

TAXREP 52/09

EXTRA-STATUTORY CONCESSIONS - SECOND TECHNICAL CONSULTATION ON DRAFT LEGISLATION

Comments submitted on 7 October 2009 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales to HM Revenue & Customs in response to the consultation document 'Extra-statutory Concessions – Second Technical Consultation on Draft Legislation' issued on 15 July 2009.

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INTRODUCTION

1. HM Revenue & Customs (HMRC) has identified the need to legislate some extra statutory concessions (ESCs) which appear to exceed the scope of its discretion. It is consulting on the draft legislation to ensure it gives effect to the existing concessionary tax treatment.
2. On 15 July 2009 HMRC issued its second technical consultation document on draft legislation to implement ten further concessions. The ten concessions for which draft legislation has been published in this second technical consultation document are:
 - ESC A61: Clergymen's heating and lighting etc expenses
 - ESC A68: Payments out of a discretionary trust which are taxable as employment income
 - ESC B10: Income of contemplative communities or of their members
 - ESC B47: Furnished lettings of dwelling houses - wear and tear of furniture
 - ESC D26: Relief for exchanges of joint interests
 - ESC D44: Rebasing and indexation: shares derived from larger holdings held at 31 March 1982
 - ESC D50: Treatment of compensation
 - Estimated Gift Aid donations by companies
 - Zero rating of nurses' prescriptions by pharmacists and GP dispensing (two concessions)
3. We are pleased to provide in this document the comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) on this technical consultation.
4. Information about the Tax Faculty and the ICAEW is given in Annex A. We have also set out, in Annex B, the Tax Faculty's ten tenets for a better tax system, by which we benchmark proposals to change the tax system.

KEY POINTS SUMMARY

5. We welcome the proposal to enshrine in legislation the concessions listed in this technical consultation. This will give taxpayers the added security that the treatment is now certain and they no longer need to rely on HMRC allowing a concession to be applied.
6. We have the following specific points about the proposed legislation:
 - The definition of discretionary employment income payments (DEIP) in the proposed s 496B(2) of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) should make it clear that the DEIP is the grossed up amount of the trust payment.
 - The new provisions relating to wear and tear allowance should include a commencement date.

- There should be box on the self-assessment return to enable the wear and tear election to be made and also a provision for the election to be made outside a return in certain circumstances.
 - For clarity and certainty, it is important that the drafting of the legislation is improved in several places, in particular the sections relating to the wear and tear allowance and also contemplative communities.
7. We should like to see the proposed legislation amended:
- in the proposed s 496B(4) ITEPA 2003 to allow for early repayment of tax in the year in which the employee benefit trust is wound up;
 - to remove the complex provisions relating to time apportionment of allowances for contemplative communities;
 - to include the renewals basis for furnished lettings as well as the wear and tear allowance;
 - in the proposed s 308B (3) ITTOIA 2005 to allow partial relief where the property has been let furnished for only part of the tax year.
 - to reduce the time limit for adjustments and taxation of the chargeable gain where relief is claimed for exchange of joint interests.

SPECIFIC COMMENTS ON DRAFT LEGISLATION

ESC A61: Clergymen's heating and lighting etc expenses (IT and NIC)

8. The proposed legislation would appear to give statutory effect to ESC A61 and we have no comments to make.

ESC A68: Payments out of a discretionary trust which are taxable as employment income

9. We are concerned that in the proposed s 496B(2) of the Income Tax (Earnings and Pensions) Act 2003 there is scope for misinterpretation of the amount which should be treated as the discretionary employment income payments (DEIP).
10. In the context of discretionary trusts, the term 'payment' usually refers to the net payment which then has to be grossed up at the trust rate to ascertain the taxable amount. When dealing with employment income the 'payment' is generally taken to be the gross amount before any deduction has been made for PAYE etc..
11. We consider that it is important that the definition of a DEIP should make it clear that the payment concerned is the grossed up amount of the trust payment.
12. We are disappointed to note that in the proposed s.496B ITEPA 2003, sub-s 4 allows a claim to be made only after the end of the tax year. The Inland Revenue

(as it then was) published a Press Release on 4 April 1996 (PR66/96) indicating its willingness, on request, where a trust has been wound up to accept an early tax return and to give early written confirmation that it does not intend to enquire into the final return.

13. The wording of this sub-section seems to preclude this approach and we should therefore like to see it removed or amended so that in the tax year in which the trust is wound up, the trustees may make the claim earlier.
14. The addition of supplement to repayments when the concession is put on a statutory basis is welcomed.

ESC B10: Income of contemplative communities or of their members

15. In order to improve certainty, provide clarity and to prevent possible abuse, the proposed legislation needs to define more fully some of the terms used. In particular, the phrase 'contemplative religious community' is used widely in the proposed new sections of the legislation but is not defined.
16. Similarly we note that although there is a requirement for a member in the proposed sub-s 507A (11), Income and Corporation Taxes Act 1988 (ICTA 1988) to have taken vows (or made equivalent commitments), there is no requirement for these vows to be in connection with the contemplative religious community. We do not believe that this is intended to be the case.
17. Further, although certain terms are defined in sub-ss 1, 10 and 11 for the purposes of the proposed s 507A, ICTA 1988, the same terms are not similarly defined for the purposes of s 507B, ICTA 1988 although it would appear that the same definitions should apply. This shortcoming needs addressing.
18. The proposed legislation seems quite complicated as compared with the ESC it will replace. The complexity arises because the new legislation requires time-apportionment of the personal allowance for the purposes of exemption from corporation tax and also introduces a requirement for the individual to have been a member of the community for at least six months before being treated as a qualifying member.
19. Although s 160(5), Finance Act 2008 allows an order to modify an existing concession, we question the need for such complexity. The loss of tax to the Treasury as a result of not time-apportioning the relief and giving the full allowance without requiring a member to have belonged to the community for six months would appear to be negligible.

ESC B47: Furnished lettings of dwelling houses - wear and tear of furniture

20. We have a number of issues about this piece of proposed legislation.
21. We note that the legislation does not indicate a commencement date and consider that it is imperative that the new legislation is stated to start with a particular tax year (personal, partnership and trust tax) or accounting period (corporate tax). This is particularly because the proposed legislation requires an election which

has not in the past been required (see para 23) and also because the proposed basis of calculation differs from the concession in some respects.

22. We are particularly concerned that this proposed legislation is dealing only with the wear and tear allowance mentioned in the concession but that the 'renewals' basis which appears in the concession is not being addressed at this same time. This is unsatisfactory and we believe that the renewals basis should be enacted at the same time. In the meantime, is it intended that paragraph 5 of ESC B47 will continue to apply?
23. In the proposed s 308A, Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005) there is a requirement for the election for wear and tear allowance to be made on a person's return with a corresponding requirement to be introduced by the proposed s 248A, Corporation Tax Act 2009 (CTA 2009) for those required to file corporate returns. Two issues arise.
24. First, we are concerned that the legislation does not seem to cover the case of those who are currently not within self assessment and are not required to submit self assessment returns based on current HMRC criteria. This includes those who are able to have small amounts of property income taxed through their PAYE code and those currently residing abroad whose rental business results in a loss or is less than the personal allowances due, so HMRC no longer ask for tax returns to be submitted.
25. As the proposed legislation is currently drafted, such individuals would appear not to be able to make the relevant election unless they submit tax returns. Was this the intention? If this was not the intention, then how does HMRC intend in future to deal with taxpayers who would not currently be in a position to make the election on a return?
26. Second, we should like to be reassured that the mechanism (we assume a box to tick) by which taxpayers must make the election on their return is in place on the return for the tax year in which the election must first be made, or that appropriate guidance highlights to taxpayers the need to make a narrative election on a return. We raise this because we are aware that the lead-in time for changes to tax returns is in the order of twelve months and we are concerned that taxpayers made be penalised when they were not aware of the requirement for the election to be made.
27. The proposed sub-s 308B (3), ITTOIA 2005 appears unduly restrictive as compared with the concession. We consider that would be more equitable to those with property rental businesses who move from providing furnished to unfurnished accommodation or vice versa to be allowed to apportion the allowance according to the time the property was let furnished and unfurnished, perhaps on a just and reasonable basis or alternatively by strict time apportionment of the rents received. Without such a provision, a very short period of unfurnished letting would result in the wear and tear allowance being lost for the whole tax year for that property.
28. Turning now to the mechanics of the calculation, members have advised us that the phrase 'which would normally be borne by a tenant' which appears in the concession gives difficulty in practice because, for example, some service

charges include items which might, but are not always, usually borne by a tenant. We consider it would therefore be helpful if the phrase 'or anything else' which appears in the proposed sub-s 308A(6), ITTOIA 2005 and 248A(6), CTA 2009 was expanded to provide examples of other items which are considered to be covered by this phrase.

29. It is also our view that the drafting of the proposed sub-ss 308B(6), ITTOIA and of 248A(6), CTA 2009 do not accurately reflect the concession. In the concession, the wear and tear allowance is based on rents received less the tenant's council tax and water rates where this is paid by the landlord and less other material amounts included in rent which are usually borne by the tenant.
30. The draft legislation requires rents received to be reduced only by amounts 'receivable' by the landlord which are 'attributable to' costs borne by the landlord 'in respect of council tax, utilities or anything else the costs of which are.....normally borne by the lessee'. This would mean that only in circumstances where the rent charged to the tenant is specifically stated to include specified amounts for items such as council tax would the wear and tear allowance be based on a reduced rent amount.
31. In contrast, the concession required the deduction of such items from rents before calculating the wear and tear allowance, where they were paid by the landlord, whether or not they were recharged to the tenant. While we do not have an issue with this change, we wonder whether it was intentional.
32. We believe the aim of the proposed sub-s 308B(7), ITTOIA 2005 is to prevent the claiming of the wear and tear allowance by two persons for the same furniture and equipment. This could apply, for example, to either the same flat being sub-let in its entirety to another tenant or to a room in a rented flat being sub-let. This would seem an appropriate approach although in the former case we might question why the person sub-letting the flat should be entitled to any wear and tear allowance as they may not have provided any furniture or equipment.
33. However, we consider that the drafting should be made clearer so that it covers both the situations mentioned in the previous paragraph and gives adequate clarity. In the proposed sub-s 308B(7), ITTOIA 2005 the words 'equivalent' and 'premises' are not defined and in our view could be misinterpreted.
34. For example, what precisely is meant by 'an equivalent amount'? Does this mean that condition B is met only when the amount paid by the sub-tenant is exactly the same as the amount paid to the landlord? And what does the term 'premises' mean in this context? A rental business could comprise a block of four flats rented from a landlord with two of these flats being sub-let. Is the second sub-let flat 'another relevant furnished letting of the same premises' in the context of the first sub-let flat? In our view it could be.
35. The phrase 'dwelling house' can be found in the proposed sections 308B (3) (a) and (b), ITTOIA 2005 and 248B (3) (a) and (b), CTA 2009. We consider that, given the standard dictionary definition of a dwelling-house as being a 'house', using the words 'a dwelling house' may be construed to exclude flats, maisonettes, studios and similar properties which are also used as living accommodation. In our view the definition (and not simply any associated

guidance) should be expanded so that it is clear that properties of the type we mention are also included. We accept that the term was used in the original ESC but consider this change is needed for clarity and certainty when the provision is enacted.

36. Finally, ESC B47 requires that if the wear and tear allowance basis is used, it should be used consistently on all furnished properties. The proposed legislation appears to widen the scope of the concession by allowing the election to be made on a tax year by tax year basis for a property income business. We welcome the flexibility this will bring to taxpayers.

ESC D26: Relief for exchanges of joint interests

37. Members are pleased that this concession is being added to the statute book to assist taxpayers who wish to rationalise holdings in jointly owned properties. The legislation appears to follow the original ESC closely.
38. We do however note that the proposed legislation at sub-ss 248C(2) and (3), Taxation of Chargeable Gains Act 1992 (TCGA 1992) contains provisions for the deferred gain to be chargeable if the land becomes 'excluded land' within six years of the acquisition. In view of the move towards reducing time limits generally, often to three or to four years, we consider that the six year time limit is unduly long in the circumstances.
39. Furthermore, the proposed s 248C(4), TCGA 1992 would permit adjustments of capital gains under s 248C(3), TCGA 1992 at any time notwithstanding the provisions of s34, Taxes Management Act 1970 (time limit for assessments). We do not consider that it is appropriate for the adjustment to be permitted for an indefinite period.
40. We are aware that there have been issues in the past relating to the terminology used for property transactions where the legal systems vary in different parts of the UK. We should therefore appreciate confirmation that the terms being used are appropriate for all jurisdictions to which they need to relate.

ESC D44: Rebasing and indexation: shares derived from larger holdings held at 31 March 1982

41. We have no comments to make on this proposed legislation.

ESC D50: Treatment of compensation

42. We have no comments to make on this proposed legislation.

Estimated Gift Aid donations by companies

43. We have no comments to make on this proposed legislation which we believe achieves the objectives stated although we do note that a time limit of twelve months is being introduced which is not in the concession.

Zero rating of nurses' prescriptions by pharmacists and GP dispensing

44. We have no comments to make on this proposed legislation.

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ANNEX A

THE 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 128,000 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 11,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on +44 (0)20 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.

ANNEX B

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>).