

Ref: Budget 2009

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Dear Dave

### **Budget 2009**

### **Representations of The Chartered Institute of Taxation to HM Revenue and Customs, HM Treasury and Government**

The Chartered Institute of Taxation (CIOT) is pleased to submit to you suggestions for the 2009 Budget. We consider that there are three key areas which warrant special consideration and these are set out below.

#### **Small business tax, income shifting and NICs**

The welcome deferral of the income shifting provisions should be complemented by a well thought out further response from Government on the taxation of owner managed businesses (OMBs). Any attempt to legislate for income shifting should be limited to a simple set of rules which could deal with whatever the precise mischief is that concerns the Government, without creating additional burdens. Further problems could be eliminated by the integration of NICs and income tax – or at the margins by their alignment – and taking time to get this complex area of tax right.

#### **Statutory residence test**

There is an urgent need for the UK to adopt a comprehensive statutory residence test that is easily understood, is readily workable by employers and allows an unrepresented individual to know when he is/is not resident in the UK. Such a test would provide certainty for taxpayers, employers and HM Revenue & Customs (HMRC) alike, and would help the UK's international competitiveness.

#### **Taxpayers' Charter**

We welcome the current consultation and we intend to be heavily involved in this project. We consider that the vires for the Charter should be included in the 2009 Finance Bill. This will help this extremely important project proceed to a fruitful conclusion, as the changes coming through under the Modernisation of Powers, Deterrents and Safeguards review, and indeed in many other areas, emphasise the need for a Taxpayers' Charter.

## Conclusion

We have selected those areas on which we consider Government and the tax authorities should concentrate. More details are set out in Appendix A, together with other important measures for consideration such as Green Taxes.

We continue to believe that full consultation at the right time, together with simplification, is key to a steady improvement of the tax system. We would therefore welcome further discussion with you, with the aim of working towards legislation on these areas being introduced in the next Finance Bill.

An abbreviated version of this letter, without the appendices, has been sent to Ministers, other Members of Parliament and their colleagues.

Yours sincerely



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President  
The Chartered Institute of Taxation



Ian Menzies-Conacher  
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## Appendix A

### 1. **Capital Gains Tax and Investment Income**

#### 1.1. ***Statutory Residence Test***

There is general agreement that a statutory day counting based test would be widely welcomed and would significantly simplify this area. We would be very supportive of taking this issue forward in consultation with representative bodies and stakeholders, and would be willing to provide detailed input into such a project. We would suggest consulting on a test based either solely on the number of days in the tax year that an individual was present in the UK or one that takes into account a set proportion of days from one or two prior years.

#### 1.2. ***Remittance Basis***

Significant concerns have been expressed as to the wording of Finance Bill 2008 Schedule 7, due both to its being introduced, in effect, in draft form and the numerous amendments made recently. While we are aware that the Financial Secretary has promised that the legislation will not be reviewed for this and the next Parliament, we would hope that that simply refers to the overall policy objective.

1.3. We would hope that it would not preclude sensible changes to the detail of the proposal where they are advantageous to the taxpayer (and hopefully to HMRC as well). It is essential that both the wording and the practical impact of the new provisions are kept under review and, where it is sensible to do so, improvements should continue to be made to the law in this area.

#### 1.4. ***Interest on offshore loans***

The effect of ITTOIA 2005 section 832B, as introduced by Finance Bill 2008 Schedule 7 paragraph 53, is to only allow a deduction for non-UK interest paid against the income from of a trade, profession or vocation. However, the FAQs produced by HMRC say that a deduction of interest paid is to be allowed against non-UK property income. We agree that this should be the case and the legislation should be amended so that interest paid on a non-UK loan for a non-UK property is allowed when computing the rental profit.

#### 1.5. ***Capital Gains Tax***

When simplifying it is important to repeal redundant legislation. Now that taper relief has been repealed, the amendments made to TCGA 1992 section 2 to prevent personal losses being offset against a TCGA 1992 section 87 gain, which had already received taper relief in the hands of the trustees, should also be repealed so that section 2 reverts to its simpler, pre-taper version.

#### 1.6. ***Entrepreneurs' Relief***

It seems unfair that the relief does not encompass an entrepreneur who has a substantial shareholding but who is not also a director or officer. Entrepreneurs who risk their capital in a venture will not necessarily be directors; they may leave the running of the company to others and rely on their shareholding to control the company. For instance, business angels

may risk their money in a failing company and may make their expertise available to the company but may not become directors of it. It would be appropriate, in such circumstances, for Entrepreneurs' Relief to be given.

## 2. Corporate taxes

### 2.1. ***Repeal of clause 37 Finance Bill 2008 - legislation of Sharkey v Werner***

As we have said in previous correspondence with you, we do not support or welcome the proposed change in law contained in clause 37. As set out in our earlier letters, it is our view, and HMRC will be aware, that it was not clear whether case law (including *Sharkey v Werner*, which is the case relied upon for the so-called 'market value rule') applies to require an adjustment to the accounting treatment in relevant circumstances in light of Finance Act 1998 section 42.

2.2. *Sharkey v Werner* and other similarly ancient cases were directed at identifying the business income profit before section 42 was enacted, and before accounting standards were codified. In any event, to the extent it continued to be good law, the *Sharkey v Werner* rule is fundamentally unfair. A requirement to bring in market value will result in the taxing of profits which have not, in fact, been enjoyed by the business, and may never be made. In our view, the change can only be interpreted as being, in essence, a tax raising measure, accelerating tax charges where no profit has actually been realised.

2.3. We can see no reason why there should be any adjustment to the accounting treatment in circumstances where stock is disposed of or appropriated other than by way of sale. The treatment under GAAP, which requires a transaction to be accounted for either at the cost price of the stock or at the price actually paid on the disposal, reflects the reality of the situation and provides a suitable basis for taxation. This change also came at a time when the Government published a Simplification Review in tax calculations and returns for smaller companies which envisages, as a key element, the possibility of aligning accounts and tax rules for smaller companies.

2.4. Accordingly, we recommend that this change be reversed.

### 2.5. ***Related companies simplification review: Associated companies***

We are pleased to be taking part in this simplification review. At the last meeting with HMT/HMRC, in June 2008, it was agreed that the review should focus in the short term on the associated company rules as they apply to the small companies' rate. We agree that this is an area where change is urgently required, and look forward to working towards a workable solution to the issues currently facing small companies which can be included in Finance Bill 2009.

2.6. However, we would also urge the Government to ensure that time and resources are made available to review other areas as well where Income and Corporation Taxes Act 1988 sections 416 and 417 apply, to see if their use is appropriate, and review these sections themselves in the wider context.

### 2.7. ***Targeted reliefs***

We understand that the Government uses targeted reliefs to seek to influence taxpayers' behaviour. However, we have a number of points to make in relation to this Government's tendency to do so. Targeted reliefs,

such as the Enterprise Investment Scheme, generally run counter to the Government's overall aims of simplifying the tax system and, by their very existence, increase the compliance burden and cost for both taxpayers and HMRC.

- 2.8. The issue of targeted reliefs has been considered in a variety of circumstances recently, including by PricewaterhouseCoopers LLP in their report, published in October 2007, entitled *Enterprise in the UK: Impact of the UK tax regime for private companies* and by the CBI Tax Task Force, which published its report, entitled *UK Business Tax: a compelling case for change*, in March 2008.
- 2.9. The subject was also considered by the House of Lords Select Committee for Economic Affairs as part of its review of the Finance Bill 2008. We draw your attention to Chapter 5 (Encouraging Enterprise) of that Committee's Second Report of Session 2007-08 published on 12 June 2008 and reiterate the comments made by representatives of the CIOT, which were given in evidence to that Committee.
- 2.10. In particular, we agree with the recommendation set out at paragraph 254 that:  
"a review should be carried out, putting these targeted tax reliefs in the context of other schemes targeted at small business, weighing the economic benefits of retaining them against the economic benefit of their removal, so allowing a modest contribution to a reduction in tax rates across the board and getting rid of much complexity."

2.11. ***Reform of corporation tax and, in particular, taxation of capital assets***

We believe that there should be a revival of the consultative process on corporation tax (CT) reform that was started a few years ago and abandoned. As you are aware, we are generally in favour of taxable profits being based on the accounts, with fewer departures from these and fewer targeted reliefs. We believe that this could result in a lower mainstream rate. In particular, we recommend that consideration should be given as to whether or not there should be a separate tax on capital gains. The intangible assets regime has demonstrated that what have historically been capital items from a tax perspective can be taxed in accordance with the accounts.

- 2.12. We consider that this could be extended to all taxable capital assets, replacing corporate chargeable gains in their entirety. This would simplify the system and make the existing rollover reliefs within the intangible assets regime and capital gains regime more meaningful, as they could be interchangeable.
- 2.13. In any simplification there would be winners and losers and implications for the ongoing tax position of taxpayers. One way of dealing with a substantial number of these issues is to allow taxpayers to retain their established tax attributes: for example, when ACT was abolished, shadow ACT remained. When the wider review of corporation tax (CT reform process) was conducted some years ago, our view was that the capital/revenue distinction and the 'schedular' system could have been abolished, but that shadow capital losses and accumulated indexation allowance and shadow trading and other 'schedular' losses could have remained. These shadow losses could then have been only utilisable against the specific category of profits

they relate to in the future.

- 2.14. An approach along these lines would have defused a lot of opposition to the proposed change to an accounts basis for taxable profits at the time of the CT reform discussions and achieved major simplification for most taxpayers - with complexity remaining only for those taxpayers with tax attributes they wish to retain.
- 2.15. ***Capital allowances for business expenditure on cars – (see also paragraphs 3.2 to 3.5 regarding transport below)***

As long as there is a distinction between 'expensive' cars (cars that cost more than £12,000) and other cars, we think that expensive cars that are purchased by a business should be put into the 10% (for high CO<sub>2</sub> emission cars) or 20% pools (on an overall revenue neutral basis). This would simplify the capital allowances computations considerably, since at present allowances have to be calculated separately for each such car. However, we would go further and abolish the distinction altogether, relying solely on the CO<sub>2</sub> emissions test.

### 3. **Employment taxes**

#### 3.1. ***Further PAYE/NICs Alignment***

If our proposal for integration of PAYE and NIC at paragraph 7.1 is not taken up, then further alignment of the treatment of payments for PAYE and NICs purposes would reduce the PAYE administrative burden on employers. Wherever possible only one 'test' should be needed to decide whether a payment is liable for PAYE/NICs. HMRC's "Employer Further Guide to PAYE and NICs" (Booklet CWG2) lists around 20 payments where the PAYE and NICs treatment differs. Such differences cause confusion for employers, especially new employers, who are uncertain whether or not to apply PAYE and/or NICs.

#### 3.2. ***Authorised Mileage Allowance Payments (AMAPs)***

The cost to an employee of using his own car for business travel has become a major issue recently and has led to questions in the House of Commons and in the press about the current rates for AMAPs. Certainly, the recent significant increases in fuel costs have highlighted that, in many cases, the AMAP rates may not reflect the real cost of driving.

3.3. Since fuel is a significant, but price volatile, component of the total cost we suggest that the AMAP rates should be split into two elements: one to cover the non-fuel costs of a car and the other to cover the fuel costs, and linked to the Advisory Fuel Rates published by HMRC for company cars. This would then accommodate the trend of reduced wear and tear/depreciatory costs coupled with increasing/volatile fuel prices. Furthermore, we would also suggest the introduction of a regulation-making power to allow AMAPs to be revised during the year (as required), rather than waiting for the Budget cycle and primary legislation.

#### 3.4. ***Extension of the ITEPA 2003 section 243 (local buses) exemption to trams***

Extending the existing tax and NICs exemption allowing employees to benefit from free or reduced cost travel to work on local and works bus services to include trams would further encourage environmentally friendly travel and, as bus tickets are often also valid for use on tramways, would avoid potential issues with the qualification for the existing local buses exemption.

#### 3.5. ***Car parking exemption in connection with park and ride schemes***

There are environmental and congestion impacts when an employee chooses to drive to work through a city centre, etc, rather than opting for local public transport. A limited exemption permitting employers to meet the cost of local car parking in connection with park and ride schemes, ie where an employee switches to public transport, could reduce the amount of employee car mileage and benefit the environment.

#### 3.6. ***Provide an exemption where employer provides transport home for employees' safety/security***

We suggest that a specific exemption from tax and NICs is introduced to cover occasions when an employer has to provide transport home for an

employee as a result of health and safety considerations. The employer's duty of care can extend to ensuring that an employee gets home safely in various circumstances (eg where the employee's safety has been put at risk because of threats made during the course of their working day) but, at present, where the employer pays for the transport home, eg a taxi, the expense may well be taxable on the employee.

3.7. We also suggest that the exemption cover circumstances where an employee has to convey to their home documents, files or other material that is of such an important nature that it is inappropriate for it be taken on public transport for fear of mishap or its being mislaid.

3.8. ***Remove requirement to retain receipts for small expenses (deregulatory)***

The introduction of a provision permitting employers to reimburse small expenses incurred by employees without the requirement to obtain and retain a receipt would be a welcome deregulatory measure. The provision could be aligned with the areas in VAT where a VAT invoice is not required.

3.9. ***Small benefits exemption (deregulatory)***

Employers' administration burdens could be further reduced through the introduction of a tax exemption for small benefits, similar to that found in the Irish benefits code. In this way, where an employer provided an employee with a small benefit (say, with a value not exceeding £25), that benefit would not need to be reported on Forms P11D or be subject to Class 1A NIC.

3.10. ***Elderly care vouchers exemption***

Many employees have key responsibilities in caring for their elderly parents or other relatives, and they may do this by way of a combination of taking time off work themselves and/or paying for care. We think that taking care of the elderly should be encouraged by Government as a key social responsibility of the younger to the older generation and that, accordingly, this should be acknowledged in the employment tax code. In particular, we suggest that, if employers provide financial assistance geared to care for the elderly, then, within limits, this should be exempted. Such exemption could be modelled on the existing childcare vouchers scheme.

#### 4. **Environmental taxes**

##### 4.1. ***A holistic approach***

The review of environmental taxes needs to have a radical holistic rethink as opposed to minor tinkering which adds to complexity but has little real effect. Any tax changes (even in those areas not obviously connected to the environment) should, perhaps as part of the impact assessment process, have to consider the potential environmental impact. This would minimise unintended consequences.

##### 4.2. ***Green taxes – a level playing field***

At present, environmental taxes impact on those in the United Kingdom that are subject to them or those in other countries such as EU countries where there are equivalent taxes. However, many countries have not yet developed any green policies. This can mean that 'green goods and services' are unfairly taxed relative to those emanating from countries with either no environmental policy or very lax ones. If environmental tax policies are to succeed, efforts need to be made now to ensure that all goods and services reflect environmental costs. Budget 2009 should commence action to create a level playing field.

##### 4.3. ***Car taxes – (see also paragraphs 3.2 to 3.5 regarding transport above)***

The tax and duties relating to cars and fuel for cars is an area which has been subject to many small changes in recent years. Instead we suggest that a holistic approach is taken. We reattach the appendix to our business taxation of cars paper submitted in late 2006 as an example of the sort of evaluation approach that is needed. This considered the comparative effect on car CO<sub>2</sub> emissions of a range of taxes, rather than focusing on whether one tax might increase or decrease emissions. The final summary line indicates the overall effect of each tax in relation to CO<sub>2</sub> emissions (see Appendix B).

## 5. EU & Human Rights

### 5.1. *Exit charges*

Following the recent opinion of the European Court of Justice (ECJ) in *Cartesio Oktató és Szolgáltató*<sup>1</sup>, we would welcome a review of the various exit charge provisions within the UK legislation, including, in particular, Finance Act 1988 section 130 and Taxation of Chargeable Gains Act 1992 (TCGA) sections 179 and 185.

5.2. It is our view that these exit charges limit the freedom of establishment and, as such, do not comply with the EC Treaty as interpreted by the ECJ. We would welcome an EU-compliant exit charge and suggest that this could be formulated on the basis suggested in the EU Communication published on 19 December 2006 which suggested that member states “provide for an unconditional deferral of collection of the tax due until the moment of actual realisation”.

### 5.3. *Merger Directive*

We welcome The Corporation Tax (Implementation of the Mergers Directive) Regulations 2008 (SI 2008/1579) which more fully implements the Mergers Directive, which is intended to give a deferral of any tax charge which would otherwise arise for all cross border (within the EU) legal mergers.

5.4. TCGA new section 140GA goes a long way to ensuring that there is a tax deferral in respect of an ‘inbound’ merger, where, say, a UK company ‘absorbs’ an Italian company in circumstances where the relevant companies are not carrying on a trade, or for some other reason do not qualify for substantial shareholdings exemption. Prior to SI 2008/1579 there was not a deferral in these circumstances because the condition in section 140E - that the gains of the transferor, if arising immediately before the transfer, would be within the charge to tax (section 140E(5)) - would not be satisfied.

5.5. However, although the new section 140GA introduces a new relief overriding TCGA section 24 (Disposals where assets lost or destroyed, or become of negligible value) and TCGA section 122 (Distribution which is not a new holding within Chapter II), it does not provide relief in respect of TCGA section 22 (Disposal where capital sums derived from assets). We suggest that the position be clarified either by further legislation or by the Government confirming that a liquidation distribution (arising under each of the 26 EU member states’ company law) will always be characterised as a capital distribution rather than a capital sum.

5.6. In addition, the new section 140GA(a) requires the transferee company to hold the **whole** of the ordinary share capital in the transferor company. This requirement does not appear to comply with Article 7 of the Mergers Directive (as amended), which specifies that gains accruing to the receiving company (the parent in an upstream merger) shall not be liable to any taxation, although derogation is allowed where the parent company owns less than 20% (reducing by stages to 10%). Further, if the assets being

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<sup>1</sup> Case C-210/06

transferred upstream constitute a UK permanent establishment, it appears that their disposal will be liable to UK tax (see below). This does not comply with Articles 4 and 10 of the Directive.

In practical terms, consider, say, a UK parent company with a 90% holding in an EU subsidiary that is dissolved without going into liquidation. TCGA section 136 cannot be satisfied because the UK company cannot issue shares to itself, and so the conditions of Schedule 5AA paragraphs 1 and 2 are not met.

- 5.7. As a result the UK parent will be taxed on a disposal of the shares in its dissolved subsidiary under TCGA section 122. In addition, if the assets transferred to it constitute a UK permanent establishment, the foreign subsidiary will be taxed on their disposal since TCGA section 171 is dis-applied by the proviso to section 171(2).

We suggest that these issues be rectified.

5.8. ***Cadbury Schweppes<sup>2</sup> and controlled foreign companies (CFC)***

In light of the delay in relation to the consultation on the taxation of profits of foreign companies, we suggest that Income and Corporation Taxes Act 1988 (ICTA) sections 751A and 751B be reconsidered and amended as, in our view, they do not constitute an adequate legislative response to the judgment of the ECJ in *Cadbury Schweppes*. Sections 751A and 751B are inadequate for a number of reasons:

- a. The relief afforded by section 751A is confined to the 'net economic value' created by 'qualifying work' for the CFC and its members taken together with other group companies. These concepts confine the relief to value referable to labour. This is not, in our view, a proper reflection of the *Cadbury Schweppes* judgment. Rather, the ECJ judgment requires that the resident company be given an opportunity to provide evidence that the CFC is actually established in the relevant EU territory and that its activities there are genuine (paragraph 70).
- b. Paragraphs 66 and 67 then note that the finding as to whether or not the CFC is actually established and carrying on genuine economic activities in its host Member State must be based on objective factors which are ascertainable by third parties, with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment.
- c. However, there is no suggestion anywhere in the ECJ judgment that, if a resident company can establish to the satisfaction of its host state tax authorities that an EU (here non-UK) subsidiary is actually established and carrying on genuine activities in a non-UK EU Member State, then the resident state CFC regime can continue to apply as regards profits referable to capital, intellectual property or other assets as compared with profits (or net economic value) attributable to work undertaken by employees or persons acting under the direction of the CFC.

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<sup>2</sup> Case C-196/04

- d. The relief under section 751A has to be claimed. We consider that, if a CFC can be demonstrated to be actually established and carrying on genuine economic activities locally, then the UK resident company should not be subject to the procedural requirement of having to claim the relief. It should be entitled to the relief as of right. In this regard, we would cite the judgment of the ECJ against Sweden in the *Jessica Safir*<sup>3</sup> Case.
- e. The relief must be claimed by the company on or before the filing date for the relevant company tax return of the resident company. Ordinarily, this will be within one year from the end of the accounting period of the CFC in question. This will be before the eighteen-month timeline for evaluating whether or not the CFC should, or has, met an “acceptable distribution policy” requiring that it distributes 90% of its UK chargeable profits to the UK.
- f. If the HMRC Commissioners refuse an application by a resident company under section 751A, the company must appeal within thirty days in writing. This time limit seems unreasonably tight.

#### 5.9. **Gift Aid**

We refer to our consultation response on Gift Aid, submitted to HM Treasury in September 2007, which is available at <http://www.tax.org.uk/showarticle.pl?id=6029&n=3794>. In this response, we highlighted the fact that Gift Aid relief is limited to UK Charities under UK legislation and case law<sup>4</sup> and that to obtain relief for donations to an overseas charity the latter has to set up a UK charitable arm through which UK donations can be channelled. This has various restrictions, which were highlighted in our earlier response.

- 5.10. In our view, the fact that Gift Aid is limited to UK charities is contrary to EU law. We recommend that, as a minimum, Gift Aid be extended so that it applies to gifts to charities registered within an EU member state.
- 5.11. However, in addition, we suggest that, as a matter of policy, the Government consider extending the scheme so that it applies to charities wherever they are situated in the world.
- 5.12. We recognise that the Government would be concerned to ensure that the charities which could benefit from the scheme were subject to appropriate regulation, and that there would need to be a mechanism for determining which foreign charities should qualify on this basis. We suggest that this could be dealt with by giving HM Treasury the power to publish an approved list of charities. Charities could be included on the list either in an individual capacity or by reference to their registration with the equivalent body to the Charities Commission in their jurisdiction where HM Treasury was satisfied that that body provided sufficient checks and regulatory controls.
- 5.13. In connection with Gift Aid, it was disappointing that the 2007 consultation has not yet resulted in any meaningful changes. Although this was badged as a consultation to facilitate wide-ranging improvements, the Finance Bill 2008 changes have, in administrative terms to charities, been fairly trivial.

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<sup>3</sup> Case C-118/96

<sup>4</sup> *Camille and Henry Dreyfus Foundation Inc v IR Commrs* HL1955, 36TC126

Our proposal for a composite rate of tax which charities could reclaim has the merit of significantly reducing burdens on charities and individuals in keeping a record of individual charitable donations. This would allow the net changes in tax reclaimed to be neutral for the Exchequer: a win-win situation.

5.14. **Cross border group relief**

In order to comply fully with the judgment of the ECJ in *Marks & Spencer*<sup>5</sup>, the provisions relating to group relief: overseas losses of non-resident companies contained in ICTA Schedule 18A should be extended to also apply to consortium companies.

5.15. **Time limits**

In the joined cases of *Fleming (trading as Bodycraft) v Revenue and Customs Commissioners*<sup>6</sup> and *Condé Nast Publications Ltd v Revenue and Customs Commissioners*, the House of Lords held that there should be adequate transitional provisions in relation to changes in time limits in order to comply with EU law and the principle of legitimate expectation. In our view, Finance Act 2004 section 320 (Exclusion of extended limitation period in England, Wales and Northern Ireland) and Finance Act 2007 section 107 (Limitation period in old actions for mistake of law relating to direct tax) do not comply with this principle and should, therefore, be amended.

5.16. **Data protection**

Recent events, both within HMRC and in other government departments, have demonstrated a less than satisfactory level of protection of individuals' data held by different bodies. Given that there are also rules providing for exchange with foreign governments, the risk of data loss is ever-increasing.

5.17. The tax system has always relied considerably on building trust with taxpayers. It is therefore necessary to move faster on satisfying taxpayers that their data are safe with both UK government departments and those others who are allowed access. Stricter rules need to be established to protect taxpayers' data. In addition, there should be regular reports to demonstrate that action is being taken.

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<sup>5</sup> Case C-446/03

<sup>6</sup> [2008] UKHL 2

## 6. **International**

### 6.1. ***Treaty Clearance***

Currently, as noted in our letter to Mark Neale of 11 January 2008 on simplification, a UK company paying annual interest to an overseas lender may not pay the interest gross, or at a reduced treaty rate, until it receives treaty clearance from the HMRC Residency, following an application for treaty clearance made by the non-UK resident lender. The revised procedures for applicants for treaty clearance announced in 2007 were clearly welcome in reducing the timescale for obtaining treaty clearance notices and bringing the process more into line with the principles underlying Self Assessment (SA).

- 6.2. We consider that this process could be further improved and developed by removing the need for an application for clearance. Consideration may be given to an optional scheme such as that operated under Income Tax Act 2007 section 911 in relation to royalty payments. It is considered that the resulting reduction in applications would free up resources significantly and assist business by mitigating the administrative burden.

### 6.3. **Budget 2009 – Applications for reduced rate of withholding on interest payments under double tax treaties**

The time currently taken to process a simple application made under the UK treaty network to receive interest gross (or at a reduced rate of withholding) is about 18 weeks and this is far too long. Until the clearance under the treaty is issued by HMRC a UK borrower has to withhold tax on payments of interest to overseas lenders.

This state of affairs makes UK plc very uncompetitive as the majority of other OECD countries permit a borrower to self assess the application of the relevant treaty and determine whether or not tax should be withheld. In the UK, such a system has been introduced for royalties, but not for interest.

The current rules are also very inefficient for HMRC. We understand (from figures given to us at the Thin Capitalisation Workshop on 11 July 2008) that last year approximately £200million of withholding tax on interest collected and accounted for to HMRC had to be repaid (either by cheque or CHAPS) once the treaty process has been completed.

We suggest that urgent consideration is given to addressing this issue, preferably by extending the “reasonable belief” provisions which apply in respect of royalties to interest. Alternatively, if this is not possible, because, for example, of the terms of certain treaties (which require notice to be given by HMRC), we suggest that a process is put in place under which an overseas lender can be approved for a period of, say, two years, removing the need for the lender to make a treaty application in respect of each loan to a UK borrower.

## 7. Management of Taxes

### 7.1. *Integration of income tax and National Insurance Contributions (NIC)*

As set out in our response to the recent consultation entitled "Improving the collection of National Insurance Contributions from the self-employed" (available at <http://www.tax.org.uk/showarticle.pl?id=6929&n=3794>), we propose a merger of these two taxes. We also suggested that, were that proposal too radical to be acceptable, Classes 2 and 4 NICs should be merged and brought fully within SA. In addition, the complicated systems of small earnings exceptions and deferments for the self-employed are ripe for review and could become redundant if Classes 2 and 4 NICs are brought within SA.

7.2. We appreciate that various reviews have concluded that a radical change is not warranted. However, it is felt that such reviews did not adequately consider the costs and benefits to the UK as a whole, but addressed individual sectors without looking at the bigger picture.

### 7.3. *Simplification*

The last year has provided us with a wealth of tax changes, which in many cases have made the UK tax system far more complex. We suggest that a set of guidelines be produced against which all tax changes should be measured, even considering scoring proposed changes to tax legislation for attributes such as complexity, ease of implementation and administrative burdens, then rejecting those with excessive scores. This would focus the minds of policy makers, helping to produce legislation which simplified the UK tax system rather than making it more complex. This might also discourage frequent changes in the tax legislation which in themselves add to complexity. The score could be included in any impact assessment.

### 7.4. *Modernisation of Powers, Deterrents and Safeguards (MPDS)*

#### *Consultation process*

We have contributed, and will continue to contribute, to the various consultations on HMRC MPDS. In many ways we congratulate HMRC on the way this is being carried forward, but feel that we need stronger feedback from the consultative process with better explanations of why particular routes have/have not been chosen.

### 7.5. *Taxpayers' Charter*

The changes coming through under the MPDS review, and indeed in many other areas, emphasise the need for a Taxpayers' Charter. We welcome the current consultation and will, of course, be heavily involved in it, and would emphasise here how important we think this is. We consider that the vires for the Charter should be included in Finance Bill 2009.

### 7.6. *Single Taxes Management Act*

While we opposed the introduction of a New Taxes Management Act last year, the reason for that was due to the timing in that many of the provisions to be included in such an act were about to be changed as part of the

MPDS review. However, once this review has been substantially completed, we consider that steps should be put in place to consolidate the legislation into a single accessible act.

7.7. ***Detailed technical points relating to MPDS***

7.8. *Penalties for late partnership tax returns*

Unlike in section 93(7) relating to an individual's return, there is no provision to reduce the penalty for a late partnership return down to the outstanding tax liability, if less than £100. We appreciate that there is scope for making a reasonable excuse claim under TMA section 118(2), but this can be costly in terms of professional fees or time incurred and introduces an element of uncertainty.

7.9. Therefore, we suggest that the legislation be altered to insert into TMA section 93A a sub-section similar to sub-section 93(7), but relating to the liabilities of the partners, so that the effect will be that if the tax liability of all the partners has been settled no penalty will be charged for a late partnership return.

7.10. *Set-off and surrender of group relief*

Finance Bill 2008 clause 125(5)(a) states that when set-off is considered "any assignment ... shall be disregarded". If a joint surrender of and claim for a tax repayment has already been submitted by two group companies and utilised to set against a tax liability of the claiming company, then we consider that HMRC should not be able to treat this as an assignment and make a subsequent set-off to displace the surrender. If HMRC were allowed to do this, there would be significant uncertainties within groups and the risk that HMRC could use the set-off provisions to increase the net interest liabilities of groups which have paid the right amount of tax by due dates.

## 8. **Owner Managed Business taxation**

### 8.1. ***Review and Reform of Small Business Taxation***

We continue to press for a timely review of small business tax, with the intention of introducing a system which is fit for purpose in the 21<sup>st</sup> century, with a level playing field irrespective of the structure chosen. At present, there are still tax advantages from incorporating which can outweigh the additional administrative burdens of incorporation. Much of this is due to the lack of integration of NICs and income tax. If this was resolved the need for 'IR35' and the 'Managed Service Company' legislation could evaporate, together with the need to legislate for some income shifting.

8.2. Given a level playing field, the incentives to incorporate a business would be commercial ones. Part of this review might entail consideration of a minimum level of capital in a company to benefit from the slightly lower rates of tax in companies.

### 8.3. ***Income shifting***

The income shifting consultation produced a significant response from many of our members who could foresee the enormous problems with the potential implementation of the original draft proposals. In fact, as a body, we received more comments on this subject than on most other consultations in recent years. Our detailed comments on this, including reference to the enormous administrative burdens that would be unleashed, are set out in our response at:

<http://www.tax.org.uk/showarticle.pl?id=6578&n=3794>

8.4. We are still unable to understand why the Government has highlighted one form of income shifting for special treatment, where those affected most would generally be small business owners earning modest incomes and would have significant compliance costs with often little or no change in the Exchequer's tax revenue.

8.5. We would recommend that the proposals be quietly dropped – far better to improve the tax regime for small businesses as a whole. However, if the proposals are brought back in any form, we would suggest that these be introduced in such a way as to eliminate uncertainty as to the application of the legislation to most owner managed businesses. One could devise a simple checklist of tests which required yes or no answers, devised to catch the extreme type of business that Government would like to pursue but to ignore all others. If all answers were positive then tax consequences would arise, perhaps by treating the shares held by the spouse as a settlement of the key worker.

8.6. Tests to be considered would need to be consulted on, but could for example be variants of:

1. No business premises away from home - rented/owned by business
2. Cost of sales less than 10% of turnover
3. Balance sheet fixed assets and stock under 1/3 VAT threshold
4. Owners live in same family/economic unit
5. At least one owner works less than 20% of the hours of the other owner

These could be tested on a trial basis on a sample of businesses to endeavour to catch, and only catch, extreme examples of perceived abuse.

8.7. ***Disincorporation relief***

We note the gradual closing of the gap between the small companies' rate and the main rate. This trend is likely to reduce tax-incentivised incorporations in the future, which we would support. However, the changes over the last decade in tax have left many small businesses in corporate vehicles when a sole trade or partnership would be more appropriate and reduce administrative burdens for both small business and HMRC. However, extracting a business from a corporate status presents tax problems. We would recommend that a form of disincorporation relief is introduced.

## 9. **Property taxation**

### 9.1. ***Reform of the Stamp Duty Land Tax (SDLT) legislation dealing with group relief***

The treatment of transfers of real property inter-group for SDLT purposes should be the subject of an overall review with the aim of simplifying the current legislation. This legislation has been the subject of numerous amendments to counteract avoidance since its introduction in Finance Act 2003, including the latest measure in Finance Bill 2008 adding new paragraph 4ZA.

9.2. This latest amendment formed part of our Finance Bill 2008 representations in which we highlighted its effect as catching wider commercial transactions as well as the perceived abuse at which it was targeted (see further below at 9.3). The number of piecemeal amendments and the resulting complexity mean that even the simplest of transactions requires advice. This is unfair to the majority of compliant taxpayers and leads to uncertainty.

9.3. As previously noted in our submission dealing with Finance Bill 2008 clause 93, introducing new paragraph 4ZA, the definition of 'change of control of the purchaser' imposes a withdrawal of group relief in circumstances where the restructuring of which it forms a part is carried out without any avoidance motive. This may include, for example, preparatory transfers of assets within a pre-reconstructed group prior to a division of assets in a voluntary liquidation of a parent company under the Insolvency Act 1986 section 110. We do not believe that the intention is to impose a claw-back charge in such circumstances as evidenced by the amendments made to the Finance Bill 2008.

9.4. In order to mitigate this problem and simplify the tax codes, consideration should be given to aligning the definition of a chargeable gains tax group in the Taxation of Chargeable Gains Act 1992 and the definition of a group for SDLT group relief purposes.

### 9.5. ***Reduction in the administrative burden***

#### 9.6. *Removal of the requirement to certify instruments effecting low value transactions for stamp duty at £1,000*

Finance Bill 2008 clause 95 introduced a measure to exempt low value transactions from stamp duty. We wholly support this reform. However, we suggest the position could be further improved by the removal of the requirement to certify instruments effecting low value transactions for stamp duty at £1,000. Our objection is that the requirement to certify may require investigation into the details of related transactions of which the transferor has no knowledge and the requirement for certification is again wholly disproportionate to any possible abuse.

#### 9.7. *Removal of FA 1990 sections 107-111 (abolition of stamp duty and stamp duty reserve tax)*

The removal of FA1990 sections 107-111 from the statute book would obviate the need to make consequential amendments (such as are required as a result of the changes introduced by Finance Bill 2008 clause 96 and

Schedule 32) when changes are made to the stamp duty code. The provisions were introduced to provide for abolition of stamp duty and stamp duty reserve tax on 'the abolition day'. Given that there is no current intention to bring these provisions into effect, their continued presence leads to unnecessary complexity and lack of certainty. We consider this should be acknowledged by their removal.

9.8. ***SDLT relief backdated leases granted to tenants holding over***

Finance Act 2003 Schedule 17A paragraph 9A provides for overlap relief in the holdover period. There is considerable uncertainty surrounding the effect of this provision. The uncertainties stem in part from its interaction with FA 2003 Schedule 5 paragraph 1A and, in part, from its application to different statutory (Landlord and Tenant Act 1954 Part II) and non-statutory regimes. Although guidance will be helpful, in the interests of simplicity and certainty the legislation requires review and amendment.

9.9. ***Property Authorised Investment Funds (PAIF)***

As set out in our previous submission, we are in favour of an extension of the existing SDLT relief for conversion to an open ended investment company to offshore property unit trusts that wish to enter the PAIF regime. As the new regime is restricted to open-ended investment companies (OEICs) (for reasons which are well understood) which, by definition, have to be companies incorporated in the UK (TA 1988 section 468A), an extension of the SDLT relief to offshore funds on conversion to an OEIC would not seem unreasonable. Otherwise, the regime may be seen as unduly restrictive, thereby reducing its appeal.

9.10. Although technically it may be possible for some offshore property unit trusts to utilise the current SDLT relief, the two-stage process necessary to do so (becoming an UK authorised unit trust followed by extinguishment of the units and issue of new shares in the OEIC) is cumbersome and is an impediment to entry into the regime.

9.11. The transfer of units in an offshore property unit trust is outside the scope of SDLT, Stamp Duty and Stamp Duty Reserve Tax (SDRT). Therefore, there should be no loss to the Exchequer if SDLT relief is available on conversion to an OEIC. In fact, the tax take would be augmented by the current SDRT charge on dealing in shares by investors in open-ended companies under FA 1999 Schedule 19. In addition, administrative and other incidental fees would be brought onshore.

9.12. ***Integral Features***

Finance Bill 2008 introduces CAA 2001 new section 33A, including a list of assets falling within that category. We consider that the opportunity provided by section 33A(7) to add to the list of assets should be used to add environmentally beneficial building features (as specified in our consultation response to Business tax reform; capital allowances changes - attached) to the list.

10. **Succession taxes**

10.1. **Charities – (see also paragraphs 5.9 to 5.12 regarding Gift Aid)**

The European Commission has ruled that refusing inheritance tax exemption in respect of charities established in other EU countries which would be charitable if established in the UK is discriminatory, and has requested that the British Government deals with this point. What steps are being taken to ensure that HMRC will accept that gifts to foreign charities can qualify for the same charitable reliefs as gifts to UK charities?

10.2. **EU issues**

The limitation on exemption for gifts to foreign domiciled spouses and the restriction of agricultural property relief to exclude let farmland in the EU also appear to be discriminatory. What steps are being taken in this area?

10.3. **Disabled beneficiaries**

Under IHTA 1984 section 89, a trust for a disabled beneficiary is subject to inheritance tax on his death. To avoid a double charge to tax, a capital gains tax uplift should also be given even if there is no actual interest in possession at the death.

10.4. **Business property relief**

Consideration should be given to granting a relief for joint ventures operating within private trading groups similar to that given under the old business assets taper relief legislation.

10.5. **Pre-owned Assets Tax**

Sales of part for full value should be excluded transactions and not within the POAT provisions.

**11. VAT and indirect taxes****11.1. *Partial exemption – adjust limits in capital goods scheme***

HMRC are consulting on the simplification of the partial exemption rules. Their timetable indicates that they will only deal with capital items in 2010/2011. In the meantime, it should be noted that the values used in the relevant legislation have not changed since the introduction of the scheme some 18 years ago.

- 11.2. It should be relatively simple as an interim measure to make the scheme more manageable for larger businesses for whom the current £250,000 and £50,000 limits create significant burdens by raising these limits by the rate of inflation since 1990.

*Relevant legislation - VAT Regulations 1995 Part XV.*

**11.3. *Partial exemption – make provision for optional adjustments by small business***

The CIOT has previously commented that the exclusion of assets other than property and computers over a certain value from the scheme can impose undue hardship on smaller taxpayers where they have a change in use of capital items. The most notable example of this is the case of *Chard Bowling Club*<sup>7</sup>.

- 11.4. The CIOT considers that the VAT regulations should provide an option for smaller businesses to make adjustments in appropriate circumstances where there is a change of use of goods or services on which VAT was previously disallowed. Failure to provide such an option is in the view of the CIOT *ultra vires* the VAT Directive.

- 11.5. The need for such an option would increase if the recommendation above is adopted.

**11.6. *Partial exemption – de minimis limits***

The values contained in the current partial exemption *de minimis* limits in the VAT Regulations 1995 regulation 106 have not changed for a considerable period. These will be dealt with in the partial exemption consultation in 2009/2010 but, until this legislation is simplified, it would be appropriate to raise these limits.

*Relevant legislation – VAT Regulations 1995 regulation 106.*

**11.7. *Payments on account – adjust limits***

The requirement to make monthly payments on account was introduced more than 15 years ago. The threshold above which payments on account had to be made was £2 million – the current limit. It would be appropriate to raise these limits to reflect or at least partly reflect the impact of inflation on businesses.

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<sup>7</sup> VTD 15114

*Relevant legislation* – VAT Regulations 1995 regs 44 to 48 and the VAT (Payments on Account) Order 1993.

#### 11.8. **Compliance with European Community VAT Law**

The CIOT has repeatedly pointed out that there are several aspects of UK VAT law where the VAT Tribunals or the Courts have found it to be *ultra vires* the relevant European VAT law. In addition, there are provisions of EU VAT law that have not been implemented at all. Among the provisions that need to be implemented properly are:

- Article 132(1)(f) – The UK has not implemented the exemption for cost sharing activities;
- Article 135(2)(a) – The UK has widened the exclusion from exemption in relation to the letting of holiday accommodation;
- Article 135(2)(c) – UK legislation does not exclude from exemption the letting of permanently installed equipment; and
- Articles 184 to 186 – UK legislation improperly limits adjustments in relation to changes in use of goods and services.

#### 11.9. **Option to tax**

VATA 1994 Schedule 10 severely restricts the option to tax. The restrictions create considerable problems in large groups of companies where in any particular deal those negotiating may not even be aware that of the relationship that exists between the parties.

11.10. The rules were introduced to prevent avoidance but, following the decision in *Halifax plc*<sup>8</sup>, it is clear that most of the schemes that were targeted by this legislation would not succeed and the need for legislation as complex as the anti-avoidance rules is questionable. Further, they can create difficulty because they interfere with ordinary commercial transactions in which no avoidance is either intended or even occurs.

11.11. Abolition of the rules or at least limitation of their application to avoidance transactions would greatly simplify matters for affected businesses.

*Relevant legislation* - VATA 1994 Schedule 10.

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<sup>8</sup> *Halifax plc and Others v Commissioners of Customs & Excise* (Case C-255/02)

## Appendix C - Car and Car Fuel Taxes and Duties – Summary of evaluation criteria

Relevant tax or duty:	Vehicle Excise Duty	Fuel Duty	Capital Allowances/Corporation Tax deduction	Fringe benefits tax	VAT	Congestion charge/road pricing
<b>Evaluation criteria:</b>						
Effect on actual CO2 emissions	Indirect effect only: VED is charged on the car's availability rather than actual use.	Direct effect on usage, particularly in congested circumstances where petrol consumption is higher.	Indirect effect only: charge relates to owning or leasing a car rather than using it.	Indirect effect only: charge relates to provision of a car rather than using it.	VAT on purchase increases costs because it is mainly irrecoverable. It seems unlikely that this has any impact on use, only on the choice of financing. VAT will automatically be chargeable on fuel. There is no possibility of increasing the rate of VAT on cars without increasing the standard rate generally, nor is there any possibility of adjusting the VAT recovery, so this would have little or no impact. There is VAT on private usage and this may have some impact if adjusted, but there are limitations on how VAT on private use can be determined.	These charges would appear to have a direct effect on usage, particularly in congested circumstances where CO2 emissions absent the policy would appear likely to be greatest.
Likely impact on behaviour	Directly affects car running costs and so very visible to procurement departments. However, the amount is comparatively small.	Directly affects car running costs and so very visible to procurement departments. The amount depends on mileage and fuel-efficiency.	Tax line cost which may not be a concern to procurement departments and typically less of a concern to businesses generally than "above the line" costs. Quantum impact also likely to be low.	Directly affects employment costs through Class 1A and any economic tendency to "compensate" employees for income tax cost.	This affects the cost of leasing and purchase, because the cost of the car is increased by irrecoverable VAT, so the lease rentals or depreciation charge are increased. However, although there is an impact on P/L account, it is unlikely to be highly visible except in a business that has a very large car fleet and very few other assets.	Charges (and penalties) will directly impact running costs.

Relevant tax or duty:	Vehicle Excise Duty	Fuel Duty	Capital Allowances/Corporation Tax deduction	Fringe benefits tax	VAT	Congestion charge/road pricing
<b>Evaluation criteria:</b>						
Ability to avoid the tax without reducing CO2 emissions	No obvious legal method.	No obvious legal method for journeys wholly within the UK (but see Appendix A para A 1.5).	It would seem possible to avoid the effect of the disallowance if employees were to own their own cars and charge the corporate employer for their use, as has already happened in response to fringe benefits tax (see Appendix A Part A2).	There has already been a trend for employees to own their own cars, with resultant increases in CO2 emissions (see Appendix A Part A2).	Some mitigation is possible because of differences between the tax treatments of lease v purchase, but unlikely to be significant in the context of environmental issues.	No obvious legal method. See Appendix A para A 1.4
Compliance costs	Very little incremental cost of differential charging by CO2 emission. The tax disc shows details of each individual car and model in any case.	Very little for businesses generally.	Can be significant, depending on the complexity of the rules. Details are required (and may need to be carried forward from year to year and matched against disposals) which would not normally need to be collected for the tax return and which may even double or multiply the length of the typical computation.	Incremental complexity would appear to be less than for corporation tax as in any event a form needs to be produced relating to each employee, but greater than for VED, as it may increase the level of detailed information required.	The accounting system is likely to manage the VAT cost, and an additional transaction will make little or no difference.	Depends on form of charging adopted.
<b>Summary</b>	Small indirect effect only but low compliance cost and difficult to avoid.	Significant direct effect and relatively little downside.	Relatively ineffective in reducing CO2 emissions and imposes disproportionate compliance costs.	Can have significant albeit indirect effects, but some suggestion the maximum effect has already been achieved, and a trend to avoid the intended effect through employee ownership has already been noted.	Seems unlikely to achieve any significant reduction in CO2 partly because of EU constraints and partly because tax distortions impact the lease v purchase decision more than use of the car.	Seems likely to be effective in reducing CO2 emissions, potentially at acceptable compliance cost.

## **Appendix C**

### **12. The Chartered Institute of Taxation**

- 12.1. The Chartered Institute of Taxation (CIOT) is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

The CIOT's comments and recommendations on tax issues are made solely in order to achieve its primary purpose: it is politically neutral in its work. The CIOT will seek to draw on its members' experience in private practice, Government, commerce and industry and academia to argue and explain how public policy objectives (to the extent that these are clearly stated or can be discerned) can most effectively be achieved.

The CIOT's 14,000 members have the practising title of 'Chartered Tax Adviser.'

The Chartered Institute of Taxation  
18 July 2008