The Budget, the Finance Bill and beyond…The consultation process rolls on

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A round-up of developments from the Budget and the work of the Technical Teams

A recurrent theme of Technical Newsdesk is that consultation in advance of new measures helps to ensure that the policy objectives are clearly defined and that the legislation serves those objectives without creating unintended consequences. To that end, the growing commitment of governments to consultation has been very welcome and the recent practice of publishing draft legislative proposals soon after the autumn statement has opened a valuable opportunity for detailed comment in advance of the publication of a Finance Bill.

A large proportion of the work of the ATT, CIOT and LITRG Technical Teams is in responding to consultations and commenting on draft legislation published by the government in order to achieve greater simplicity and clarity in the tax system. The Budget in March was a set-piece fiscal event around which it is possible to take stock and update you on some of the developments arising and look forward to what is coming up.

Restriction in relief for finance costs for residential property businesses

The positive developments for increased consultation have underlined the negative consequences of introducing significant changes without consultation and draft publication of intended Finance Bill provisions.

The introduction by Finance (No. 2) Act 2015, s 24 of the restriction in relief for finance costs related to residential property businesses illustrate particularly well the consequences of omitting both the consultation stage and the advance draft stage. In the first place, the absence of prior consultation makes it harder to identify and understand the objectives of this new measure. It also makes it difficult to know whether an identified consequence of the Finance Bill provision (for example, in the particular case, its jarring interaction with the high income child benefit charge) is seen by the government as acceptable collateral damage or whether it was unintended. Finally, and partly in consequence of both previous points, it can distract from the task of considering whether the legislation is correctly drafted.

In relation to the last point, during the Finance Bill debate the ATT alerted HMRC to the possibility that, as a result of apparently conflicting terminology, there were drafting errors in the part of the provision on the restriction of the available tax reduction. Notwithstanding that warning, the provision passed into law unamended – as of ITTOIA 2005, s 274A(4).

Clause 26 of Finance (No. 2) Bill 2016 implicitly recognises the inadequacies of the hastily drafted ss 274A and 274B. Both are replaced in their entirety. The explanatory note observes first that the clause ‘clarifies that the basic rate reduction is available to beneficiaries of deceased person’s estates’ (something overlooked in the original enactment). It then adds that the clause ‘also ensures that the basic rate reduction applies and is calculated as intended’. Happily, the significantly redrafted replacement provisions are better designed and include, amongst other changes, a reworking of the restriction of relief where the amount on which the individual would otherwise be entitled to relief exceeds their adjusted total income. This revision, which addresses the ATT’s comment on the original legislation, is contained in proposed s 274AA(3).

Personal savings allowance

Clause 4 of Finance (No.2) Bill, which will introduce the new personal savings allowance (PSA) is updated from the draft clause published on 9 December 2015 after consultation. However, our concerns over the complexity of operation of the PSA – three levels of PSA and penal marginal rates of tax, for example – have not been addressed.

We noted in our comments on the draft clause that the ‘method for transition from one allowance level to the other … is slightly different, depending on whether the transition is from the £1,000 to the £500 allowance or from the £500 allowance to no allowance. Draft clause 12B(8)(a) does not contain a sub-clause equivalent to draft clause 12B(8)(b)(ii).’ It appears that this may have been an oversight since parts (a) and (b) of sub-s 8 now mirror one another, thus clarifying the definition of additional rate income.
We also welcome the amendments to s 12A(1), which clarify the interaction of the PSA and the starting rate for savings, something that was raised in the CIOT and ATT briefings.

Other concerns raised by LITRG have not been addressed. These include a possible increased compliance burden for some personal representatives (since the savings allowance will not be available to personal representatives or executors of estates in administration) and the inclusion of a power to change the savings allowance to which an individual is entitled at any time before the end of the tax year in which they will have effect.

Dividend tax

This is also unchanged in Finance (No.2) Bill, other than a small amendment to include the new rates. The draft clause had only mentioned the dividend nil rate. Finance (No.2) Bill sets out the changes to the dividend ordinary rate, the dividend additional rate and the dividend trust rate. Although, presumably an oversight, it does not mention the dividend upper rate. This was something to which LITRG drew attention in its response.

Stamp duty on additional purchases on residential properties

HMRC released the response document to the short consultation on this proposal on Budget day and George Osborne announced in his speech that there would no longer be an exemption from the higher rates for ‘significant investors’. The chancellor announced that the period in which an individual could replace their main residence and be exempt from the charge or able to claim a refund (depending on whether there is a gap between purchases or an overlap of purchases of main

residences) would be extended from the proposed 18 months to 36 months. Since this was something ATT suggested in its response to the consultation, this was a pleasing result.

However, it was the only one: the rest of the details remained, on the whole, as initially proposed. This includes the fact that individuals who have a ‘bridging loan’, used by those who buy their new home without selling their old one at the same time (usually due to problems within the housing chain), will still be required to pay the higher rate of stamp duty up front and will only be able to claim a refund once the old home has been sold – as long as this is within 36 months. The ATT commented in its initial response that this would induce many house buyers in such a situation to pull out of the purchase rather than pay the additional cost, which they may not be able to afford. In turn, this will have a detrimental effect on the position of the other people in the same chain.

HMRC has now issued the legislation and also guidance. The guidance includes, at Chapter 8, an extensive question and answer section which members may find useful to read. It can be accessed here.

Sporting testimonial payments

The government has doubled the exemption from £50,000 to £100,000. CIOT’s concerns remain though, especially on the meaning of ‘customary’.

If there is a customary expectation that an employee who is or has been a sportsperson will receive a sporting testimonial, it is the government’s view that income falls within the charge to tax as earnings from the employment no matter who arranges the event. What is unclear is what happens when a club typically agrees to a testimonial after 10, 15 or 20 years of service? This needs to be clarified. Similarly, the interaction with the rules set out in ITEPA 2003, Part 7A (disguised remuneration) remains opaque. Certainty is required that qualifying sporting testimonials fall solely within new s 226E.

Apprenticeship levy

The apprenticeship levy will be introduced from 6 April 2017 and charged at a rate of 0.5% of an employer’s total pay bill (total earnings for class 1 NIC purposes). Each

unconnected employer will receive an allowance of £15,000 to offset against their levy payment.

Although the government believes that the levy allowance will mean the levy will be payable only on pay bills in excess of £3 million a year, the CIOT has serious concerns that many connected family companies with much lower pay bills will have to pay it. This is because only one company under the 'connected company test' can qualify for the £15,000 levy allowance, so any other connected company cannot receive any part of the allowance, even if it has not been fully used by the nominated company. We understand that the reason for this is that it would be 'too complicated' to provide for unused levy allowance to be transferred.

The CIOT believes this is unfair and that connected companies should be given the opportunity to claim any part of the levy allowance unused by the 'nominated' connected company.

IHT residential nil-rate band downsizing

Changes from the draft clauses published in December 2015 are not material. Unfortunately the major anomalies that the CIOT highlighted were not corrected.

The first was if the deceased owned an outright interest and a life interest (an IPDI) in a dwelling, in which case only one interest may qualify for downsizing relief.

The second was that the amount of downsizing relief is frozen as a fixed sum rather than increasing on a proportionate basis the relevant allowance on the ultimate death, as is the mechanism for the transferable nil-rate band and the basic carry-forward of the RNRB.

Inevitably, the Budget and Finance (No.2) Bill include some other measures that previously had not been announced or consulted on:

Deduction of income tax at source: royalties

The aim of the legislation (which at the time of writing has been published only in part) is to ensure that all royalties arising in the UK will be subject to the deduction of income tax at source unless the UK has explicitly given up its taxing rights under an international agreement. In principle we have no objection to this. However, it will

be important to ensure that the definition of royalties to which the new rules apply matches that in the UK's double tax treaties.

Profits from trading in and developing UK land

The chancellor announced in the Budget the introduction of a new set of rules to tax trading profits derived from land in the UK. This is intended to prevent property developers using offshore structures to avoid UK tax on their profits arising from trading in property in the UK. Arguably, such structures could have been taxed using the diverted profits tax rules, but these specific rules should put the position beyond doubt. We have not seen any legislation for these proposals at the time of writing. This legislation is expected to be introduced at the report stage of the Bill.

Taxable benefits: application of Chapters 5 to 7 of Part 3 of ITEPA

Clause 7 of Finance (No.2) Bill has been newly introduced and appears to be as a direct result of the decision in *HMRC v Apollo Fuels, B Edwards and others* [2016] EWCA Civ 157 (17 March 2016), where the Court of Appeal found that the lease of a car to an employee who paid lease charges at full market value was not a taxable benefit.

The legislation seeks to prevent the concept of 'fair bargain' applying to the taxation of benefits in kind which have specific charging rules. Amendments are being made to the rules which tax employer-provided living accommodation, cars and vans (and related benefits), and loans. There is a specific exclusion for the hire of a vehicle on the same terms as a member of the public, from an employer whose normal business is to hire cars or vans, but not for living accommodation and loans, although existing exemptions remain for houses and loans provided by local authorities on ordinary commercial terms.

Employment income provided through third parties

Clause 18 is also new. As well as tackling one specific scheme, the legislation in Finance (No.2) Bill will introduce a TAAR into the disguised remuneration rules (to

take effect from 16 March 2016). Further legislation will follow in Finance Bill 2017 to ensure loan/debt schemes fall within Part 7A.

In addition, the government intends to introduce a new tax charge on all pre-2011 loan schemes, where the loan has not been repaid or taxed in full by 5 April 2019. A consultation on the detail is to take place this summer which the CIOT intends to respond to and we welcome comments from members on the government's proposals and draft legislation (when published).

In other areas, however, we are pleased to report that the government has listened to our concerns:

Entrepreneurs' relief

The Finance (No. 2) Bill includes draft legislation to amend the unintended consequences of the FA 2015 changes to entrepreneurs' relief in order to support businesses by ensuring that the relief remains available on specified genuine commercial transactions. This is discussed in more detail on page 50 below.

Part surrenders of life insurance policies (Lobler)

We have reported before in Technical Newsdesk on the CIOT's involvement in seeking a change in the law governing the tax rules for part surrenders and part assignments of life insurance policies to prevent excessive tax charges on these products. It is therefore good news that the government has confirmed (Red Book para 2.113) that it will change the rules. The government will consult formally later this year with a view to legislating in Finance Bill 2017. This is welcome given that the regime has a particularly harsh impact on elderly or retired taxpayers who may have invested life savings or proceeds on downsizing their home. The CIOT (represented by Hui Ling McCarthy pro bono) made submissions in the case of *Joost Lobler v HMRC* in 2015 in the wider public interest of finding a solution for taxpayers across the board in equivalent positions to Mr Lobler. Subsequently, the CIOT has led an informal consultation to find a legislative solution (the submission is here).

Reforms to the taxation of non-UK domiciliaries

While we await much of the further detail on these proposals, the Red Book (para 2.44) confirmed that the government would legislate all non-dom reforms in Finance Bill 2017. As we said in the response to the 2015 consultation on ‘Reforms to the taxation of non-domiciles’, the CIOT’s strong preference is for the complete package of measures to be introduced into legislation at the same time rather than in stages, in particularlegislating in respect of the entire package with the benefit of prior consultation on the complex area of the treatment of offshore trusts.

Travel and subsistence expenses rules

We were pleased to note that the government has abandoned further work on proposals to change the travel and subsistence rules. Although there are areas of complexity under the rules, the existing rules do seem to be generally understood and operated correctly in practice.

In the discussion document, issued at the end of 2015, the Treasury put forward a proposed framework of changes with a list of underlying principles. However, the Treasury explained in its response document issued a few days after the Budget, that, although the responses to the discussion document had supported the principles as set out in the proposed framework, there were difficulties in translating these to a workable set of rules. The Treasury no longer believes that the proposed framework provides enough simplicity to justify the upheaval for employees or the potential cost to the Exchequer.

The ATT and CIOT were critical of a number of the proposals in the discussion document, in particular, those dealing with homeworkers. However, it does seem a shame that the Treasury appears to have given up at the first attempt in trying to reform some areas, which we agreed did need improvement.

The Treasury has pledged to continue to look at other areas of travel and subsistence that are worthy of a review and where it feels it can achieve progress. But it does appear to be focusing now on simplifying reporting requirements rather than tackling any fundamental changes.

The Budget also brought to an end several other measures that had been consulted upon in 2015 and early 2016:

Pensions tax

A consultation response has been published by the government. At present no changes to the tax relief regime have been proposed.

Distributions

We discuss on page 48 the changes that are being made on company distributions. However, the government has confirmed that it has no plans for a more wide-ranging review of the distributions legislation.

What we will be doing now

The immediate task for the Technical Teams following publication of Finance (No.2) Bill will be to provide briefing material to MPs considering the Bill – partly to fulfil our educative role, partly to put any continuing concerns on the public record (where our members and others will see them), and partly in an attempt to persuade the government to place on the parliamentary record its intentions with parts of the legislation where this remains unclear.

Since 2014 we have also been invited by the Finance Bill Committee to make formal submissions to the Committee, which are published along with other committee evidence.

In addition, it remains open to us to provide more informal briefings (sometimes as short as a couple of paragraphs) to individual MPs in response to requests or where we think they would find these particularly useful. This most often applies to opposition spokespeople. The CIOT, ATT and LITRG remain politically neutral – our briefings now may be used primarily by Labour and SNP members, but before 2010 they were used mainly by the Conservatives and Lib Dems.

A key rule in preparing these briefings is that nothing we put in one should come as a surprise to the government if it is quoted in Parliament. In general, all concerns will be ones we have expressed in earlier consultations. If legislation is new and has not previously been consulted on, we will make our concerns known to the government earlier or, if this is not possible, at the same time as we communicate them to the MPs scrutinising the Bill.

Following this, the Technical Teams will not be idle as a significant number of consultations to be conducted over the summer were also announced by the government in the various Budget documents.

As well as the disguised remuneration consultation mentioned above, the Budget announced several other consultations on employment taxes:

- Alignment of dates for ‘making good’ payments;
- Off payroll working in the public sector (IR35 obligation to be moved from PSC to engager plus changes to the test);
- Pensions advice allowance (£500 allowance);
- OTS review on moving NICs to an annual, cumulative and aggregated basis;
- Salary sacrifice arrangements when specified benefits-in-kind are received;
- Simplifying PAYE settlement agreements (PSAs); and
- Termination payments (to tax all PILONs and particular damages awards plus removal of foreign service and employer’s NICs on excess over £30,000).

Business Tax Road Map

Published with the Budget was the Business Tax Road Map setting out the government’s policy intentions for business taxation for the short to medium term. The document updates the government’s thinking on tax deductibility of corporate interest (this being an action arising out of the OECD/G20 BEPS project). Further consultation on the detailed design of the rules is promised.

The chancellor announced that there will be changes to the rules on how companies can utilise losses. Further detail is given in the Business Tax Road Map, which also says that the government will consult on the design of the reforms in 2016, with legislation to follow in 2017.

The Business Tax Road Map also announced that the government will review the Substantial Shareholdings Exemption (SSE), citing that this needs modernisation. We will wait to see whether a broader exemption for some investment activities (such as property investment) is on the cards.