Draft Finance Bill 2016: round-up of submissions on draft clauses

General Features

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A round-up of our submissions on the draft clauses

Introduction

The draft Finance Bill clauses were, in the main, published on 9 December, and comments were invited until 3 February. A full list of submissions made by the CIOT, ATT and LITRG is in the table at the end of the Technical section, but here we summarise most of the submissions made.

Unless stated otherwise, the changes take effect on 6 April 2016 (or 1 April 2016 for corporates).

Clauses 1 to 4: Personal savings allowance, and changes to dividend taxation

Draft clause 1 introduces a new nil rate of tax for savings income (such as interest) within a savings allowance for individuals. Every individual will have an annual savings allowance of £1,000 unless they have any higher rate income for the year, in which case their allowance will be £500, or any additional rate income, in which case their allowance will be nil.

Clause 2 introduces an allowance for the first £5,000 of dividend income. This will operate as a 0% tax rate inserted into the Income Tax Act 2007 (ITA 2007).

Clause 3 abolishes the dividend tax credit.

Draft clause 4 and Schedule amend Part 15 of the Income Tax Act 2007 (ITA) to remove the requirement on deposit takers, such as banks and building societies, to deduct income tax from the interest or other returns they pay on particular savings, investments and alternative finance arrangements.

The introduction of the savings allowance, combined with the cessation of the tax deduction scheme for interest (TDSI), and the replacement of the dividend tax credit with the new dividend allowance will represent a small tax reduction for most taxpayers with small amounts of investment income, and there will be a compliance saving for some, although there will be exceptions.

The CIOT and LITRG submissions to HMRC on the personal savings allowance clauses express concern that they will lead to unnecessary complexity and some ‘cliff-edge’ tax liabilities for taxpayers whose income falls just over the higher rate threshold.

Example: Becky has earned income and £1,000 of savings income. Her total income equals the basic rate limit, so she is entitled to a £1,000 savings allowance. Her savings income is taxed:

£1,000 x 0% = £0.00

Anne has earned income and £1,000 of savings income. However, her total income is £1 above the basic rate limit, so she is entitled to a £500 savings allowance. Her savings income is therefore taxed:

£500 x 0% = £0.00
£499 x 20% = £99.80
£1 x 40% = £0.40
£100.20

For Anne, a £1 increase in income produces a dramatic £100.20 tax charge, so Anne is in fact £99.20 worse off than Becky, which is plainly unfair.

The new allowances are also complex:

- There are two savings allowances depending on whether a taxpayer pays tax at the basic rate or higher rate (or three if you include the fact that the allowance is not available to those on the additional rate).
- Despite their name, the savings allowance and dividend allowance are not tax-free allowances; savings and dividend income that is within the 'allowance' will still count towards an individual's basic and higher rate limits, and will therefore affect allowances and charges that depend on whether an individual's income crosses a particular threshold (for example, the high income child benefit charge (£50,000)).
- The starting tax rate for savings is retained and will operate alongside the savings allowance. This is likely to be confusing for the 1.4 million taxpayers who will continue to pay tax on their savings income after the allowance is introduced.
- The dividend changes will also affect the level of savings allowance entitlement. It is likely that this will be confusing for the two million taxpayers who will still be paying tax on their dividend income after the measure is introduced. This figure includes the estimated 200,000 individuals who will pay tax on their dividend income for the first time.

We asked that HMRC produce guidance and tools that provide clear explanations and worked examples of how the savings allowance interacts with the dividend allowance, the various tax bands, and the starting rate for savings. Taxpayers need to be able to understand it so they can make informed decisions about their financial affairs. LITRG also called for a communications strategy to draw taxpayers' attention to the changes.

Trustees and personal representatives will not receive either the dividend allowance or the savings allowance and will remain liable to the trustee or standard rates applicable in full on the relevant category of income. However, the abolition of the dividend tax credit applies regardless of the status of the recipient. All trustees and personal representatives will face an increased compliance burden if a return would not have been required previously because the 10% dividend tax credit satisfied all liability on the dividend income. There is a strong argument for raising the figure for informal settlement to minimise compliance costs.

There will also be an impact on some individuals who make charitable donations because the removal of the dividend tax credit may mean that they no longer pay enough tax to cover that attributable to their gift aid donations and would be liable for the shortfall. This would be particularly iniquitous to donors with small incomes. We asked whether it would be more reasonable for a notional credit to be maintained in relation to donations made by taxpayers whose income is insufficient to cover the tax reclaimable by charities.

The ATT also submitted comments on Clauses 1 and 2 to HMRC, raising several points similar to those made by the CIOT and LITRG.

Clause 8: Statutory exemption for trivial benefits in kind

The government is proposing to include in Finance Bill 2016 (having omitted a similar draft clause published in December 2014 from the 2015 finance bills) a statutory exemption to exempt trivial benefits in kind (BIKs) from income tax and NICs. The exemption is subject to qualifying conditions, including a £50 cap on individual BIKs to employees and an annual cap of £300 per employee if they are a director or other office holder of a close company.

Although the CIOT believes that the draft legislation is reasonably clear, we have asked HMRC for clarification on some parts. For example, whether a gift of chocolates and wine is a single 'benefit' rather than two separate items, the cost of which is to be assessed separately. We also believe that greater clarification is needed on the difference between a reward for 'particular services' (which the legislation excludes from qualifying for the exemption) and one for services.

Clause 9: Employment intermediaries and relief for travel and subsistence

The government is introducing legislation to prevent agency workers, umbrella company workers, and workers engaged by their own personal service company (PSC) (where IR35 applies) claiming a deduction for home-to-work travel and subsistence costs if the workplace would not be regarded as a temporary one had the worker been engaged directly by the end client.

In its response, the CIOT has raised a concern that the legislation in relation to workers engaged through PSCs may not work as proposed. The government's stated intention is that the restriction on home-to-work travel and subsistence will apply only to PSCs if there is a 'deemed employment relationship' under the IR35 rules. However, we think it is not clear in the legislation that, if there is an IR35-type arrangement but no deemed employment contract exists after applying the IR35 test, the supervision, direction or control (SDC) test does not need to be considered.

We have also asked HMRC to confirm whether existing provisions, which provide for the PAYE liability on general earnings to be transferred to the UK client or agency when there is an overseas intermediary or payer, will also transfer the obligation to account for PAYE on the paid/reimbursed travel and subsistence expenses. This is not clear as these expenses will no longer meet the test for a corresponding income tax and NICs deduction as a result of applying this new legislation to agency workers.

Clause 11: Employee share schemes–simplification of the rules

Clause 11 amends the tax treatment of unapproved employee share schemes. The main effect is that restricted stock units (RSUs) awarded to internationally mobile employees (IMEs) are taxed under the rules that deal specifically with employment related securities (ERS) rather than those dealing with earnings generally.

The legislation aims to clarify the tax treatment of RSUs provided to IMEs through unapproved share schemes. The proposed amendments will, for the most part, provide the clarity of treatment that the Office of Tax Simplification (OTS) has previously recommended. However, the CIOT believes that confusion will remain on

the definition of a ‘right to acquire’ if the employer has the discretion to award either cash or shares. We therefore recommend that HMRC provides clear guidance for when a cash alternative exists.

Clause 12: Reduction of pensions lifetime allowance

Clause 12 will reduce the pension lifetime allowance (LTA) for funds held in an approved pension scheme from £1.25m to £1m. It is also proposed that from April 2018 the LTA will increase in line with the consumer prices index (CPI).

As part of the reduction to the LTA the government is also introducing two transitional protections for individuals with combined pension funds in excess of the reduced LTA. These are in addition to those provided each time the LTA has previously been reduced. The CIOT is concerned that the protections may not work as intended and has sought clarification on the use of the phrase ‘at any/the particular time’ in the legislation.

Clauses 16, 17, 18: Company distributions

Clauses 16, 17 and 18 will amend the transactions in securities (TIS) rules in the Income Tax Act (ITA) 2007 Part 13 and the distributions rules in general.

The amendments proposed by draft clause 16 are intended to rationalise the treatment of payments by companies to their members. Clause 17 proposes an enquiry-based procedure in place of the counteraction notice procedure. And clause 18 is a targeted anti-avoidance rule (TAAR) to apply when someone receives a distribution from a members’ voluntary liquidation but then has some connection with a same or similar trade activity within two years. This will treat the distribution from a winding?up as if it were a distribution chargeable to income tax, rather than as a capital receipt, if particular conditions are met.

In response, the CIOT’s overall concern is that the draft legislation may go wider than intended, leading to more uncertainty for business and difficulty in advising clients as to how HMRC or the courts would treat a transaction. The ATT questioned the implications of bringing into account amounts that could have been paid to an associate of a person in determining what part of the relevant consideration could have been paid as a qualifying distribution.

Since clause 16 (3) is clear that the transactions in securities legislation will include ‘a distribution in respect for securities in a winding-up’, the CIOT queried whether it was necessary to introduce a TAAR as well.

On clause 17, the ATT identified the need for a proper inter-linking of the proposed enquiry-based procedure with the clearance procedure and seeks clarification on the time limit for raising a counteracting assessment.

The ATT focused on the practical application of clause 18, and the CIOT was concerned that the TAAR would have some unwanted consequences. Both highlighted problems that might be created by the imprecision of the proposed provision (for example, the identification of what is a same or similar trade), the complexity of the connection test, and the inclusion of the rebuttable presumption of a main purpose of tax avoidance, Much will depend on HMRC’s interpretations, so some clarification from HMRC will be essential. The CIOT and ATT suggested that a clearance procedure was required.

Transitional issues

Draft clause 16(10) provides that, if HMRC has issued a clearance notice under s 701 ITA 2007 before 6 April 2016 but the transaction occurs on or after 6 April 2016, the clearance will not be valid where the transaction can be counteracted because of the amendments made by this clause, but the counteraction can only be on the basis of the amendments made by this clause.

The CIOT asked HMRC to confirm its position on these transitional issues. HMRC responded in a letter dated 29 January 2016 (which it agreed we could publicise) as follows:

> 'Firstly, I can confirm that the Clearance and Counteraction team are already using the following wording where they believe that a clearance given now might not be valid should the proposed changes be brought in on 6 April 2016:
>
> 'The Board take the view that the notification given in this letter may become void with effect from 6 April if the proposed changes to the transactions in securities provisions which were published on 9 December 2015 come into effect as drafted.
>
> 'I can also confirm that the team have also been providing a view on the matter where they have been specifically asked. Following your feedback, and representations received from various other parties, the Clearance and Counteraction [team] have agreed that it would be helpful to go further than this. Starting now, all clearances will contain either the wording quoted above, or the following wording (or variants thereof):
>
> 'The Board consider that this clearance will not be affected by the proposed changes to the transactions in securities provisions which were published on 9 December 2015.
>
> 'Assuming that the proposed legislation is passed by Parliament, there will be a slightly different issue from 6 April 2016 until Royal Assent is received. I can also confirm that during this period both clearance and refusal letters will contain similar wording to the above in order to provide the applicant with as much certainty as is possible. The precise wording is currently the subject of discussion with HMRC solicitors.'

Clause 33: Hybrid and other mismatches

The CIOT commented on the draft examples that were published by HMRC on 22 December 2015 to support the proposed new rules to counteract tax avoidance through hybrid and other mismatch arrangements.

The draft legislation largely reflects the OECD model proposed in response to BEPS action 2 and we did not have any comments on its detail. We took the opportunity, however, to comment on the published examples and the further guidance on the application of the hybrid rules expected this year.

We noted that the legislation has several requirements for judgments as to reasonableness in applying the rules, which results in an inherent uncertainty within its framework. We said this uncertainty made the role of guidance particularly important in order to ensure that taxpayers can apply the rules with confidence and have an adequate understanding of HMRC's view of the provisions.

We also queried whether there was any policy rationale or intent behind the selection of the OECD examples by HMRC to be used as the basis for its own instances. The fact that a selection had been made raised the question of why the particular examples were chosen. For example, HMRC has not included any examples involving permanent establishments.

We asked for more examples in the complicated area of imported mismatches.

These provisions will be introduced on 1 January 2017.

Clause 37–39: Sporting testimonials

The ATT and CIOT have responded to draft legislation that provides that sporting testimonial payments made to professional sportspeople, when there is no contractual right or usual custom to receive one, will be subject to PAYE. However, an exemption of £50,000 will be available under new section 308(B) ITEPA 2003.

Testimonial payments made due to a contractual right or a customary expectation will still be charged under s 62, ITEPA and the exemption will not apply.

The ATT recommends a clear definition in both the legislation and the guidance as to what HMRC means by 'professional sportsperson'. It appears that HMRC intends the legislation to catch anyone employed under a contract of employment even if they play part-time and may consider themselves amateur. The ATT believes there could be confusion without this clarity.

The CIOT asked HMRC to clarify the interaction of the new legislation with the existing legislation in Pt 7A, ITEPA ('disguised remuneration') because the testimonial committee could be regarded as a third party and the sporting testimonial exemption applies only if income is not otherwise taxable as earnings.

The ATT did not agree that testimonial payments arising from events arranged as a mark of respect after a sportsperson's death should be subject to any charge under s 226(E). The CIOT recommended the government reconsider its decision not to implement a full exemption for testimonials arising from a sportsman or sportswoman's permanent termination of their professional career through illness or injury.

Both the ATT and CIOT expressed concern about use of 'customary' in guidance to determine when the payment will not qualify for the £50,000 exemption. It is understood that this is intended to refer to what is customary for the employer. However, we are both concerned that the term could be mistaken to apply to what is customary for a sport and could lead to the exemption being incorrectly denied.

The changes are expected to have effect from 6 April 2017 for sporting testimonials granted after 25 November 2015. The practice contained in EIM64120 will continue until 5 April 2017 and for any testimonials after 5 April 2017 agreed before 25 November 2015.

Clause 40: Property business deductions

This provision introduces a deduction for capital expenditure on replacing furnishings and appliances provided by a landlord of a dwelling-house for the use of a lessee. It also repeals the wear-and-tear allowance and the renewals allowance for property businesses. The ATT's response poses various questions to bring greater clarity to the proposals, including:

- whether the term 'lessee' extends to licensees and tenants at will;
- how the provisions apply to items for the use of more than one tenant;
- whether the requirement for the items to be used 'in the dwelling house' exclude their use out of doors;
- whether the old item has to be removed from the house in order for it to have been replaced;
- how the 'substantially the same' test will be applied;
- what evidence will be required to substantiate a deduction for what would have been the cost of an item that was substantially the same when the new item is different from the old; and

- what, if any, adjustment will be required when a new item that qualified for deduction under the new legislation is then taken out of use in the property business and retained by the landlord.

Clause 43: IHT – domicile

This provision would treat an individual as UK domiciled for IHT purposes if they have been resident in the UK for at least 15 of the previous 20 tax years, rather than as now 17, ending with the tax year in question. It also proposes a rule to provide that an individual born in the UK with a UK domicile of origin who has acquired a domicile of choice elsewhere will be treated as domiciled for IHT purposes if at any time they are resident in the UK and have been resident here in at least one of the two previous tax years. The draft clause does not take account of responses made to the September 2015 consultation, so we await publication of the revised version. Meanwhile, the CIOT repeated the comments we made last year, and highlighted the need for clarity in the commencement provisions.

The amendments will take effect in relation to events after 5 April 2017.

Clause 44: IHT increased nil-rate band on downsizing

This provision expands the inheritance tax (IHT) residence nil-rate band (RNRB) provisions to when an individual downsizes from a higher value to a lower value residence, or ceases to own one, and other assets are left on death to direct descendants. The associated schedule sets out the conditions for entitlement to the additional amount (the downsizing addition), the effect of the addition, and how the amount of the residence nil? rate band that has been lost as a result of downsizing or disposal should be calculated.

This draft legislation is complex, but its introduction was necessary once it was accepted that a perverse incentive not to downsize should not be created. We believe that the legislation will work in practice only if HMRC makes available comprehensive (and comprehensible) guidance and online calculators.

We pointed out that the policy objective is not met when an individual has more than one interest in a property. This would be the case if the deceased held their own 50% interest and was also the beneficiary of an immediate post-death interest from the estate of their spouse or civil partner. As drafted, the legislation permits only one interest to qualify for relief.

Draft s 8FE sets out how the value of the RNRB which has been lost as a result of downsizing or disposal of a residence (the ‘lost relievable amount’) should be calculated. Subsection (3) freezes the value of the allowance at its value at the time of the downsizing. This is anomalous compared with the carry-forward mechanisms for the transferable nil-rate band (s 8A) and the basic brought-forward RNRB (s 8G). Those operate on the basis that the allowance on the survivor’s death is increased by the percentage that the original allowance was unused.

The change will apply for deaths on or after 6 April 2017 and for downsizing moves or disposals on or after 8 July 2015.

Clause 48: VAT: installation of energy-saving materials (ESMs)

Clause 48 is intended to ensure that UK law on the VAT treatment of the installation of ESMs is compliant with EU law. The European Court had previously ruled that the UK had failed to properly restrict the availability of the reduced-rate relief on the installation of ESMs to defined categories of customer. The ATT questions the practicality of expecting an ESM installer to be able to establish whether their customer is a qualifying person.

The clause itself is silent on the procedure for establishing whether a customer is a qualifying person and entitled to the reduced rate of VAT. However, the parallel consultation published by HMRC alongside the draft legislation envisages the installer having an obligation to obtain and retain documentary evidence of the customer's status as a qualifying person.

The ATT notes that the European Court judgment did not prescribe the manner in which the UK should implement the changes or regulate compliance. We suggested that it would be better for the customer to provide the installer with a form of self-certification, thus relieving them of the burden of checking eligibility. Any greater burden on the installer risks defeating the government's stated objective of retaining as much of the existing relief as is possible. The amendments will take effect on supplies made from 1 August 2016.

Clause 60: General anti-abuse rule penalty

The CIOT has written to HMRC about clause 60, which proposes a new automatic penalty under the general anti-abuse rule (GAAR).

We feel this goes against the general direction of travel on penalties, which are generally becoming more mitigatable. We observed that, when the CIOT had discussions with Graham Aaronson QC about the GAAR he made it clear to us that his committee considered that penalties of the type being suggested were inappropriate. We told HMRC that we consider it inappropriate that the government was seeking to impose such penalties before there has been a single case brought under the GAAR.

We also consider that the proposed penalty is difficult to reconcile with article 7 of the European Convention on Human Rights, which require criminal penalties to comply with principles of legal certainty. Also, penalties have also been held to be contrary to the European Convention when they are disproportionate.

Finally we observed that the imposition of such automatic draconian penalties may make the courts less receptive to arguments that the GAAR applies because in marginal cases they may consider the imposition of such penalties to be inappropriate. In which case the penalties could prove counterproductive.

The new penalty will apply to tax arrangements entered into on or after royal assent.

Clause 63: Serial tax avoidance

The CIOT has raised concerns with HMRC about clause 63, the introduction of a special regime in relation to 'serial avoiders'.

We feel these proposals give rise to a double penalty: the penalty itself, and the denial of tax reliefs in the future, which is in effect a disguised penalty. Further, the effect of these provisions is to create an absolute offence for tax purposes because there is no requirement of deliberate conduct or carelessness. We consider that the combined effect of these proposals could be to impose disproportionate penalties.

In addition, the transitional rules render these provisions retroactive because they can apply to planning that has already been undertaken if the taxpayer does not correct the return. Retroactive legislation is potentially contrary to the convention especially when it is of a criminal nature and there is no special justification.

The regime comes into effect on 6 April 2017.

Clause 67: Civil penalties for enablers of offshore tax evasion

The CIOT has written to HMRC about the drafting of clause 67, and in particular paragraph 1 which introduces penalties for enablers of offshore tax evasion.

Our primary concern is that the legislation applies to failure to take reasonable care as well as to tax evasion. During the consultation last year, we thought it reasonably clear that the new civil penalty for enablers would apply in relation to 'tax evaders' only. Indeed, paragraph 5.5 of the consultation document, under the heading 'Who should be liable to a penalty?' specifically referred to the term 'evader'.

The draft legislation in effect replaces 'evader' with 'Q', so that there is no longer any requirement for the taxpayer to be a tax evader. Draft paragraph 1(4)(b) refers to another person (Q) carrying out 'offshore tax evasion' by engaging in behaviour that makes Q liable to a 'relevant penalty'. 'Relevant penalty' is defined in paragraph 1(6) as including a penalty under paragraph 1 Sch 24 FA 2007 etc which covers penalties for both careless and deliberate errors.

In our view, it should be possible for the offence of enabling to take place only when the taxpayer has acted deliberately to evade tax. This would still meet the policy objective.

We consider that including a failure to take reasonable care makes the legislation unnecessarily complex. We ask HMRC to provide a clear statement of how and in what circumstances it intends to use this legislation.

The definition of 'enable' in paragraph 1 (3) is 'encouraging' and 'assisting' offshore tax evasion but also includes the term 'otherwise facilitating' which seems vague, requiring no active involvement and is potentially very wide. We think the term 'otherwise facilitating' should either be dropped completely (our preference) or defined specifically within the legislation.

We also noted that the term 'deliberate' is not used in the legislation when referring to the enabler's behaviour, despite the policy paper clearly stating that the penalty applies only if the enabler's behaviour is deliberate. We stated that the legislation ought to be specifically targeting dishonest deliberate action. We also raised the possibility of these provisions being contrary to EU law.

It is not known when the changes will come into force as the draft legislation provides for them to be introduced on such day as the Treasury may appoint by regulations made by statutory instrument.

Clause 71: Simple assessment

This clause and the accompanying schedule give HMRC the right to issue a simple assessment if a taxpayer has not been issued with a notice to complete a tax return and has not filed one. Broadly it is intended to be used when an end of year tax calculation (form P800) has been issued showing tax underpaid, but the taxpayer has not made a voluntary payment of the outstanding tax. The assessment will create a legally enforceable debt without having to place the taxpayer in self-assessment, a route that is both time-consuming and costly for HMRC and the taxpayer. Of course, the taxpayer has the right to object to the assessment and apply to postpone some or all of the tax shown as payable.

In addition, the proposals would enable HMRC to withdraw a notice to complete a tax return from individuals before issuing such an assessment, thus streamlining administration.

LITRG broadly supports this measure but requests guidance on when this power may be used. It also points out the unfairness in that, although taxpayers have a specified time of 30 days to deal with such an assessment, HMRC has no limit for responding to objections.

This measure will have effect on and after the date of royal assent to Finance Bill 2016.

Clause 83–88: Permanent establishment of the OTS

These clauses provide for the permanent establishment of the Office of Tax Simplification in statute, set out its functions and make provision for its governance and operation.

The OTS was established in July 2010 to give independent advice to the government on simplifying the UK tax system and to reduce tax compliance burdens on businesses and individual taxpayers. The CIOT welcomed the measures to put the OTS on a statutory footing. To try to stem the ever-increasing quantity and complexity of legislation, we recommended that the measures went further than proposed, including:

- Measures to ensure that the OTS has enough resources to undertake the projects the Chancellor of the Exchequer instructs it to and also those it wishes to undertake proactively.
- That the OTS should not only be required to report annually on its own performance, but that it should also report on the increases or decreases in the complexity of the tax system year-on-year to try to identify a ‘direction of travel’ for it.

That the OTS should scrutinise proposed legislation that it identifies for review. Historically most of the OTS’s work has been on legislation already on the statute books, so publishing commentary on proposed legislation from a complexity perspective will highlight the importance of simplifying new legislation.

We also recommended that the senior staff at the OTS, in particular the chair and tax director, are adequately remunerated for the time they spend undertaking their non-board duties as opposed to the relatively nominal sums they are paid now.