Response from ICAS to the HMRC consultation document

Income Tax: Extension of averaging period for farmers

14 September 2015
Income Tax: Extension of averaging period for farmers – A Consultation Paper

About ICAS

1. The Institute of Chartered Accountants of Scotland (ICAS) is the oldest professional body of accountants. We represent over 20,000 members who advise and lead businesses. Around half our members are based in Scotland, the other half work in the rest of the UK and in almost 100 countries around the world. Nearly two thirds of our members work in business, whilst a third work in accountancy practices. ICAS is also a public interest body.

General comments

2. ICAS welcomes the opportunity to comment on the consultation ‘Income Tax: Extension of averaging period for farmers’, issued by HMRC on 8 July 2015. We are grateful to HMRC for meeting with representatives to discuss the consultation and this paper is restricted to general comments.

3. ICAS members who advise and support those who work in the farming sector are grateful that the economic difficulties and volatility risks in the farming community are recognised; they also welcome efforts by the Government to alleviate these.

4. It is recognised that the farming industry has asked for extended averaging and whilst some of our members welcome this, others have been more cautious about potential administrative burdens and related compliance costs attaching to the proposals. ICAS members, however, wish to ensure that any measures which assist the farming sector are wherever possible simple to administer and that implementation is smooth. As a part of this, any changes should build upon the existing scheme.

5. ICAS members consider that the current two years averaging works well in most cases.

6. ICAS recommends that:
   • Two year averaging should be retained, and that optional five year averaging should also be made available. This extension of an optional averaging should be based on past results rather than on future results, and should be revocable
   • The marginal relief calculation should be removed to provide simplicity
   • The volatility test should be retained if there is optional 5 year averaging, in order to prevent small and insignificant adjustments which would otherwise arise
   • Net Relevant Earnings (NRE) for pension payments should be fixed on actual results in year.

7. We have a number of concerns around administration and costs, which are discussed below, and as a result of these considerations we make the recommendations in the paragraph above in order to manage the potential costs and complexities whilst offering flexibility.

8. Assuming rates and bands stay relatively level, it is probable that in most instances it would be beneficial to elect for extended averaging. There are instances however where averaging would not be allowed because the volatility test would be failed.

Cash flow

9. ICAS members have also noted that for many farmers absolute tax saving over the averaging period is not really the key point, it is cash flow that matters; does the farmer have the cash in a bad year to pay the tax payments from earlier profitable years? Thus, one might average even when there was no tax saving. It would be beneficial if time to pay arrangements were extended when there is market volatility and/or an exceptional circumstances test applied.
Complications
10. There are a number of practical difficulties that have been raised by ICAS members in relation to averaging that would be exacerbated by five years averaging. These include:
   • Allocation of profit share in a family partnership
   • Tax credits
   • Student loans
   • Child benefit
   • VCTs
   • Gift Aid
   • Capital allowances (two year claim period)
   • Pension payments.

11. We understand that in practice insurance companies have very few requests to adjust premiums as a result of averaging, ie overpayment, but it would be helpful if pension payments could be fixed to the actual net relevant earnings of the year and not changed by averaging.

Software solutions
12. Concerns have been expressed about the compliance costs that may attach to any extended averaging and whilst software ought to be able to address this, ICAS is not aware of plans by tax software houses to bring this into their packages. It may be that only the premium providers will do so but, even so, it is not a simple matter of inserting this year’s numbers and the answer drops out, especially if losses have been claimed.

13. It is probable that averaging calculations will remain time-consuming and, therefore, costly.

Devolution of income tax rates and bands
14. From 2016/17 on, Scottish tax rates will mean an added cost where partners are tax resident in different parts of the UK, or change residence, and make it even more unlikely that software would address averaging. Also, as rates and bands of income tax are devolved to Scotland and other parts of the UK this may lead to further fluctuation.

Issues around professional advice and extended averaging
15. Although an election under HMRC’s proposed second option may be beneficial in a majority of cases, it would be problematic for a professional adviser to recommend making an election, especially if the election is irrevocable.

16. It is always the case that a professional adviser has to consider not just the absolute tax saving but also the cost of obtaining that saving, and not many clients are happy to pay £100 to save £50, or even pay £100 now to save £150 in a year’s time.