Comments to HMRC and HM Treasury on the Draft Clauses and Explanatory Notes for Finance Bill 2014

4 February 2014
About ICAS

The Institute of Chartered Accountants of Scotland (“ICAS”) is the oldest professional body of accountants. We represent around 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 members play leading roles in around 80% of FTSE 100 companies. ICAS is also a public interest body.

1. General Comments

1.1 ICAS welcomes the opportunity to comment on the draft clauses for the Finance Bill 2014; general comments on the approach are given as well as detailed observations below for the policy lead named on each area.

1.2 In collating these replies our members remain concerned about the volume of legislation to be enacted as part of the Finance Bill. ICAS supports the tax making policy objectives that the fiscal environment should be stable, predictable and simplified. Our disappointment is that this Bill again adds considerable volume and complexity to a legislative framework which is already inappropriate for a self-assessment regime. We do however appreciate that a number of changes proposed for consultation – such as in relation to IHT and undistributed income - have been changed and we welcome the fact that HMRC have responded to the representations made.

1.3 ICAS is a strong supporter of the work of the Office of Tax Simplification (“OTS”). We would welcome more of the recommendations of the OTS being implemented which, combined with a reduction in the volume of legislation, would make clear steps towards achieving the goal of tax simplification.

1.4 As the purpose of release of the draft clauses and explanatory notes in December, before the Finance Bill consideration in the following spring, is to allow more informed consultation, we would also make some observations on the format of the document issued by HMRC and HM Treasury. The publication combined the draft clauses with the explanatory notes into one document of 673 pages, without an index or sequential page numbers. This makes identifying specific clauses and provisions more difficult for our members, at a busy time of year for all tax practitioners, due to the 31 January filing date. We have used the page numbers in the pdf copy of the document online and in this response. We would very much welcome the publication of draft legislation and explanatory notes as indexed and numbered documents in future to assist in the consultation process.

2. Partnerships Review (James Ewington)

2.1 ICAS responded to the consultation ‘Partnerships: A review of two aspects of the tax rules’ that was issued in summer 2013 and also gave evidence to the House of Lords Finance Bill sub-Committee in January 2014 regarding the proposed Finance Bill 2014 clauses (available at http://icas.org.uk/hol_fbsc_taxation_of_partnerships.pdf).

2.2 This topic generated significant and widespread interest and concern amongst our members, on their own behalf and on behalf of their clients, particularly in the rural and professional sectors. Their concerns focus on the complexity of the provisions, and the widespread application that will affect commercial structures regardless of tax avoidance intentions.

2.3 ICAS is concerned that the measures now proposed are significantly different from those raised in the earlier summer 2013 consultation document. They are sufficiently different that the consultation process should have been repeated to allow fuller exploration of the concerns now emerging.

2.4 ICAS calls for the enactment of the proposed legislation on disguised employment in LLPs and mixed partnerships to be postponed so that it can be considered as part of the review currently being conducted by the Office of Tax simplification.
2.5 ICAS has reservations when the legislation uses expressions that lack certainty. This can be found, for example, in section 863B(1)(b) with the use of ‘substantially wholly’, and section 863B(4) with the use of ‘significant influence’. Although guidance has been provided and is helpful, it is always preferable to have clear statutory provisions. If guidance is to be included as part of the package of measures, it needs to be fully considered both within the full consultation process and by Parliament in order to ensure it expands appropriately on the legislation, rather than replace or revise that legislation.

2.6 The draft legislation for Limited Liability Partnerships (LLPs) which has been published with its three conditions in tests A – C has been described as a ‘sledge hammer to crack a nut’ and the consequences go much further than the original targeted mischief. The effect of the Finance Bill clauses is that the tax status of many LLP members will change despite the fact that they are ‘true’ members and would currently be considered to be partners should they be in a traditional partnership.

2.7 Condition A may affect incoming members who are relatively junior, as such individuals sometimes receive a fixed profit share for a short period before becoming entitled to an equity share. In most circumstances there is no intention of any disguised salary; this is simply long established commercial practice. Likewise, a similar situation occurs for many members who are approaching retirement and who go onto fixed profit shares as they move towards withdrawing from the partnership. Our members emphasise that normal commercial practice is that partnership shares are, and have always been, split with an element being based on performance. That was the case in general partnerships and is now the case for LLPs. Equally, reward for sector or office performance has always been key. In summary, this test will not function as intended to exclude the majority of commercial practices. These specific circumstances should be catered for with a motive test.

3. Specific comments – other areas

3.1 Employee share schemes and employment related securities (Andrew Ellis and Colin Strudwick); page 21 pdf.
ICAS welcomes the introduction of these new provisions following the OTS review of the share scheme legislation. Along with the provisions on internationally mobile employees this is a beneficial step towards providing simplification and more practical ways to achieve the policy intention. The complex nature of the individual situations of many mobile employees and the types of share plan that they participate in will mean that it is very challenging to deliver clarity, even with the rewritten rules.

3.2 Tax relief for social investment – (Kathryn Robertson); page 141 of pdf.
ICAS welcomes the introduction of relief for investment by qualifying individuals into qualifying social enterprises. There are complex conditions attaching to both the individual and the organisation and the draft legislation covers some 43 pages but the provisions do not yet give any indication of the level of tax relief available for the investments, which is the essential point in a tax relief to encourage investment behaviour. The rules regarding this relief are so complex as to risk making it of no real practical use to social enterprises who have limited resources and are unlikely to be able to confirm their own status with potential investors. Simplification should be considered, or practical guidance and support clarified by HMRC before proceeding.

3.3 Recommended Medical Treatment – (Employment Income Policy team); page 204 of pdf.
Concerns arise about the exclusion from the exemption from income tax on recommended medical treatment under the provisions of clause 320 C (1), which appears to allow the exemption only where the payment/reimbursement made is not “pursuant” to a relevant salary sacrifice arrangement or flexible remuneration arrangement. These arrangements under current rules create a taxable benefit, required to be reported on form P11D. If these new rules were enacted in their current form, there would appear to be a difference in the tax treatment of medical treatment between “qualifying” arrangements – not taxed up to £500 – and medical treatment under salary sacrifice/ flexible remuneration pay structures where all the amounts paid would be taxable.
It is important for clarity of the legislation that it should be confirmed that if any employers change the terms of their remuneration packages to pay the first £500 outside a salary sacrifice or flexible remuneration arrangement, they would not then be not paying these “pursuant” to such an arrangement, so that these amounts would not be subject to tax. It would be inconsistent for the legislation to discriminate against employers and employees who already provide this benefit and are taxed on it. Clarification should also be provided that, without further provision, the £500 mentioned in the draft legislation is inclusive of VAT. There may be recommended medical treatments where there is VAT charged, such as bereavement counselling for example, and these services may be subject to VAT.

3.4 Tax treatment of financing costs and income (Roger Muray and Judith Diamond); page 367 of pdf.

The aim of the amendment to the debt cap provisions is to ensure that UK resident companies without ordinary share capital can be regarded as relevant group companies and do not have the effect of breaking a debt cap group. This is achieved by modifying the application of Chapter 6 of Part 5 CTA 2010 to apply to companies or other bodies corporate which do not have share capital, and the holders of capital in such companies, in the same way as they apply to companies with ordinary share capital and the holders of ordinary shares in such companies. The rules also aim to ensure that ownership through an entity other than a body corporate or through a trust or other arrangement is looked at in the same way as ownership through a company or other body corporate.

Whilst we understand the policy objective behind the change, we believe that the amendments need to be re-drafted to enhance clarity. The provisions refer to a “corresponding ordinary holding” in an entity, trust or other arrangement, which for these purposes means a holding which “provides the holder with economic rights corresponding to those provided by a holding of ordinary shares in a company”. It is unclear what is intended by this definition, on the basis that ordinary shares do not typically convey any form of economic rights, either to distribution of income or to return of capital. Entitlement to value on such shares is by voting a dividend, or realisation by change of ownership, or winding up, rather than being a right provided by a share itself. The wording in the legislation should be amended to set out more clearly the intention that the holder of a security which corresponds to an ordinary shareholding will be treated as an equity holder of the entity in question. Alternatively, it will be important that clear guidance is produced and that this includes a number of examples to make the intended scope and operation of the legislation clear.

3.5 Derivative contracts between group companies (Chris Murricane and Tony Sadler); page 642 of pdf.

The title has now been amended to “Disguised Distributions” and we agree that this better reflects the behaviour HMRC would like to stop rather than the use of derivatives to manage commercial risks. The draft legislation is quite widely drafted and we remain concerned that the rules may catch commercial arrangements as well as as abusive arrangements. The level of guidance which has been issued in support of the legislation demonstrates how complex is it to clarify the position in this area.

3.6 VAT special schemes (Andy Heywood); page 526 of pdf.

ICAS welcomes the incorporation of article 28 of the principal VAT Directive 206/112/EC for telecommunications and electronically supplied services into UK law. These changes should ensure consistency of treatment across the EU for these services, simplify compliance for businesses in the sector and remove some of the existing anomalies. However, concerns arise that these fundamental changes to the VAT treatment – moving from liability where the supplier is based to liability where the customer is based – will need to be more widely communicated to businesses and taxpayers to raise awareness before 1 January 2015. In particular there may be a number of smaller businesses where telecommunications and electronically supplied services are not a “core” part of the business and may move into this area – for example by providing downloadable content accessible by their customers – and may not be aware of the impact. Under the new rules, businesses will need to submit two VAT returns - one covering normal supplies and supplies to UK customers and one covering their supplies under these rules. We believe HMRC should do more to raise awareness in the smaller business sector to ensure that the transition is effective.
We also consider that with the pace of technological change it would be sensible to revisit the definitions of broadcasting services, electronically supplied services and telecommunications activities to confirm that these cover all the types of activities under current business models. It would be helpful if HMRC could issue guidance about the types of services it considers are within the definitions – particularly to assist smaller businesses who may be moving into this area for the first time.