TAXREP 33/13

(ICAEW REP 99/13)

ICAEW TAX REPRESENTATION

FINANCE BILL 2013

Briefings submitted in April, May and June 2013 by ICAEW Tax Faculty in relation to the provisions in Finance Bill 2013

Contents

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall, Moorgate Place
London EC2R 6EA UK
icaew.com/taxfac

T +44 (0)20 7920 8646
F +44 (0)20 7920 0547
E taxfac@icaew.com

INTRODUCTION

1. ICAEW Tax Faculty submitted Briefings to the Public Bill Committee on individual clauses in the Finance Bill.

2. This memorandum reproduces the text of all those Briefings.

3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. 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.

5. 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.

6. 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.

Clause 16 and Sch 3 – Limit on income tax reliefs

Summary of main points

- This clause is to enact the proposal in the 2012 Budget to restrict income tax reliefs to a maximum of £50,000 or 25% of the taxpayers adjusted total income for the year.
- The measure is intended primarily to tackle avoidance, but it will hit small businesses by restricting loss relief for commercial losses. The measure will reduce cash flow, hamper business growth and could lead to small businesses that are experiencing difficulty in the current economic climate going bust. Effectively this removes an important source of finance for new business.
- Although we welcome the various changes that the Government has made to the original proposals in the light of comments made, we remain concerned about a number of aspects to this measure.

Conflict with the growth agenda

1. We note that charitable donations were removed from the list of restricted reliefs back in 2012, but commercial losses and qualifying interest payments remain subject to the restriction. The restriction of relief for commercial losses and the prevention of relief on loan interest for loans for commercial businesses potentially run counter to the Government's own initiatives in the growth agenda.

2. One of the original key policy purposes 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 appreciate why the Government would wish to restrict relief in those circumstances but the actual policy being implemented has resulted in a much wider restriction. For example, there is no targeting of 'year after year' and the restriction can apply in the very first year. These proposals will impact 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.

3. 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 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. In the current very difficult economic climate many otherwise viable businesses are on a knife edge financially. They may be just coping with their level of borrowing but 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.

4. The measure also conflicts with the temporary increase in the Annual Investment Allowance from £25,000 to £250,000 with effect from 1 January 2013. 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.

5. 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 taxpayers 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, as set out in the example below.

   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 business loss arising of £20,000 due to capital allowances. 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.

   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.

Proposed change(s)

6. We have previously 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 loss relief for artificial (ie non-commercial) losses.

Interest relief on loans

7. 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. The tax relief will have been factored in to the cash flow by individuals when taking out the loan, so to remove the relief now could cause financial hardship.

Proposed change

8. To preserve legitimate expectations, transitional provisions are needed to exempt loans obtained before this legislation is enacted. If this proposal is not accepted, we believe it would be reasonable to taper withdrawal of tax relief on the interest.

Loss relief on shares

9. 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 EIS etc, 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 original investment decision.

Proposed change

10. To preserve legitimate expectations we believe the cap on share loss relief should only apply to investments made after the announcement of the proposed restriction.

Clause 17 and Sch 4 – Cash basis for small businesses

Summary of main points

- Originally suggested by the OTS as a simpler tax system for the smallest businesses, this alternative tax accounting system just creates more regulatory confusion for them.
- We do not think that these proposals should be implemented from 6 April 2013 in their current form; they should be delayed for a year.
- The proposals as drafted remain complex and HMRC has yet to publish proper guidance.
- We are concerned that this will not be the simplified system proposed by the OTS, but rather will just be an alternative tax system for small business.
- The size limit for using the scheme should be reduced to that recommended by the Office of Tax Simplification that is a turnover limit of £30,000 for entering the scheme and £40,000 before a business must leave the scheme.
- These proposals would be far simpler for small business if the VAT registration limit for cash basis accounting was specified at the start of the tax year, rather than the end as currently drafted.

Support for the initiative

1. We were pleased that HMRC consulted on these proposals from an early stage. 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.

2. Although the legislation has improved since the draft clauses were published in December 2012, many of our detailed points on the legislation have not been taken.

Problems with the initiative

3. It remains complex and HMRC has yet to publish proper guidance even though those who will use the scheme will already be in accounting periods affected by the changes. We do not think that these proposals should be implemented from 6 April 2013 in their current form.

4. The rules which define when a business may use the cash basis are linked to the VAT registration limit. This is increased each year in the Budget. Because of the way the drafting works, a business nearing the maximum limit will not know whether it is allowed to enter the cash basis scheme until near the end of the tax year affected. We consider this to be unacceptable and in the interest of giving taxpayer certainty suggest clause 31B (7) should be changed so that it becomes the 'VAT threshold' in relation to a tax year, means the amount specified at the start of that tax year in paragraph 1(1)(a) of Schedule 1 to VATA 1994.

    Illustration
    Bob is considering whether his income is below the relevant maximum for 2013/14. He must compare his income with the VAT threshold at the end of the year, so with whatever it is on 5 April 2014. This won't be known until Budget 2014. Bob is therefore unsure whether he can use it or not and has to keep proper accounts all year just in case.

    We do not consider this to be simplification.

5. 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.

6. 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.

7. 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.

8. The legislation remains 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.

Recommendations

9. This scheme 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.

10. 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 and TAXREP 16/13. 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 size limit for using the scheme should be reduced to that recommended by the Office of Tax Simplification that is a turnover limit of £30,000 for entering the scheme and £40,000 before a business must leave the scheme.
    - Sideways loss relief, capped at £50,000, should be allowed.

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

    - 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.
    - 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 cash basis for barristers arises due to specific problems in that profession and should be the subject of separate legislation.

General points

12. 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.

13. We are pleased that the draft legislation published in December 2012 has been amended to disapply the '*Sharkey v Wernher'* legislation, s 172B, ITTOIA 2005 to the situation where small quantities of goods are being taken for a proprietor's own use. However, clause 106C (2) now requires an adjustment on a just and reasonable basis. This will require careful guidance as the expression will be virtually meaningless to those businesses affected.

14. 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.

Specific points on draft legislation

Eligibility criteria

Para 5

31A(3)

15. 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

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

17. 31B(7) states

    '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.

18. 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.

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

20. This will mean that in order to determine whether a person has exceeded the relevant maximum for a year, that person cannot 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. If this drafting is retained, we recommend using the VAT limit at the start of the year instead of at the end of the year.

21. This provision would be simplified if numerical amounts were used instead of the VAT threshold, so £79,000 and £158,000. The legislation already allows for these amounts to be increased by Treasury Order in 31B (8).

22. 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)

23. 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.

24. 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

25. The term 'person' in tax legislation is usually taken to include a company. Although the new s31C 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)

26. 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

27. 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.

28. 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 cannot use the cash basis. We do not think that this drafting works as intended.

29. 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

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

31. 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 s24, ITTOIA 2005 already covers this.

32. 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

33. (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

34. 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.

35. The £500 will include the 'incidental costs of obtaining finance'. Bank charges are not 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.

36. 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.

37. 57B(3) allows £500 in calculating the profits of a trade for any period. This would appear to mean that an individual with several trades may claim a deduction of £500 for each of them.

Para 18

New s94A(5)

38. Why do we need the reference to CSOPs since this legislation does not apply to companies?

Para 22

96A Cash basis: capital receipts

39. 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.

Clause 22 – Arrangements made by intermediaries

Summary of main points

- This clause will cause office holders to be taxed like other workers within the intermediaries legislation.
- Prior to this amendment an office holder engaged via an intermediary structure such as a company, would not come within IR35 legislation.
- A company's auditor is an officeholder of the company and therefore is potentially included in this definition. Such a result could then mean that in certain circumstances the audit fee would be liable to PAYE.
- The clause should be amended to put beyond doubt that for the purposes of this provision, an auditor is not an officeholder of the company.

What the clause does

1. This clause brings all office holders within the IR35 rules. At the moment, the IR35 legislation does not apply to office holders, just to workers.

2. 'Office holders' is not actually defined although the courts have tried. Consequently the term has wide application, eg a company's auditor or a pension fund's actuary.

3. This clause will amend Chapter 8 of Part 2 of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 – the intermediaries legislation (IR35).

4. The accompanying notes state that this amendment puts 'beyond doubt' the position regarding income tax on these payments. Such payments are already subject to NIC under separate legislation, and the stated purpose of this amendment is to equalise the treatment for income tax and NIC.

5. 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.

6. 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.

Example 1: How IR35 works

7. Many business people set up their own company and sell their services through that company rather than invoicing clients directly. For example, Tom Tucker is an electrician who has many clients. He works through his own limited company, Tucker Ltd, in which he owns all the shares and is the only employee. The company is known as an intermediary and often the worker is the only employee of the company and owns all the shares.

8. There are many reasons for using this structure, eg, limiting their personal liability if the work goes wrong, maintaining independence, but also because tax can be saved by both the worker and the client if a corporate intermediary is used. This structure is used by many businesses, eg, builders, IT contractors, accountants, solicitors, teachers and persons holding senior managerial positions within businesses and government departments. The use of this within government has attracted considerable criticism as unacceptable tax avoidance.

9. To prevent businesses and their employees using an intermediary structure to avoid paying employment taxes and National Insurance, we have intermediaries legislation (commonly known as IR35).

Example 2 – Unintended consequences for auditors

10. Pike & co is a firm of chartered accountants. The owner of the firm, John Pike, is appointed as the auditor of one of its clients, Clements Ltd, and receives an audit fee of £20,000 for undertaking the annual audit. Under this amendment Clements Ltd would need to apply the IR35 rules and deduct PAYE when paying the audit fee to Pike & Co.

ICAEW concerns

11. Although we appreciate the policy purpose of the change, we are concerned that this change is too widely targeted. For example, a company's auditor is an officeholder of the company and therefore is potentially included in this definition. Such a result could then mean that in certain circumstances any audit fee would be liable to PAYE, as shown in the example above.

12. We do not believe that this is the intended target of this amendment. An auditor may hold a specific office of the company but it is wrong in principle for that remuneration to be potentially subject to the IR35 rules.

13. The clause should be amended to put beyond doubt that for the purposes of this provision, an auditor is not an officeholder of the company, thus preserving the existing and long established treatment that any fees are subject to tax in the firm.

14. Finally, 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 recommend that the legislation should clarify this point.

Suggested amendments to clause 22

15. Add after sub-clause (1):

In section 49(5) ITEPA 2003 add after ‘in subsection (1)’:

‘save that an auditor of an audited person is not to be regarded as an officer or employee of the person provided the auditor is registered under section 1239 Companies Act 2006 The register of auditors.’

Clause 26 and Sch 10 – Transfer of assets abroad

Summary of main points

- This clause aims to bring the current Transfer of Assets Abroad (TOAA) rules in line with European laws on the freedom of movement of capital and establishment. However as drafted it will not achieve this.
- The EU Commission believes the TOAA rules are discriminatory as investments outside of the UK are taxed at a higher level than domestic investments.
- Most people including professional advisors do not understand the rules as drafted. This clause will only add a further level of complexity.
- This clause and schedule should be withdrawn and alternative proposals included in next year’s finance bill.
- If this clause cannot be withdrawn, at the end of this briefing we have detailed a number of minimum changes required to make it work.

What the clause does

1. This clause and Schedule (Part 2) provide for a new exemption from the TOAA rules where there is a genuine transaction and not to provide an exemption would breach an EU treaty freedom.

2. The Government has made a change to the previous draft legislation such that where a transaction is part genuine and part not genuine, the income arising from the genuine part of the transaction will be exempt from the TOAA provisions. We welcome this change.

How the Transfer of Assets Abroad rules work

3. The Transfer of Assets Abroad (TOAA) rules apply to individuals who are resident in the UK where there has been a transfer of assets to a person/entity that is not UK tax resident. If as a result of the transfer (or any associated operations) income becomes payable to that person/entity abroad and a UK resident individual can still actually or potentially benefit from income of the person/entity (or receive a capital sum or other benefit from the arrangement) the rules apply an income tax charge. There are currently exemptions from these charges where the individual satisfies HMRC that there is no UK tax avoidance purpose to the transfer or associated operations; or that the transactions are genuine commercial transactions and any UK tax avoidance purpose is incidental.

4. Clause 26/Schedule 10 introduce changes to the TOAA legislation in response to the European Commission’s issued infraction notice IP/11/158 of 16 February 2011. On 24 October 2012 the European Commission (EC) announced its intention to refer the UK to the Court of Justice of the European Union (CJEU) in relation to the TOAA rules. The EC considers that the legislation is disproportionate and goes beyond what is reasonably necessary in order to prevent abuse or tax avoidance. The EC considers there to be discrimination as investments outside the UK are taxed more heavily under the TOAA than domestic investments, restricting the freedom of

establishment and free movement of capital contrary to Articles 49 and 63 of the Treaty on the Functioning of the European Union and Articles 31 and 40 of the EEA Agreement.

ICAEW concerns

5. We support the objectives that the Government are trying to achieve, namely making the TOAA regime compliant with EU law while protecting the exchequer. However, it is our view that clause 26/Schedule 10 will not make UK law compliant with EU principles.

6. We are disappointed that the points we made in our 2 earlier representations (TAXREP 53/12 and TAXREP 11/13) on these changes during the consultation process have, in the main, not been taken on board.

7. It is our view that, in addition to being non-compliant with EU law, the TOAA legislation as amended will add to the complexity of legislation that is already incoherent and overly complex. Many taxpayers and even many professional advisers cannot understand the TOAA rules because of the extensive case law and complexity of the existing legislation. This was a factor which led the EC to say the measure was disproportionate. The changes add a further tier of complexity and must therefore be subject to the same criticism.

8. Given the complexity of the TOAA rules and the additional burden this places on taxpayers, on top of self assessment, our view is that short-term UK residents should be excluded from the legislation. The definition of short term resident for this exemption could be the same as that used for the new ‘overseas workday relief’ (within Schedule 44).

Specific issues with the drafting of the new exemption

9. The new exemption (new s742A ITA 2007) is drafted in a novel way. By providing for exemption for genuine transactions where not to do so would breach one of the EU treaty freedoms (s742A(3)(4)), this will leave taxpayers with a great degree of uncertainty. Not only will it be necessary for taxpayers and/or their advisors to have an in depth knowledge of the relevant provisions of EU law in order to determine whether or not the exemption applies, by making reference to EU law, which itself is subject to uncertainty and decisions in the ECJ, it may be impossible to conclude whether or not condition A of the exemption is satisfied.

10. To be within the new exemption, a ‘genuine transaction’ must consist of the provision of goods or services to others on a commercial basis (new s742A(8)). While we appreciate the need to exclude artificial transactions, 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 the TOAA provisions apply. 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). As such, we, remain concerned that transactions undertaken by active investment companies, which should come within the new exemption, may not qualify as they fail to meet the definition of a ‘genuine transaction’.

11. We do not understand why new s742A(7) makes reference to assets being used in or income being received in the course of activities being carried on outside of the UK. Amendments have been made to similar provisions to amend s13 TCGA 1992 (clause 61(3) Finance (No. 2) Bill) and we consider that the same amendments are required here.

12. New s742A(6) ITA 2007 provides that (subject to sub-section (11)) 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.

13. 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.

14. The new exemptions should not be limited to transactions effected after 5 April 2012. To be EU compliant the amendments need to include pre-existing structures.

Recommendations

15. As already stated, we support the objectives that the Government is trying to achieve, but cannot support clause 26/Schedule 10 in its present format as:

    - in our view the objectives (namely making the TOAA regime compliant with EU law while protecting the exchequer) are not achieved.; and
    - taking the above into account the changes would introduce additional complexity without any benefits.

16. However, as previously stated in TAXREP 53/12, given that a General Anti-Abuse Rule is being introduced and the other issues regarding the TOAA rules (lack of coherence and complexity), we consider that there needs to be a wholesale review of this legislation.

17. We recommend that this clause and schedule be withdrawn from Finance Bill 2013 and that HMRC enter into discussion with experts from representative bodies to together devise a solution that meets the Government’s objectives as well as improving the clarity and workability of the legislation. This is required both to assist taxpayer compliance and HMRC enforcement of the provisions.

18. We accept that a delay in adjusting UK tax law by an additional year is not ideal but we feel it is preferable to enacting the legislation now and having to correct it in the next Finance Bill. Since EU law has priority over UK law affected taxpayers will not be disadvantaged as they will be able to submit self assessment tax returns on the basis of the EU law position.

19. If deferring the legislation for a year is not acceptable then we would ask that (at least) the following changes are made:

    - Amendments so that the rules recognise that investment transactions as well as trading transactions can fall within the ‘genuine transaction’ definition, that other business activity is possible and the level of activity will vary depending on the nature of the business.
    - The ‘genuine transaction’ definition should expressly include the letting of property and active investment in shares and other investments.
    - Amendments so that the rules recognise that ‘genuine transactions’ do not necessarily take place at arm’s-length.
    - Amendments to new s742A(7) to remove the references to assets being used in or income being received in the course of activities being carried on outside of the UK. As mentioned above, similar provisions were originally in the draft 2013 Finance Bill clauses relating to s13 TCGA 1992 and were taken out for the Finance Bill version (see clause 61(3) Finance (No. 2) Bill). The same amendments are required here.
    - The TOAA rules should contain a *de minimis* provision.
    - The commencement provisions need to be modified so that the new exemption applies to pre 6 April 2012 transactions.

Clause 30 – Loss relief surrenderable by non-UK resident established in EEA state

Summary of main points

- Clause 30 amends the restrictions on when companies resident in the European Economic Area (EEA) can surrender losses attributable to their UK permanent establishments as group relief from corporation tax in the UK.
- This clause derives from a recent decision of the Court of Justice of the European Union (CJEU) in the case of *Philips Electronics UK Ltd*.
- 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*.
- We consider that it would be more appropriate to remove Condition C for UK permanent establishments of EEA companies, without imposing any further conditions for those companies.

What the clause does

1. Clause 30 amends the restrictions on when companies resident in the EEA can surrender losses attributable to their UK permanent establishments as group relief from corporation tax in the UK. Currently, companies resident in the EEA are subject to the same rules as non-EEA resident companies. From 1 April 2013, a new restriction will apply for EEA-resident companies based on whether their losses are relieved in another country in any period, rather than on whether they could potentially be relieved in another country.

2. Section 107 of the Corporation Tax Act 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 (ss107(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.

3. The proposed amendment removes this restriction for UK permanent establishments 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.

Why the change

4. The proposed amendments to s107 of the Corporation Tax Act 2010 are in response to the decision of the CJEU in the case of *Philips Electronics UK Ltd* (C-18/11).

5. In the *Philips* judgment the CJEU held that the then existing law, which is now ss107(5) and (6) Corporation Tax Act 2010, was unlawful and was not capable of being justified by any public policy argument.

6. The UK was in effect told to scrap any such restriction on the use of losses by UK permanent establishments of a company resident in the EU (but not the UK) which operates with regard to the utilisation of the loss or any part thereof in another country than the UK.

ICAEW concerns and recommendations

7. 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*.

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

Clauses 57–60 – Disincorporation relief

Summary of main points

- The clauses propose to introduce a disincorporation relief, which mirrors an existing relief for incorporation and is a welcome development.
- In principle similar businesses should be taxed in the same way regardless of whether or not they are operated through a company.
- Under current rules, where a business being operated through a company is transferred to the shareholders, (eg a business operated through a one man company is transferred out to be operated by the shareholder personally as a sole proprietor) the transfer may face immediate tax charges.
- These clauses allow, subject to conditions, for tax charges arising on the transfer of land and goodwill to be deferred
- However, two aspects of the draft legislation are too restrictive and should be amended:
    - the £100,000 asset limit is too low; and
    - relief should be reviewed after five years but not stopped.

What the clauses do

1. The measure was originally suggested as part of a review of small business tax rules undertaken by the Office for Tax Simplification (OTS). The clauses propose to introduce into UK tax legislation a disincorporation relief. Under current rules, where a business being operated through a company is transferred to the shareholders directly, eg a business operated through a one man company is transferred out to be operated by the shareholder personally as a sole proprietor; the transfer may give rise to immediate tax charges. These clauses allow, subject to conditions, for tax charges arising on the transfer of land and goodwill to be deferred. This is achieved by rolling over any gain: the base cost of the asset transferred is reduced by the amount of the gain deferred.

2. We welcome the proposed disincorporation relief. The new relief mirrors a long-standing existing relief where an unincorporated business incorporates, and it is an anomaly that no relief was available where an incorporated business disincorporated. In our view businesses should be able to operate in the most commercially efficient and appropriate way and tax should not be a disincentive to an appropriate disincorporation.

Our concerns

3. However, we remain of the view that two aspects of the draft legislation are too restrictive and should be amended, namely that:

    - the £100,000 asset limit is too low; and
    - relief should be reviewed after five years but not stopped.

Proposed amendments

£100,000 limit on total asset value

4. 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.

5. 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. For example, the EU definition of a micro-company is one with annual turnover or balance sheet total not exceeding €2m. We originally recommended that the limit should be set in line with this definition and, if that was not accepted, then it should certainly be at least £500,000. In the interests of simplicity, we suggest the latter amendment.

Proposed amendment

6. In clause 58(4), substitute '£500,000' for '£100,000'.

Five year limitation

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

8. 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 for 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.

9. 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.

10. 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.

Proposed amendments

11. In clause 57

    At the end of clause (1)(b)k, delete 'and'.

    Delete clause 57(1)(c).

Clause 64 and Sch 24 – Charge on certain high value disposals by companies etc

Summary of main points

- This clause introduces a capital gains tax charge on UK resident and non-resident non-natural persons (NNP), on the disposal of high value residential properties that are liable to the annual tax on enveloped dwellings (ATED) set out in clauses 91–172.
- At present UK registered companies pay corporation tax on gains made rather than capital gains tax, under this change both resident and non-resident companies will pay capital gains tax on disposals which is a higher rate.
- While we understand the policy purpose of this change, the approach that has been taken is fundamentally flawed. It is not properly targeted, is highly complex and burdensome and likely to be expensive to administer and enforce.
- We believe that clause 64 should be deleted pending a rethink about how the Government can achieve its policy objectives in a way that is properly targeted, less burdensome and more effective.

What does the clause do?

1. This clause introduces a capital gains tax charge on UK resident and non-resident non-natural persons (NNP), which will usually be limited companies but will also include collective investment vehicles, on the disposal of high value residential properties that are liable to the annual tax on enveloped dwellings (ATED) set out in clauses 91–172 and Schedules 31–33.

2. At present UK resident limited companies pay corporation tax on gains made rather than capital gains tax (CGT). Given that the capital gains tax rate is higher than the corporation tax rate, under this provision both resident and non-resident companies will all pay CGT on disposals and not corporation tax.

3. As noted above these provisions therefore need to be read in conjunction with those provisions and our concerns below relate partly to the ATED provisions being too widely targeted. We will be providing a further briefing in respect of those clauses but of necessity have included some detailed problems with the ATED rules below.

When is it effective?

4. The new CGT charge will apply to disposals by non-natural persons of high value residential properties liable to ATED on or after 6 April 2013. Gains arising since 6 April 2013 will be liable to CGT.

5. Any gains attributable to the period before 6 April 2013 will remain subject to tax under the original rules, ie gains made by UK resident companies will be subject to corporation tax.

What we are concerned about

6. The extension to CGT that is being enacted in clause 64 and Sch 24 is one of a package of measures put forward by the Government originally in the 2012 Budget and elaborated on in the consultation document entitled Ensuring the fair taxation of residential property transactions published on 31 May 2012. We have said repeatedly that while we appreciate the policy purpose of the Government, we believe the approach that has been adopted is fundamentally flawed. It is not properly targeted, is highly complex and burdensome and likely to be expensive to administer and enforce.

Recommendations

7. We believe that clause 64 should be deleted pending a rethink about how the Government can achieve its policy objectives in a way that is properly targeted, less burdensome and more effective.

8. If this is not accepted, then as a minimum we recommend that the start date for clause 64 and the related ATED provisions should be deferred until 6 April 2014.

Further detail

9. Given that clause 64 applies only if the ATED rules apply, it is necessary to consider also the ATED rules when considering the effect of clause 64. We have three major concerns about this provision, namely:

    - Added complexity and costs. The approach adopted namely introducing replacing the existing charge for UK resident companies with a new CGT that will apply to all companies, introduces considerable extra complexity into the UK tax system and will impose extra burdens on companies and on HMRC.

- The ATED is too widely targeted: the reliefs do not go far enough with the result that many more properties will be subject to ATED and the new CGT charge than should be the case.
- The start date and transitional provisions are inadequate.

Added complexity and costs

10. In our view the proposed change to the legislation adds an additional level of complexity to the taxation of UK companies that will be costly and burdensome for companies to comply with and for HMRC to administer. It would be simpler and less complex to charge non-UK companies corporation tax on gains and bring them into line with UK companies rather than add an additional tax charge and complexity for UK companies. Alternatively a relief could be introduced for non-UK companies to reduce their charge to CGT on ATED property gains to a level equal to an equivalent UK resident company paying corporation tax on an equivalent gain.

11. We accept that the EU law position has been the driver for the extension of the CGT proposals to UK companies. However, we had hoped the necessary changes would be made to the reliefs such that the number of UK companies affected is as low as possible. We also hoped that every effort would be made to simplify compliance for affected UK companies and that the tax payment date and the return submission date for UK companies would be in line with the corporation tax deadlines where the company has to file a corporation tax return. This does not appear to have happened thus increasing the compliance burden for the affected companies.

The ATED is too widely targeted

12. We are concerned that the ATED rules are too widely targeted and will therefore apply in a much wider range of circumstances than is intended. We will be submitting a further detailed briefing on those provisions but because of their critical importance in determining whether the new CGT charge applies we have summarised below brief details of the types of situations where ATED will apply when we do not think it should.

13. We welcomed the commitment in the December 2012 Response document to exclude from the ATED charge (and, therefore, also from the CGT extension) genuine businesses carrying out genuine commercial activity. However, we do not think the 2013 Finance Bill achieves this. We recommend amendments be made to exclude such businesses.

14. The ATED reliefs (in contrast to what appears to be the case for the SDLT reliefs) require the beneficial owner of the dwelling to be carrying out the relievable trade or activity. The requirement will mean that relief cannot be claimed in a number of circumstances despite there being a genuine business, for example:

    - The company owning the residential property may be part of a larger group and another company in the group carries out the activity.
    - The property might be owned within a trust/company structure with the company having granted the trust a lease to use the property. In turn the company may allow a beneficiary to use the property and the beneficiary may carry out the activity.

We do not think this is necessary and recommend that the requirement be removed.

15. The current anti-avoidance legislation with respect to non-qualifying persons using the residential property is too widely drawn. We accept that Government does not want to allow relief where a benefit is provided to such individuals but, where there is no benefit as the property is let out for an arm’s-length rent and UK tax paid on the rental income, the relief should be available.

16. In particular, we do not think the restrictions on non-qualifying persons should be retained within the property rental business relief (clauses 131–134). Provided the lettings are at arm’s-length relief should be available.

17. Similarly, where an employee has use of a UK residential property owned by a NNP and is subject to a benefit in kind income tax charge as a result of this use our view is that the exemption should apply.

18. In the context of the relief for dwellings open to the public (clause 135), the condition that the activity must be carried on with a view to profit should be removed in favour of a condition that the activity must be on arm's-length terms. If the profit condition is kept we are concerned that the relief will not be available in situations where it is intended to apply. For example, given the upkeep costs, charging the public to look round an historic building will often be to get a contribution towards the costs. It is unlikely to be commercially viable to charge sufficient to make a profit. We appreciate that there is no intention to deny relief in these circumstances and that HMRC intend to cover this in the guidance. Relief by guidance is not desirable; it should be encapsulated within the legislation.

19. We welcomed the draft legislation published on 31 January 2013 dropping the conditions disqualifying an individual from relief where the employer carries out a non-qualifying activity (now clauses 143–145). However, the provision withholding relief if the employee's interest in the employer company/partnership exceeds 10% should also be dropped. Relief should be due where tax is paid in full on the provision of the benefit and the free use of the property is part of an emoluments package for an employee and so for the purposes of the business.

20. While we welcome the change to allow relief where there is occupation by a former long-serving farmworker, the relief for farmhouses (clauses 146–147) is also problematic and may deny relief in contract farming cases (depending on the specific terms of the agreement). In our view the relief should apply where part of the farmhouse is used for the business rather than having to be occupied by a qualifying farm worker.

21. There should be grandfathering relief for dwellings open to the public and farmhouses. In these cases the decision to hold the property in a company will generally have been made many years ago and the company will often be UK resident. Such companies may not even now realise that there is an issue since most of the publicity about these changes has focused on non-resident companies.

22. Relief will be due in cases where there is a development of a block of flats with a company carrying out the development, owning the freehold and providing various services to the occupiers. In these cases there is no connection between the company owning the freehold and the various individuals owning the leases and the company would be carrying on a commercial trade.

23. There is a no relief where there is a block of flats subject to leaseholds where the freehold is held in a company owned by the lessees. (Typically the freehold would be acquired through the acquisition of shares in the company owning the freehold. On the sale of the leasehold the seller would be obliged to also transfer across the shares in the company to the person who has acquired the leasehold interest.) Often the value of the freehold will be very low as the leases will have many years to run but this will not always be the case, there will be some cases where the value of the freehold may breach the £2m mark. Given the wholly commercial reason behind the establishment of the company this is a situation where there should be a relief.

24. A very similar problem can arise where the individual leasehold owners want to come together to buy the freehold for their building. The official Gov.UK website covers this directing individuals to the Shelter website where it is stated that the normal way to carry out the transaction is to use a company as the vehicle to acquire the freehold (see http://england.shelter.org.uk/get_advice/renting_and_leasehold/leaseholders_rights/buying_the_freehold/buying_a_share_of_the_freehold). In our view the Government never intended to catch these situations and an additional relief is required to prevent individuals who hold the freehold for their building in this manner being caught by the change in legislation.

25. We are pleased that the relief for charitable companies (clauses 148–149) covers property held for investment purposes. However, we are concerned that relief is only allowed to charities within the Taxes Act definition because of the territorial limitations to that definition and that relief is only available to charitable companies rather than also covering companies that are wholly owned subsidiaries of a charity. Thought should also be given to a grandfathering provision for properties held by charities or the wholly owned subsidiaries of charities.

26. Consideration ought also to be given to introducing a specific relief to provide sovereign immunity which should in these circumstances apply to corporate vehicles owned by a Head of State – since property may well be held through such vehicles for practical and security issues.

The start date and transitional rules are inadequate

27. We have also expressed concern that the timeframe for restructuring was insufficient and that there was nothing in the package of measures to incentivise de-enveloping (though this was a stated aim in the original Consultation Document).

28. However, in spite of the considerable reservations we (and many others) have expressed about these provisions, they are effectively already in force.

Clause 76 and Sch 28 – Close companies

Summary of main points

- A close company is a company with five or fewer shareholders – often family companies such as professional practices or small farming businesses.
- At the moment, when close companies lend money to their shareholders instead of paying them dividends, there is a 25% tax charge on the amount of the loan made which is refundable if the loan is repaid. It is possible to avoid that charge if the loan is routed via a partnership – and this clause aims to close that loophole.
- But the wording in this draft will crack down on legitimate commercial activity as well as tax avoidance, hitting vulnerable businesses like family farming enterprises, and damaging growth

Close companies and the loophole this clause tries to close

1. In general terms, a close company is a company with five or fewer shareholders. Many family companies are close companies. There are longstanding provisions (now in section 455, Corporation Tax Act, or CTA, 2010) to counter tax avoidance when close companies lend money to their shareholders, or those connected with them, instead of paying them dividends. The shareholder receives a loan which if received as a dividend would have been subject to income tax, potentially taxable at higher rates. However, section 455 imposes a 25% tax charge on the amount of the loan made which is refundable if the loan is repaid.

   Example 1
   Bill and Ben each own 50% of the shares in Carrot Ltd.

   If Carrot Ltd makes a loan of £24,000 to Ben, the section 455 tax charge applies and the company must pay a £6,000 tax charge (calculated as 25% of the loan or advance).

What this clause is intended to do

2. The Government has been concerned that taxpayers have been avoiding a section 455 charge by the company lending the money to intermediary bodies, such as partnerships and LLPs.

Example 2
Bill and Ben each own 50% of the shares in Carrot Ltd. Carrot Ltd and Ben are also partners in the Soup Partnership.

If Carrot Ltd made a loan of £24,000 to Ben directly, then the company must pay a £6,000 tax charge. If however Carrot Ltd makes the loan to the Soup Partnership, under existing rules the tax charge does not currently apply. The Soup partnership then loans the money to Ben.

3. To counter this sort of planning it was announced on Budget day that section 455, CTA 2010 would be amended to 'tackle avoidance' with effect from 20 March 2013.

4. Page A119 of the Tax Information and Impact Notes (TIINs) states that:

   'Legislation will be introduced in Finance Bill 2013 to apply the section 455 tax charge to any loans from close companies to participators made via partnerships (including LLPs) in which the close company and at least one partner/member is a relevant person who is a participator (or associate of a participator). Part 10 CTA 2010 will be amended to ensure that there will be appropriate exceptions and relief from the charge.'

5. This note in the TIIN makes it clear that the intention is to tackle avoidance where loans are not made to the participator but routed via a partnership. It does not suggest that normal commercial arrangements with a partnership or an LLP will be affected by the proposed new legislation.

6. However, the problem is that actual draft legislation will also result in genuine commercial transactions being potentially taxable.

How this draft clause amends previous tax law

7. This clause changes section 455 of the 2010 Corporation Tax Act 'Charge to tax in case of loan to a participator'. The actual new wording proposed for section 455 is set out in schedule 28 and it states that:

   'This section applies if a close company makes a loan or advances money to … a limited liability partnership or other partnership one or more of the partners in which is an individual who is –
      i. A participator in the company, or
      ii. An associate of an individual who is such a participator.'

8. As can be seen, the proposed wording in the legislation does not require that the benefit should flow on to the participator himself or herself, but rather it is sufficient if a loan or an advance is made to the LLP or the partnership itself. The proposed wording therefore will apply to more situations than was set out in the original Budget proposal and goes beyond the intentions as explained in the TIIN.

   Example 3
   The facts are as in Example 2, but instead the Soup Partnership needs £24,000 to buy a new cooker. If Carrot Ltd makes a loan to the Soup Partnership in order for it to buy a cooker, the loan will be potentially taxable under the proposed new section 455. Carrot Ltd would therefore have to pay a tax charge of £6,000 in respect of a commercial transaction in which Ben receives no benefit.

Our concerns

9. We understand and accept why the Government wishes to counter tax avoidance using hybrid structures involving companies and LLPs as set out in Example 2. However, Example 3 highlights our concern that the redrafted section 455 could have an impact on genuine

commercial arrangements, thereby damaging business activity and running counter to the Government's growth agenda.

10. It is quite common to have companies and partnerships/LLPs operating within a commercial structure, in particular within professional practices and farming businesses. This would typically be the case where the company already has commercial activities of its own and subsequently comes into partnership. For example, a merger between a professional practice undertaken by a limited company and an LLP may involve the limited company becoming a member in the LLP and hiving down its activity into the LLP.

11. To take a not unusual farming example, some of the farming activity is undertaken by part of a family through a corporate structure, some activities are undertaken by another part of the family through a partnership, and some joint activities are undertaken through an LLP of which both parties are members.

    Example 4
    Mr and Mrs Jones operate Apple farm through their family company, Apple Ltd, together with their daughter Susan. They each own 1/3 of the shares. Susan and her husband run a camping business as a partnership in one of the fields, during the school holidays in the summer.

    The field and outbuildings on it are maintained by a limited liability partnership in which Apple Ltd, the daughter and husband are equal partners.

    The LLP needs money for renovating the generator. Apple Ltd advances the LLP the necessary funds. Apple is potentially subject to a section 455 charge on the advance.

12. The real problem with the proposed new wording for section 455 is that it does not require there to be any tax avoidance motive (unlike the new Chapter 3A provisions also in Schedule 28). It applies automatically if the relevant circumstances are in point, as it would in Example 4 above. All it needs is for a single member of the LLP to be a shareholder in the company. This could very easily apply even where there is no significant overlap between shareholders in the company and members of the LLP.

13. We accept that the new section 455 can only apply where the company makes a loan or an advance of money to a partnership or LLP. However a loan or advance could be widely interpreted and there is uncertainty even on this point.

Proposed amendment to section 456, CTA 2010

14. While section 455 has been redrafted, it would seem that section 456 is not sufficiently broad to provide an exception to a charge under section 455 where the arrangements involving the LLP are wholly commercial. A possible solution to our concerns would be to provide a further sub-section in the existing section 456, or an amendment to section 455(1), to ensure that commercial arrangements involving hybrid structures of corporate partners with an LLP are not affected by the proposed change.

Proposed amendments

15. On page 373, after line 26 insert:

    (2) 'Unless Chapter 3A applies, section 455 does not apply to a loan or advance made, or a contribution of a partner's/member's capital, in accordance with the terms of a partnership agreement entered into on arm's-length commercial terms'

16. On page 373, line 27:

    Delete '(2)' and insert '(3)'.

HMRC guidance

17. The above comments set out our proposed amendments to address a key concern with clause 76 of the Finance (No. 2) Bill. We will be discussing with HMRC more detailed aspects of the changes to the rules where we believe more guidance is required.

Clauses 203–212 – General anti-abuse rule (GAAR)

Summary of main points

- The GAAR is an important new anti-avoidance tool, intended to deter aggressive tax planning by creating a general rule to supplement targeted anti-avoidance laws.
- If it works well, it should also offer certainty to business, and maintain the UK's tax competitiveness.
- We have one remaining concern here, about how the GAAR fits with the UK's tax treaties. Though the Government has informally told us it does not see a problem, we think it would be valuable to have concerns about this stated on the public record during the committee stage.

Clarity and targeting of legislation

1. 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 had been considerable uncertainty as to whether particular arrangements will actually be caught. This potential uncertainty has now been addressed through recently published guidance.

Simplification

2. It is too early to tell whether the GAAR would lead to any meaningful simplification of the tax system – indeed 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.

International legality

3. We remain 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 override the UK's international obligations already written into its double tax treaties and could therefore be held to be unlawful.

4. We accept that in relation to treaties with fellow OECD members this concern is possibly addressed by specific OECD agreements, but this still leaves about 90 countries 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 important that the UK honours its international treaty commitments.

5. We believe our 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 provision (or something similar to it) should be reinstated.

Clause 226 and Sch 47 – Corporation tax: deferral of payment of exit charge

Summary of main points

- The Court of Justice of the European Union recently ruled that the UK's exit tax regime is not compliant with the EU Treaties.
- This clause seeks to update the rules to make them compliant, but we don't think it succeeds.

Policy background

1. With this clause, the Government is trying to update the rules around how the tax system seeks to tax unrealised profits and gains when a company ceases to be resident in the United Kingdom or a non-resident company ceases to carry on all or part of its business in the UK.

Our view on the clause

2. The Government has already made some concessions here, for example agreeing to extend the relief on revaluations of trading stock when a company ceases to be UK resident. But there will still be a capital allowances balancing charge in similar circumstances..

3. The main problem is that under European law it should be possible for gains to be deferred until the relevant asset is actually disposed of: the proposed 10 year cap (new Schedule 3ZB, paragraph 14(2)(b)) on deferrals in some cases, and compulsory spreading in others, means that the current draft legislation does not achieve this.

4. We also consider that the equivalent charge in s80 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.

Clause 227 and Sch 48 – Penalties: late filing, late payment and errors

Summary of main points

- This clause updates HMRC's regime of penalties for non-compliance, to accommodate Real Time Information – the biggest change to PAYE in seventy years.
- We fear tens of thousands of small businesses, like pubs or farms, could face particular problems with the requirement to report payments to employees 'on or before' the date they are made.
- This clause should be amended to defer the penalty regime from 6 April 2014 to 6 April 2015, giving the half a million businesses yet to start using RTI more time to adapt, and comply properly.

Introduction

1. RTI is the biggest change to PAYE in 70 years. In broad terms it obliges all employers to submit, online:

   - a return to HMRC on or before making any payment to an employee and/or
   - a return in respect of every tax month, and
   - a final return within two weeks of the tax year ending,

   instead of, under traditional PAYE, submitting just one return per employee (P14) and per employer (form P35) annually some six weeks after the tax year end containing the year's figures, answering questions and making declarations.

2. On 12 June 2013 HMRC announced that 1.4m employers are now reporting under RTI. This is an impressive statistic but means that over half a million employers have still to begin RTI reporting. Feedback from our members suggests that while there have been some practical issues (which are only to be expected in a change on this scale), the transition for those employers who are now reporting under RTI has gone relatively well.

What we are concerned about

3. We are however concerned that many small employers will face particular problems with the requirement to report payments to employees 'on or before' the date they are made. This requirement will in our view impact disproportionately on the smallest employers, adding to their compliance burdens.

4. Even with the relaxation to allow reporting within seven days of payment (in some very limited situations) announced in November 2012, this could still significantly increase the number of times employers have to run their payrolls (potentially from 12 times a year to 52). In March 2013, in response to these concerns, Ministers announced that employers with fewer than 50 employees could report monthly rather than on or before/within seven days until 5 October 2013. On 12 June 2013 this easement was extended to 5 April 2014 to allow HMRC time to fully understand the issues and for practical solutions to be found. We welcomed both the easement and its extension and we will engage constructively with HMRC to help identify long-term solutions.

Recommendations

5. Provisions in the Finance Bill introduce penalties for RTI filing failures from 6 April 2014. In view of the fact that around a quarter of employers, including the very largest, have yet to begin filing under RTI, that many small employers will continue to use the easement until 5 April 2014 and that a permanent solution to the 'on or before' issue has yet to be found, we believe that the penalty regime should be deferred to 6 April 2015. This would give all employers and HMRC a full year in which to adjust to the changes before the penalty regime takes effect. It would also be in the spirit of encouraging an orderly transition to RTI and would be fair, giving early adopters the longest period of 'soft landing'.

Proposed amendment

Amend Schedule 48, paragraph 16(2) and 16(3) to read:

> (2) The amendments made by paragraphs 2 to 9 and 15 have effect for the tax year 2015/16 and subsequent tax years in relation to failures to make returns with a filing date (as defined in paragraph 1(4) of Schedule 55 to FA 2009) on or after 6 April 2015.

(3) The amendments made by paragraphs 10 to 14 have effect for defaults made in relation to the tax year 2015/16 and subsequent tax years (see paragraph 6(2) of Sch.56 to FA 2009 (as amended by paragraph 12(3) of this Schedule) as to when a default is made in relation to a tax year).

E ian.young@icaew.com

icaew.com/taxfac

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)