

TAXREP 42/05

FORM 42

PARTIAL REGULATORY IMPACT ASSESSMENT (RIA) Part 7, ITEPA 2003 Reporting Requirements

Memorandum submitted in September 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in relation to a request for future improvements to the published version of Form 42

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FORM 42
PARTIAL REGULATORY IMPACT ASSESSMENT (RIA)
Part 7, ITEPA 2003 Reporting Requirements

INTRODUCTION

1. Schedule 22 of the Finance Act 2003 set out a new regime for the taxation of employee share schemes. The new regime includes new reporting requirements in respect of share transactions by employees and future or ex-employees. Details of share transactions need to be disclosed on Form 42.
2. Further to earlier discussions, we have again been asked to suggest improvements to the form and to comment on the costs associated with its completion. The request for comments is contained in the partial Regulatory Impact Assessment published on 1 July (www.hmrc.gov.uk/ria/final_form42_partial.pdf)

GENERAL COMMENTS

3. Firstly, we welcome the current review and support its stated aim of reducing the compliance and administrative burden on small companies in particular.
4. With this in mind, we have concentrated on how the form will be used by the vast majority of small companies (estimated at around 400,000 last year), which are not issuing shares under schemes, but which have issued shares on incorporation.
5. During the past two years, we have submitted a number of suggestions which would greatly reduce the compliance burden in relation to the completion of this form. Those comments which remain relevant to the current consultation are repeated under Further Suggestions below.

SPECIFIC COMMENTS

6. The duty to provide information is set out by s421(J), ITEPA 2003. This imposes a burden far in excess of that originally anticipated when Part 7 of the Act was first published. Although we accept that these requirements are intended to ensure that the rules in Part 7 are being properly applied, we still disagree with the principle that all founder shares in owner managed companies are within the spirit of this legislation.
7. We are particularly concerned with the comment in paragraph 4 of the RIA that:

The reporting requirements provide valuable data which enables us to gauge the impact of changes in policy and the likely cost or yield from these changes to the Exchequer.
8. We note that of the 411,000 forms submitted last year, 405,000 forms (98.5%) were submitted by newly incorporated companies, the vast majority of which would not consider that they have an employee share incentive scheme. There is no tax at risk from these companies which are operating within the scope of the

law. To impose an administrative burden of this magnitude in order to collect information to enable government to gauge the possible effect of policy changes to tax rules is an abuse of administrative power under the tax system. Collection of statistics should be a separate task under the remit of the relevant government department, such as the Office of National Statistics.

9. Furthermore, this administrative burden is in direct conflict with the Government's stated aim of reducing the costs of red tape. On Thursday 15 September 2005 John Hutton, Chancellor of the Duchy of Lancaster and Minister for the Cabinet Office, announced the launch of the cross-government Administrative Burdens Reduction measurement exercise, recommended in 'Less is More'. The measurement exercise will identify the administrative burdens placed on business, charities and the voluntary sector by regulation. The resulting baseline will be used by the government to set targets for reductions. We suggest that abolition of the requirement for Form 42 by some 405,000 companies would produce an instant and dramatic cost saving.
10. Using the cost estimate in paragraph 9 of the RIA, the minimum unnecessary cost imposed on business by the need to complete Form 42 is in excess of £16 million. It appears that the estimate of £40 to £200 per form excludes HMRC's own time spent in logging, collating and processing the forms. It is therefore likely that this cost is severely underestimated.

RIA paragraph 14: *Going forward we need to build on the improvements achieved already by looking at, for example, the range of information being provided, the structure of the Form and also consider other easier methods of discharging the reporting obligations. We would therefore welcome comments and suggestions as part of the informal consultation on what further improvements can be made to the Form 42 reporting process taking into account the purpose of the Form.*

11. Confining our response to the vast majority of persons who are required to complete it, being newly incorporated small family companies, there is no information on Form 42 which is not already available from inspection of the Form CT41G and the return made to Companies House.
12. In the case of a share acquisition, much of the information required by Form 42 will already have been submitted to the authorities:
 - By completion of a duly completed and stamped share transfer form.
 - By submission of Form 88 to Companies House following an issue of shares.
 - By completion of Form CT41G for formation shares. There is the issue of timing in that the Form CT41G will not be submitted until three months after the company comes within the charge to tax, so usually when it starts to trade. However, if the company has not started to trade, it seems unlikely that there is any tax at risk.
13. Consideration should be given to streamlining existing processes in order to reduce the number of instances when Form 42 is needed.

RIA paragraph 21: *It is difficult for us to estimate how much it costs a business to complete a Form 42. It seems likely that the cost will vary depending on, for example, the number of employees, type and number of events, use of professional adviser and quality of and accessibility to information held by the employer. As stated earlier, anecdotal evidence suggests newly incorporated companies are being charged between £40 to £200 by accountants for completing the simplified version of Form 42. We would therefore welcome comments on the level of fees charged for completing the Form, either in its simplified or full version.*

14. It is not clear where the estimate of £40 to £200 comes from. As already stated it is unlikely that these cost estimates include HMRC time. Also, there is no mention of the estimated costs for those completing the long version of the form.

15. In more complex cases or where securities are issued to overseas employees it will take a considerable amount of time to collate the relevant data. We explained the position of multi national companies in our initial TAXREP 50/04 as follows:

We understand that the 7 July deadline is likely to lead to the imposition of penalties for many international groups of companies who find it impractical to collate the information needed on a world wide basis in such a short time frame. We are concerned to hear reports from our members that the Revenue appears not to be willing to consider an extension to the deadline in such circumstances. We are concerned that companies that seek to comply but have practical difficulties in doing will face penalties in the nature of an annual levy. Consideration needs to be given to ensuring companies are able to agree more realistic deadlines for complying.

16. It will be likely that the £3,000 penalty imposed on such companies is viewed as a cost of completing the form rather than as a penalty for deliberately missing the deadline.

RIA paragraph 22: *Overall the improvements that we hope to achieve should reduce costs particularly for small businesses. For example, if less information was needed or the information could be delivered in a different way or method then this would positively impact on business by reducing the time and resources needed to provide that information. We would also therefore welcome comments on any other costs associated with the process and the extent to which business consider costs could be reduced by further improvements to Form 42. We would particularly welcome examples of this from businesses affected, telling us about the size of the business and the issues they face in completing the Form*

17. See our comments to the previous question.

RIA paragraph 25: *The Form 42 reporting obligation has impacted on small businesses when they incorporate or use employee shares. We hope to identify changes that should directly benefit small companies. Although it is not possible to remove particular groups or sectors from the Form 42 reporting obligations we can consider improvements to the reporting process to help reduce the burden on some businesses. It would be helpful to receive comments or proposals of any changes to Form 42 that can be achieved that would be of particular benefit to small*

businesses. In this context it would be helpful to receive information about the most common transactions in employee shares that are undertaken by small businesses and their frequency, to demonstrate the extent of the benefits that would flow from the proposed improvements.

18. Founder shares should not be reportable on Form 42. The tax at risk is negligible whilst the costs imposed on new businesses are considerable.
19. Although paragraph 25 of the RIA says that particular sectors cannot be exempted from the reporting requirement, we do not think that the cost of completing the form is justifiable in all cases. Further consideration should be given to allowing a concession for flat management companies which by their nature will not usually have employees and will not be providing employee benefits. This will afford a welcome administrative relief. This could perhaps be extended to provide an exemption for other companies fulfilling certain criteria.

FURTHER SUGGESTIONS

For reducing the compliance burden of completing Form 42

Guidance notes

20. The current form is overcomplicated by mixing together matters of information and instructions for completing the form with the boxes for completion. We recommend that the two are separated, in a similar manner to the design of the self assessment tax return forms, and that the guidance notes are published separately.

Pre numbered boxes

21. All boxes for completion should be pre-numbered.

Market value of securities

22. Income Tax self assessment has a procedure, CG34, for establishing the valuation of unquoted securities for the purposes of establishing a capital gain on a disposal. This enables an ITSA Tax Return to be submitted on time whilst reducing the likelihood of an unnecessary enquiry whilst the taxpayer and the Revenue agree the disposal value. There should be a cross reference to a situation where the acquirer has acquired such shares.

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WHO WE ARE

23. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 125,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
24. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
25. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.