TAXREP 21/13

(ICAEW REP 25/13)

FINANCE BILL 2013
Comments on the draft clauses published on 11 December 2012

Comments submitted by ICAEW Tax Faculty in relation to the draft clauses for inclusion in Finance Bill 2013 published on 11 December 2012.

The detailed comments were submitted prior to the deadline of 6 February 2013 and published as TAXREPs 4 – 20/13.

The current document contains the comments in all those submissions and was submitted on 15 February 2013 to the Exchequer Secretary at HM Treasury and the Tax Assurance Commissioner and the Director General Business Tax at HM Revenue & Customs (HMRC)

Contents

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FINANCE BILL 2013 DRAFT CLAUSES

INTRODUCTION

1. The present document reproduces all the Tax Faculty comments on the draft Finance Bill 2013 clauses published for comment on 11 December 2012. Our comments were contained in TAXREPs 3 – 20/12 submitted to the relevant government policy officials before the deadline of 6 February 2013.

2. We welcome the Government's commitment to provide greater time for scrutiny of draft tax legislation following a period of prior consultation.

3. The provisions considered below will be published by the Government on 28 March 2012, after appropriate amendment, as part of the Finance Bill 2013.

4. Our Ten Tenets for a Better Tax System which we use as a benchmark to evaluate tax legislation and the tax system are summarised in Appendix 1.

WHO WE ARE

5. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

6. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

7. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

GENERAL COMMENTS ON THE DRAFT CLAUSES

Tax policymaking needs to be improved

8. While we welcome the early publication of the draft legislation and accompanying explanatory notes, the document runs to 1,073 pages and the accompanying overview document runs to 296 pages. The document needs an index – it is not grouped around any clear themes and it is difficult to find the material without being forced to go through the whole of the document.

9. In June 2010, the Government in its discussion document Tax Policy making: a new approach identified five problems with the UK tax system, namely:

- a lack of clear strategy for the tax system;
- consulting too late in the policy development cycle;
- length and complexity of the tax code;
- uncertainty due to the volume and timing of tax changes; and
- inadequate Parliamentary scrutiny of tax legislation.

10. We agree with the Government on these problems. However, now we are over half way into this Parliament, we are not sure that much progress has been made in tackling them. For example, starting with the volume of policy changes and the need for proper consultation, in paragraph 1.5 of that same document the Government stated that:

> *to increase stability, the Government will slow down the rate of change to the tax code, focusing on fewer and better developed proposals supported by improved processes for changing tax law.*

11. The Finance Act 2012 was the longest on record and on the evidence of the draft clauses so far the Finance Act 2013 will not be far behind. It is becoming clear that the pace of change has not slowed down. The worthy goal of slowing the rate of change becomes lost by an insatiable need to develop new initiatives that all need to be implemented within a short timetable. While we support the Government's growth agenda, many of the growth measures are being hampered by a tax system that is far too complicated and becoming more so and still lacks the stability needed to enable businesses to plan with certainty. As for tax simplification, the tide is running in the opposite direction. The UK has acquired an unenviable reputation as the country with the longest tax code in the world - and it looks set to maintain that reputation with the 2013 Finance Bill.

Tax simplification remains as elusive as ever

12. This Government established the Office for Tax Simplification (OTS) in June 2010. The high hopes that accompanied its formation are not being realised. The fact is that the establishment of the OTS has not so far succeeded in reducing to any reasonable extent the complexity of the tax system – indeed the UK tax system is now more complicated than ever. While the OTS has done excellent work, it is under resourced for the task and its work is being undermined by a constant plethora of new policy initiatives.

13. The Government needs to make some radical decisions if it really wants to simplify the tax system. Lord Howe once famously remarked that tax simplification is like:

> *'trying to repaint Brighton pier at a time when its owners are trying to extend it to the French coast'*.

14. The tax system should be treated in exactly the same way as legislative targets set in other Government departments. We think the time has come for the Government to adopt the one in one out (or better still one in two out) policy to tax legislation that it has adopted elsewhere across Whitehall.

Consultation needs to be improved

15. The UK tax system is caught in a culture of never ending change and an inevitable casualty of this is proper and effective consultation. While there have been some good consultation exercises (for example the GAAR), too often the impression is that consultation is merely a box that has to be ticked on the policy formulation schedule rather than an active and sincere process of engagement with those who can help to improve the policy and make it work.

16. For example, take the proposals to limit income tax reliefs. While we support the Government's aim to curb the use of artificial losses to save income tax, the proposals will damage legitimate businesses that have suffered commercial losses. Such businesses need unrestricted tax relief to help them through difficult times. We do not think that Treasury officials have a proper understanding of what businesses, and particularly those in the SME sector, actually need.

Tackling avoidance

17. The Government is rightly concerned with tackling tax avoidance. It is important that tax measures, particularly anti avoidance measures, are properly targeted. We have concerns that the anti-avoidance measures highlighted below are, to varying degrees, not as properly targeted as they should be. In relation to the GAAR, this will be addressed through the use of Guidance. We understand the rationale for this but it remains to be seen if it will result in greater clarity being obtained more quickly.

18. A long and complicated tax system inevitably introduces additional complications and anomalies. This is exacerbated by higher actual and effective tax rates that are often accompanied by new reliefs, thus encouraging exploitation. The current measures to curb the avoidance of SDLT demonstrate just how complicated the tax rules on sales of property have become as the rates of SDLT have increased.

Give HMRC time to recover

19. The endless cycle of policy changes also has an impact upon tax administration and costs, both for HMRC and taxpayers. Since the merger of Inland Revenue and HM Customs & Excise in 2005, the amalgamated department has had to contend with steep budget and staff cuts. The number of staff has fallen from nearly 100,000 in 2005 to about 70,000 today with a target of about 60,000 by 2015. Service standards have suffered a major decline ever since and taxpayers' patience with poor service levels has been stretched to breaking point.

20. While there are some welcome signs of improvements, we remain very concerned that they will not be sustainable because of the number of other challenges that HMRC faces in managing and implementing more changes to the tax system. These include not only the implementation of real time information (RTI) for employers and the high income child benefit charge but also the new annual residential property charge. HMRC needs time to recover and rebuild its reputation through a series of solid and sustained service improvements, but whether it will be allowed such a breathing space given the scale of the tasks it has been set remains a concern.

Estimated compliance costs for changes (particularly for RTI) are far too low

21. As for taxpayers, all of the measures below have the potential to increase tax compliance costs, in some cases considerably. We are not convinced that HMRC's methodology and approach to estimating the compliance costs of new measures are sufficiently robust and produces costs that truly reflect the actual costs incurred by businesses. Too often, we believe that cost estimates are understated and any benefits overstated.

22. The forthcoming roll-out of RTI will impose significant extra costs on employers. We do not see how the implementation of RTI, and in particular the need for employers to submit online returns on or before payment date, can result in a net saving annual saving for businesses of £300m a year as set out in HMRC's impact assessment dated 15 March 2012 and reaffirmed in the technical note published on 16 November 2012. Our view, which we believe is widely supported outside of Government, is that RTI will result in an increase in admin burdens on businesses generally and that this will fall disproportionately on smaller employers.

DETAILED COMMENTS ON THE DRAFT CLAUSES

Tax residence and ordinary residence

Key point summary

23. We are pleased to note that some of the points raised by ICAEW have been taken into account in producing this revised draft legislation but disappointed that other points have been passed over.

24. We are still very concerned about the length and complexity of the legislation (54 pages of draft legislation and 38 pages of explanatory notes for the statutory residence test alone). It is doubtful that an unrepresented individual will be able to navigate the legislation correctly particularly if they are not definitely resident and not definitely non-resident but in the middle ground.

25. The stated aim of the legislation is to provide certainty but because of the complexity and the provision that the rules can be changed by statutory instrument, possibly without consultation, it does not achieve that aim.

26. We welcome the changes to the overseas workday relief.

Other major points

27. We are still concerned that the full time working abroad test does not cater satisfactorily for self-employed individuals. The draft legislation is framed by reference to the working patterns of employees which can be very different to those of a self-employed person.

28. Whilst we welcome the increase in the number of work days in the UK from 20 to 30, the definition of a working day being any day where three or more hours are worked is unnecessarily restrictive, particularly as the definition of work is unclear. It will be very difficult for individuals to correctly record and monitor their work time.

29. Automatically including travel time as UK working where it is funded by the employer or could be claimed as a business expense is inappropriate; it should only be included to the extent that the individual is working whilst travelling.

30. The definition of a home still lacks precision and certainty. Given that 'home' is used in the automatic residence test, the accommodation tie and the split year provisions it is our view that the definition should be clear, unambiguous and without any subjectivity.

31. The second automatic residence test (see para 8 of the draft Schedule) of an only home in the UK can result in some anomalies. As currently drafted it appears to apply if there is a 91 day period wholly or partly in the tax year where there is no overseas home. For example: Jane has a house in the UK where she spends the month of August and two weeks in March each year, a total of 46 days but otherwise lives in Brazil (with which the UK does not have a double tax convention). She decides to sell her home in Brazil and the sale is completed on 1 April (year 1) but her replacement home she wants to buy, still in Brazil, is under construction and will not be completed until mid-July in that same calendar year (year 2). She goes on a cruise for the period April to June. However.it would seem that under the second automatic residence test she will be treated as automatically resident for both years 1 and 2.

32. We welcome the modification that half terms holidays will be treated as term time but our view is that the restriction to 21 days for other holidays is too short.

Temporary increase in annual investment allowance

Support for the initiative

33. We support the increase in the Annual Investment Allowance for qualifying capital expenditure on plant and machinery and integral features.

Problems with the initiative

34. We are less enthusiastic about the frequency of change to this amount and consider the different calendar dates now being used are an unnecessary complication. When the rate was decreased to £25,000, the change was from 1 or 6 April. Now it is increased to £250,000, but from 1 January for both taxes. In overview:

Annual investment allowance	Rate
1 or 6 April 2008 to April 2010	£50,000 per annum
1 or 6 April 2010 to April 2012	£100,000 per annum
1 or 6 April 2012 to 31 December 2012	£25,000 per annum
1 January 2013 to 31 December 2014	£250,000 per annum

35. This makes the supporting calculations complex and totally non-intuitive for business. It is likely that many will think their expenditure qualifies in full because it is below the headline rate, but they will be caught by the limits imposed by the actual legislation.

36. We note too that the temporary increase takes effect from 1 January 2013 for businesses subject to income tax as well as for those chargeable to corporation tax. This is a small point, but most changes to income tax are from 6^{th} of a month.

37. Very many businesses will have a basis period spanning either the decrease in rate or the increase in rate. Some will span both. It will be very important to have clear guidance from HMRC on how to handle this and we suggest a calculator tool will be needed on the HMRC website.

General points

38. We continue to advocate tax simplification and to support the work of the Office of Tax Simplification and the Administrative Burdens Advisory Board (ABAB). The transitional provisions necessary whenever the AIA rate changes add complexity to the tax system. In this case we have seen a series of rapid changes which are complex and destabilising.

39. Whenever the rate changes, there is a delay while HMRC updates its system to incorporate the rate change. The delay is inevitable, but is regrettable. This prevents companies which wish to file their returns shortly after their year end from being able to do so.

40. The cost estimates set out in the Tax Information and Impact Note (TIIN) are virtually impossible for us to verify. When the AIA rate was reduced by the Finance Bill 2011, the TIIN estimated that for a full year the tax savings would be £1,900m. Now that it is being increased again, the cost for the only full year affected will be just £670m, even though the amount of the new AIA is much larger. There are variations in the years either side, but the tax savings and tax costs still do not appear to correlate.

41. We note that HMRC has said that it will be possible to subsume the additional IT and compliance costs of the increase and subsequent decrease into its business as usual budget. This statement makes a nonsense of the TIIN. The purpose of a TIIN is to assess the likely cost of a particular measure in its own right. To ignore the cost because it can be recouped elsewhere is incorrect.

42. There is no separate mention of the additional IT costs this will impose on IT suppliers in the commercial sector. We presume these will also be significant.

Specific points on draft legislation

43. We have no points on the detail of the legislation although as noted above, find it complex.

44. We believe that detailed HMRC guidance will be necessary to make the legislation usable by businesses.

Employee owner shares CGT exemption

Key point summary

45. The policy that ‘This measure is intended to relieve those individuals taking up the “employee shareholder” status from any CGT charge that might arise on the disposal of shares acquired through the adoption of the new status.’ is negated by new subsection 236B(3).

46. We recommend that new section 236B is rewritten to make it consistent with the policy by making it clear to whom the exemption applies, as well as the assets to which it applies.

General comments

47. We attach in Appendix 2 some comments on various aspects of employee ownership shares which may be of interest. Some of these were incorporated in the consultation response that we submitted on 8 November 2012 to BIS. We have not checked with legislation already enacted whether the points have been addressed.

Detailed comments on the draft legislation

New section 236B

48. The note attached to the consultation draft says under ‘Policy Objective’ (second sentence) that ‘This measure is intended to relieve those individuals taking up the “employee shareholder” status from any CGT charge that might arise on the disposal of shares acquired through the adoption of the new status.’. However, new subsection 236B(3) says ‘But an employee shareholder share ceases to be exempt when the employee disposes of it.’. This appears to remove employee ownership shares from the scope of the exemption when the employee disposes of them, which contradicts both new subsection 236B(1) and the policy behind these amendments.

49. We suggest that new subsection 236B(3) be deleted and the rest of new section 236B be reworded to make it clear to whom the exemption applies, ie the individual to whom they were issued or allotted under an employee shareholder agreement, as well as the asset to which the exemption applies, on the lines of the following:

> Possible rewrite of new section 236B:
>
> ‘(1) A gain which accrues on the disposal of exempt employee shareholder shares by an employee to whom they were issued or allotted under an employee shareholder agreement is not a chargeable gain.
>
> (2) Shares are exempt employee shareholder shares if.
> (a) they are employee shareholder shares, and
> (b) the requirements of sections 236C and 236D are met in relation to them.
>
> (3) In this section and sections 236C to 236G –
> ’employee shareholder share’ means a share issued or allotted in consideration of an employee shareholder agreement;
> ‘employee shareholder agreement’ means an agreement such as is mentioned in section 205A(1)(a) of the Employment Rights Act 2006 (employee shareholders);
> ‘employee. and .employer company’, in relation to an employee shareholder agreement, mean the individual and the company which enter into the agreement.’

Other new sections

50. We are not commenting at this stage on the remainder of the draft legislation on this topic; if further comments do arise then we shall make them during the Finance Bill process.

Enterprise management incentives: CGT entrepreneurs' relief

Key point summary

51. We welcome the policy decision to include the time that the option is held in the qualifying period.

52. However the legislation provides that the qualifying period is a year and a day. This creates a trap for the unwary and we consider that the legislation should be amended to make the period exactly a year to align with most people’s general understanding.

General comments

53. We welcome the fact that the capital gains tax (CGT) entrepreneur relief (ER) qualifying period for relevant enterprise management incentive (EMI) scheme shares will under the draft legislation published on 11 December 2012 include the period for which the option was held.

54. We recommended this approach in our submission dated 4 October 2012 to HMRC and HM Treasury (TAXREP 48/12) so that the EMI regime could act as a real incentive by reflecting what happens in practice, namely investors exercise the options around the time the company is sold, and align with the way that the rules operated under the former taper relief regime.

55. The legislation achieves this by specifying that the shares qualify inter alia where ‘the option grant date falls before the beginning of the period of 1 year ending with the cessation date’ (new subsections 169I(7A) and (7B), Conditions C and D).

Detailed comments on the draft legislation

Paragraph 1(3): amended section 169I

56. New subsections 169I(7A) and (7B), Conditions C and D contain a trap for the unwary investor, as the wording of the legislation effectively makes the qualifying period a year and a day rather than 12 months.

57. As most people think that the qualifying period is one year, we recommend that these two conditions should be reworded so that the period is truly one year.

58. We therefore suggest the following amendments

- In new section 7A(b), after the words ‘the option grant date falls’ insert the words ‘on or’.
- In new section 7B(b), after the words ‘the option grant date falls’ insert the words ‘on or’.

Other draft legislation

59. We have are not commenting at this stage on the remainder of the draft legislation on this topic; if further comments do arise then we shall make them during the Finance Bill process.

Extension of IR35 for income tax to officers

Major points

60. This clause will amend Chapter 8 of Part 2 of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 – the intermediaries legislation (commonly known as IR35) to extend the application of this chapter to office holders. Prior to this amendment an office holder would not be considered to be an employee so an office holder engaged via an intermediary would not come within this legislation.

61. The Autumn Statement introduces this amendment as putting ‘beyond doubt’ the position regarding income tax on these payments. This implies that these clauses are anti-avoidance legislation, but they are not. IR35 itself is anti avoidance legislation, but this is a change in the law.

62. We note that IR35 already extends to officers for National Insurance. This change equalises the tax treatment of office holders engaged through third parties with the treatment under the relevant National Insurance legislation. In our view, officers are already in the same position as individuals who would be in an employment relationship if engaged directly for NIC.

63. This extension will apply both where the worker is named as an office holder of the client but paid through an intermediary and where the intermediary (third party) is named as the office holder of the client. It will apply in each case where the worker would be considered as an office holder of the client if the services were provided directly under a contract between the worker and the client.

64. Providing there is also a requirement for the personal service of the worker, this clause will mean that any payment made to the worker via an intermediary will be brought into charge for income tax.

65. HMRC has advised us that it is not the intention that the amendment should apply in circumstances where the office holder is the office holder of his or her own company. We suggest that the legislation should make this clear.

66. We also understand that there is no intention to include company auditors within the definition of officer for this purpose. We would however like confirmation of this and it would be helpful to have a definition of officer for the purpose of this clause. The position of company secretaries also needs clarification.

Attribution of gains to members of closely-controlled non-resident companies and transfer of assets abroad

Key point summary

67. We are disappointed to note that the points we made in TAXREP 53/12 have not been taken on board. We reiterate all the points made in that representation with particular emphasis as below.

68. We are pleased to note that you will be will be undertaking a more thorough review of the wider representations made in the responses to the consultation document published on 30 July 2012.

Major points

69. It is our view that the amendments made to the draft legislation as published on 11 December 2012 do not increase the likelihood of the UK law being EU compliant; if anything the position is worse than previously.

70. EU law makes no distinction between trading and investment activities. It is the actual substance of an activity that is relevant and should determine whether s13 and/or the transfer of assets abroad (TOAA) provisions apply.

71. There is concern that active investment companies may not fall within the definition of economically significant activities; the definition should expressly include the letting of property and dealing in property and dealing in shares and other investments. In addition freedom of establishment was allowed where a single asset was held (National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam: C-371/10).

72. The s 13 and s 720 provisions relate to the freedom of movement of capital. Notwithstanding the increase in the threshold for s 13 to 25% the s 13 legislation can apply in situations where there is not definite influence (because of the wide connectedness definitions) and having regard to this and to the antecedents of the legislation it is clear that the legislation is not limited to cases where there is definite influence over an establishment (see Scheunemann v Finanzamt Bremerhaven: C-31/11 particularly at para 27ff.

73. We welcome the increase to 25% from 10% for the participation test but the 25% holding should apply to individual holdings, and not include associates, or at the very least the 25% threshold should apply only where the shareholding without associates exceeds say 10%.

74. The issue of partners being connected persons (for the purpose of determining the interest of a participator in a company) for s 13 has not been addressed. This is particularly pertinent for private equity investors.

75. We do not consider that the new approach to the TOAA exemption in Condition A of new s 742A is EU compliant.

76. If the new s 742A test as drafted is introduced, it would be extremely difficult for individual taxpayers to be clear as to whether or not they satisfy Condition A.

77. New s 742A(5) ITA provides that (subject to sub-section (10)) to be a genuine transaction the transaction must be on arm's length terms. There are many transactions that are not on arm's length terms albeit they are nonetheless 'genuine'. For example, a dividend paid between a corporate and its parent company. Such dividend could not be paid unless the two corporates were connected.

78. There is no *de minimis* for the TOAA provisions. In theory, the transfer of only £1 could result in a potential charge on the transferor on income of an offshore structure.

79. The new exemptions should not be limited to transactions effected after 5 April 2012 (ref to page 22 of the Summary of Responses). To be EU compliant, the amendments need to include pre-existing structures.

80. The new relevant income matching rules in ss 732 -735 ITA apply a LIFO principle. This is in contrast to the current remittance basis rules that have been in place since 2008 which provide for FIFO matching. This inconsistency will lead to confusion and probably extra costs for persons who have spent time and money determining relevant income pools on a FIFO basis.

Cap on unlimited income tax reliefs

Key point summary

81. We had a number of concerns with the proposals when first published and to the extent that our concerns raised in TAXREP49/12 have not been addressed by such changes that have been incorporated in the draft Finance Bill clauses we reiterate those points. In particular we repeat our statement:

> The solution must recognise the difference between artificial manipulation of tax liabilities to reduce tax liabilities and the impact of potential changes on the commercial reality faced by the small and medium sized business sector – the very sector that the government is looking to as the engine of economic revival.

82. The restriction of relief for commercial losses and prevention of relief on loan interest for loans for commercial businesses is not good for the economy and runs counter to other government initiatives.

Major points

83. We have a real concern that these proposals simply seek to raise money through a further form of tax on business. For example, sideways relief for losses and relief for the types of loan interest that are covered, are only available in specific business related situations and the legislation restricts relief to commercial situations.

84. It is our understanding that the original policy purpose of this measure was to target 'wealthy individuals using reliefs year after year and to excess to reduce their income tax bills to zero'. We understand that policy target but that is not what the measure in the Finance Bill actually does: there is no targeting of 'year after year' but instead a blunderbuss that limits relief in the very first year that it might apply. These proposals are also targeted at people who have made genuine investments in business with a legitimate expectation of being taxed on the resulting income or profits and obtaining tax relief for losses.

85. Because of this much wider targeting, the real losers of this measure are likely to be ordinary small and medium sized businesses that have suffered genuine commercial losses, a result which is completely at odds with the Government's growth agenda and could conflict directly with other (very welcome) measures to promote growth that the Government has already taken. For small businesses tax is an important element of cash flow. Many such businesses are currently on a knife edge, just coping with their level of borrowing and are likely to falter or even fail if interest rates rise or cash flow stalls. This measure could therefore threaten the viability of businesses that are suffering temporary trading difficulties.

86. Taxpayers who have previously entered into medium/long term borrowing arrangements, for example, to acquire interests in family companies or trading partnerships, will now face a restriction on the income tax relief they were entitled to at the time such agreements were entered into. Transitional provisions are needed to exempt loans obtained before this legislation is enacted; the tax relief will have been factored in to the cash flow by individuals when taking out the loan so to remove the relief will cause hardship and potentially bankruptcy. At the very least we would expect a tapered withdrawal of tax relief on the interest.

87. Unincorporated businesses are already trading in accounting periods where loss relief will be restricted, that is accounting periods ending in 2013/14, i.e. any accounting period ending on or after 6 April 2013 so for an accounting year starting on or after 6 April 2012. These businesses have had no certainty over how they can use their losses. We therefore believe that this cap should not be retrospective for these businesses and should be postponed until 2014/15.

88. It is worth noting also that as part of the growth agenda from 1 January 2013 the Government has increased the limit on the Annual Investment Allowance (AIA) to £250,000 for a period of two years. However, the benefit of this increased limit will be much reduced if smaller businesses that make a substantial investment in equipment based on the higher limit for AIA are then subject to this loss limitation provision, as they may not be able to relieve the whole of the investment made against other income, this shows a lack of joined up thinking.

89. Although relief for pension contributions will not be directly affected by the cap, the fact that they must be deducted to arrive at the individual's total income for the purposes of establishing the limit means that a taxpayer will need to consider their payments for the year in the light of the impact this may have on their ability to claim other reliefs. We have set out below an example of how the legislation might work in practice.

Example
Jonathan has total income of £280,000 for 2013/14. His pension contributions amount to £30,000 (gross). He also pays qualifying loan interest of £48,000 and has a property business loss arising of £20,000 from, for example, capital allowances. He made an EIS investment of £60,000.

Jonathan's EIS income tax relief is unaffected by the cap. Jonathan's uncapped reliefs are £48,000+£20,000=£68,000 and so exceed £50,000. With adjusted net income of £250,000 (280,000 - 30,000), a cap of 25% of this figure applies, i.e. £62,500.

Jonathan must decide whether he wishes to claim the interest relief ahead of the property business loss or vice versa. The former is likely to be his preferred course of action so that the unrelieved part of the property business loss (£5,500) can be set against Jonathan's total income for 2014/15.

By contrast, if Jonathan had made no pension contributions in 2013/14, he could have claimed tax relief of up to £70,000 (25% x £280,000), in which case both his loan interest and his property business loss would have been fully tax-deductible in 2013/14.

90. In our earlier response to the consultation, we suggested that the limits for calculating the cap should be increased to the greater of £250,000 or 50% of an individual's income. This would ensure that the cap was targeted only at those with considerably higher levels of income. Another alternative would be to only restrict relief for artificial (ie non-commercial) losses.

91. We are pleased to note that the restriction for share loss relief has been removed for EIS/SEIS investments. However, there will be investors who made investments and did not qualify for the relief, for example they may be connected to the company or own too great a percentage of the shares who will have factored the tax relief on any loss into account when making their investment. We believe the cap on share loss relief should only apply to investments made after the announcement of the proposed restriction.

92. The definition of adjusted net income is not clear and taxpayers are likely to need professional help and within firms of accountants it will require senior experienced members of staff to deal with the calculations.

Cash basis for small business

Major points

93. We were pleased that HMRC consulted on these proposals from an early stage. The considerable discussion these proposals have generated amongst our members and committees, as well as the considerable discussion we have been able to have with HMRC, shows the enthusiasm of our members for simplification and a reduction in the tax administrative burden, particularly for the smallest businesses.

94. Unfortunately, having now seen the first attempt at legislation, we do not think these proposals can be made ready for implementation from 6 April 2013. This should be delayed for a year if at all possible to allow more time for proper considered thought to be given to the legislation. HMRC's guidance is being written concurrently with the design of the system, commercial software is not yet available let alone tested, and most potential users of this system, the small businesses themselves, remain totally unaware of its existence.

95. We have been told that this will be an iterative process which will be improved through practical experience. While we welcome this open approach and ready acceptance to make necessary improvements going forward, we do not consider this to be the way to implement radical change to the tax system which it is estimated could affect 3m businesses in the UK.

96. We are increasingly concerned that this will not be the simplified system proposed by the Office of Tax Simplification (OTS), but rather will just be an alternative tax system for small business. This is very disappointing and a missed opportunity.

97. We note too that the timetable is being driven to a large extent by the political imperative to implement Universal Credit (UC) from later in 2013 for some businesses. Although UC will not affect very many self employed people initially, it will affect anyone who joins a household which has been transferred into UC.

98. The draft legislation is impenetrable. While the Tax Law Rewrite Style is no longer being used, it is odd that such complex drafting has been used to define what was to have been a simpler tax system for small businesses.

99. We have considered the structure of the system being proposed and have many concerns as set out in our earlier representations, see TAXREP 21/12. However, following discussions with HMRC and mindful of the likelihood that this legislation will proceed with only minor changes from 6 April 2013, we suggest the following matters could still realistically be addressed at this stage:

- The proposals as currently drafted are not suitable for partnerships. These should be excluded until the problems have been resolved.
- The easiest and most pragmatic solution to small quantities of goods being taken for a proprietor's own use, would be to disapply the 'Sharkey v Wernher' legislation, s 172B, ITTOIA 2005.
- Sideways loss relief, capped at £50,000, should be allowed.
- The ability to move between the cash and accruals basis each year makes the system more complicated than it needs to be and means that anti avoidance legislation is needed. We have heard HMRC's concerns about this complexity and have had meetings to discuss the issue. We have suggested restricting an individual's choice to move between cash and accruals accounting to once every five years, unless the business exceeds the income limit or unless there are other commercial reasons to change. This rule follows the existing rule restricting a change of accounting date, s 217(4), ITTOIA 2005.

100. In relation to the cash basis proposals more generally, our other key points remain:

- We support tax simplification and the work of the OTS and the Administrative Burdens Advisory Board (ABAB).
- We were broadly supportive of the proposals originally made by the OTS which suggested a turnover limit for the cash basis of £30,000. The Government's higher turnover limit changes significantly the nature of the OTS's proposal which was to allow very small (usually unrepresented) businesses to adopt the cash basis. We remain convinced that the turnover limits for any cash basis proposal should be in line with the recommendations made by the OTS. Many of the problems we have identified could be ignored if these rules were only available to very small businesses with income below £30,000.
- Cash accounting cuts across one of the fundamental tenets of taxation, namely horizontal equity across taxpayers; all taxpayers in similar circumstances should be treated the same.
- The ability to move from cash to accruals each year will
    - add further complexity to the rules
    - add to the administrative burden
    - increase the amount of tax lost through legitimate tax planning.
- We do not support the use of the cash basis by a business of any size where that business has other than minimal levels of fixed assets, stock, debtors or creditors, nor for growing businesses.
- Those using the cash basis will still need to prepare proper accounts to support mortgage or loan applications.
- The reporting system which is being designed to accommodate UC will be incomprehensible to most small businesses, should be reassessed and aligned more closely with the income tax rules.
- The cash basis for barristers arises due to specific problems in that profession and should be the subject of a separate consultation.

General points

101. We continue to advocate tax simplification and to support the work of the OTS and the Administrative Burdens Advisory Board (ABAB). We are pleased that HMRC has modified its proposals following earlier consultation, but consider that this legislation still misses its target. This proposes an alternative system for taxing small businesses, but it is not a simpler method.

102. This draft legislation will implement a cash basis for small business tax. The consultation described this as a simpler tax system for small businesses, its purpose intended to make life easier for the 3m smallest businesses in the UK. While we accept that few small business owners will ever attempt to read the legislation, the complex structure makes it difficult even for qualified tax professionals to use.

103. Experience shows that complex legislation leads to anomalies and requires complex anti avoidance provisions as it attempts to cover all possible situations. It also leads to a greater need for extensive guidance, which users rely on rather than the law itself.

104. As drafted, these clauses will be extremely difficult to use. This was an obvious time to make use of the tax law re write project style of more straightforward drafting and it is disappointing that this opportunity has been missed.

105. In order to use the cash basis, the taxpayer must make a claim. We think that care is needed to ensure that an individual completing a tax return knows whether or not they are making the election. While a simple tick box on the tax return is one way to do this, a tick is easily overlooked or the box could be ticked by mistake, especially if tax return is being completed online.

Specific points on draft legislation

Eligibility criteria
Para 5

31A(3)

106. The term ‘firm’ is not a tax term, but is used here to describe a business. This term needs to be defined. As the cash basis is not available to companies, this should be made clear.

31B VAT threshold

107. This seems to use particularly opaque drafting, probably made worse by using the ‘VAT threshold’ rather than numerical values.

31B(7) states

108. “the VAT threshold”, in relation to a tax year, means the amount specified at the end of that tax year in paragraph 1(1)(a) of Schedule 1 to VATA 1994.

109. A tax year is the income tax year, so we presume this means the VAT threshold that applies at the 5 April at the end of the year.

110. The VAT threshold is usually set from 1 April and changes every year although in 2009, the VAT threshold changed from 1 May.

111. This will mean that in order to determine whether a person has exceeded the relevant maximum for a year, that person can’t be sure until they know what the VAT threshold is at the end of that year. This will mean for many businesses, keeping both cash and accruals accounts for a year.

112. This provision would be simplified if numerical amounts were used instead of the VAT threshold, so £77,000 and £154,000. The legislation already allows for these amounts to be increased by Treasury Order in 31B(8).

113. 31B(3) imposes a restriction by reference to a person’s receipts of the previous tax year, which cannot exceed twice the VAT threshold for that year. We do not recall such a restriction being in previous iterations of these proposals and wonder why this has been included?

31B(4)

114. When determining the ‘Relevant maximum’, condition C means that the entire income of a partnership falls to the controlling partner, but none of the partnership income falls to the other partners.

115. The legislation is not sufficiently clear about in its concept of controlled partnerships. Also the aggregation of partnership cash basis receipts would appear to be entirely for controlling partners with none for minority partners (ie no apportionment). What happens if there is no controlling partner?

31C Excluded persons

116. The term 'person' in tax legislation is usually taken to include a company. Although the new s 31C will be inserted into the Income Tax Trading and Other Income Act 2005 (ITTOIA 2005), it should be made clear that these rules do not apply to companies by adding them to the list of excluded persons.

31C(6)

117. We do not see why small farmers and market gardeners who use the averaging rules should not also be allowed to use the cash basis.

Elections under s 25A

31D (1)(b) Effect of an election for the cash basis

118. The proposal is that where an individual has an interest in a partnership as well as a sole trade, an election for the cash basis should apply to all businesses the individual owns. We are not sure that this will work.

119. A and B are in partnership. A also has his own business where receipts are £25,000 and so elects for the cash basis. B also has his own business where receipts are £80,000 and so can't use the cash basis. We do not think that this drafting works as intended.

120. In our view, partnerships should be excluded from being able to use the cash basis, at least until the rules have settled down.

31E Calculation of profits on cash basis

121. Is each partner then taxed on all of the partnership's income?

122. The distinction between trade, profession and vocation is merely a Victorian class distinction and has no place in legislation for a modern, simplified tax system for small businesses. We also wonder if this is actually necessary since existing s 24, ITTOIA 2005 already covers this.

123. It is usual to speak in terms of receipts and payments or alternatively of income and expenses. As neither the term receipts nor expenses is being defined by the legislation, this will require extensive guidance to ensure that they are properly understood and applied consistently. Properly constructed legislation would make this more certain. We also note that while receipts is an acceptable concept for a cash basis, expenses is a term used in accruals based accounting. This is of course a problem created by the hybrid system for taxing small businesses which is currently being proposed.

Para 10

51A Cash basis: interest payments on loans

124. (3) This seems to deny relief for integral features under the cash basis. Why should a shop keeper not expect tax relief for the cost of installing a new water heating system?

Para 15

57B Cash basis: interest payments on loans

125. While we welcome the £500 deduction for interest paid and the light touch which is to be applied to this, we are concerned that it still needs proper definition.

126. The £500 will include the 'incidental costs of obtaining finance'. Bank charges aren't mentioned, but increasingly many banks now charge a monthly fee for their accounts. This fee usually entitles the account holder to a cheaper overdraft and exemption from some charges, as well as other benefits. This may leave some businesses unsure whether their banking costs are deductible.

127. There is no requirement for the £500 loan interest to be incurred wholly and exclusively for business purposes. This will allow interest on many personal loans which have only a small element of business use to qualify for tax relief.

Para 12
55C Cash basis: rental payments

128. The cash basis is meant to be simple and apply tax on 'cash receipts less expenses'. However, in the case of expenses in relation to rent, which could be rent of anything, not just property, the deduction is limited to amounts paid in respect of costs relating to the accounting period and a maximum of 3 months afterwards. This brings an element of accruals accounting into the mix.

129. Three months does not seem to be a long enough period. For example the rent paid in advance for a photocopier could be prepaid for much longer periods. An expenses cap might be a better solution to prevent very large prepayments being deducted, if that is the concern.

Para 14
56A and 95A Overview of rules for calculating profits on cash basis

130. This seems to be an odd choice of title. In what way do these paragraphs give an overview?

Para 18
New s94A (5)

131. Why do we need the reference to CSOPs since this legislation doesn't apply to companies?

Para 19
94B Cash basis: VAT payments

132. The restriction in this clause will mean that the element of VAT in some payments made by a person using the cash basis will never get tax relief.

133. Consider a business which is using the cash basis constantly. It ceases to be VAT registered on 31 March 20xx and makes a VAT payment on account of its final quarter on 25 April xx. If its year end for income tax is 5 April 20xx, no deduction is available for the VAT payment.

Para 22
96A Cash basis: capital receipts

134. The rules for a change in proportion of non-business use are complex in relation to the size and scale of the likely tax at risk, particularly since cars are already dealt with through a fixed rate deduction. We suggest a de minimis for small items of expenditure such as computers.

Para 29
106E Amounts not reflecting commercial transactions

135. In small business cases, the easiest and most pragmatic solution would be to disapply the *'Sharkey v Wernher'* legislation, s 172B, ITTOIA 2005. The practical problem otherwise will be to identify whether business funds or private funds were used to fund the acquisition. If *Sharkey v Wernher* is ignored, then the cost is simply excluded as private expenditure which is simple and understandable, and avoids having to make estimates of market values. The tax affect will be minimal and we doubt whether unrepresented small businesses adjust for this at all under the current rules.

Para 60 of Schedule 1

In section 59 of CAA 2001 (unrelieved qualifying expenditure), after subsection (4) insert -
(5) If a person carrying on a trade, profession or vocation enters the cash basis for a tax year, no amount may be carried forward as unrelieved qualifying expenditure from the chargeable period ending with the basis period for the previous tax year.

(6) Section 240B of ITTOIA 2005 (meaning of “entering the cash basis”) applies for the purposes of this section as it applies for the purposes of Chapter 17A of Part 2 of that Act.

136. This doesn’t seem fair where fixtures (and any other items of plant and machinery that wouldn’t be deductible or relieved in another manner under the cash basis) are concerned. The unrelieved expenditure attributable to these assets will essentially be lost whether the business uses the cash or the accruals method in the future.

Para 52
New Chapter 17A of ITTOIA 2005
240C Unrelieved qualifying expenditure

(1) This section applies if:

(a) a person carrying on a trade enters the cash basis for a tax year (“the current tax year”), and
(b) at the end of the basis period for the previous tax year, the person has unrelieved qualifying expenditure to carry forward from the chargeable period ending with that basis period.

(2) But this section does not apply if section 240D (assets not fully paid for) applies.

(3) In calculating the profits of the trade for the current tax year, a deduction is allowed for the relevant portion of that expenditure.

(4) The “relevant portion” of the expenditure means the amount of the expenditure for which a deduction would be allowed in calculating the profits of the trade on the cash basis for a period if the expenditure was paid during that period.

(5) Section 59(1) and (2) of CAA 2001 has effect for the purposes of this section.

137. This section appears to need a rule or further detail on how to identify the ‘relevant portion’ (bearing in mind that all assets may have been pooled together, without separate records of fixtures / other assets that cannot give rise to a cash deduction – indeed, since 2009, motor cars will have been pooled unless there is private use).

138. Section 240(D) (relating to assets not fully paid for) has subsection 4 which says:

(4) The amount of any capital allowance obtained in respect of expenditure on the provision of any plant and machinery is to be determined on such basis as is just and reasonable in all the circumstances.

139. We wonder if a similar provision, referring to a just and reasonable basis, should be inserted into 240C?

140. We also suggest a table, published by HMRC, to set proportions that could be used for different trade types.

141. The law should really block businesses with sizable plant pools moving to cash accounting, claiming the cash deduction for the relevant portion of the pool, and then reverting to accruals accounting again.

Trade profits: deductions allowable at a fixed rate

Major points

142. We were pleased that HMRC consulted on these proposals from an early stage. The considerable discussion these proposals have generated amongst our members and committees, as well as the considerable discussion we have been able to have with HMRC, shows the enthusiasm of our members for simplification and a reduction in the tax administrative burden, particularly for the smallest businesses.

143. Unfortunately, having now seen the first attempt at legislation, we do not think these proposals can be made ready for implementation from 6 April 2013. This should be delayed for a year if at all possible to allow more time for proper considered thought to be given to the legislation. Moreover, HMRC's guidance is being written concurrently with the design of the system, commercial software is not yet available let alone tested, and most potential users of this system, the small businesses themselves, remain totally unaware of its existence.

144. We have been told that this will be an iterative process which will be improved through practical experience. While we welcome this open approach and ready acceptance to make necessary improvements going forward, we do not consider this to be the way to implement radical change to the tax system which it is estimated could affect 3m businesses in the UK.

145. We are increasingly concerned that this will not be the simplified system proposed by the Office of Tax Simplification (OTS), but rather will just be an alternative system.

146. We note too that the timetable is being driven to a large extent by the political imperative to implement Universal Credit (UC) from later in 2013 for some businesses. Although UC will not affect many self employed people initially, it could soon affect anyone who joins a household which has been transferred into UC.

147. We are broadly supportive of the proposals to allow a system of fixed rate deductions, but consider that:

- The amounts specified for deductions are too low.
- There should be only one rate for using a private car for business, being 45 pence a mile. This could more easily aligned with the Universal Credit rules which are based on monthly rather than annual usage.
- The requirement to keep a record of hours spent using a home for business purposes represents an additional administrative burden, which cuts across the purpose of this proposal.

148. We welcome the decision to make using fixed rate deductions for expenses other than cars optional for businesses using the cash basis.

149. We consider that businesses should be able to use actual costs rather than fixed rate deductions for cars.

150. In relation to the cash basis proposals more generally, our key points remain:

- We support tax simplification and the work of the OTS and the Administrative Burdens Advisory Board (ABAB).
- We were broadly supportive of the proposals originally made by the OTS which suggested a turnover limit for the cash basis of £30,000. The Government's higher turnover limit changes significantly the nature of the OTS's proposal which was to allow very small (usually unrepresented) businesses to adopt the cash basis. We remain convinced that the turnover limits for any cash basis proposal should be in line with the recommendations

made by the OTS. Many of the problems we have identified could be ignored if these rules were only available to very small businesses with income below £30,000.

- Cash accounting cuts across one of the fundamental tenets of taxation, namely horizontal equity across taxpayers; all taxpayers in similar circumstances should be treated the same.
- The ability to move from cash to accruals each year will
  - add further complexity to the rules
  - add to the administrative burden
  - increase the amount of tax lost through legitimate tax planning.
- We do not support the use of the cash basis by a business of any size where that business has other than minimal levels of fixed assets, stock, debtors or creditors, nor for growing businesses.
- Those using the cash basis will still need to prepare proper accounts to support mortgage or loan applications.
- The reporting system which is being designed to accommodate UC will be incomprehensible to most small businesses, should be reassessed and aligned more closely with the income tax rules.

General points

151. We continue to advocate tax simplification and to support the work of the OTS and the Administrative Burdens Advisory Board (ABAB). We are pleased that HMRC has modified its proposals following earlier consultation, but consider that this legislation still misses its target. This proposes an alternative system for taxing small businesses, not just a simpler method.

152. This draft legislation will implement a cash basis for small business tax. The consultation described this as a simpler tax system for small businesses, its purpose intended to make life easier for the 3m smallest businesses in the UK. While we accept that few small business owners will ever attempt to read the legislation, the complex structure makes it difficult even for qualified tax professionals to use.

153. Experience shows that complex legislation leads to anomalies and requires complex anti avoidance provisions as it attempts to cover all possible situations. It also leads to a greater need for extensive guidance, which users rely on rather than the law itself.

154. As drafted, these clauses will be extremely difficult to use. This was an obvious time to make use of the tax law re write project style of more straightforward drafting and it is disappointing that this opportunity has been missed.

155. We think that the election to use fixed rate deductions should be more formal than a tick on the tax return. It will be difficult for many small businesses to be consistent in their approach to this.

156. We are broadly supportive of the proposals to allow a system of fixed rate deductions, but consider that:

- The amounts specified for deductions are too low.
- Set rates should be reviewed regularly to keep pace with inflation.
- There should be only one rate for using a private car for business, being 45 pence a mile. This could more easily aligned with the Universal Credit rules which are based on monthly rather than annual usage.
- The requirement to keep a record of hours spent using a home for business purposes represents an additional administrative burden, which cuts across the purpose of this proposal.

157. We welcome the decision to make using fixed rate deductions for expenses other than cars optional for businesses using the cash basis.

Specific points on draft legislation

S94H The appropriate mileage amount

158. We disagree with the reduced mileage rate for the business use of a car in excess of 10,000 miles. Mini cab drivers and driving instructors and others whose businesses require extensive use of a car will be unfairly disadvantaged.

159. We are also concerned that as fuel prices increase rapidly on occasion, the fixed rates will not change quickly enough to keep pace.

160. When the initial mileage rate was increased from 40p to 45p for the first 10,000 miles a couple of years ago, no adjustment was made to the 25p rate. As a minimum, this should have been increased to 30p in recognition that the fuel element has increased and will continue to do so.

161. We consider that businesses should be able to use actual costs rather than fixed rate deductions for cars.

S95J Use of home for business purposes

162. Many small businesses are run by people who live in rented accommodation. The rent paid is likely to be very disproportionate to the fixed rates being suggested.

163. There is also an argument for considering regional variations in the fixed scale of rates.

164. We consider the issue of apportioning or otherwise splitting expenses for business/private is a difficult one and more thought needs to be given to it. Clear guidance will be needed to enable this matter to be dealt with in a way that achieves the intended simplification.

165. Many small businesses use their home for storage. An allowance should be available for this.

S95K Premises used as a home and as business premises

166. S94K (1)(b) The term ‘mainly’ needs definition.

167. These rates for the income tax to be charged seem disproportionate to the deduction allowed by S94J.

168. A single scale such as this cannot cater for the range of sizes of business and geographical variety with associated range of costs.

New s240DA in ITTOIA 2005 - Cars with low carbon dioxide emissions

169. (1) This section applies if:

> *(a) a person carrying on a trade has incurred expenditure on a vehicle that is first-year qualifying expenditure by virtue of section 45D of CAA 2001 (expenditure on cars with low carbon dioxide emissions),*
> *(b) the person has obtained a first-year allowance in respect of that first-year qualifying expenditure, and*
> *(c) the person enters the cash basis for a tax year.*

(2) An amount equal to the market value of the vehicle is to be treated as a receipt in calculating the profits of the trade for that tax year.

(3) The market value of the vehicle is determined at the beginning of the basis period for the tax year.

(4) If the first-year allowance obtained by the person was reduced under section 205 of CAA 2001 (reduction where asset used only partly for qualifying activity), the market value of the vehicle is to be proportionately reduced.

170. If retained, we think that this provision needs to clarify that the vehicle is still owned by the taxpayer at the point of entering the cash basis.

171. However, Government policy has been to encourage expenditure on environmentally friendly cars. A simpler solution to previous relief having been given on cars through the 100% first year allowance, would be to deny further relief going forward under the cash basis, while then not needing the add back described in this clause.

New s33A Cash basis: capital expenditure – ss11 non-depreciating assets

172. (11) Head 7 is expenditure on acquiring, creating or improving any asset which, at the time of its acquisition or creation, could not reasonably be expected to decrease significantly in value with the passage of time.

173. 'Expected to decrease significantly in value' and 'passage of time' are both too vague to be workable. We suggest that there is a tie in with long life assets here and a period of, say, 25 years is considered instead. Businesses that make their own tooling and moulds will be affected by this.

Deferral of payment of corporate 'exit charges'

Our comments

174. We believe that the current proposals in the draft clauses still fall short of what is required in order for the proposed legislation to comply with European law and EC treaty freedoms. Under European law it should be possible for gains to be deferred until the relevant asset is actually disposed of: the proposed 10 year gap on deferrals in some cases, and compulsory spreading in others, means that the current draft legislation does not achieve this.

175. The current proposals relate to exit charges arising in relation to chargeable assets, intangible assets, loan relationships and derivative contacts. However, when a company ceases to be UK resident, it is treated as ceasing to carry on its trade and this can give rise, for example, to capital allowances balancing charges and profits arising from the revaluation of trading stock. We consider that companies should also be able to defer payment of tax in respect of these assets.

176. We also consider that the equivalent charge in s 80 TCGA 1992 in relation to trustees ceasing to be UK resident is likely to be in breach of EC treaty freedoms where UK trustees resign and are replaced by trustees of another EU or EEA state.

Questions in Technical Consultation

Question 1: Other EU/EEA Member States have either changed, or are in the process of changing, their rules to permit deferral in the area of exit taxes. What experiences, if any, from your dealings with these countries do you think the UK should take into account when adopting its own arrangements?

177. We are aware that Austria, Italy, the Netherlands and Sweden have already introduced rules for the deferral of corporate exit charges, and there are proposals to introduce legislation in France this year. Since most of these rules have been introduced relatively recently, we have limited practical experience to date.

Question 2: Which of the three options outlined in likely to be most attractive to your business, or to the business that you represent?

178. This will depend upon the particular facts and circumstances of each case. As indicated in the consultation document:

- immediate payment may be attractive to businesses which do not want to deal with the administrative requirements of deferral and / or are unwilling to pay interest;
- the instalment method may be attractive where there are a very large number of assets such that the tracking required under the realisation method would be administratively complex; and
- the realisation method may be attractive to businesses which expect to hold the assets for more than six years and where the number of assets involved is not such as to render the realisation basis unduly onerous to apply.

179. The realisation method is likely to be attractive to most taxpayers unless they would find the associated monitoring requirements too administratively burdensome. However, we agree that companies should be given a choice of any of these three alternative methods.

Question 3: (i) Do you agree that companies that chose to defer until realisation of assets should be required to provide regular information on all assets held?

180. See the response to Question 4 below.

(ii) If there were to be a de minimis threshold for reporting then in your view what should that level be, and how should assets below the threshold be treated?

181. We suggest that a company should only be required to report to HMRC where aggregate net profits and gains under the exit charge provisions (as defined) total £1 million or more.

Question 4: What is the most appropriate form of report and annual return and what is the minimum amount of information that should be required?

182. We agree with the European Commission proposal that it should be sufficient for the company concerned to make an annual return stating that the company is still in possession of the assets transferred, accompanied by a declaration made at the time of the actual disposal or realisation of an asset.

Question 5: The Government is proposing a requirement to provide adequate security against non-payment of the tax liability in certain cases. Do you agree that such security should be requested in exceptional cases only or should there be a requirement to provide security in all cases?

183. In the *National Grid Indus BV* case (C-371/10) judgment, the Court of Justice of the European Union (CJEU) indicated that Member States may request security, such as a bank guarantee, where there is a risk of non-recovery of the tax (paragraph 74). However, in the *de Lasteyrie* case (C-9/02), which concerned French exit tax provisions for individuals, the CJEU held that a provision for deferral of payment of tax which was conditional on the setting up of guarantees was a restriction on the freedom of establishment.

184. Giving security can be onerous and costly. Based on the CJEU judgments in *National Grid Indus BV* and *de Lasteyrie*, and taking into account the fact that HMRC can obtain assistance with collection of tax under some double taxation agreements or the EU Mutual Assistance Recovery Directive (MARD), we consider that security should only be requested in exceptional cases where there is a serious risk of non-recovery of tax and the MARD does not apply. The circumstances in which security will be requested should be incorporated into the legislation, or at least set out in published HMRC guidance.

Question 6: It is envisaged that only changes necessary to permit the deferred payment of exit taxes in appropriate cases will be made.

(i) What, if any, other changes to the existing exit tax regime that have not been discussed in this document do you think are required?

185. When a company migrates its tax residence out of the UK it ceases to be within the charge to corporation tax. This can result in capital allowances balancing charges and the (re)valuation of trading stock and we believe that a company should be able to defer payment of tax in respect of these charges when it migrates to another EU or EEA member state.

(ii) Do you have any other comments on the scope or design of the reform?

186. Based on the CJEU's decision in the *National Grid Indus BV* case we believe that any limitation on the deferral period would be contrary to EU law.

UK group relief rules – amendments

Our comments

187. The proposed amendments to s 107 CTA 2010 are in response to the decision of CJEU in the case of Philips Electronics UK Ltd (C-18/11). We are concerned that the proposed changes are not sufficient to fully implement this decision.

188. Section 107 CTA 2010 currently restricts group relief for losses of UK permanent establishments (PEs) of non-UK resident companies, but only if certain conditions are met. Condition C (s107(5) and (6)) effectively requires that the loss is not deductible for foreign tax purposes in any period. This means that group relief is not available if losses are potentially deductible overseas, even if no overseas deduction is claimed. The proposed amendment removes this restriction for UK PEs of EEA companies, and replaces it with a different condition which effectively requires that the loss is not deducted for foreign tax purposes in any period.

189. The change means that the provision should operate more proportionately (so that relief is only restricted to the extent that a loss is actually deducted overseas), but we do not consider that this goes far enough to address the CJEU decision in Philips Electronics. The issue of proportionality only arises in circumstances where a measure which restricts a fundamental freedom can be justified; in which case the measure must nonetheless be proportionate. However, in the *Philips Electronics* case the CJEU concluded that s 403D(1)(c) ICTA 1988 (now rewritten to s 107(5) and (6) CTA 2010) is a restriction on the freedom of establishment which cannot be justified by overriding reasons in the public interest, and that the provision should be disapplied.

190. We therefore consider that it would be more appropriate to remove Condition C for UK PEs of EEA companies, without imposing any further conditions for those companies.

Ensuring the fair taxation of residential property transactions

General comments

191. While we understand the Government's policy concern about the avoidance of stamp duty land tax (SDLT), taken as a whole this package of measures is of serious concern, adding considerable extra complexity and uncertainty into the UK tax system and imposing new administrative burdens on both HMRC and taxpayers while maintaining the unsatisfactory 'slab' system of taxation used by SDLT.

192. We are concerned at the targeting of these measures although we accept, and welcome, the various reliefs that have been introduced in order to try and improve the targeting. Nevertheless, taken as a whole these measures in effect apply a punitive tax regime to residential properties held in companies and are designed to discourage the holding of residential property through companies. However, the regime will apply regardless of whether the company concerned eventually sells the property which will give rise to an SDLT charge on the purchaser in the normal way. This appears unfair – it would be reasonable to allow the company to elect out of this regime in exchange for providing an undertaking that SDLT would be paid in the normal way if the company was ever sold rather than the property – although we accept that such a measure would add complication to an already highly complicated provision.

193. There are many reasons other than tax as to why residential property is held through a company. Given that these are punitive measures, there needs to be proper transitional provisions and time given for existing structures to be reorganised or unwound without giving rise to further tax charges. The policy is to discourage 'enveloping' residential property valued at more than £2m but the proposals do not provide for taxpayers to effectively 'de-envelop' existing arrangements.

194. Annual residential property tax (ARPT) is a stand-alone tax on residential property valued at more than £2m which is owned through a company. Separate ARPT returns will be required to be lodged at the time the payment is made, therefore imposing new administrative burdens and costs on companies owning such property but also, as noted above, imposing on HMRC the administration of a brand new tax at a time when resources and headcount are being cut.

195. For 2014/15 onwards, the chargeable period starts on 1 April and the ARPT and return are due by **30 April in that chargeable period,** i.e. at the end of the first month of the period, so ARPT for 2014/15 will be due on 30 April 2014. For 2013/14 only, the ARPT return and payment are due on or before 31 October 2013. HMRC therefore has nine months to design, build, test and implement ARPT so that companies can make a return and pay ARPT for 2013/14 by 31 October 2013 with the return for 2014/15 due and payable only six months later, ie by 30 April 2014.

Major points

196. The new rules impose a number of complexities, including the following:

- Rather than a straight ad valorem charge, APRT will use a slab system similar to that used in SDLT. This will create unfairness at the margins, for example a residential property worth £2m will not attract ARPT but if it was worth 1p more then APRT of £15,000 will be payable (0.75% ARPT) every year. A residential property worth £5m will also pay ARPT of £15,000pa (0.3% ARPT rate) but if it is worth 1p more the rate will be £35,000pa (0.7% ARPT), a difference of £20,000 every year.
- The maximum amount of ARPT will be £140,000pa payable for properties worth more than £20m.
- ARPT will be calculated by reference to the market value of the property which will have to be revalued every five years.
- Where a property is owned at the beginning of the year, then the ARPT will be due and payable 30 days later. If the property is subsequently sold, then a claim will have to be made to recover the excess ARPT paid.

197. From a compliance perspective the available reliefs will probably take many properties out of the rules, but further work is needed on the details of the reliefs to ensure that they work properly. However, there are various conditions attached and a claim will need to be made so even where the reliefs do help there is still an additional compliance burden.

198. While we appreciate the specific relief afforded by clause 47, we do not think it goes far enough because, for various reasons, many residential properties connected to farming businesses were put in farming companies and they will now be caught up in these rules. Clause 47 states that the relief for farmhouses requires that the qualifying farming trade must be carried out by the person beneficially entitled to the interest in the dwelling. Given the complex structures of some farming businesses the relief should be granted to dwellings where the farm trade is carried on by a person connected to the person with the beneficial interest. One solution might be to 'grandfather' residential properties in a farming company out of these rules.

199. We are concerned that the reliefs for the 15% SDLT rate will not be introduced until Royal Assent of Finance Bill 2013 (para 3.9 of the responses); this delay could hinder and delay development work which would be contrary to the Government's growth agenda.

200. The relief for properties exploited to provide an income require that there must be a qualifying trade carried out on a commercial basis with a view to make a profit (clause 36). The high maintenance costs of many historic homes mean that the business often only makes a contribution to the running costs and do not generate a profit. We do not think such businesses should be denied the relief.

201. The relief for property rental businesses as drafted appears to be restricted to those businesses in charge to corporation tax (clauses 34 and 35); we believe the relief should also be available to unincorporated, such as partnerships, property rental businesses.

202. Many of the companies owning properties will have no cash resources with which to pay the ARPT. Is there an intention to extend the scope of s 809V ITA2007 such that funds remitted from offshore to pay the ARPT will not be treated as a remittance?

203. The new ARPT runs to 60 clauses and two schedules and occupies 49 pages of draft legislation. It adds considerable extra complexity into the UK tax system. In addition there are 10 pages of draft legislation for the new CGT charge on UK companies to apply to disposals from 6 April 2013. It is our opinion that this is too tight a timetable in which to design workable new rules for disposals after 6 April 2013, and we believe that the introduction of the rules should be deferred for a year to allow time for the rules to be finalised and for those affected to take advice and where needed make changes to existing arrangements.

General anti-abuse rule

General

204. Any anti avoidance provision needs to be properly targeted, and a balance needs to be struck between the need for taxpayers to have certainty and the need to counter abusive tax arrangements. The approach of the GAAR throughout has been to counter egregious tax schemes while leaving tax planning in the centre ground. While we have consistently supported the proposed GAAR, there remains considerable uncertainty as to whether particular arrangements will actually be caught. This potential uncertainty could have been addressed by adopting a clearance procedure within the GAAR. However, the GAAR does not include a clearance procedure because it is believed that the GAAR is sufficiently targeted only at abusive schemes.

205. In practice, it remains unclear as to whether particular arrangements will fall within the GAAR and, for example, whether the GAAR would have countered the various tax avoidance schemes that have come before the courts in recent years. Further, the scope of the GAAR has been extended to include IHT and, while in principle we can appreciate why this step was taken, in practice IHT planning will often be undertaken for personal/family reasons with little or no commercial rationale, thus potentially triggering the GAAR.

Guidance

206. In the main we believe these concerns about the scope of the GAAR can be addressed by suitable examples in the Guidance. However, it will be some years before we will be able to tell if this is the case. HMRC needs to continue working with stakeholders to add more examples to the guidance of what will be caught by the GAAR.

207. In relation to the draft Guidance we set out below the points that we made in the meeting with HMRC on 16 January 2013.

208. The example at 4 deals with IHT and gifts with reservation in the context of a deferred lease scheme. At 4.1.5.3 the question is asked whether the arrangements intend to exploit any short comings in the relevant tax provisions. There is then the statement that 'the failure of the rules to cover a situation where an individual creates two different interests in a property is a shortcoming that the scheme is intended to exploit'. We suggested at the meeting that this wasn't quite right. These rules were based on the Estate Duty provisions from the last century, and all of the estate duty cases about these rules were based on a minute dissection of whether two separate classes of assets had been created; these rules were then introduced for inheritance tax purposes so that this distinction was well understood. We made the point that a high level of tax knowledge was required in order to make sense of the guidance. The Pre-owned assets tax (POAT) would, in any event, apply in the circumstances outlined which meant that no one would ever do a deferred lease now. HMRC noted at the meeting that they were aware that the IHT rules had changed so the idea would not be put into practice. We recommend the replacement of the current example by a different one.

209. We also recommended that the example in 7.2.2 needed to be changed. There was a suggestion that after the share for share reorganisation a loan note holder having sold his shares moved to Spain and redeemed his or her loan notes tax free. The text simply says 'Some time after the exchange'. We recommended that it should be clear that the intention to emigrate should not exist at the time of the share for loan note swap, because under HMRC practice this might cause share for share treatment to be withheld.

210. Finally we also suggested that the example of putting a farm in a trust in section 8 was weak; we would not consider that such a step was egregious tax planning or that putting a farm into a trust was contrived.

Clearance

211. The current draft clauses do not include a specific clearance measure. We remain concerned that the GAAR will impose considerable extra administrative burdens on those responsible businesses engaged in the centre ground of tax planning in that they will wish to be satisfied that any tax planning arrangements, however unexceptional, will still need to be tested against the GAAR.

212. We understand that CBI is preparing a number of specific corporate examples of standard and acceptable tax planning to demonstrate what the GAAR is not intended to catch for prospective inclusion in the Guidance. We believe the guidance should also include standard examples of transfer pricing in relation to acceptable international arrangements so that there is a clear perception of what is acceptable international tax planning.

International legality

213. Aside from the administrative burdens we are also concerned about whether the GAAR is lawful in relation to its application to the UK's tax treaties. The UK ratified the Vienna Convention on the Law of Treaties on 25 June 1971 and Article 26 states that 'Every treaty is binding upon the parties and must be performed by them in good faith' and Article 27 further states that 'A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. The proposed GAAR will effectively over-ride the UK's international obligations already written into its double tax treaties and could therefore be held to be unlawful.

214. We accept that in relation to treaties with fellow OECD members this concern is probably addressed by specific OECD agreements, but this still leaves about 100 treaties with non-OECD countries where the GAAR may be unlawful as it stands. Amendments to the nature and scope of double tax treaties need to be agreed bilaterally not unilaterally and it is essential that the UK honours its international treaty commitments.

215. We believe this concern could be addressed relatively easily by amending the draft clauses to make it clear that where the context so requires the GAAR will not be regarded as overriding the UK's treaty obligations. Such a statement was included in the draft illustrative GAAR produced by Graham Aaronson and we believe that this provisions (or something similar to it) should be reinstated.

Transitional rules

216. The operation of the proposed transitional rules, where part of the planning is before Royal assent and part after is not clear. The problem is mainly in the private client area where actions can be taken many years in advance and there could then be actions, and consequences, after Royal Assent.

217. For example what would happen where A had undertaken a home loan plan and simply decided to pay pre-owned assets tax to preserve the IHT advantages and then dies after Royal Assent; would death mean that the completion of the home loan plan would be considered to have taken place, so that the GAAR would apply. At the meeting on 18 January 2013 HMRC confirmed that death cannot be an avoidance step.

218. We then gave a further example of B who establishes some pilot Will Trust before Royal Assent in conjunction with his Will. Under his Will his shares in his private company will be transferred to the Pilot Will trust in some fractional amounts; the reason being that their value would be significantly fragmented as compared to the value of a 100% holding. The question was - assuming the GAAR could apply in any event - would B's death be treated as an avoidance step in its own right; or would the Will be treated as speaking from the date of death, and therefore be treated as being post Royal Assent. HMRC said that death would not be treated as an avoidance step, and that they were currently minded to treat the date of execution of the Will as being the material date. We then queried what would happen if the Will was altered by a later Codicil or if some other step was taken? HMRC said that it might bring the GAAR into play.

219. We also asked about growth shares; was it enough that the growth shares were owned before Royal Assent or would they be caught if the growth in value event took place after Royal Assent. HMRC said if they were caught, growth could be apportioned to the periods before and after Royal assent.

220. We also asked about base cost shift in partnerships, where the partner giving up the right to capital was not taxable but the recipient might be (but had a higher base cost). Is the arrangement grandfathered at the time the partnership was set up, or is it the time of the base cost shift that matters? At the time of the 16 January meeting HMRC were not sure but seemed to think it is the time of the base cost shift.

The future

221. It is too early to tell whether the GAAR will lead to any meaningful simplification of the tax system - indeed in the short to medium term it is likely to add to existing complexity. Over time, it may counter abusive arrangements for which specific anti avoidance provisions exist so that they could be repealed. Further, if it is found to be effective, it should reduce the need in the future for additional targeted anti-avoidance measures. However, the experience of other countries (for example Ireland) is that it could take 20 years for the GAAR to be tested in the courts, so the Government will have little choice but to continue with its existing legislative approach to countering avoidance.

Withdrawing a notice to file a self-assessment return

222. ICAEW wishes to thank HMRC for the opportunity to comment on the draft legislation on withdrawing a notice to file a self-assessment return.

223. We have considered the draft legislation and have no comments to make further to those we made in our response of August 2012 to the original consultation document in TAXREP 38/12. We welcome the proposal which we believe to be both sensible and workable.

224. We note that reference is made within the consultation draft published on 11 December 2012 to extending the policy wider than SA. We would strongly urge HMRC to consider introducing the same policy for Corporation Tax returns. We think that the same benefits would accrue as under the self-assessment policy – certainty and a reduction of administration costs for both companies and HMRC.

Real time information: penalties

Key point summary

225. We accept that there is a need for penalties to encourage compliance and the penalty regime as a whole seems sensible. Given that much policy as to how RTI will work is unresolved and many more complex but not uncommon employment circumstances (see Appendix 2) are largely untested in practice, the relaxations to the penalty regime in 2012/13 and 2013/14 announced on 29 November 2012 are both essential and welcome.

226. We remain concerned that RTI will impose burdens and costs on employers and that penalties will be chargeable for failing to achieve the impossible. The relaxations to the payday deadline announced on 12 November 2012 do not materially reduce the additional burdens. We believe that allowing employers to submit the full payment submission for each payment on or before the 19th of the month following payment would:

- remove such burdens and costs from employers;
- obviate most penalties;
- help achieve the government's growth agenda;
- enable employers to submit more accurate information thereby increasing the accuracy of universal credit awards, and obviate the need for employer corrections and consequent adjustments to UC awards;
- enable HMRC still to check that employers have paid the right amount of PAYE on time; and
- not stop employers with employees with simple employment patterns from submitting the FPS when they run the payroll so the job is done all in one go.

227. If the deadline is not put back to 19th of the month following payment then we consider that where the examples in Appendix 2 apply the penalties legislation needs to incorporate an automatic reasonable excuse let-out where a default would arise for failure to meet the deadline. In this context regard also needs to be had to IR35 deemed payments.

228. HMRC's costs impact assessment published on 15 March 2012 is wholly unrealistic. It should be updated with true data, preferably by Budget 2013.

229. We are disappointed that our request to HMRC for a marked up version of the legislation that the draft legislation is amending has been turned down. Such a document would make it easy to check whether the legislation will work as intended, and we would have thought HMRC would have such a document for this very purpose. In the spirit of better consultation of which publishing in advance draft Finance Bill legislation for comment is a major part, such a document should be available as a matter of course.

General comments

230. We understand the need for penalties to encourage timeous and accurate filing of RTI returns and timeous payment of PAYE liabilities and we think that on the whole the regime seems sensible. And given the lack of an operationally proven system including the more complex but not uncommon employment circumstances such as those listed in Appendix 2 and the absence of testing at full capacity a year before go-live (see Lord Carter of Coles' report of March 2006 on HMRC's information technology), and numerous points unresolved and guidance for employers still being written by HMRC despite there being only nine weeks until most employers will be mandated to operate RTI, we welcome the announcement on 29 November 2012 of certain relaxations to the penalty regime for 2012/13 and 2013/14.

231. As we have said elsewhere, the RTI rules need to be framed in such a way that they can be complied with in practice so that penalties are not levied for failing to do the impossible.

232. In particular we continue to be concerned about the burdens and additional costs that RTI will impose on all employers. Many of these are the result of the tight deadlines by which the full payment summary (FPS) for every payment has to be submitted. This is normally on or before payday save for 'notional' payments and relaxations announced on 12 November 2012. In many cases, the deadlines will be difficult if not impossible to meet, and meeting them will create additional burdens on employers. We include in Appendix 2 a list of examples of where we expect difficulties to arise and where the proposed penalty model may therefore prove unfair.

233. We believe that the relaxations to the deadlines announced on 12 November will not materially reduce the burden and costs on employers. Most of the relaxations will necessitate the employer running payroll and submitting RTI returns every week, rather than monthly, unless employers and employees enter into loan agreements, which themselves would create administrative burdens, or employers 'fudge' payment dates, which would mean that RTI data on HMRC's and DWP's database would not necessarily agree with data known to universal credit claimants. It would have been more practical for the relaxations to have specified the next regular payroll run, rather than within seven days. Also for payments at the end of a shift, allowing electronic payments as well as cash and cheque payments would have been helpful, given that payments by mobile phone text are becoming more common.

234. We consider that the added burdens on and costs for employers, especially smaller and medium sized employers, will discourage recruitment, especially by growing businesses ready to take on their first employee. This seems to cut across the government's growth agenda.

235. The silver bullet that would enable employers to submit accurate data on time without excessive administrative burdens and costs or the need for relaxations and workarounds would be to allow employers to submit their RTI returns on or before the 19th of the month following the end of the tax month of payment.

236. Extending the deadline would have a number of advantages in addition to easing the burden on employers and ensuring the penalties are not levied for failing to do the impossible or impractical.

237. It would improve the accuracy of the data submitted thereby reducing the need for and number of corrections. This would mean that the data obtained by DWP from HMRC to means test universal credit (UC) would be right first time and there would be a smaller number of changes to awards resulting from corrections submitted by employers. Keeping the income of universal credit claimants as constant as possible will make it easier for them to budget, which is especially important given that UC will be payable monthly rather than weekly or in multiples of weeks.

238. We also believe that even if the deadline were extended to the 19th of the month following payment, most employers running payrolls comprising the majority of employees, most of whom have straightforward employment situations, would submit FPS when they run the payroll so they can complete the job all in one go.

239. Monthly reporting would not adversely affect HMRC's ability to check that employers account correctly and on time for their monthly remittances of PAYE income tax and NIC.

240. If the deadline is not put back to 19th of the month following payment then we consider that where the examples in Appendix 2 apply the penalties legislation needs to incorporate an automatic reasonable excuse let-out where a default would arise for failure to meet the deadline. In this context regard also needs to be had to IR35 deemed payments.

241. We have referred above to costs of compliance. The estimated transitional costs and ongoing cost savings in HMRC's impact assessment published on 15 March 2012 are wholly unrealistic – we are aware of no employers or payroll agents who envisage any transitional or ongoing cost savings. On the contrary, all are budgeting for additional transitional and ongoing costs. We (and other professional bodies) have provided HMRC with contact details of payroll agents who are happy that HMRC visit to discuss the impact of RTI and provide estimated costings, and we believe that HMRC has contacted all of them.

242. We consider that the costs impact assessment should be updated using true costs, and published at Budget 2013.

Detailed comments on the draft legislation

243. We are disappointed that HMRC has been unable to accede to our request to provide a marked up version of the legislation that is being amended by the draft legislation on which comments are invited.

244. We acknowledge that in the past it has not been customary to provide such documents. However, given that it is now government policy that draft Finance Bill legislation is published for comment to help improve its quality, we would expect that such a document would be available as a matter of course. It would help both HMRC and external commentators easily to check that that the draft legislation works as intended, and we should have thought that HMRC would have prepared such a document to ensure that the amending and amended legislation are correctly worded.

245. We are not commenting at this stage on the draft legislation. If comments do arise then we shall make them during the Finance Bill process.

Vulnerable beneficiary trusts

Key point summary

246. We are pleased to note that the definition of vulnerable beneficiary has been extended to include those in receipt of personal independent payment by virtue of entitlement to the daily living component at either the standard or enhanced rate. We also welcome the modification such that the trustees will be able to apply small amounts of income and capital without having to prove that it is for the benefit of the vulnerable beneficiary.

247. However, we are disappointed that several of the points raised in our original submission have not been taken into account in the draft legislation and to that extent they are reiterated. We are still of the view that the opportunity should be taken for a complete review of the vulnerable beneficiary trust regime.

248. We have a specific concern with the draft legislation published on 17 January 2013 as it would seem that for trusts created on or after 8 April 2013 the statutory power of advancement in s 32 Trustee Act 1925 will have to be excluded or restricted in order for the trust to qualify as a bereaved minor trust or an 18-25 trust. Our technical analysis of this point is given below.

Draft legislation

The s 32 power of advancement

249. The draft amendments for trusts with vulnerable beneficiaries, issued on 17 January 2013 appear to go further than intended, in that, in addition to *"removing a rule that accepts that a trust does not fail to secure that the income and capital conditions are met by virtue of the existence of a statutory power of advancement. (Removal of the rule will require a qualifying trust deed to explicitly deny the trustees' the statutory power during the vulnerable person's lifetime (or other relevant period))…"* for vulnerable beneficiaries, this same restriction appears to have been applied to trusts for bereaved minors (s 71A Inheritance Tax Act (IHTA) 1984) and '18-25' trusts (s 71D). This does not make sense and we believe it is a mistake, especially in view of the proposed relaxation included at ss 71A(3B) and 71D(6C) respectively, which will allow small [as defined] amounts of trust income or capital each year to be applied for someone other than the bereaved minor.

250. The statutory power in s 32 Trustee Act (TA) 1925 is not a power to advance only, but is also a power to apply capital for benefit of the beneficiary. This is not however unlimited: the trustees may not, under the guise of 'benefit' pay capital to a beneficiary in order for them to benefit persons who are not beneficiaries under the trust i.e. they may not seek to circumvent the provisions of the trust deed, in order to benefit non-beneficiaries.

251. The word 'benefit' has been held - inter alia - to allow capital to be paid or applied in paying a beneficiary's debts, in maintaining and supporting a beneficiary, to pay capital outright to the beneficiary provided the trustees are satisfied that it would be for his or her benefit, or to resettle capital for the beneficiary's benefit. The power is often used to – for instance – pay school or university fees, in the case of school fees often receiving a discount for up front payment. The provision of a good education for the beneficiary is surely within the spirit and intent of the qualifying conditions in ss 71A and 71D IHTA 1984, and HMRC has never indicated that it disagrees with that view.

252. There is no avoidance motive to be considered here, provided the power is only exercised so that the trust continues to meet the conditions in ss 71A and 71D IHTA 1984. If the exercise of the power were to cause the trust to leave the protected s 71A or s 71D regime, then the trust would be subject to the relevant property rules, and tax would be collected accordingly.

Trusts for bereaved minors and '18-25' trusts

253. When ss 71A and 71D were first drafted, the provisions currently at s 71A (4)(a) and s 71D(6)(a) were not included in their current form. Following representations from the ICAEW, CIOT, STEP and firms in practice during the Committee stages of Finance Bill 2006, these subsections were added in June 2006, to make clear that the existence of the statutory or extended s 32 power in a trust deed would not prevent it from qualifying as either a s 71A or s 71D trust, provided other conditions were met.

254. It was the case – and continues to be – that the drafting of the rest of ss 71A and 71D ensures that, in order to qualify within those sections, there are protections for the child beneficiaries – the greatest of these being at s 71A(3)(b) *"that, for so long as the bereaved minor is living and under the age of 18, if any of the settled property is applied for the benefit of a beneficiary, it is applied for the benefit of the bereaved minor"* [the minor becomes absolutely entitled as against the trustees at age 18, so it is inappropriate to extend this protection beyond that age] and s 71D(5)(b) *"that, for so long as B is living and under the age of 25, if any of the settled property is applied for the benefit of a beneficiary, it is applied for the benefit of B"* [again, B must become absolutely entitled as against the trustees on attaining age 25, so the protection of s 71D(5)(b) covers the period up to that point].

255. It is clear that the mere existence of the statutory (or extended) power of advancement in such cases cannot represent a risk to vulnerable beneficiaries, because the drafting of the sections ensures that the settled property is only applied for their benefit. If the property may be otherwise applied, the trust will not fall within ss 71A or 71D, and will thus be a normal relevant property trust with no advantageous inheritance tax treatment and no added protection for its minor beneficiary at all.

256. The Government's plans make sense in terms of trusts within s 89 IHTA, since s 89 currently only provides that *"not less than half of the settled property which is applied during his life is applied for his benefit"*, i.e. the level of protection for the vulnerable beneficiary is not at the same level as that provided by ss 71A and 71D. It is however perverse to extend this restriction to those sections, which already impose conditions as to the whole of the trust capital and income (subject to the proposed relaxations regarding capital and income of the lower of £3,000 or 3% of the maximum value of the settled property, during any tax year).

257. Accordingly, we would welcome confirmation that this change to ss 71A and 71D was not intended, and confirmation that the proposed changes to s 71A (4)(a) and s 71D(6)(a) will not be included in Finance Bill 2013.

Trusts arising under an intestacy

258. There is also an inconsistency between bereaved minors' trusts arising as a result of intestacy (governed by s 71A(1)(a)) and those which arise under a Will (governed by ss 71A(1)(b) and 71A(2), to which the conditions in ss 71A(3) and 71A(4) (as amended) apply).

259. The statutory power of advancement applies to statutory trusts for issue on intestacy, but this will not prevent those trusts from qualifying as s 71A trusts. However, if the power applies to equivalent trusts written into Wills, it will prevent those trusts from qualifying and they will then be subject to the inheritance tax relevant property regime for trusts. This has the perverse effect that – as the legislation is currently drafted – bereaved minors will potentially be in a worse position if their parents have made a Will (and omitted to restrict s 32 TA 1925 or the Will was made at a time when the s 32 power was not considered a problem) than if they had failed to do so and died intestate.

Grandfathering

260. It appears that these changes are only intended to affect trusts arising after 8 April 2013. However, the grandfathering provisions in para 7, Sch 1, Finance Bill 2013 do not take account of trusts made by Will. This is again perverse since s 71A and s 71D trusts are specifically intended to be created by Will.

261. Wills that have been made before 8 April 2013 and which contain trusts for the testator's children to take say at age 18 or up to age 25, will almost always include either the statutory or an express power of advancement (so as to enable the trust property to be advanced to pay school fees for example or to enable the children to benefit in some other way). However, a Will does not technically come into operation (and so the trusts will not be 'created') until the testator dies and if this occurs after 8 April 2013, the settlement will not be within the current grandfathering provisions.

262. It surely cannot be the Government's intention that clients must incur costs in revising their Wills yet again, following the wholesale revision exercise required following the Finance Act 2006 changes? We therefore propose that grandfathering is extended to include Will trusts established on the death of a person on or after 8 April 2013 where the Will was written on or before 8 April 2013.

Disincorporation relief

Key point summary

263. We welcome the proposal for a disincorporation relief. We support the work of the OTS in its efforts to simplify the tax system for the smallest businesses and are pleased that HM Treasury has taken forward its work on a possible disincorporation relief. We consider that entrepreneurs should be able to operate in the most commercially efficient and appropriate way for their businesses and tax should not be a disincentive to an appropriate disincorporation.

264. There are two aspects of the draft legislation which we think are too restrictive and should be amended:

264.1. The £100,000 asset limit is too low.
264.2. The relief should not be introduced just for a five year period.

Comments on draft legislation

Limit on total asset value

265. We appreciate that the relief is aimed at small businesses and agree that setting an upper limit on the market value of qualifying assets will achieve this.

266. However, the £100,000 maximum is very low. Many smaller companies which could benefit from the relief could have goodwill and/or interests in land with a total value in excess of this. The EU definition of a micro-company is one with annual turnover or balance sheet total not exceeding €2m. We recommend that the limit should be set in line with this definition. It should certainly be at least £500,000.

Five year limitation

267. Clause 1(1)(c) provides that the relief will be available for five years from 1 April 2013.

268. We do not agree with this time limitation. The relief should be a permanent part of company tax legislation. There will always be a need a disincorporation relief – there are a whole range of reasons why disincorporation may be sensible and desirable for a company. The reliefs for incorporation are not time-limited and the disincorporation relief should mirror that.

269. We are aware that the OTS suggested a five-year term for the relief, so that it could be reviewed to see if it is useful and effective. We support the proposal to review new legislation, but this can be done without placing a time limit in statute.

270. We are concerned that unless the government reviews the relief and announces its intentions well in advance of the 31 March 2018 end-date, the situation will create uncertainty for small companies. Some may disincorporate without considering if this is the best option, in order to make use of the relief while it is available

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APPENDIX 1

ICAEW 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 icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)