ICAS briefing paper for the Finance Bill Committee

1 July 2016
About ICAS

1. The following briefing paper has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland (‘ICAS’) is the world’s oldest professional body of accountants and we represent over 20,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. Evidence provided by ICAS aims to inform in a positive and constructive manner. ICAS is apolitical and will not take a stand for or against a particular political position. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in the design and implementation of fiscal measures, and to point out operational practicalities. Our representatives also contribute based on the collective experience of decades of work which ICAS members and staff have undertaken with both the UK and Scottish Parliaments and tax authorities, and other European and worldwide institutions, on a shared agenda that seeks better outcomes for all stakeholders.

Tax Policy and the Finance Bill 2016

3. This briefing paper sets out the key concerns of the ICAS Tax Committee in relation to the Finance Bill 2016 and related tax policy matters. We would be happy to discuss our concerns further with members of the Finance Bill Committee.

4. We are grateful for opportunities to raise concerns through the tax consultative process but there remain a number of wider policy matters that we believe should be addressed, which are outlined below.

5. In addition to the issues discussed below, we believe that consideration needs to be given to the impact of devolution on tax policy. Certain tax powers are being de-centralised, for example, income tax to Scotland and corporation tax to Northern Ireland. However, there is a lack of co-ordination and ICAS is concerned that there does not appear to have been proper consideration of potential unintended consequences. One effect of de-centralising corporation tax is to introduce tax competition between the regions of the UK. We question whether this was intended and whether it is desirable. There is also scope for confusion with the apprenticeship levy, which is charged under reserved powers but disbursed via devolved powers.


Tax Policy Issues

Complexity of tax legislation

7. ICAS supports the work of the Office of Tax Simplification (OTS) and welcomes the fact that it is being placed on a permanent footing, but believes that in general too little is being done to address complexity in tax legislation. Complexity and volume of legislation causes difficulties for individuals and companies trying to comply with their tax obligations. In some cases, it may also lead to bad advice being given by advisers – not deliberately but simply because of an inability to cope, especially in smaller firms. Clearly there is both significant volume and complexity in this Finance Bill.

8. In some cases, we recognise that it may be difficult to take radical steps. As the OTS noted in its recent report on the closer alignment of tax and NIC, a full merger of the two systems ‘is a step too far at this stage’. We are pleased that the Government has asked the OTS to produce two further reports on possible simplification in this area and we hope
these will bear fruit. In this context, however, we note that income tax rates and bands are being fully devolved to Scotland from April 2017, whilst NIC remains reserved. Attempts to align reserved and devolved powers may highlight unintended consequences of the new devolved measures.

9. In other cases, we are concerned that opportunities for simplification have been missed and OTS recommendations not adopted for less obvious reasons. For example, in the case of termination payments the Government has announced that it will adopt some OTS suggestions but these are mainly those which will increase revenue, rather than the overall package proposed by the OTS which could have included far more simplification.

10. The OTS also carried out a significant project on tax reliefs in 2011 but very few reliefs were removed in subsequent Finance Acts. This is an area which would benefit from an analysis of the cost and take up of reliefs, including a review of whether they have had the intended behavioural impact. Those determined to be ineffective should be removed because they add complexity for very little benefit. All new reliefs should also include a ‘sunset clause’ so that they are reviewed after a set time; if they are not delivering the expected benefits they should be allowed to expire.

11. Where new legislation is being introduced, every effort should be made to avoid introducing additional complexity. Unfortunately, this is frequently not happening. The recent introduction of the Inheritance Tax residence relief involves excessive complexity. It would have been far simpler to increase the IHT threshold; if this was not considered possible because of the potential effect on IHT receipts then perhaps change should have been deferred until economic conditions were more favourable and the simpler approach could have been adopted.

12. The Government's 'triple lock', i.e. the promise not to raise income tax, national insurance or VAT rates during this Parliament is also leading to additional complexity. Instead of a straightforward rate increase to a major tax, various less transparent and more complex revenue raising measures have been adopted, such as the increases to SDLT and Insurance Premium Tax.

Distortions in the tax system

13. Tackling complexity is not helped by distortions in the tax system caused by the differential between capital gains tax rates and income tax rates; changes in the current Finance Bill will increase this differential. Currently the additional and higher rates of income tax are 45% and 40% whereas the CGT rates are 28%, 18% and 10% where entrepreneurs’ relief applies. We commented in our response to the recent consultation on Company Distributions that in view of the differentials between income tax and capital gains tax rates many taxpayers will be inclined towards the less costly option (i.e. extracting value in forms subject to CGT rather than income tax). Despite the notion of ‘fairness’, very few taxpayers will want to pay more tax than they are legally required to do. As a result, more anti-avoidance rules are introduced, leading to more complexity. This will be exacerbated by the further reduction in CGT rates to 20% and 10%, included in the current Finance Bill.

14. Distortions in the tax system affect behaviour. Detailed anti-avoidance legislation is therefore introduced to prevent abuse. Unfortunately, this causes problems for compliant taxpayers who want to comply but struggle to understand the resulting complexity. Determined ‘avoiders’ are likely to ignore or seek to get round the rules.

Certainty and stability

15. Over recent years the corporation tax rate has been significantly reduced, as part of government plans to make the UK corporate tax system competitive. It is clearly important that the UK has a regime which attracts investment. However, some of our members are now concerned that continuing reductions in the corporation tax rate are being pursued at the expense of certainty and stability. For example, the Budget announced a further reduction in the corporation tax rate but also introduced unexpected changes to the rules on company losses for larger companies which could be costly. Furthermore, the changes could have unintended consequences for companies’ subject
to certain regulatory regimes. Frequent and unpredictable changes could deter foreign investment rather than encouraging it. There needs to be a sensible balance between reducing rates and counterbalancing changes which may have detrimental results.

16. The 2010 Corporate Tax Roadmap was very useful in setting out long term strategic aims and direction of travel; it was welcomed by ICAS. Unfortunately, the recent Business Tax Roadmap seemed to take a less strategic approach, appearing more like a list of short term policy proposals. This may in part be due to distortions in tax policy arising from the ‘triple lock’ (noted in paragraph 12). When increases in the major revenue raising taxes are prohibited a short term approach to other taxes is perhaps inevitable because there will always be the possibility of needing to make rapid changes to generate additional revenue.

17. Another area of the tax system which would benefit from a period of stability is pension taxation. There have been major reforms to pension tax in the last few years; some of these linked to pension freedoms have been welcomed but others (frequent changes to the annual and lifetime allowances for example) have added complexity. At the same time, we have seen increases in the State Pension Age, the abolition of contracting out and the introduction of auto-enrolment. The 2016 Budget announced the introduction of lifetime ISAs which may be seen as supplementary to, or an alternative to, traditional pension saving by some. Frequent changes and complexity make long term planning for retirement difficult. ICAS has called for the Government to consider setting up an independent pensions/retirement savings commission as a standing advisory body which seeks to achieve long-term stability for the UK pensions system and cross-party consensus.

Administrative Burden of Taxation and HMRC resources

18. There appears to be a lack of understanding, amongst policy makers, of the operational impact of tax policies on businesses and individuals. We would like to see more business and behavioural awareness amongst policy makers.

19. The administrative burden of taxation is shifting increasingly to taxpayers – VAT and PAYE always placed administrative burdens on businesses which were then increased and extended to individuals by the introduction of self-assessment. Real Time Information (RTI), and now Making Tax Digital, continue this trend without any apparent appreciation of the effect this will have on businesses and individuals.

20. We believe it is vital that HMRC is properly resourced. HMRC staffing levels have been significantly reduced since 2010. This is already having an adverse impact on service levels provided to smaller businesses and individuals who do not have access to the personal service provided by HMRC’s customer relationship managers (large companies) or High Net Worth Unit (wealthy individuals). Recently there have also been worrying signs that even the service provided by customer relationship managers to large businesses is deteriorating, with companies experiencing increased turnaround times and difficulties in obtaining responses.

21. Lack of HMRC resources may undermine key measures to tackle tax evasion. For example, common reporting standards should assist tax authorities by providing information about taxpayers across borders. It is vital that HMRC has adequate resources to be able to analyses the data comprehensively and to follow up where necessary.

22. The UK tax system depends on a degree of trust and voluntary compliance – coercion alone is not enough. The erosion of any personal contact between the majority of taxpayers and HMRC undermines this vital trust. It also fuels distrust of those, like large companies, who still have a personal relationship with HMRC. We comment on ‘Making Tax Digital’ (MTD) below but in the context of HMRC resourcing we believe it is essential that MTD is not used as an excuse to reduce HMRC staff numbers further in the short to medium term. It should instead be used to free up staff for interaction with larger numbers of taxpayers to provide vital assistance to those struggling with the transition to MTD and to rebuild trust in HMRC.
Making Tax Digital

23. ICAS supports the overall objectives of ‘Making Tax Digital’, as set out by HMRC in December 2015. The four ‘foundations’ are laudable goals, but we have significant reservations about the timescale and the mandatory approach.

24. While many of the aspects of this proposed digital future are promising, there is a significant gap between the current digital capability of many businesses (and individuals) and the level of digital and accounting competence required to make the plan work.

25. In particular, some small businesses and individuals may be pushed into non-compliance due to an inability to use the mandatory digital systems in this over-ambitious timeframe.

26. We are very concerned about the negative messages about tax agents which are being suggested by publicity around MTD and the exclusion of agents from viewing their clients’ online accounts. We believe agents are vital to implementation and every effort should be made to work with agents from the outset.

27. The challenge of mandatory digital reporting on the proposed timescale is immense. Imposing mandatory quarterly filing by 2018 (for some taxpayers) and 2020 for all, allows insufficient time to effect the revolution that is needed, particularly in small business attitudes and capability. The proposed requirements are likely to impose significant costs on business.

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Appendix 1

Specific Finance Bill Issues

Clause 35: Distributions in a winding up

1. The ICAS submission in response to the consultation ‘Company Distributions’ [https://www.icas.com/technical-resources/icas-response-company-distributions-consultation] noted that if the proposed targeted anti-avoidance rule (TAAR) relating to distributions in a winding up went ahead it would be essential that there should be a clearance mechanism to mitigate the adverse consequences for non-tax motivated transactions. HMRC believes the TAAR is needed to address what appears to be a small number of abusive transactions in certain specific circumstances. The legislation is however very broadly drafted and potentially catches a much wider range of transactions.

2. Without a clearance mechanism, shareholders undertaking Members Voluntary Liquidations will be left with uncertainty. The TAAR will inhibit some commercial transactions, including commercially motivated company reconstructions (outside the scope of the proposed exemption) with adverse consequences for jobs and the economy. HMRC may also waste time on ultimately pointless enquiries. We therefore repeat our call for a clearance mechanism to be provided.

3. ICAS also expressed concern that the TAAR would drive increasing numbers of directors to use the ‘striking off’ provisions in s1003 Companies Act 2006 rather than taking the proper route to wind up a company via liquidation. Under s1030A CTA 2010 up to £25,000 can be treated as a capital distribution on striking off. Whilst a clearance procedure for the new TAAR will not completely remove the incentive to use the striking off approach it might reduce it by allowing some certainty that a liquidation will not be caught by the TAAR.

4. Additionally, our original submission noted there could be a rise in court applications to have a company wound up on ‘just and equitable’ grounds or because the company has passed a resolution to be wound up by the court on the basis that the purpose of the company has been achieved. This could be a defence against the suggestion in the TAAR that the winding up had a main purpose of avoiding or reducing a charge to income tax. The cost of a court application may be seen as worthwhile if it puts beyond doubt or significantly strengthens the argument that a main purpose or one of the main purposes was not tax avoidance or reduction. This is unlikely to be desirable in terms of court workloads. The provision of a formal clearance procedure would remove the need for court applications solely as a defence against application of the TAAR.

5. The published response document (to the original consultation) includes the comment in paragraph 2.50 that the ‘government would stress that it would still expect the vast majority of distributions from a winding-up to be treated as capital (as is currently the case)’. Unfortunately, as noted in the preceding paragraphs, this has not been reflected in the legislation. HMRC intends to publish guidance to illustrate the application of the new TAAR and has invited the submission of examples. Without a clearance procedure this will not address any of the points we raise above, particularly where circumstances are not precisely aligned with examples HMRC choose to give. This approach also leads to the highly unsatisfactory position where taxpayers are taxed by law and untaxed by guidance.

Clause 149 and Schedule 19: Large Businesses - Publication of a Tax Strategy

6. In the ICAS submission in response to the consultation ‘Improving Large Business Tax Compliance’ [https://www.icas.com/technical-resources/large-business-tax-compliance] we made the point that only UK companies large enough to have Customer Relationship Managers should fall within the requirement to publish a tax strategy.

7. HMRC’s original impact assessment indicated that only the largest 2000 businesses in the UK should be within scope. However, under the clause and schedule as currently worded (para 7 Schedule 19 bringing in the OECD Country by Country reporting
definitions) small companies within large multinational groups (MNEs) will be required to produce a UK tax strategy even though the UK presence is small and where the finance team might amount, in some cases, to little more than a book-keeper.

8. This is likely to present practical problems because MNEs with limited UK activities will not be likely to have a UK tax strategy and the UK based entity is unlikely to have the autonomy to produce one. Additionally, producing a UK tax strategy, when UK activities are very limited, does not appear to be a good use of resources.

9. ICAS believes that the legislation should include a de minimis exemption for small entities which would otherwise be brought within the rules solely because they are within a large MNE.