



## ICAEW TAX FACULTY REPRESENTATION

### TAXREP 1/11

### OFFICE OF TAX SIMPLIFICATION – REVIEW OF TAX RELIEFS

*Memorandum submitted in January 2011 to the Office of Tax Simplification (OTS) by the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) in response to a request for comments on the interim report published by OTS in December 2010.*

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# OFFICE OF TAX SIMPLIFICATION – REVIEW OF TAX RELIEFS

## INTRODUCTION

1. We set out below our response to the request for comment on the review of tax reliefs in the interim report of the OTS published in December 2010.

## WHO WE ARE

2. The ICAEW 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 ICAEW provides leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 775,000 members worldwide. The Tax Faculty is the focus for tax within ICAEW.

## TAX SIMPLIFICATION

3. In the ICAEW Tax Faculty paper, The Emergency Budget 2010 (TAXREP 27/10), submitted to the Government at the beginning of June 2010, which was after the setting up of the Office of Tax Simplification had been announced, we wrote:

‘We welcome the Government’s commitment to tax simplification and the establishment of an Office for Tax Simplification (OTS).

The UK has one of the longest tax codes in the world and this puts the UK at a competitive disadvantage to other countries. In practice simplification is harder to achieve: it is a large task and inevitably there will be winners and losers. We would be delighted to participate in this agenda and contributing to the OTS.

As a general principle, we believe that tax simplification should focus around reducing rates and simplifying tax reliefs: the Government proposal to reduce the rate of corporation tax and simplifying reliefs and allowances therefore appears to be a step in the right direction. It is important to ensure that tax simplification measures include suitable transitional provisions to protect legitimate expectations.’

4. ‘Simple’ is one of the Tax Faculty’s Ten Tenets which are reproduced in Appendix 1 to this paper. We believe that tax rules should aim to be simple, understandable and clear in their objectives.
5. We believe that some parts of the tax system have become particularly complicated and should be the subject of review by OTS. The OTS is already reviewing the taxation of small business: this is a welcome development given that this is a particularly difficult area. Other areas which could form part of subsequent work by OTS include:
  - differences between income and capital;
  - trust taxation, in particular settlor-interested trusts and trustee residence; and
  - the rules regarding residence and ordinary residence;

### **Criteria used in the Interim Report**

6. The criteria identified in the report for evaluating existing reliefs are:
  - policy rationale;
  - evidence of taxpayer take up;
  - tax cost; and
  - the administrative burden.
7. We believe that the above criteria are reasonable and provide a sensible framework for evaluation although we doubt that in many instances sufficient evidence will be available under these headings for a fully considered view. Further, the work needed to obtain the necessary information and evidence may be out of proportion to the conclusions that might be obtained.
8. It will be necessary to apply these criteria with pragmatism and common sense and, given the limited resources available, care must be taken to ensure that reviews will be cost effective and not subject to the law of diminishing returns. In order to ensure that all reliefs receive fair attention, and that the process has some discipline, a possible approach would be to allot the time spent evaluating each relief by reference to a set time allocation weighted by likely priority. This will result in some reliefs receiving less attention but provided any limitations are documented this could be factored into the initial review and if time permits further work could be undertaken in the future.

### **Detailed comments**

9. We have set out our detailed comments in relation to particular reliefs in Appendix 2.
10. We have also listed in that Appendix those reliefs from Annex A on which we have made no comment in the current response.
11. We have not at this stage been able to look in detail at any of the reliefs set out in Annex B to the Interim Report. We will liaise with the OTS to ensure they receive our comments in advance of publishing any 'final' report in respect of those, Annex B, reliefs.

### **The need for wider ranging reviews**

12. One conclusion from this initial review is that reviewing a lengthy list of tax reliefs in isolation is not likely to result in major simplification. This is because many of the important tax reliefs identified are a structural part of the existing tax system, for example principal private residence in CGT and potentially exempt transfers in IHT. These play essential parts in the operation of the existing tax systems and to remove them would distort the operation of the UK tax system.
13. We believe that if these structural reliefs are to be reviewed, it should be as part of a wider ranging review of the underlying tax policy and regime. In short, these reliefs should only be removed as part of a more fundamental review(s) of all or parts of the UK tax system with simplicity as the key objective and where any removal of reliefs was counterbalanced by lower rates.

E [ian.young@icaew.com](mailto:ian.young@icaew.com)

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## APPENDIX 1

### THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

Any 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>).

## **APPENDIX 2**

### **DETAILED COMMENTS**

#### **REFERENCE NUMBERS ARE AS USED IN THE INTERIM REPORT**

We comment below on the reliefs set out in Annex A of the interim report.

Those reliefs on which we are not commenting are listed at the end for completeness.

The absence of comment on a particular relief does not imply support for its retention or deletion but in the short time given to provide our initial comments we have not received feedback from our members on all reliefs.

#### *Ref 50/53 – Enterprise Investment Relief*

A capital gain that would otherwise be chargeable is deferred if equivalent proceeds are invested in qualifying EIS shares and there is then no CGT on the subsequent disposal of those shares after a qualifying period.

These are the latest statutory provisions to encourage investment in entrepreneurial businesses which first began in the 1980s with the Business Start-Up and Business Expansion Scheme provisions.

Any change to the current provisions ought to be undertaken in the context of overall efforts to encourage entrepreneurial activity in the UK economy and the overall costs and benefits of the various incentive schemes. In relation to EIS, the most recent statistics published on HMRC's website in late December 2010 indicated that in 2008/09 there were 23,000 separate subscriptions amounting to £500m and that 891 companies raised money through the EIS scheme for the first time.

#### *Ref 54 – Entrepreneurs' Relief*

When the general rate of CGT was increased from 10% to 18% in 2008, the then Government introduced a relief based on the old retirement relief rules that enabled taxpayers disposing of businesses to keep a 10% rate for gains up to £1m.

Headline rates of tax play a very important role in establishing perceptions about the tax regime. The UK government is pursuing a growth agenda and the tax environment should be seen as supportive of innovation and entrepreneurs in fostering growth. A more favourable rate of CGT for gains from disposals of business sends a powerful and positive message to actual and potential entrepreneurs.

For that reason we suggest the relief should be retained.

#### *Ref 69 – CGT Principal Private Residence Exemption*

This is the fundamental relief from any CGT charge on the disposal of one's main residence so that the full proceeds are available to invest in a replacement property. The relief has been in place since CGT was introduced in 1965.

Arguably some of the elements of the relief, and the conditions that have to be satisfied, could be subject to review so that the relief fully reflects today's property market.

The OTS interim report suggests that the conditions for the relief to apply should be:

- Rewritten in a simpler format;
- Reviewed to test which are still appropriate; and
- Researched to see whether any can be streamlined.

We support this recommendation.

#### *Ref 81 – CGT Venture Capital Trusts*

This is the relief from CGT on disposal of VCT shares and any change would be a policy decision for Government and should only be carried out following a review of current measures to encourage entrepreneurial activity in the UK economy.

The most recent statistics published on the HMRC website in late December 2010 indicated that £340m was raised in 2009/10 via the VCT scheme.

Our own view is that this is an important relief and should be retained.

#### *Ref 89 – CGT chattels exemption*

We think it is reasonable to exclude from CGT the proceeds from sales of chattels of up to £6,000 and there then need to be provisions to ensure that when proceeds are just over £6,000 there is an appropriate amount of tax chargeable.

#### *Ref 157 – Film Tax Relief*

These are the most recent provisions designed to encourage investment in the UK film industry.

There is always a balance to be struck between encouraging the UK film industry and creating a tax relief which is 'exploited' as a tax relief rather than as an aid to economic/cultural activity which is deemed worthy of encouragement.

#### *220 Real estate investment trusts*

REITs were introduced in FA 2006 and came into effect from 1 January 2007 after a lengthy period of consultation. It has generally been recognised as having been very successful. REITs have been adopted in a number of countries throughout the world following the lead of the United States. The success of the REITs regime may be difficult to gauge in the light of the financial crisis which began in 2007/2008 and which has had a particularly disadvantageous effect on the property sector.

We believe the relief should be retained and at some stage a review should be undertaken of its efficacy.

#### *228 Surplus ACT*

There are few companies who are still likely to be able to benefit from this relief which was carried over when ACT was abolished in 1998/99 to give potential relief to those businesses who had not used up all their ACT at the time ACT payments were abolished.

To the extent that such businesses still have an expectation that relief will be available to them then it would be unreasonable to disbar them from potential relief.

### *230 Tonnage tax*

In order to benefit from the tonnage tax regime companies must maintain a significant workforce in the UK in order to demonstrate that the business is managed from the UK. Our understanding is that a number of these companies would abandon their UK bases if the tonnage tax regime was abolished which would have a detrimental impact on the UK public finances.

### *300 Blind person's allowance*

There is an argument that the allowance should be extended to other persons who suffer disabilities that are equally debilitating.

### *310 Charities – transitional relief on distributions*

Claims for relief have to be made within two years of the end of a chargeable period ending before 6 April 2004 so no further claims can be made (s 35, F(No 2)A 1997) .

It would appear that these provisions are now spent and can be deleted.

### *326 Deeply discounted securities – incidental expenses*

The particular provisions in s 439(4), ITTOIA 2005 apply to incidental expenses incurred before 27 March 2003.

If it is clear that all valid claims will have been made then this particular provision can be deleted.

### *335 Enterprise Investment Scheme*

If any changes are to be made then these ought to be considered in the overall context of UK tax incentives for innovation and enterprise. See our comments under item 50/53 above.

### *341 Farmers' averaging of profits*

The averaging provisions (s 221, ITTOIA 2005) also apply to profits from literary, dramatic, musical or design i.e. creative works which is covered under 388 below.

We believe this relief should be retained in respect of both farmers and creative works.

### *372 Inter-American Development Bank securities*

The relief exempts from UK income tax liability non-UK resident who might otherwise be potentially liable because the security and the issuing authority has links with the UK.

The relief extends to other issuing authorities including the European Economic Community and the European Investment Bank.

We believe the original purpose behind the relief is still relevant.

### *380 Life assurance premium relief*

While the relief no longer applies to insurance policies taken out after 13 March 1984 there are still circumstances where relief continues to be available and for income tax purposes these are now contained in ss 457-459, ITA 2007. See item 458 below re s 458 and payments to police organisations.

### *381 – Life assurance premiums paid by employers under E-FRBS*

As far as we are aware this provision extends the relief available under the previous item to payments made by the employer on behalf of the employee.

### *385 Life insurance policies – 5% rule*

The 5% is treated as a return on capital and is not taxable. It is an important element of the long-standing tax regime for insurance company products and should not be abolished.

### *387 Life insurance policies – top slicing relief*

This relief does not ‘marry’ well with other parts of the tax system and we believe a review could help create better formulated tax policy in this area.

### *388 Literary and creative artists’ profits*

This is covered under item 341 above.

We believe this relief should be retained in respect of both farmers and creative works.

### *444 Payroll giving 10% supplement*

Claims to the supplement were required by 5 April 2004 so we believe this relief could now be abolished.

### *457 Police organisations*

This is covered under item 380 above and relates to the superannuation, life insurance and funeral benefits element of payments to police organisations.

### *466 Repair and maintenance of work equipment*

This relief is analysed in the OTS Interim Report.

The conclusion is that the relief should be retained and we endorse that conclusion.

There is also a suggestion that a single flat rate could be introduced rather than the current 34 different rates and that the relief might be extended to other industries. We think these are worthwhile suggestions as to how to improve and simplify this part of the tax system.

#### *472 Seafarers' earnings deduction*

When the general 100% foreign earnings deduction was abolished in 1998 it was retained for seafarers and presumably the policy reasons for the retention remain valid today.

#### *490 Trade union subscriptions*

This is covered under item 380 above and relates to the superannuation, life insurance and funeral benefits element of payments to trade unions.

#### *497 UEFA Champions League Final in 2011*

This relief is evaluated in the Interim Report and is deemed to satisfy the OTS criteria as an appropriate relief which should be abolished once the event has taken place in 2011.

#### *507 Venture Capital Trusts*

These are the provisions which set out the way in which the tax system provides relief for Venture Capital Trusts. See our comments earlier in respect of this and EIS reliefs.

#### *524 Capital allowances – flat conversion allowances*

We have no information on the take up of this relief but we wonder whether it has made much of a commercial impact.

#### *530 Capital allowances – safety at sports grounds*

This is a major issue for businesses with sports grounds where health and safety requirements are rightly of particular importance and must not be compromised. We would note that the fortieth anniversary of the Ibrox Park deaths was headline national news recently.

#### *545 Demergers*

This is a fundamental part of the existing UK tax system and facilitates business restructuring by removing unexpected tax charges in certain defined circumstances.

We believe the relief should be retained.

#### *597 Woodlands*

The tax regime for woodlands was recast in 1988. Under the current regime the costs of planting and managing woodlands is covered by grants while the income from woodlands is generally tax free and there are also reliefs from Inheritance Tax. Before any major changes are made to this regime it would be sensible to consult with representatives from the farming and forestry industries. The perceived role of woodlands, particularly their potential environmental impact, has changed considerably since 1988.

#### *618 Cycles and cyclists' safety equipment*

We believe this relief should be retained.

### *638 Late night taxis*

We think that in principle this relief should be retained, because the measure supports growth in that it allows employees to stay at work to complete the job in the knowledge that they will be able to get home safely and in comfort.

We are aware that a number of firms, and their staff, in the City of London benefit from this relief. Paragraph 4.111 of the Interim Report states that the amount of the relief is 'very small' but it is very significant in the context of individual firms and can run into £ millions of relief.

### *739 IHT- Potentially exempt transfers*

This relief has been a fundamental part of the IHT regime since 1986. As such we believe it should be retained until such time as there is a wider review of inheritance tax policy.

### *819 Class 4 – Exception for divers and diving supervisors*

For income tax purposes the earnings of divers and diving supervisors are treated as derived from a trade but for NIC contribution purposes they are treated as employed earners and so are liable to Class 1 NIC contributions. The exemption from the Class 4 contribution liability is to prevent double imposition of NIC liabilities and should be retained.

### *833 Disregard for employers contributions to which Article 15(2) of the Taxational Pension Schemes (Transitional Provisions) Order 2006 applies – and benefits referable to those contributions*

These are important grandfathering provisions in relation to benefits from pre 2006 schemes and this relief needs to be retained.

## **Reliefs in Annex A on which we have not commented**

We do not have personal experience of the following reliefs nor have we received representations from our volunteers and members of our technical Committees in respect of the reliefs.

- 170 Harbour authorities
- 171 Harbour reorganisation schemes
- 182 Land remediation relief
- 219 Pool betting duty payment
- 242 Shipbuilders' relief
- 246 Angostura bitters
- 247 Black beer
- 468 Reserve Bank of India and the State Bank of Pakistan
- 511 Approved profit sharing schemes
- 518 Capital allowances – business premises renovation allowance
- 521 Capital allowances – dredging
- 533 Capital allowances – short-life assets
- 540 Community Investment Tax Relief
- 595 Trustee Savings Banks income from investments with the National Debt Commissioners
- 617 Cycle to work days – provision of meals

651 Miners' coal and allowances in lieu of coal  
774 IPT – Long term business

We have only commented on a couple of the IHT and NIC reliefs and have made no comments on the Stamp Duty reliefs.

**Reliefs listed in Annex B**

We have not had an opportunity to look at these reliefs in any detail.

However we note that some of the reliefs listed form a fundamental part of elements of the UK tax system, for instance the taxation of small business, refs 210, 211 and 226, and need to be looked at as part of the OTS review of small business taxation. Other reliefs listed include for example the reliefs which make up the main building blocks of the Inheritance tax regime and if these are to be examined it ought to be in the context of an overall review of the current IHT regime.

We propose to liaise with the OTS to ensure that they have the benefit of our views on the Annex B reliefs before publishing any final report in relation to those reliefs.