less than the capital deposited in the account.

9 We should like to see both these issues addressed.

INCREASE IN THE INCOME TAX RATES AND CHANGES TO THE PERSONAL ALLOWANCES AND PENSIONS RULES

10 Tax rates are properly a matter for government to decide. Nevertheless, the proposed changes to the tax rules for higher earners will do little to address the budget deficit. Given the predicted size of the deficit, it is inevitable that action will be needed to bring the UK's finances back into balance and that this is likely to involve a mixture of more broadly based tax increases and cut-backs in public expenditure.

11 The ICAEW is concerned about the impact of the various proposed changes to the income tax rules, namely:

- the new 50% tax rate (replacing the proposed 45% rate);

- the withdrawal of personal allowances for those earning over £100,000 (creating a marginal 60% tax rate);

- the scaling back of tax relief on pension contributions (creating very high effective tax rates);

and their combined effect upon the UK as a place to live, work and invest.

The 50% tax rate

12 The Institute of Fiscal Studies (IFS) has expressed doubts as to whether the 45% tax rate would result in a net increase in revenues and the day before the Budget suggested that the optimal tax rate was 40%. We suggested in our 2009 Budget submission that a detailed economic analysis should be made of the proposed change before any final decision is made to proceed with the increase. Given the weight of evidence that such rates may not be effective in raising revenue we remain of the view that a detailed economic analysis of the impact of the proposed 50% tax rate needs to be made, before any such policy is implemented.

13 For trusts, the proposal to raise the trust rates of tax are 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 most individuals on high incomes currently only 2% of taxpayers are in the £100,000 plus income bracket (according to paragraph 2.48 of the PBR 2008) so we would expect significantly fewer will be in the 50% marginal rate band. Many beneficiaries such as minor children, vulnerable beneficiaries and all those not liable at the new 50% higher rate who receive payments of trust income will be able to apply for tax refunds before the trustees have even had to file a tax return and pay tax for the year.

The withdrawal of personal allowances

14 The way in which the personal allowance is withdrawn does not result in a progressive tax system. Withdrawing the personal allowance at a rate of £1 for every £2 of income above £100,000 results in an effective marginal income tax rate of 60% (61½% with NIC) on income between £100,000 and £112,950 (using the 2009/10 personal allowance of £6,475) into the UK tax system. The same comments apply as to the effective rate as for our comments above about the 50% rate.

15 Aside from this concern, these proposals introduce considerable complexity into the income tax system and associated tax calculations. There is a major practical problem, with associated costs for both HMRC and taxpayers, where the taxpayer is within PAYE. The actual amount of the allowance depends upon the level of income in the tax year which will not be known until the after the end of the tax year. The PAYE system cannot deal effectively with such situations and will have to be based on estimates. In circumstances where an individual usually has income well below £100,000 but receives a one-off bonus which takes income up to £120,000, that taxpayer will face an unexpected underpayment of in excess of £2,590 simply because PAYE will not be able to deal with this. That taxpayer will have expected PAYE to be collecting the right amount of tax during the year.

16 The result will be an increase in the need for form filling, the issue and processing of which together with making the associated payment/repayments or coding adjustments will increase the administrative burden and costs for many taxpayers and HMRC. We recognise that a similar situation happens at present for the less well off elderly taxpayers within age allowance taper.

17 A more straightforward option would be for personal allowances to be given in full but for the rate of tax applying to be higher over £100,000 of taxable income. This would have the benefit that PAYE would then be able to deal effectively with bonuses and the like so that underpayments of tax would be less likely. Some analysis will need to be done to identify an appropriate rate of tax.

Restriction of tax relief for pension contributions

18 We are very concerned by the level of complexity of the proposed new rules in connection with the restriction of tax relief for pension contributions and the tax rates that can ensue. Furthermore the anti-forestalling provisions effectively accelerate the reduction in relief by up to two years in many situations, for example in redundancy and when approaching retirement, where taxpayers often pay larger than usual contributions to improve their pension provision.

19 At this stage it is not easy to ascertain exactly how these new rules will work. Our initial calculations suggest that individuals are likely to face very high marginal rates. We are still working through the detail but would be happy to supply the Committee with further information on this point.

20 As part of the anti-forestalling provisions in advance of the restriction on tax relief for pension contributions for taxpayers of earnings of £150,000 or more, the proposal as per Budget Note 47 will prevent higher rate tax relief for most pension contributions on or after 22 April 2009 other than where contributions ’are paid quarterly or more frequently’. This appears unnecessarily restrictive.

21 Pension contributions made by the self employed individuals are often one-off, annual, contributions once the likely level of profits for the tax year is known. Therefore, many self-employed who nevertheless make regular contributions will not pass this test and face the possible immediate loss of higher rate relief. We recognise that in his Ministerial Statement on 22 April 2009 the Financial Secretary to the Treasury stated "The Government recognise

that those with less regular contribution patterns may be affected and would welcome views on whether there are ways of ensuring the contributions of this group are protected in the same way as those making more regular patterns, while continuing to meet the objectives above".

22 In order to ensure that such individuals continue to benefit from relief we suggest that there should be a second test calculated by reference to average contributions made in, say, the highest two tax years 2006/7, 2007/8 and 2008/9 - perhaps indexed up by reference to the changes in the annual personal allowance.

23 The inclusion of pension contributions made by employers in taxable income is likely to result in the new provisions affecting those with incomes considerably below the £150,000 threshold being quoted. This, together with the anti-forestalling provisions, is likely to result in compliance issues particularly for those taxpayers who do not believe that they will be affected by these changes. HMRC will need to undertake an extensive publicity campaign so that taxpayers understand the changes.

24 In the same way as mentioned above in connection with personal allowance withdrawal, dealing with the changes through PAYE and the net pay arrangements is likely to be very cumbersome and difficult, resulting in extra costs for HMRC, employers and taxpayers and adding to the administration burden for employers and pension schemes.

FOREIGN COMPANY PROFITS

25 It was confirmed in the Budget that dividends and other distributions received by UK companies from foreign companies will be exempt for corporation tax and the relief will also apply to all companies. We welcome the Government's commitment to introduce this improvement to the UK tax system and to have confirmed that the exemption will extend to small companies and will apply to dividends and other distributions received on or after 1 July 2009.

26 We remain concerned that the introduction of the worldwide debt cap, which will now apply to accounting periods beginning on or after 1 January 2010. Whilst the revisions announced on 7 April 2009 will remove many from the complexities of the tests, the rules will still need to be considered by all companies looking to invest into the UK and hence will place an additional hurdle that investors will need to overcome before choosing the UK.

27 For those companies that continue to be affected, the rules will be extremely complex in practice and will undermine the competitiveness of the UK tax system. In the absence of revised draft clauses, which will presumably be contained in the Finance Bill to be published on 30 April 2009, it is difficult to form a judgement as to how complex, and how damaging to the reputation of the UK tax system, the world wide debt provisions are likely to be.

28 We intend to make detailed representations once we have had a chance to review these detailed provisions.

29 We welcome the decision of the government to disengage changes to the Controlled Foreign Company (CFC) regime from the introduction of the dividend exemption and we have already submitted an informal paper to HMRC with our comments and recommendations about the CFC regime.

VAT

Changes to the place of supply rules

30 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. In our 2009 Budget submission, we expressed 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,

31 We remain concerned that due to the number of issues that need to be resolved, businesses will not be ready in time to implement these changes by 1 January 2010. In particular, we have:

i) called on HMRC in February 2009 to agree the removal of the time of supply changes from the VAT Package, and to harmonise the principal time of supply around the invoice date. HMRC may regard this as unrealistic, but the alternative, namely imposing a reporting requirement which both HMRC and business know cannot be implemented, is even worse.

ii) asked HMRC not to agree to the Commission's joint and several liability proposals, which would allow the tax authorities of the 26 other EU Member States to assess UK businesses for the unpaid foreign VAT which should have been paid by their customers in the other Member State.

32 We consider that the changes will do little to combat cross-border (MTIC) VAT fraud. As we have stated publicly on many occasions, MTIC fraud will only be halted when the obvious loophole in the VAT system, known to the Commission and to Member States since before 1993, is blocked, and VAT is charged on intra-EC cross-border supplies as it is on domestic transactions. However, Member States cannot agree on this and the result is that we continue with the faulty, fraud-prone 'transitional' system, but with the Commission and national tax authorities increasingly placing further costs on business to police it. In addition, by extending the range of services subject to the reverse charge, the Commission and Member States need to recognise that they have also extended the opportunities for cross-border VAT fraud.

33 The timing of these changes is unfortunate. Many businesses are fighting for survival in the worst financial climate for decades. HMRC are now asking them to divert resources and incur significant additional on-going costs without any commercial benefit to the business itself. This demonstrates a lack of understanding of the current business environment by those concerned with framing VAT policy.

34 We are increasingly concerned at the additional costs being transferred to business by HMRC. From the inception of VAT, businesses have been required to work as unpaid tax collectors for government. In addition, businesses are increasingly being required to carry out a tax audit function for government. We do not think it overstates the position to say there is a real danger that the changes, taken as a whole, will:

- deter some UK businesses, particularly SMEs, from supplying goods and services cross-border within the EU; and
- encourage others to re-route supplies, transferring business activity away from the UK.

Temporary reduction in the VAT rate from 17.5% to 15%

35 In our 2009 Budget submission, we were concerned that changing the VAT rate back to 17.5% on 1 January 2010 is a highly inconvenient time for businesses, particularly retailers. In addition, for the reasons given above, we are concerned that the start date for the proposed changes to the VAT place of supply rules for services will also come into affect from the same date, thus businesses will need to deal with a major change in the VAT system and a change in rate at the same time.

36 We suggested 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. This recommendation has not been accepted but we remain concerned about the date and that consideration should be given to a short deferral of the date.

HMRC'S POWERS AND SERVICE STANDARDS

Working with tax agents

37 We welcome the publication of the consultation paper 'Working with tax agents'. The paper recognises the vital role that tax agents play in the delivery of the UK tax system. The paper considers a number of possible reforms and we look forward to commenting on these in due course.

38 We note that HMRC is not convinced of the need for a proposed registration scheme for agents. We agree with HMRC's position. We look forward to further discussions with HMRC aimed at ensuring that all those involved in delivering the tax system are appropriately skilled and work to agreed professional standards.

Publishing the names of deliberate tax defaulters

39 The ICAEW supports efforts to combat tax evasion and it is right that government considers a variety of policy options. The proposed measure is based closely upon the approach that has been adopted in Ireland for a number of years, although the Irish scheme also appears to cover a wider variety of offences including, for example, excise frauds such as cigarette smuggling and fuel duty evasion.

40 Whilst we recognise the attraction of this particular measure, nevertheless we have some concerns with it:

- we are not convinced that the measure is fully compliant with the Human Rights Act 1998 and believe that there is need for a detailed statement about this aspect;

- we do not understand why tax credits are excluded and think that it is just as important that such a scheme is extended to false tax credit claims; and

- consideration should be given to extending to scheme to cover frauds related to excise duties and related areas.

Personal tax accountability of senior accounting officers

41 The proposal set out in Budget Note 62 to require senior accounting officers to certify that the accounting systems are adequate for the purposes of tax reporting was an unexpected announcement and appears a disproportionate response to the identified problem. It appears to reflect a Sarbanes Oxley style requirement which appears unnecessary for the vast majority of companies.

42 A corporation tax return includes a declaration that the return is correct and complete. It needs to be signed by someone authorised to do so, invariably a senior officer of the company. A tax return cannot be correct and complete if the company does not have processes and internal systems that enable a correct and complete return to be made. Therefore, this proposed new requirement appears to impose further onerous obligations whilst adding nothing new in terms of tax compliance.

43 The proposed measure is disproportionate because it applies a potentially onerous personal liability on all the senior accounting officers *ab initio.* HMRC's risk analysis procedures should identify the small number of large companies that do not have adequate accounting systems to prepare a correct and complete return. It would then be reasonable to target those companies with measures such as this. In other words that the company and its senior accounting person is first put on notice that continued default will result in a fine.

44 We would suggest that rather than introduce this measure, if HMRC is concerned about internal accounting systems it would make more sense to extend the existing declaration that is required on the corporation tax return.

HMRC service standards

45 We remain concerned that the current efficiency programme is leading to a reduction in service standards 'on the ground' and that further efficiency savings are likely to lead to a further reduction in service standards. We refer Committee Members to our recent submission to the Committee which included detailed comments on HMRC's service standards and which was based upon a recent survey of members. We are in the process of finalising the results of this survey and would be happy to provide further evidence to the Committee on this point.

TAXPAYERS' CHARTER

46 We welcomed in our 2008 Pre-Budget Report submission the government's decision to introduce a new Taxpayers' Charter.

47 We recommended that the Charter should have statutory backing and we were delighted that the Chancellor announced in his 2008 Pre-Budget Report that he had accepted the need for such backing. We are concerned that the Budget Note seems to indicate that this statutory backing will 'require HMRC to prepare and maintain a Charter' but beyond that the only (statutory) requirement is said in the Budget Note to be

> 'to report annually on how well HMRC is doing in meeting the standards in the Charter.'

48 In our representation we recommended that:

- the legislation should set out the process by which the Charter is established and kept under regular review and how and when appropriate reports are to be made;

- the legal effect of the Charter should be covered and the extent to which HMRC should take account of the Charter; and
- there should be independent oversight of the Charter and the regular review process should be under the aegis of a Parliamentary Select Committee.'

49 HM Revenue & Customs recently published, 3 February 2009, a second Consultation Document containing a draft of the proposed Charter. We have submitted (TAXREP 20/09) our detailed comments on this prior to the deadline for comments of 12 May 2009.

50 Budget Notice BN92 published on Budget Day adds very little of substance to what has already been published in the earlier Consultation Document.

51 In our response to the February Consultation Document we noted that the draft Charter contained in that document will require significant revision before final publication if the Charter is to serve its proper purpose which is to set out clearly the rights (and obligations) that taxpayers enjoy (or owe) in their relationship with HMRC.

52 The rights of taxpayers will need to be more clearly stated in the final Charter and we are concerned that many important rights are currently omitted from the draft Charter.

53 We agree with HMRC that the primary Charter document should be a simple short statement but this then needs to be underpinned by more detailed statements explaining what the various rights and obligations mean in practice, plus where further information is available.

54 We remain of the view that the title of the Charter should be aimed at the taxpaying public and that to call it an HMRC Charter, which appears to be the current intention, does not give the correct signal. We do appreciate that HMRC is responsible for much more than just the collection of tax, for instance the payment of tax credits. Nevertheless, HMRC is responsible for the collection of a very considerable number of different taxes and all residents of the UK will pay one or other of these. For example, those below the income threshold will still pay VAT. So we have recommended that the Charter should be called a **Taxpayers' Charter** which is the name adopted by almost every other jurisdiction in the world that has introduced such a Charter.

ABOLITION OF THE FURNISHED HOLIDAY LETTINGS RULES

55 We were surprised to see that the special tax rules for Furnished Holiday Lettings (FHLs) will be extended in 2009/10 to include properties in the EEA but will then be abolished entirely for 2010/11.

56 We appreciate the potential problems with compliance with EU rules, but we suspect that this change is likely to have a serious impact on the provision of holiday lettings in tourist areas. There is concern that it could encourage FHLs to be sold off (most likely as second homes) or transferred to being let as unfurnished residential accommodation and thus reduce the stock of tourist accommodation. There is particular concern about the impact on investment in multiple unit complexes if entitlement to capital allowances is lost.

57 We think that an economic analysis of the proposal needs to be undertaken and whether the concerns about the EU aspects of this could be resolved in a way that does not involve the complete withdrawal of the scheme.

58 We assume that there is concern that the more generous loss treatment could lead to a loss of revenue to the Exchequer if claims are made on holiday homes. However, the FHL activity must be commercial and if necessary the existing rules could be tightened.

59 The deemed trading qualification of FHLs overcomes the lack of a substantive definition of what constitutes a trade in the Taxes Acts. If the FHL rules are to be abolished in their entirety then clear and detailed guidance will be required as to what level of services establishes a trading activity. Further, the cost of furnishing properties is substantial and it is entitlement to capital allowances that remains most important as well as start-up loss relief to help finance the considerable capital costs.

60 We are also concerned about the implications of the abolition of the FHL rules on hotel companies as it has been common since the 1980s for seaside hotels to also provide some furnished self-catering accommodation. If FHLs will no longer be entitled to capital allowances then will it be necessary to distinguish between furnishings in hotel rooms as opposed to self-catering units? This is likely to be practically very difficult.

61 We recommend that there should be detailed consultation on the implications of this significant and unexpected proposed change in the legislation.

FURTHER CONTACT

62 For any further enquiries please contact:

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Appendix 1

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 2

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.