Office of
Tax Simplification

Review of tax reliefs

final report

March 2011

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Contents

Foreword

"To boldly go where no man has gone before" was the proud boast of the crew of Star Trek's USS Enterprise. I think that this phrase must have been in the Chancellor's mind when, last July, he set us off on our voyage of discovery into the world of tax reliefs and allowances. No one, until the formation of the Office of Tax Simplification, had attempted to list and subsequently assess the worth of the UK's tax allowances and reliefs.

This report now signals that this job has been completed. During our voyage of discovery (which has lasted a mere five months rather than the five years of USS Enterprise) we found 1,042 reliefs, allowances and exemptions; far more than any of our initial estimates. We published the list so people could see what we had found, and subsequently put out for consultation the criteria we proposed to use in order to make the recommendations which form this report. Through a process of prioritisation, we selected 155 reliefs for detailed scrutiny and the annexes to this document set out how we arrived at our conclusions. In undertaking this work I am indebted on behalf of the OTS for the assistance we received from HM Revenue & Customs, HM Treasury, the Consultative Committee, and the 60 or so organisations who contacted us with a whole raft of very helpful comments and recommendations.

In reading this report I very much hope you will regard it as the start of the journey towards the simplification of the UK's tax system. In this context, the themes emerging from the review are set out in Chapter 2 and there is a summary of our proposals in Chapters 3 - 5. However, where appropriate, we have not shied away from pointing out where in our judgement whole areas of tax law are particularly complicated. For example, the whole system of capital taxes and that of employee benefits and expenses may need a more in depth review than we have so far been able to undertake. We have looked beyond simplification and have addressed some practical aspects of policy, for example ideas to encourage more investment in small companies

The cartoon at the start of this report takes us back to the days of the late eighteenth century when William Pitt laid out the aims for his income tax in 1799. Then he said that the aim of the system was to "prevent an undue abatement, and to proportion to the real ability [to pay] by a liberal, fair and efficient application". Since that time, successive Chancellors have inevitably challenged this principle as they have sought to respond to the many competing policy requirements involved in raising revenue in an ever more complex world.

This report has been put together within a tight timetable. That could not have been done without the unstinting efforts of our private sector secondees, whose services were given free of charge. My very grateful thanks go to Tom Byng of Deloitte, Caroline Turnbull-Hall of PwC and Partha Ray of BDO. Their efforts were also ably supported by a small but dedicated secretariat led by Jeremy Sherwood of HMRC, with Tunde Ojetola in particular playing a major role in this project.

Finally I would like to record my thanks and profound appreciation to the Project's tax director John Whiting. There have been times when he appeared to have been working full-time on this project in spite of the (very!) part-time requirements of his contract. However, without his dedication to the cause of simplification, knowledge of the tax system, and wise counsel this report could not have been completed.

Our report has now gone to the Chancellor. All of us look forward to his response to our recommendations as part of his Budget 2011 address.

Rt Hon Michael Jack
Chairman, Office of Tax Simplification
March 2011

Executive summary

Following the interim report published in December 2010, we have received comments and feedback from taxpayers, advisers, HM Revenue and Customs ("HMRC"), HM Treasury, and other interested parties on our methodology and on particular reliefs. Of the 1,042 reliefs we originally identified, this report looks in detail at 155[1].

Our starting point was to review individual reliefs; an alternative method might have been to start with a fundamental reappraisal of each tax, thereby looking at groups of reliefs in their full context. Both approaches are equally valid; however, we consider that our approach has been the correct one for our project and circumstances. It has allowed us to review reliefs and identify wider issues in specific areas of tax that might lead to a wider review. It has also meant that we could quickly establish a methodology for our work and deliver results in a short timescale[2].

We have been assisted in our review of reliefs by both HM Treasury and HMRC and have gathered evidence for our conclusions from our Consultative Committee as well as the 60 or more representations that we have received from stakeholders (whether representative bodies, advisers or taxpayers).

During the review, a number of key themes have emerged:

- Merging income tax and NIC – this is a long term project of structural reform that would deliver major simplification;
- Employee benefits and expenses – The longer term aim would be to align the treatment of employee benefits, with shorter term aims of simplifying many minor benefits with a de minimis limit of £100/£500, or amending the current £8,500 threshold;
- Inheritance tax and trusts – the reliefs for inheritance tax are integral to the policy and we consider that a more appropriate approach would be to review the tax as a whole;
- Capital gains tax, particularly as applicable to companies – the capital gains systems for individuals and companies have drifted apart, with gains by individuals taxed at a lower rate than income to reflect inflation, whereas companies are still required to calculate indexation. Our aim would be to realign the treatments and simplify the tax, but as there are changes in relation to corporate capital gains expected in Finance Bill 2011, this is clearly a longer term project; and
- Environmental taxes – Both landfill tax and aggregates levy should be reviewed, as both regimes contain basic charging provisions with numerous exemptions and it may be more appropriate to define what is caught rather than what is excluded.

Our review has suggested that these areas are particularly complex areas, for example due to the number and complexity of the reliefs involved. Whilst each area is deserving of a full review, we recognise that these are complex and time consuming areas involving important matters of government policy that go beyond the current remit of the OTS.

[1] An additional four reliefs were reviewed in the interim report that have not been included here as they are under separate consultation.

[2] We would point to others studies, in particular the Mirrlees Review, which has looked at the overall structure of taxes. It would be impossible for the OTS to try to emulate the Mirrlees approach with our timescale and resources.

Out of the total of 155 we are recommending that 54 remain unchanged, 37 be looked at in more detail, and 47 be abolished on the basis that they are either time expired, there is no ongoing policy rationale, the value is negligible, or the benefit is outweighed by the administrative burden.

We also suggest that 17 reliefs be simplified, including:

- Enterprise investment scheme;
- Venture capital trusts;
- Entrepreneurs' relief; and
- Surplus advance corporation tax.

In framing our recommendations, we have borne in mind our brief to arrive at 'revenue neutral' proposals. Our resources do not permit a fully costed set of recommendations; in any event the real work on revenue implications must be carried out along with consultations over those of our recommendations that the Chancellor adopts. However, we think our report achieves a broad balance: the costs to the taxpayer of the reliefs recommended for abolition are balanced by the cost to the Exchequer of widening some other reliefs, and our suggestions for substitutions which will deliver simplification dividends.

There is the question of the remaining 883 reliefs that we have not looked at in detail. They have been categorised in our initial work and there is clearly scope for simplifying a number of them. The OTS could start further projects to cover sections of these reliefs but such work would logically be part of wider projects reviewing specific taxes or the way taxes affect particular sectors.

We have presented these recommendations to the Chancellor of the Exchequer and expect a formal response as part of Budget 2011, leading to consultation on draft legislation under the new policy making approach with amendments possibly included in Finance Bill 2012.

1 Introduction

Box 1.A: William Gladstone, 1863 Budget speech extract

"...for it must be borne in mind, that in every case exemption means a relief to A at the charge of B"[1]

1.1 This is the final report of the Office of Tax Simplification ("OTS") on the review of tax reliefs. The aim of the report is to arrive at recommendations on a number of tax reliefs identified in our interim report, to inform the Chancellor of the Exchequer ahead of Budget 2011.

1.2 In the course of our work we have identified certain reliefs that we recommend should be either abolished (for example where the relief is time expired) or, where a relief is considered to be valid, simplified to reduce the burden on the taxpayer. However, we have not looked in detail at the majority of reliefs and we therefore have no recommendations to modify them in this report.

1.3 During the course of our work, in addition to arriving at recommendations on particular reliefs, a number of common themes emerged and these have been drawn together in Chapter 2. Our recommendations of reliefs to abolish or simplify, together with details of the other reliefs reviewed, are included in Chapters 3 – 5 of this report. Our detailed analysis on each of the reliefs reviewed for both the interim and final reports (excluding four reliefs from the interim report subject to separate consultation, referred to in 5.5 below) is contained in Annexes A – Q, where we have grouped together reliefs either on the basis of the tax to which they relate, the industry sector to which they apply or some other common factor (for example reliefs identified as potentially expired).

1.4 Our remit for the tax reliefs project is to:

- review a list of all reliefs, allowances and exemptions, applying to both businesses and individuals, within the taxes and duties administered by HM Revenue and Customs ("HMRC"); and
- identify those reliefs that should be repealed or simplified to support the Government's objective for a simpler tax system.

1.5 We recognised that given our limited time and resources, it would be an impossible task to look in detail at each of the 1,042 tax reliefs that were identified in our first publication[2].

[1] Hansard HC Deb 16 April 1863 vol 170 c.224
[2] OTS "List of all tax reliefs", 8 November 2010, http://www.hm-treasury.gov.uk/ots_taxreliefreview.htm

Consequently, as set out in our interim report[3], we have decided not to review 883 reliefs[4], leaving us with a more manageable group of reliefs to consider in detail.

1.6 These 883 reliefs which we have decided not to consider further include:

- those subject to international agreements;
- those reliefs that are structural and an integral part of the tax system, for example to avoid double taxation;
- those reliefs that are subject to current HMRC/HM Treasury consultations, to avoid duplication of that work; and
- VAT reliefs - we have decided not to carry out any detailed review of VAT reliefs because of the interactions between EU law and UK political commitments, and in the light of the EU announcement, on 1 December 2010, that there is to be an evaluation of the current VAT system[5]. However, it is clear from the limited work we have carried out[6] and submissions received that there is considerable scope for simplification in this tax.

1.7 Our interim report set out 74 reliefs (in annex A to that report) that we were planning to look at and a further 75 (in annex B to that report) that would be looked at if sufficient time were available. This report covers all 149 of those reliefs (four of which were considered in the interim report[7]), plus a further six that were reviewed in our interim report[8]. Four further reliefs were also considered as part of the interim review, and these are not included in this report as they are subject to consultation[9].

1.8 In the course of our work it became apparent that some reliefs could not be looked at in isolation and need to be considered in the context of the policy rationale behind specific legislation (for example lease premium relief[10]), whilst it was practical to look at other reliefs together (for example four separate reliefs on EIS schemes have been reviewed as one[11]).

1.9 Our review takes into account:

- the impact of removing or simplifying individual reliefs, both for specific taxpayers and the wider economy; and
- the Government's wider objectives for the tax system, including the need for it to be internationally competitive, support fairness and provide sustainable revenue.

1.10 It is important to make clear that we cannot make any decisions about any individual reliefs – we can only make recommendations. Ultimately it is for the Chancellor of the Exchequer to decide on changes to tax law; in doing so he will take account of the advice he receives from the

[3] OTS "Review of tax reliefs; interim report", 13 December 2010, http://www.hm-treasury.gov.uk/ots_review_tax_reliefs_interim_report.pdf
[4] OTS "Review of tax reliefs; interim report", 13 December 2010, Chap 1, para 1.9; http://www.hm-treasury.gov.uk/ots_review_tax_reliefs_interim_report.pdf
[5] European Commission "Green paper on the future of VAT – towards a simpler, more robust and efficient VAT system", 1 December 2010
[6] OTS "Review of tax reliefs; interim report", 13 December 2010, Chap 4, paras 4.39 – 4.46; http://www.hm-treasury.gov.uk/ots_review_tax_reliefs_interim_report.pdf
[7] Repair and maintenance of work equipment, exemption from benefit charge for late night taxis, capital gains tax on disposal of private residence and income tax relief for the UEFA Champions League Final 2011.
[8] Luncheon vouchers – daily relief for first 15p, capital allowances – enhanced capital allowances for energy and water efficient technologies, VAT: supplies to charities / sales by charities, lease premium relief, millennium gift aid and National Savings Bank – Ordinary Account.
[9] Research and development tax credits (the large company regime and that for small and medium sized enterprises), vaccine research relief and gift aid
[10] See Annex P
[11] See Annex A

OTS. Any changes that might result would, of course, be subject to the normal Finance Bill procedures.

1.11 The impact of changing reliefs in practice is uncertain and difficult to estimate due to behavioural effects, which in many cases have not been incorporated in the broad estimates of revenue in the report. We accept that the Chancellor may ask HMRC and HM Treasury to carry out further analysis of our proposals and indeed we anticipate that any significant changes will require formal consultation in line with the 'Tax Policy Making'[12] methodology.

Our work to date

1.12 The first objective of the OTS was to collate all the reliefs administered by HMRC, which are the subject of the review. The list was drawn up with the help of HMRC. It was subsequently verified against tax legislation by the OTS and omissions, duplicates and inconsistencies were rectified.

1.13 We developed a list of all reliefs that we were able to identify: for the first time 1,042 tax reliefs were collated. This was published on 8 November 2010[13].

1.14 A strategy document was published alongside the list of reliefs in November 2010, which set out that our task was to make recommendations, based on analysis of evidence we would gather over the course of our review, for reliefs that could be sensibly repealed, modified, streamlined, simplified or delivered in a different way so as to make the tax system simpler.

1.15 On 13 December 2010 our interim report was published[14]. This set out our provisional criteria, against which a sample of 14 reliefs was tested. The aim of that report was to test and invite comments on the methodology.

1.16 We have received comments from around 60 stakeholders commenting on different reliefs that have been reviewed in this report (as well as those addressed in the interim report). All submissions have been carefully considered and although it will be appreciated that we cannot take all comments into account, the vast majority are reflected here.

Our review criteria:

1.17 The goal of the OTS is to simplify the tax system. In the context of reliefs, that goal might be thought to be best achieved by abolishing reliefs. However, we have been clear from the start that abolition is only one route to simplification and that abolition of a relief might in fact add to complexity, by drawing more people or transactions into the tax system. We have considered extending or otherwise modifying a relief at least as much as we have considered abolition.

1.18 The criteria used in our review are set out in Box 1.B

[12] HMT "Tax policy making: a new approach" 22 June 2010
[13] OTS "List of all tax reliefs", 8 November 2010, http://www.hm-treasury.gov.uk/ots_taxreliefreview.htm
[14] OTS "Review of tax reliefs; interim report", 13 December 2010, http://www.hm-treasury.gov.uk/ots_review_tax_reliefs_interim_report.pdf

Box 1.B: Review criteria

- Whether the policy rationale for the reliefs is still valid and whether it remains the optimal method to achieve the policy objective, given other potential Government interventions;
- Evaluation of whether there is currently a policy rationale for the relief;
- The likely impact of changing or repealing the relief or exemption;
- Evidence of taxpayer take-up and awareness of the reliefs;
- Evidence of complexity, compliance costs and administrative burdens in claiming the reliefs; and
- Evidence of the impact the reliefs have on taxpayer behaviour.

1.19 In the review of each relief, we have given weighting to each of the criteria. However, based on our experience and feedback received, different criteria take precedence in different circumstances. Therefore the weighting of the criteria have been assessed on a case by case basis.

2 Common themes emerging

2.1 Of the 1,042 individual tax reliefs, we reviewed 159 for the interim and final reports, and 155 of these are detailed in the Annexes to this report (the other four were considered as part of the interim review, and these are not included in this report as they are subject to consultation – see 5.5). We propose that 54 of the reliefs reviewed are retained without changes.

2.2 Most of these 54 reliefs are in themselves either a simplification or the policy rationale remains valid and the relief achieves it. In addition for these reliefs where the policy rationale remains valid, there is no apparent need to simplify the reliefs further. Others have also been excluded because HM Treasury ("HMT") is already consulting on them, for example as part of the ongoing consultation on reforming corporation tax[1].

2.3 During the course of our work reviewing tax reliefs and meeting stakeholders, one point that has been made to us is that an alternative, and equally valid approach, would have been to start with a fundamental reappraisal of each tax, rather than the more granular approach of starting with specific reliefs that we have adopted. We agree that this would have been possible but, on balance, we consider that our approach has been correct for the OTS's work.

2.4 This approach has allowed us to focus on reliefs as well as identify some areas that may require further and wider consideration and we have been able to establish our way of working which has meant that we have been able to deliver some results fairly quickly. As we have reviewed a wide range of taxes, our approach has also allowed us to identify common themes and assess whether some taxes need a fundamental review.

2.5 In our review of the 155 reliefs set out in this report, a number of common themes have been emerging which are summarised in Box 2.A. and explained below.

Box 2.A: Key themes

- Merging income tax and NIC;
- Employee benefits and expenses;
- Inheritance tax and trusts;
- Environmental taxes; and
- Capital gains tax, particularly as applicable to companies.

[1] HMT "Corporate tax reform: delivering a more competitive system", 29 November 2010

Income tax and national insurance

2.6 Aligning income tax and national insurance is not a new issue, and has previously been raised by both HMT[2] and the Mirrlees review[3], but it has become apparent during our work that the mismatch between the rules is a major cause of complexity.

2.7 The problems caused by the mismatch of income tax and national insurance have been raised by a number of stakeholders and have also become apparent from our review of specific reliefs e.g. NIC Class 4 exemption for divers and diving supervisors[4]. It was also a common theme raised in stakeholder meetings.

2.8 This issue will be explored in greater detail in the OTS's interim report of the Small Business Review.

2.9 During the course of this review three particular reliefs have been considered where the income tax and NICs treatment of employee benefits is different:

- disregard for (Class 1 NIC) certain apprentices and students coming to the UK[5];
- divers and diving supervisors – class 4 NIC exemption[6]; and
- payments as reward for assistance with lost or stolen credit cards[7].

Employee benefits and expenses

2.10 Generally where benefits are provided by an employer to its employees, the benefit is subject to income tax on the employee, and class 1A NICs on the employer. However there are some exceptions to this rule, which are reviewed in Annex B to this report. Some of these are exempt from income tax, some from NIC and some from both.

2.11 For some of the benefits, there are different conditions that need to be met for them to be exempt, for example some have to be made available to all employees, whereas some can only be available to certain employees. There can also be complex interactions with credit agreements, the national minimum wage and other aspects of employment law.

De minimis limit on benefits

2.12 During the course of our work, we have identified a number of small exempt benefits, for example 15p luncheon vouchers and welfare counselling[8]. One approach might be to abolish these and replace them with PAYE Settlement Agreements ("PSAs"), but this may not be seen as a simplification. However a possible simplification would be to replace these small exempt benefits with a single de minimis limit of, say £100 p.a. per employee.

2.13 In the Republic of Ireland there is a similar scheme, whereby if "your employer provides you with a benefit with a value not exceeding €250, PAYE and PRSI will not be applied to that benefit. No more than one such benefit received by you within a tax year will qualify for such

[2] Income Tax and National Insurance Alignment: an Evidence Based Assessment, 2007
[3] Institute for Fiscal Studies "Mirrlees Review: reforming the tax system for the 21st century", http://www.ifs.org.uk/mirrleesReview
[4] SSCR 2001 Reg 92 and Annex B
[5] SSCR 2001 Reg 145(3) and Annex B
[6] SSCR 2001 Reg 92 and Annex B
[7] SSCR 2001 Sch 2 Para 15 Part 10 and Annex B
[8] See Annex B to this report

treatment. Where a benefit exceeds €250 in value, the full value of the benefit will be subject to PAYE and PRSI deductions"[9].

2.14 This may lead to an increase in administrative burden. At present, if a benefit is exempt there is no need to track the cost; however, if all benefits were taxable subject to a limit, employers would need to value and track benefits.

2.15 There would also be an interaction with any PSA in force. At present, a PSA is an administratively easy way to report and pay NIC (Class 1B) on small value benefits (e.g. staff parties, gifts to staff etc). The introduction of a de minimis limit for benefits could remove the need to prepare PSAs in many cases.

2.16 Whilst this would undoubtedly be a simplification, the cost to the Exchequer must be considered. This could be a very costly change, as many more benefits would become exempt and the system could potentially be open to abuse, for example it could lead to many employees receiving benefits equivalent to, at least, the de minimis limit. If benefits are provided under salary sacrifice arrangements (whereby an employee gives up part of the salary that is subject to income tax and NIC, in exchange for exempt benefits), the cost could be even greater.

2.17 We suggest that an initial step might be for this area to be further reviewed by HMRC and HMT in conjunction with the OTS and that such a review should consider the following:

- Whether a de minimis limit would be a simplification;
- the level of such a limit;
- the design of a simple method to enable any employer to track the value of benefits provided;
- the impact for individuals with more than one employment;
- whether salary sacrifice arrangements would still be relevant; and
- any necessary anti avoidance measures.

£8,500 limit

2.18 An issue that has been raised by a number of interested parties during our review of employment related reliefs and benefits, is the existence of two different regimes, depending on income levels. This split system is a relief in itself, designed to subject lower paid employees to a reduced version of the benefits code. A threshold to define low earners was first introduced in 1948 (when the limit was £2,000); the limit was subsequently increased to £5,000 in 1975, £7,500 in 1978 and finally to £8,500 in 1979, where it has remained unchanged for over 30 years. If the £8,500 limit had increased in line with inflation it would be almost £34,000[10] today.

2.19 This dual system is a complication as it is not consistently applied and there are some benefits that are taxable on all employees (e.g. accommodation provided) whereas others (e.g. private medical insurance) are only taxed on the 'higher paid'.

2.20 For employees earning over the threshold, P11Ds are submitted and the employee is taxed on all benefits (except those that are specifically exempt). For lower paid employees P9Ds are submitted and the employee is only taxable on certain benefits, i.e. vouchers, living

[9] http://www.citizensinformation.ie/en/money_and_tax/tax/income_tax/taxation_of_benefits_from_employment.html
[10] (216.9-54.30)/54.30 = 2.994. £8,500 x (1+2.994) = £33,949. RPI at April 1979 = 54.30. RPI at December 2010 = 216.9

accommodation and those benefits that are readily convertible into cash. This two tier system can lead to different rules applying to different employees who receive the same benefit.

2.21 In addition, the taxable value of a benefit to an employee varies depending on whether the individual is a lower paid employee or not. Lower paid employees are taxed on the market value of the benefit, whereas higher earners are taxed on the greater of cost to the employer and market value, which can lead to complexity, as shown in Box 2.B.

Box 2.B: Example of complexity with different values

Company X purchases two identical televisions and gives one to a higher earner and one to a lower earner.

The lower paid employee will be taxed on the market value of the TV (i.e. the second hand value) whereas the higher paid employee will be taxed on the original cost.

2.22 There is anecdotal evidence that some employers prepare P11Ds and pay Class 1A NIC s for all benefits provided to all employees, rather than ascertaining for lower paid employees whether they earn over £8,500 or not (by adding the value of all benefits received to the employee's earnings). There may be cost savings in terms of tax if the calculation was performed, but these are likely to be outweighed by the related administrative and compliance costs.

2.23 For many employers however the limit is not an issue, as £8,500 is below the minimum wage for a full time employee, and therefore this calculation and the differing rules are not relevant. However, it can be an issue for employers with large numbers of part time workers.

2.24 If the limit were increased to, say, £34,000, we anticipate that there would be a substantial reduction in the number of P11Ds to be submitted, the amount of class 1A NIC payable by the employer and the income tax payable by the employees, although this would probably be, at least partly, balanced by an increase in the number of P9Ds and the number of employees subjected to different rules. It would also, presumably, lead to a considerable Exchequer cost as many taxpayers would no longer be taxed on some benefits; we have not tried to estimate that cost.

2.25 The obvious simplification is to abolish the £8,500 limit altogether. That would bring a consistent treatment of benefits to all employees. When this has been considered in the past, such a move has been resisted on the grounds that it would penalise some low paid employees[11,12]. With the personal allowance nearing £8,500[13], and scheduled to reach £10,000 before long, surely that is an argument to tackle this outdated limit now.

2.26 In summary however, this is a complex area worthy of further in depth analysis and review in the context of the plans for the personal allowance. We would make it clear however, that purely from a simplification perspective, we recommend that the £8,500 limit is abolished.

[11] This is suggested to be mainly part-time employees who receive private medical insurance. Anecdotally, it is also suggested that some family members of small companies also benefit.
[12] HMRC
[13] In 2011/12 it will be £7,475 – Budget 22 June 2010, Press Notice 2

Inheritance tax and trusts

2.27 In the initial list of 1,042 reliefs that was originally published on 8 November 2010, 89 inheritance tax ("IHT") reliefs were identified. Of these 27 were in Annexes A and B to the interim report. IHT does not apply to the majority of taxpayers, with just over 2% of estates paying IHT in 2009[14]; the size of these estates indicates that legal advice could be afforded. Many of the issues surrounding IHT relate to policy and are outside the scope of the OTS.

2.28 Many of the reliefs in respect of inheritance tax (for example potentially exempt transfers or "PETs") are integral to the operation of the tax and define what is taxed and when. In addition there are also a number of complex reliefs and also some small ones, for example the exemptions for monetary gifts on the occasion of marriage or civil partnerships[15] which have not increased since 1975[16] and the annual exemption which has been £3,000 since 1981.

2.29 It would clearly be sensible as a simplification move to uprate the small monetary reliefs, for example the annual exemption would now be almost £6,000[17]. But it would equally be fair to consider the reliefs in the context of subsequent developments, in particular the impact of PETs and the transferable nil rate band.

2.30 We consider that a more appropriate approach to the inheritance tax reliefs is to consider the scope and operation of inheritance tax with reference to the original and desired policy rationale, and thus to consider individual reliefs in context. In addition, any review of inheritance tax needs to include a review of the taxation of trusts, which are often used to pass family assets between generations.

2.31 The Inheritance Tax Act 1984 was not considered by the Tax Law Rewrite project, and a complete review of the tax would enable the policy rationale for various provisions to be analysed, reliefs to be reviewed and, where necessary, either repealed, simplified or increased in line with inflation, and a simpler system overall to be considered.

2.32 The Mirrlees Report has considered wealth taxes and in particular concluded that inheritance tax is no longer fit for purpose as it is open to abuse, describing it as[18]:

> "a somewhat half hearted tax, with many loopholes and opportunities for avoidance though careful organisation of affairs. This leads to charges of unfairness and makes a principled defence of inheritance tax difficult".

2.33 In the light of all this our conclusion is that there should be a proper review of inheritance tax, whether by HMRC, HM Treasury or the OTS. This would clearly be a longer term project. In short, this is a tax that needs a 'top down' review of the sort alluded to in 2.3 above.

Capital gains for companies

2.34 Until 1998, the calculation of capital gains for companies was similar to the calculation for individuals as an indexation allowance, taking the inflation element of gains out of tax, applied in both situations.

[14] Guardian 11 October 2009, http://www.guardian.co.uk/money/2009/oct/11/inheritance-tax-labour-decrease-propertynnex C Table C.6
[15] IHTA 1994 s22
[16] See FA 1975 Sch 6 and the introduction of Capital Transfer Tax
[17] (216.9-74.07)/74.07 = 1.928. £3,000 x (1+1.928) = £5,784. RPI at April 1981 = 74.07. RPI at December 2010 = 216.9
[18] Mirrlees Report "Tax by design" Chap 15 "Taxes on wealth" (http://www.ifs.org.uk/mirrleesReview/design)

2.35 In 1998, indexation allowance was frozen for individuals and taper relief was introduced[19]; however for companies, the calculation continued unchanged with indexation still being available. In 2008, taper relief and indexation were abolished for individuals and replaced with a flat rate of CGT of 18%[20] (with a second rate of 28% introduced from 23 June 2010, broadly for higher rate taxpayers[21]).

2.36 Therefore there are currently two 'reliefs' to exclude an amount equivalent to the inflation element from capital gains; the indexation allowance for companies and the 18% and 28% rates for individuals. The existence of two different regimes can cause confusion for taxpayers as well as for smaller firms of advisers.

2.37 This was an issue that was raised when we reviewed the relief "Indexation allowance – Share Pooling Rules"[22]; however if indexation were abolished, this would also mean that an additional relief from Annex C to our original report ("indexation allowance"[23]) would be removed from legislation.

2.38 Removing the relief for indexation would make computations simpler and reduce administrative costs for both companies and for HMRC. As set out in F.24, we understand that the calculation of indexation is a relatively common source of error.

2.39 We would therefore suggest that the abolition of indexation be consulted on, with areas to consider including:

- Whether the abolition would be a simplification; and
- What alternative mechanism could be used to exclude the inflationary element of gains that would not increase complexity?

2.40 We would also suggest that the review should look properly at what capital gains are actually paid by companies. With the advent of reliefs such as substantial shareholdings exemption and the longstanding reliefs such as rollover, the question has to be raised whether a more careful targeting of the tax on specific transactions could deliver simplification benefits. For example, most capital gains tax on share disposals is paid by insurance companies: could these be swept into a wider reform of insurance company taxation? Such a wider review would have regard to the impact of the steady lowering of the corporation tax rate and whether that also offers scope for a radical approach to corporate capital gains. Any concerns over creating opportunities for smaller companies might even be tied up with looking at the small profits' rate of corporation tax.

2.41 However, we would note that the capital gains tax charges for individuals have only been in existence for three years and it would therefore be sensible to allow them to 'bed in' before reviewing this whole area. This is in accordance with the stability principle as set out in "The corporate tax road map"[24].

2.42 Whilst reviewing this issue, it has become apparent that a further cause of complexity in the calculation of gains is the determination of the market value as at 31 March 1982 for assets

[19] TCGA 1992 s2A and Sch A1 (now repealed)
[20] TCGA 1992 s4(2)
[21] TCGA 1992 s4(4)
[22] TCGA 1992 s110 (see Annex F)
[23] TCGA 1992 ss52A - 57
[24] HM Treasury "Corporate Tax Reform: Delivering a more competitive system" Part 1A, Box 2.A (http://www.hm-treasury.gov.uk/d/corporate_tax_reform_part1a_roadmap.pdf)

held prior to that date. This value can be substituted for the original cost for companies[25], however in many cases it is difficult (and costly) to ascertain and can lead to protracted negotiations between taxpayers' valuation teams and the local district valuers.

2.43 As the Valuation Office website[26] gives illustrative 1982 values for different land uses within geographical areas, a huge simplification would be to use these values as a starting point. It would then only be necessary to identify the appropriate geographical area and property category.

2.44 We would therefore suggest that this issue and the potential solution be included within a consultation on indexation.

Environmental taxes

2.45 The only environmental tax relief included in our report that is not in the main income tax or corporation tax acts is the relief from landfill tax of mining and quarrying waste[27]. However, our work and comments by several stakeholders has indicated that both landfill tax and aggregates levy should be reviewed, as both regimes contain the basic charging provisions with numerous exemptions (for example aggregates levy contains 28 exemptions[28]), and the question was raised whether this was the most appropriate method of legislating, i.e. should the tax be based on defining what is caught rather than what is excluded (although in practice we understand that this can be difficult)?

2.46 We suggest that that a review of these environmental taxes could be undertaken in the future.

Specific simplifications

2.47 We propose that 17 reliefs should be simplified, and we have set out some suggestions on how this could be achieved. These have come from businesses, tax practitioners and other stakeholders consulted, as well as from the private sector experience of our team.

2.48 Our specific recommendations are set out in Chapter 3.

General tidying up

2.49 There are 2 reliefs that we believe have expired and can be immediately removed from the tax code. These are listed in Chapter 5.

2.50 There are 45 others for which there is no ongoing valid policy rationale, the value is negligible, or the benefit is outweighed by the administrative burden, and we recommend should be abolished. These are listed in Chapter 4.

[25] TCGA 1992 s35(2) and s55(2)

[26] http://www.voa.gov.uk/publications/property_market_report/1982/Index.shtml

[27] FA 1996 s 44 and see Annex P. It could also be said that landfill tax is itself an environmental tax of course.

[28] See Annex C to the interim report

2.51 There are 5 reliefs for which we have not been able to come to a firm conclusion because of a lack of data or evidence. We suggest that the OTS, HMT and HMRC examine these reliefs further when time permits. These are listed in Chapter 5.

General messages

2.52 During the course of our work the following general themes have emerged, that are not specific to any area of tax:

- Our conclusions very much support the principles behind "Tax policy making: a new approach" as summarised in Box 2.C.; adherence to the principles in that document will lead to simplification by virtue of a more careful, collaborative approach to developing new tax law;
- There is a need for tax policy to be constructed in a more coherent manner, with common definitions and a common structure adopted when, for example, reliefs are being drafted;
- The tax system should only be used as an incentive where there is a strong case that the means will achieve the desired result; and
- In the interest of fairness, tax reliefs should be avoided where these satisfy special interest groups or industry sectors.

Box 2.C: Summary principles of "Tax policy making: a new approach"[29]

Predictability: Objectives for major reform to be set out, including how they will be taken forward and the timetable;

Stability: Majority of changes to be announced at least three months prior to the start of the tax year in which they come into effect or publication of the Finance Bill in which they will be included;

Simplicity: Setting up of the OTS and ensuring that simplification is at the heart of the Government's agenda

Scrutiny: More legislation to be published in draft, to allow for pre-legislative scrutiny; and

Transparency: Tailored Tax Impact Assessment, replacing the current Regulatory Impact Assessment used across Government, plus more information to be published on costing of tax policies, improved supporting documentation accompanying tax changes, and consideration of greater use of sunset clauses for post implementation evaluation.

[29] http://www.hm-treasury.gov.uk/d/junebudget_tax_policy_making.pdf

3 Specific simplification recommendations

3.1 We have identified 17 reliefs that we recommend be considered for simplification. These are reliefs where the policy rationale remains valid and the relief is essentially fit for purpose, but where our review of the relief, as well as representations received from stakeholders, has indicated that that the reliefs would be easier to use were they to be simplified.

3.2 It would be an ambitious project to embark on simplifying all 17 reliefs. The reliefs will need to be prioritised as to which should be simplified first and there are various bases on which this decision could be made, e.g. which would have the most significant impact on UK growth, which would result in the biggest administration saving etc. Many of our recommendations will have revenue gains from reliefs suggested for abolition, as well as the administrative savings flowing from our recommendations, but these need to be balanced against the Exchequer cost.

3.3 This chapter outlines our recommendations for the 17 reliefs, as well as some suggestions we have received from stakeholders. We appreciate that some of these may be outside our remit. More details are contained in the Annexes.

3.4 One consistent message coming from our evidence gathering process has been that change in itself causes complexity.

Enterprise investment scheme (“EIS”) (4 separate reliefs) (Annex A)

3.5 We recommend that the conditions to be met for both the investor and investee company (which are located in different areas of the legislation) be rewritten in a simpler form, perhaps as a checklist or flowchart (in legislation or guidance), which will be easier for taxpayers to follow to determine eligibility. However, it would be important for such an approach to be binding.

3.6 Of the conditions particular consideration could be given to:

- Clarifying the position surrounding the eligibility of directors and employees to address some of the confusion that still exists;
- A potential grace period for the shares to be fully paid up (of perhaps a few days) to ease the administration of electronic cash transfers; and
- Implementing an electronic certification process to streamline applications.

3.7 During the course of our work, we have also received the following suggestions from businesses, although we have not considered these in any detail as they fall more into the ambit of policy, and may have EU State aid implications, though all have the potential to deliver simplification:

- Whether the £2m annual limit should be raised or removed;
- Whether the two year window for using the funds should be extended ; and

- Whether the 50 employee limit should be reviewed (although it must be ensured that the relief remains targeted at those companies that require funding the most).

Venture capital trusts ("VCT") (2 separate reliefs) (Annex A)

3.8 We recommend that the conditions to be met for both the investor and investee company (which are located in different areas of the legislation) be rewritten in a simpler form, perhaps as a checklist or flowchart, which will be easier for taxpayers to follow to determine eligibility. However, it would be important for such an approach to be binding.

3.9 We also recommend that consideration be given to alignment of the time limits and conditions of the EIS and VCT schemes.

Entrepreneurs' relief (Annex A)

3.10 We recommend a simple checklist or flowchart approach to lead an individual selling his business through the conditions to ensure they are all met and he qualifies for the relief. Again, it would be important for this to be binding. The relief should also be renamed what it is – entrepreneurs' rate.

3.11 Further simplification could be achieved by aligning the conditions regarding the sale of shares and the sale of assets.

3.12 We have also received representations from businesses that:

- The 5% rule be abolished as this can lead to additional administrative burdens and unfairness; and
- Consideration be given to increasing, or possibly removing, the lifetime limit to encourage investment by serial entrepreneurs.

Annual investment allowance (Annex C)

3.13 For taxpayer certainty and simplification we recommend that the annual investment allowance limit should remain unchanged for a number of years, with an increase for inflation being made periodically, but not annually.

Enhanced capital allowances for energy and water efficient technologies (Annex C)

3.14 We have identified a number of potential simplifications to this scheme, many of which are non tax options, which businesses have suggested could help to simplify the relief. These include for example:

- A system that looks at the energy efficiency of a project as a whole rather than individual components;

- A 'kite mark' system, so that it is easy to identify assets that contain a green component;
- Use of the A-G rating that is currently used for many appliances already, for example if an appliance achieves an A++ rating then it can qualify;
- An improvement of the search tool on the website, to make it more intuitive, would help many businesses to be able to identify whether an asset qualifies;
- Education of manufacturers, so the sales staff are able to confirm whether an asset qualifies and explain and promote the scheme; or
- Self certification by manufacturers.

Unrelieved surplus advance corporation tax ("ACT") (Annex D)

3.15 Given the lapse of time since the abolition of ACT, drawing a line under surplus ACT would be simplification for those businesses affected and HMRC. We have identified the following possible routes:

- Abolish the shadow ACT regime, enabling companies to offset surplus ACT up to 20% of their taxable profits;
- Abolish surplus ACT with immediate effect. This is unlikely to be acceptable as it does not manage companies' expectations that their surplus ACT will be available for offset; and
- Abolish surplus ACT and explore compensation via alternatives that give value to the company for the ACT.

Purchase of own shares (Annex D)

3.16 We recommend that this relief be simplified and potential simplifications could include:

- A questionnaire on HMRC's website (e.g. how many shares you own now, how many will you own afterwards, total number of shares etc); and
- Publication of examples of successful, anonymised clearance applications on HMRC's website.

Demergers (Annex D)

3.17 We recommend that this relief is retained; however consideration should be given to potential simplifications, such as:

- Rewriting the conditions in the form of a checklist or flowchart, with a step by step guide on how to make an application and what information is required by HMRC in order to reach a decision; and
- Publication of examples of successful, anonymised clearance applications on HMRC's website.

Principal private residence (Annex F)

3.18 This relief is clearly of considerable importance and is itself a simplification on the basis that it keeps many taxpayers outside the CGT net. However, there has to be scope for simplification due to the numerous conditions and sub-reliefs causing complexity in anything other than straightforward cases. It is therefore proposed that these conditions be

- Reviewed to test which are still appropriate;
- Researched to see whether any can be streamlined; and
- Rewritten in a simpler format.

3.19 It has been suggested to us that the whole relief could be replaced, for example with a form of rollover relief, with a lifetime exemption, so any gain crystallised when downsizing or on death is covered for most people. However, we do not believe that this would be a simplification and this cannot be looked at in isolation, without looking at the whole rationale and design of capital taxes.

Chattels exceeding £6,000 in value (marginal relief) (Annex F)

3.20 We recommend that this relief be retained, but also recommend that the £6,000 value for chattels be updated, in line with inflation to, say, £12,000. This is likely to lead to many more disposals being removed from CGT, and would therefore simplify the system for large numbers of individuals.

Seafarers' earning deduction ("SED") (Annex J)

3.21 Despite this relief being an anachronism, on simplification grounds, it does not affect the vast majority of taxpayers and so there is no strong reason to abolish it on simplification grounds, although there is scope to simplify its operation, for example:

- Modifying the legislation so that it is dependent on the position of, or the work performed by an individual; and
- Clarification of the type of vessel served on for an individual to qualify for SED. Representations have been made that those claiming SED based on oil related platforms should be excluded from the regime and that this could be achieved by excluding vessels that do not have a designated speed of at least 10 knots.

Real estate investment trusts ("REITs") (Annex O)

3.22 This regime should be retained but we recommend that it be simplified. The legislation was rewritten as part of the Tax Law Rewrite project, but we understand that there are ongoing discussions with the property industry in relation to the conditions to be met. We therefore do not propose to duplicate work in this area.

Lease premium relief (Annex P)

3.23 This relief is part of a wider regime addressing the taxation of the premium in the hands of the lessor, and therefore the relief cannot be considered in isolation, and must be looked at in the context of the overall regime.

3.24 A proposed simplification is for the taxation of lease premiums to follow the accounting treatment (both for lessors and lessees). This would have the effect that premiums payable on short leases, being in effect advance rent, would generate a full deduction over the period of the lease. Such treatment would remove the disadvantage currently applying to traders who pay premiums as compared to those who purely pay rent. In addition, the relief would apply to premiums which are management expenses.

4 Reliefs to abolish

Cycle to work days – provision of meals (Annex B)

4.1 If an employer provides meals to employees on designated "cycle to work days" the meal is not subject to tax and NIC. The value of the relief is minimal and generally outweighed by the time and cost in providing the benefit.

Late night taxis (Annex B)

4.2 Subject to certain conditions being met, where an employer reimburses the cost of late night taxis for non-business travel, no taxable benefit will arise for the employee. The policy rationale for this relief is reducing as those who find themselves working late are increasingly doing so on a regular basis and are therefore outside the relief. In addition, the relief is not available to a large proportion of the workforce, e.g. shiftworkers.

Trade union subscriptions (Annex B)

4.3 Part of the subscription paid to a trade union that relates to superannuation, death benefits or funeral expenses though a life assurance policy qualifies for tax relief. The policy rationale is obsolete and the value is negligible.

Police organisations (Annex B)

4.4 Part of the subscription paid to a police organisation that relates to superannuation, death benefits or funeral expenses though a life assurance policy qualifies for tax relief. The policy rationale is obsolete and the value is negligible.

Luncheon vouchers – daily relief for first 15p (Annex B)

4.5 As long as certain circumstances are met the taxable benefit of employer provided luncheon vouchers is reduced by 15p for each working day. The value of this relief has eroded since its introduction in 1946 and is outweighed by the time and cost in providing it.

Miners' coal and allowances in lieu of coal (Annex B)

4.6 Free coal, or a cash equivalent, provided to miners, retired miners and miners' widows is not subject to income tax or NIC. The ongoing policy rationale is questionable, especially as the majority claim cash rather than coal, and the value is minimal. A one off 'buyout' of the relief would allow its abolition.

Divers and diving supervisors – Class 4 NIC exemption (Annex B)

4.7 Whilst divers and diving supervisors employed and performing duties in UK waters are treated as self employed for income tax purposes, they are treated as employed for NICs purposes. This relief ensures that a double charge to NICs does not arise. However, the original policy rationale for the entire regime is no longer valid, and it creates complexity for the individuals concerned. Consequently this relief is considered to be redundant.

Payments as reward for assistance with lost or stolen credit cards (Annex B)

4.8 If an employee assists in identifying lost or stolen credit cards and receives a reward from the card issuer, this reward is not subject to NIC. The policy rationale is not valid, as the payment needs to be recorded for PAYE, and so there is virtually no administrative saving. In addition the value is negligible.

Welfare counselling (Annex B)

4.9 Certain specified counselling facilities provided by an employer to an employee are exempt from class !A NICs. Although this relief is simplification, the benefit is negligible.

Disregard for certain apprentices and students coming to the UK (Annex B)

4.10 Subject to certain conditions being met there is no liability to Class 1 NICs for the first 52 weeks for an individual who is not ordinarily UK resident but who is in the UK as a student or apprentice. The policy rationale is less valid than when the relief was introduced and the use is limited.

Contracted out rebate occupational schemes (3 separate reliefs) (Annex B)

4.11 These reliefs operate to provide benefits that are broadly equivalent to the State Pension given up when an employee contracts out of the State Pension. The relief has already been withdrawn for most pension schemes, and abolition would simplify the administrative burden.

Business premises renovation allowance (Annex C)

4.12 This relief gives 100% capital allowances for expenditure incurred in converting or renovating unused business premises in certain areas and subject to certain conditions being met. It is questionable whether the relief acts as an incentive and it has a negligible impact in terms of savings.

Flat conversion allowances (Annex C)

4.13 This relief gives 100% capital allowances for expenditure incurred in converting empty or underused space over shops and commercial premises for residential use, subject to certain conditions being met. It is questionable whether the relief acts as an incentive, it is complex and it has a negligible impact in terms of savings.

Land remediation relief (Annex D)

4.14 Where a company acquires contaminated or derelict land from a third party who was responsible for the contamination, there is enhanced relief for the costs incurred in cleaning up the land. Our work indicates that the relief is not considered to influence behaviour and is not a cost effective method of achieving the policy rationale.

Tax reserve certificates issued by HM Treasury (Annex D)

4.15 Tax reserve certificates were the predecessor to certificates of tax deposit and were used to settle tax liabilities. They were withdrawn in the 1970s, although they may still be used, and should be abolished, subject to an appropriate notice period for taxpayers to exchange them for certificates of tax deposit.

Blind person's allowance (Annex E)

4.16 The blind person's allowance is an additional allowance for individuals who are certified blind or severely sight impaired. The relief is not used by the majority of blind people as they do not earn sufficient income and there may be better ways to assist those with a visual handicap.

Mineral royalties (Annex E)

4.17 Mineral royalties received by a landowner are treated as being 50% capital and 50% income. The policy rationale is no longer valid as the reduction in the highest rate of income tax since the introduction of this relief in 1970 achieves the same purpose.

Compensation for mis-sold personal pensions (Annex E)

4.18 Compensation received for poor personal pension advice given is exempt from capital gains tax. Although claims may still be made, as it is eleven years since the original deadline for claims passed, it should be abolished, subject to an appropriate notice period.

Indexation allowance – share pooling rules (Annex F)

4.19 The share pooling rules treat shares in a company as a single asset, with indexation being calculated each time an acquisition or disposal is made. Rather than looking at this particular relief in isolation, the calculation of capital gains for companies should be reviewed and consideration giving to abolishing the indexation allowance.

Partial relief for company acquisitions (Annex H)

4.20 This relief provided for a reduced rate of stamp duty where a company acquires the whole or part of another company and dates from the time when there were two rates of stamp duty; one for land transfers and one for transfers of shares. As there is one rate of stamp duty now, that applies to transfers of shares, the policy rationale is no longer relevant and the relief has no current application.

Certain leases granted by social landlords (Annex H)

4.21 This relief exempted certain leases entered into by registered social landlords from stamp duty. Since the introduction of stamp duty land tax on leases, this relief has no current practical application, and it should be abolished, subject to an appropriate notice period for taxpayers to organise their affairs.

Transfer to registered social landlords (Annex H)

4.22 In certain circumstances transfers of interests in land to registered social landlords are exempt from stamp duty. Stamp duty land tax applies to transfers of interests in land from 1 December 2003, and so this relief has no current practical application, and it should be abolished, subject to an appropriate notice period for taxpayers to organise their affairs.

Stamp duty disadvantaged area relief (Annex H)

4.23 Following the introduction of stamp duty land tax on transactions in land from 1 December 2003, this relief has no current practical application, and it should be abolished, subject to an appropriate notice period for taxpayers to organise their affairs. Consideration should also be given to its successor in FA 2003 s57 and Sch 6.

Shared ownership schemes (Annex H)

4.24 Following the introduction of stamp duty land tax from 1 December 2003, this relief has no current practical application, and it should be abolished, subject to an appropriate notice period for taxpayers to organise their affairs.

Visiting forces and allied headquarters (Annex H)

4.25 Following the introduction of stamp duty land tax from 1 December 2003, this relief has no current practical application, and it should be abolished, subject to an appropriate notice period for taxpayers to organise their affairs.

Exempt instruments (Annex H)

4.26 Certain specified and certified instruments were exempt from £5 fixed stamp duty. As the fixed rate of duty was abolished in 2008, the policy rationale is no longer relevant and the relief has no current application.

Instruments relating to National Savings (Annex H)

4.27 This relief exempts from stamp duty certain instruments relating to National Savings. As these instruments are no longer chargeable to stamp duty, the policy rationale is no longer relevant and the relief has no current application.

Payments to mariners to be disregarded for class 1 NIC (Annex J)

4.28 Where mariners receive an interim payment by way of an advance of earnings, receive a special payment whilst sick overseas or part of their earnings is paid to another person, there is an exemption from NIC. This exemption relates to out of date practices and is no longer considered to be relevant.

Stamp duty exemption for certain assignments by seamen (Annex J)

4.29 This relief relates to assignment of wages by seamen to certain bodies providing benefits to seamen, and exempted such payments from stamp duty. The policy rationale is no longer relevant as such assignments no longer attract stamp duty and so the relief has no current application.

Transfers in relation to ships and vessels – stamp duty exemption (Annex J)

4.30 As this relief exempts from stamp duty instruments for the sale, transfer etc of a ship, and there is now no stamp duty chargeable on such instruments, the policy rationale is no longer relevant and the relief has no current application.

Capital allowances – safety at sports grounds (Annex L)

4.31 Capital allowances are available for expenditure on safety precautions at certain sports grounds. As stadiums are mostly considered to be up to the required standards, the policy rationale is no longer valid, and the relief is unlikely to be claimed in the future.

Life assurance premium relief (Annex M)

4.32 For life assurance policies entered into before March 1984 relief is available for part of the premium paid. As the value of the relief is negligible for policy holders, it is a complication, and it can be costly for the insurance companies, we recommend that this relief be abolished.

Life assurance premiums paid by employers under E-FRBS (Annex M)

4.33 This relief extends the life assurance premium relief to individuals whose employers make payments into an E-FRBs scheme. As the value of the relief is negligible for policy holders, it is a complication, and it can be costly for the insurance companies, we recommend that this relief be abolished.

Payment for the benefit of family members (Annex M)

4.34 Income tax relief is available for contributions made to provide for the spouse and children of an individual, up to a maximum of £100. The policy rationale is mostly obsolete, the value is negligible, and the number of claimants is very low.

Literary and creative artists' profits (Annex N)

4.35 Literary and creative artists are, subject to certain conditions, able to average their profits and consequently their tax liability, thus enabling better management of their cash flow. In many cases this spreading is performed outside the tax system, by the artist's agent, and we do not think that there is sufficient justification as to why this sector should receive favourable tax treatment.

Angostura bitters (Annex P)

4.36 Angostura bitters are exempt from excise duty, on the grounds that it is used as a food additive rather than as alcoholic drink. As there is only one company benefiting from this relief, it receives an unfair price advantage over other cocktail bitters, though abolition of the relief does raise issues over comparability with other countries' treatment of the product.

Black beer (Annex P)

4.37 Black beer is exempt from excise duty. There is only one company that benefits from this relief and the product is regional, being mainly drunk in parts of Yorkshire. The policy rationale for this exemption, which dates back to the 1930s, is no longer valid.

Community investment tax relief (Annex P)

4.38 Individuals who invest in businesses and other enterprises in disadvantaged areas through Community Development Finance Institutions are eligible for tax relief on the amount invested. The take up for this relief has been lower than was originally anticipated, there are minimal savings and there are a number of complexities surrounding the relief. There may be other ways to encourage investment into disadvantaged areas.

Charities – transitional relief on distributions (Annex Q)

4.39 Following the abolition of the dividend tax credit, charities were entitled to transitional relief for distributions received on or before 5 April 2004.The relief has now expired.

Payroll giving 10% supplement (Annex Q)

4.40 The relief has expired, as the 10% supplement added to gifts to charities made under a payroll giving scheme was only available until 5 April 2004.

Millennium gift aid (Annex Q)

4.41 The relief has expired, as it related to donations made prior to 31 December 2000.

National Savings Bank: Ordinary Account interest (Annex Q)

4.42 The relief has expired, as the tax free Ordinary Account is no longer available.

Class 1A – exemption from prescribed general earnings (Annex Q)

4.43 The relief has expired as it only applies to employee relocations before 6 April 1998.

Class 4 NICs – allows deduction in the next tax year of losses incurred in 1989/90 or previous tax year where losses from income other than a trade or profession or vocation (Annex Q)

4.44 The relief is likely to have limited application as the last year in which relevant losses could have been incurred was over 20 years ago.

5 Other reliefs reviewed

5.1 Reliefs to retain

- Employer supported childcare (Annex B)
- Cycles and cyclists' safety equipment (Annex B)
- Repair and maintenance of work equipment (Annex B)
- Loan to employees where interest qualifies for tax relief (Annex B)
- Security expenses (Annex B)
- Disregard for benefits subject to unauthorised payment charge (Annex B)
- Exemption from class 1A NICs on certain payments by way of securities (Annex B)
- Short life assets (Annex C)
- 100% first year allowance for cars with low CO_2 emissions (Annex C)
- Mineral extraction allowances (Annex C)
- Small profits rate (Annex D)
- Marginal relief (Annex D)
- Authorised unit trusts and open ended investment companies – reduced rate of tax (Annex D)
- Mineral royalties (Annex E)
- Sea walls (Annex E)
- Post cessation trade relief (Annex E)
- Private finance initiatives and public private partners (Annex H)
- Nationalisation schemes (Annex H)
- Gifts of qualifying investments to charity (Annex I)
- Gifts of trading stock to charity (Annex I)
- VAT supplies to / sales by charities (Annex I)
- Tonnage tax (Annex J)
- Capital allowances – dredging (Annex J)
- Capital allowances – ships (Annex J)

- First year capital allowances in ring fenced trades (Annex K)
- Marginal relief for companies with ring fence profits from oil related activities (Annex K)
- Capital allowances – mining and oil industries (Annex K)
- Income tax relief for UEFA Champions League Final 2011 (Annex L)
- Pool betting duty payments related to safety improvements at football grounds or support for the arts (Annex L)
- Life assurance policies – 5% rule (Annex M)
- Life assurance policies – top slicing relief (Annex M)
- Long term business – insurance premium tax (Annex M)
- Lloyd's insurance funds - exemption from tax on profits from new funds (Annex M)
- Film tax relief (Annex N)
- Farmers' averaging (Annex N)
- Woodlands (Annex N)
- Inter-American Development Bank securities (Annex O)
- Reserve Bank of India and the State Bank of Pakistan (Annex O)
- Issue of bearer instruments by the Inter-American Development Bank (Annex O)
- Transfers of international bank stock (Annex O)
- Non resident central banks – income on securities payable out of the UK public revenue (Annex O)
- FOTRA securities – exception for overseas residents (Annex O)
- Issue/transfer of securities issued by designated international organisations (Annex O)
- Exemption for repayment supplement and interest on repayments made by HMRC (Annex P)
- Entertaining for non-trading and non-property businesses (Annex P)
- Deduction for expenditure by landlords on energy saving items (Annex P)
- Eurobonds (Annex P)
- Contracts relating to the Channel Tunnel – exemption from insurance premium tax (Annex P)
- Mining and quarrying waste – landfill tax exemption (Annex P)
- Deeply discounted securities incidental expenses (Annex P)
- Gilts issued at discount (Annex P)

- Pension contributions – disregard for benefits referable to contributions paid before 6 April 2006 and certain payments made on or after that date (2 separate reliefs) (Annex P)
- Disregard for benefits from a funded unapproved retirement benefit scheme where attributable to payments made before 6 April 1998 (Annex P)

5.2 Reliefs that have already been repealed:

- Approved profit sharing schemes (Annex Q)
- Trustee Savings Banks income from investments with the National Debt Commissioners (Annex Q)

5.3 Reliefs on which no firm conclusion is possible:

- Employment related securities for disabled employees (Annex B)
- Intangible assets – exemption for regional development grants and equivalent grants in Northern Ireland (Annex D)
- Superannuation funds (Annex F)
- Shipbuilders' relief – relief from duty (Annex J)
- Grants for giving up agricultural land (Annex N)

5.4 Reliefs on which no conclusion is possible without reviewing the area of tax it relates to:

- Inheritance tax reliefs (27 separate reliefs) (Annex G)
- Harbour reorganisation schemes (3 separate reliefs) (Annex J)

5.5 Reliefs on which consultation is already taking place

- Research and development allowances (Annex C)
- Finance leasing arrangements – various deductions (Annex E)
- Research and development tax relief (2 separate reliefs) (Interim report)
- Vaccine research relief (Interim report)
- Gift aid (Interim report)

6 Next steps

6.1 This report is an independent review of a number of the 1,042 reliefs identified by the OTS across the tax code and has been prepared to summarise the recommendations of the OTS in advance of Budget 2011.

6.2 The OTS cannot make any decisions about individual reliefs. It is ultimately for the Chancellor of the Exchequer to decide on changes to tax legislation, and in doing so he will take account of the recommendations from the OTS. Such proposals from the Chancellor will in addition be subject to the normal parliamentary process.

6.3 We expect a formal response to this report as part of Budget 2011, but we do not expect any immediate changes to reliefs, other than, perhaps, the abolition of some obsolete reliefs.

6.4 If the Chancellor of the Exchequer wishes to take any of our proposals for simplification or abolition further, the guidelines on draft legislation in "Tax policy making: a new approach" will be followed, with amendments possibly included in Finance Bill 2012, at the earliest.

6.5 Some of our recommendations represent major changes; we realise that there is a full legislative programme, limited resources and the Coalition Agreement has already set out priorities for this Parliament. However if there is a real appetite for simplification we would recommend that, at the very least, a detailed review is carried out of these areas.

6.6 Building on this report we believe that the OTS has a role to play, working with HMT and HMRC to establish a process to examine all reliefs systematically over time. This would be a combination of building review processes and timings into the introduction of new reliefs (which we appreciate is strictly outside our current remit) and ensuring that the OTS, together with HMT and HMRC, returns periodically to reviewing reliefs that we have either not reviewed or currently believe need no simplification. The latter process might well be effected by one or more overall reviews of a particular tax: as we have noted elsewhere in this report, we are well aware of the argument that simplification should start with a tax in its entirety, rather than looking at individual reliefs.

List of annexes

The following annexes contain our detailed review of the reliefs

A Small business

Enterprise investment scheme

A.1 The Enterprise Investment Scheme ("EIS") provides four separate tax reliefs for investors subscribing for qualifying shares in qualifying companies. These reliefs are:

- Income tax relief at 20% of the amount invested, up to a maximum of £500k pa[1];
- Any gain on the disposal of the shares after 3 years is free from capital gains tax[2];
- If gains have been made on the sale of other assets in the three years prior to the investment, or the year after investment, these gains can be deferred until the EIS shares are sold[3]; and
- If a loss is made it will be available to shelter other capital gains, and in certain circumstances can be set off against income tax[4]. This relief is not strictly part of the EIS regime, but it is only available on shares in an EIS company, and has therefore been reviewed in conjunction with the other EIS reliefs.

A.2 There are a number of conditions that must be satisfied in order to qualify, of which the major ones are:

- The company invested in must, at the time the shares are issued, be an unquoted trading company, with fewer than 50 staff and gross assets of less than £7million prior to the investment round and £8million after[5];
- The company can raise no more than £2million p.a. through the EIS and venture capital trust schemes combined[6];
- All cash received by the company under the scheme must be used for a qualifying activity and within two years[7]; and
- For all reliefs other than the capital gains deferral relief, the investor must own less than 30% of the share capital and voting rights[8] and, if a director, must receive only reasonable payment.

[1] ITA 2007 ss156-257
[2] TCGA 1992 s150A (2)
[3] TCGA 1992 s150C and Sch 5B
[4] ITA 2007 ss131-151
[5] ITA 2007 ss186 – 186A
[6] ITA 2007 s173A
[7] ITA 2007 s175
[8] ITA 2007 s170

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

A.3 This relief was introduced in 2000[9] to incentivise equity investment into smaller, high risk companies.

A.4 This rationale continues to be valid, and in "Financing Business Growth: the Government's response to the Financing a Private Sector Recovery"[10], the Government committed to ensuring that EIS continues to incentivise effectively investment into small companies.

Taxpayer take up and awareness

A.5 The relief is potentially available to any individual who wishes to invest in qualifying companies.

A.6 There are approximately 11,000 individuals[11] investing in around 2,000 qualifying companies[12], with total income tax savings of around £160million[13] and capital gains savings of around £10million[14]. There is also £40million[15] of deferred CGT each year, however as this is only a deferral of tax, the only saving is the time value of money.

Complexity, compliance costs and administrative burden

A.7 The legislation governing EIS is complex and lengthy at almost 69 pages[16], due to the need to ensure that the benefits are appropriately targeted and to avoid misuse. In particular, there are numerous qualifying conditions that must be met throughout the qualifying period. At times there is only partial relief (which entails special computations) and there are complex interactions with other CGT rules for shares.

A.8 Some of the complexity stems arises from the EU State aid rules, for example the provisions concerning companies in difficulty.

A.9 This complexity means that professional advice at the point of fund raising is required, in many cases to avoid unintentional errors and loss of relief. However the costs of this can, at times, be significant and reduces the benefit of the fund raising.

A.10 The rules regarding EIS relief are currently contained in TCGA 1992 ss150A-150C and Sch 5B, ITA 2007 ss156-257 and ITA 2007 ss131-151. Having the rules set out in so many different places adds to the complexity as it makes it harder to read and apply the rules.

A.11 Representations from stakeholders have indicated that there is some confusion about whether or not the relief is available to directors and employees. This lack of understanding of the rules provides an indication of the complexity. This was partly addressed when the rules were rewritten into ITA 2007, but the misunderstanding still persists.

A.12 The need for a company to have fewer than 50 employees is causing considerable difficulty, especially to companies with around that number of employees. We understand from taxpayers and representative bodies that, in several circumstances, companies have refused to

[9] Budget 21 March 2000
[10] HMT/BIS October 2010
[11] HMRC estimate
[12] HMRC estimate
[13] http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.pdf
[14] HMRC estimate
[15] HMRC estimate
[16] Tolley's Yellow Tax Handbook 2010/11 Vol 1a

take on more staff in order to ensure they can receive future EIS funding. Therefore the growth of such companies can be stifled as it makes it much harder to launch new funding rounds if the number of employees is about to be breached, due to the uncertainty about clawback of the relief. However, it is noted that the 50 employee limit is imposed by the conditions under which State aid approval was granted.

A.13 In 2007/08 there were around 1,157k companies in the UK with fewer than 50 employees[17], 53k with more than 250[18] and only 39k in between[19]. It has been suggested that increasing the limit to 250 employees would help to increase the number of medium sized companies; however this may be difficult to achieve as it would require re-opening EU State aid negotiations.

A.14 If the investee company can guarantee EIS relief, it becomes much more attractive to investors. In order to do this, it is necessary for pre-approval to be granted, which can take up to a month to be received. It has been suggested that an electronic certification system would assist with this. Whilst it is unlikely to expedite the clearance process (as this delay is caused by HMRC having to consider each claim) it would aid the administration following a share issue and reduce costs for both the taxpayer and HMRC. An added benefit is that it should prevent certificates from being lost, and if one were, it would be easy to issue a replacement.

A.15 One of the requirements is that shares are subscribed for wholly in cash and are fully paid up at the time they are issued[20]. This condition (which was designed at a time when investors paid by cheque) causes complexities in the procedures undertaken during funding. Generally investors prefer to pay by electronic transfers, but if they pay prior to the shares being issued, it results in EIS relief being denied; transfers after the shares have been issued results in the shares not being fully paid up (and thus the relief is denied).

A.16 The £2million annual limit[21] to be raised through the two schemes results in a number of companies splitting the share issue and only offering EIS relief to the first investors to sign up until the limit is reached. This introduces significant complexity and additional administrative costs, including advisers' and solicitors' fees. In addition, for faster growing companies, £2million is generally insufficient and at times this can hinder the growth of such companies. It has been raised in a number of representations to the OTS that this requirement is not necessary as there is a cap on the size of the company. However, it is noted that this limit is imposed by the conditions under which State aid approval was granted

A.17 A further complexity is that the cash has to be spent within two years of the fund raising. This means that companies are unable to plan far in advance and instead must keep raising further funds. This condition also means that the proceeds from larger share issues, with some non EIS funding, must be separately tracked.

Summary

A.18 As there are a number of conditions to be met for both the investor and the investee company, which are located in many different areas of the legislation, we would recommend that they be rewritten into a checklist or flowchart that makes it easy to follow to determine

[17] HMRC estimate
[18] HMRC estimate
[19] HMRC estimate
[20] ITA 2007 s173(3)
[21] ITA 2007 s173A

eligibility. Such an approach is likely to be in a Practice Note or HMRC guidance; however it would be important for it to be binding.

A.19 In particular, to simplify the administrative side of the relief, consideration could be given to:

- Clarifying the position surrounding the eligibility of directors and employees to address some of the confusion that still exists;
- A potential grace period for the shares to be fully paid up (of perhaps a few days) to ease the administration of electronic cash transfers; and
- Implementing an electronic certification process to streamline applications

A.20 During the course of our work, we have also received the following suggestions from businesses. They clearly have potential for simplifying the operation of the relief but as they are really concerned with policy and cost of the relief we have not considered them in any detail as they fall outside our remit of simplification:

- Whether the £2million annual limit should be raised or removed;
- Whether the two year window for using the funds should be extended; and
- Whether the 50 employee limit should be reviewed (although it must be ensured that the relief remains targeted at those companies that require funding the most).

Venture capital trusts

A.21 A Venture Capital Trust ("VCT") is an investment company that is listed in the UK[22]. If the fund meets certain conditions, three separate reliefs are available:

- Income tax relief at 30% of the amount invested, up to a maximum of £200k p.a.[23];
- Any gain on the disposal of the shares after 5 years is free from capital gains tax (although if a loss is made it will not be available to shelter other gains)[24]; and
- All dividends received from the VCT are exempt from income tax.

A.22 There are a number of conditions that must be satisfied in order to qualify, of which the major ones are[25]:

- The VCT must invest at least 70% of its assets in companies meeting similar qualifying conditions to those of the EIS scheme (see A.2 above) and cannot retain more than 15% of the income it receives;
- The income received by the VCT must be wholly or mainly derived from shares or securities; and
- No holding can represent more than 15% by value of the investments of the VCT.

[22] From 6 April 2011, this will be extended to any EU regulated market
[23] ITA 2007 Part 6
[24] TCGA 1992 s151A
[25] TCGA 1992 s274(2)

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

A.23 As with the EIS reliefs, VCT reliefs were introduced in 2000[26] to incentivise equity investment into small, high risk companies. The policy rationale behind having two schemes is that VCT schemes allow greater diversification of investments, as well as more informed investment as VCTs frequently build expertise in particular sectors.

A.24 This rationale continues to be valid, and in "Financing Business Growth: the Government's response to the Financing a Private Sector Recovery"[27], the Government committed to ensuring that VCTs continue to incentivise investment into small companies.

A.25 With a perception that banks have increasingly withdrawn from the SME sector, the role of VCTs in investing into such companies is increasingly important.

A.26 VCTs enable investors who are unlikely to have the skills or appetite for direct investment into small companies to spread their risk, and be provided with an expert investment manager.

Taxpayer take up and awareness

A.27 There are around 120 VCTs[28] actively managing the investments of around 7,000 investors[29]. The total relief claimed each year is approximately £150million[30] of income tax savings and £10million[31] of CGT savings.

A.28 In 2009/10, approximately £340million of funds was raised by VCTs for investment[32].

Complexity, compliance costs and administrative burden

A.29 The legislation governing the VCT scheme is complex and long at 33 pages[33], due to the need to ensure the scheme is appropriately focused and targeted. In particular, there are a number of qualifying conditions, and although similar in some respects, there are many differences between the EIS and VCT schemes, including the amount of relief and time limits.

A.30 Many of the complexities encountered in EIS schemes, noted in A.7 – A.17 above, apply equally to VCT schemes.

Summary

A.31 As there are a number of conditions to be met for both the investor and the investee company, which are located in many different areas of the legislation, we would recommend that they be rewritten into a checklist or flowchart that makes it easy to follow and determine eligibility. As noted above, such an approach is likely to be in a Practice Note or HMRC guidance; however it would be important for this to be binding.

A.32 In addition to the issues noted above under EIS schemes, aligning the time limits and conditions over the EIS and VCT schemes would deliver some administrative simplifications.

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[26] Budget 21 March 2000
[27] HMT/BIS October 2010
[28] HMRC estimate
[29] HMRC estimate
[30] HMRC estimate
[31] HMRC estimate
[32] Association of Investment Companies representation
[33] Tolley's Yellow Tax Handbook 2010/11, vol 1c

Entrepreneurs' relief

A.33 The standard rate of capital gains tax for higher rate taxpayers is 28%[34] (18% for basic rate payers[35]). However, if certain conditions are met, a reduced rate of 10% is available[36] on the sale of the following business assets:

- Shares or securities in a company if, for at least one year prior to the disposal:
  - a The individual owns at least 5% of the ordinary share capital and 5% of the voting rights;
  - b The individual is an officer or employee of the company or another member of the group; and
  - c The company is a trading company or the holding company of a trading group.
- Assets comprising the whole of a business or a distinct part, whether carried on by a sole trader or a member of a partnership.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

A.34 Prior to the abolition of taper relief in 2008, most business owners or employees who sold their shares or their business would have been be taxed at an effective 10% rate on their chargeable gains. When taper relief was abolished and the CGT flat rate of 18% was introduced, entrepreneurs' relief was introduced to encourage entrepreneurship.

A.35 Representations received by the OTS indicate that a more favourable rate of CGT for gains from business disposals sends a powerful and positive message to actual and potential entrepreneurs, and thus the policy rationale remains valid. However, representations have also regularly made the point that to really encourage entrepreneurship (and serial entrepreneurship in particular) there would be no £5m limit on the relief. This would certainly simplify the relief but is clearly a policy matter that we must leave to others.

Taxpayer take up and awareness

A.36 This relief is available to many individuals carrying on a business; however the strict conditions have limited the number of eligible individuals.

A.37 In 2008/09 there were around 35,000[37] claimants of the relief, saving about £140million[38] of tax. This increased to £400million in 2009/10[39] and £1billion in 2010/11[40]. Over this time the limit of gains for which the relief can be given (i.e. the lifetime limit of qualifying gains) increased from the initial limit of £1million (from April 2008) to £2million in April 2010[41] and then to £5million in June 2010[42].

[34] TCGA 1992 s4(4)
[35] TCGA 1992 s4(2)
[36] TCGA 1992 Part V Chap III
[37] HMRC estimate
[38] HMRC estimate
[39] http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.pdf
[40] http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.pdf
[41] FA 2010 s4
[42] F(No2)A 2010 Sch 1 para 5

Complexity, compliance costs and administrative burden

A.38 The rules governing this are in 12 sections[43] and are complex, primarily because the relief is available in various forms, depending on the assets and circumstances, and there are numerous qualifying conditions to ensure the relief is targeted as intended.

A.39 If the business is incorporated, as long as the conditions are met, it is possible to sell part of a shareholding and obtain entrepreneurs' relief. However, if the business is not incorporated, the entire business or a distinct part must be sold. We have received representations from a number of advisers that this can cause significant problems as, in many cases, an individual may want to retain an interest in the business, or retain some of the assets that were previously used in it.

A.40 This perceived unfairness is circumvented by many people but, in order to do so, the tax affairs need to be made more complicated and advice needs to be paid for. In addition to introducing additional administrative costs, we also understand that a number of businesses are incorporating to take advantage of the more generous relief.

A.41 Having one set of rules for companies and one for unincorporated businesses creates complexity for businesses and advisers and leads to mistakes being made.

Box A.1: Entrepreneurs' relief example (provided by adviser in Humberside)

An individual who had lived and worked on the same farm for his entire life was looking to retire and sell the business but wanted to retain the farmhouse as this was his family home. However due to this he was not deemed to be disposing of the entire business (or a distinct part of it), and so entrepreneurs' relief was not available.

A.42 On the sale of a company, the rule requiring an individual to own at least 5% of the ordinary share capital and voting rights for at least a year prior to disposal can lead to inequity and create complexity. For a year prior to selling, an individual needs to monitor the other shareholdings, to confirm whether he will be eligible for the relief, which may become unavailable at any time due to circumstances beyond his control (for example a new investor coming in and diluting the other holdings).

A.43 It can also discourage entrepreneurial spirit (which is counter to the original policy rationale), as it can discourage new share options being issued if when the options are exercised it would lead to current shareholders breaking the 5% test.

A.44 This rule does create a particular problem for family owned businesses as there can be a spread of ownership and lots of family members working for the company, of which some may have over 5% but there is only a maximum of 20 people that can benefit.

A.45 It is seen as relatively easy to circumvent the rule, and if a company or individual is willing to pay for specialist advice the position can be improved but this option may not be available to all. This has led to a number of previously simple companies having several classes of shares,

[43] Tolley's Yellow Tax handbook 2010/11 vol 1a

with different voting rights. Thus the more an individual is willing to pay for professional advice, the better the tax position that can be achieved.

A.46 The requirement for a company to be trading also creates complexity and unfairness. There is no statutory definition of trading, however there is HMRC guidance[44] which states that if over 20% of the assets, income or time is spent on non trading activities then entrepreneurs' relief may not be available. In the current economic climate many companies are retaining cash rather than paying it out as a dividend, and therefore any sale of such companies may not be eligible. As such it has been suggested that eligibility should purely be based on an income test, perhaps over a number of years.

A.47 Where part of the consideration is deferred and contingent on future events (e.g. based on future profits), an estimate is made of the most likely consideration and this is taxed at the point of sale (and may be eligible for entrepreneurs' relief). When the consideration is finally determined, a further profit or loss will accrue at that time. If there is an extra profit, this will not be eligible for entrepreneurs' relief as it is deemed to be a separate asset from the business that was sold.

A.48 Representations have also been received that the relief does not encourage serial entrepreneurs as the limit of £5million is over a lifetime. The relief may therefore be available on the sale of a first business, but it reduces the incentive to start a new venture, as any disposal would be taxed at a much higher rate. Having the limit also means that records need to be retained for a year of which disposals were made and when.

A.49 In particular, this has caused complications when the limit has changed, which has happened twice since its introduction three years ago. This can lead to complex calculations in determining which gains are chargeable at what rate.

Summary

A.50 The relief is well used and understood by the majority of advisers and beneficiaries, although at times, individuals can be caught out by some of the conditions. We would therefore recommend a simple checklist or flowchart that leads a person selling their business through the conditions to ensure they are all met. Again, as noted above such an approach is likely to be in a Practice Note or HMRC guidance, however it would be important for such an approach to be binding.

A.51 We think that useful simplification of the operation of the relief could be delivered by reviewing and streamlining some of the conditions. Such a recommendation does overlap with policy but we think that the following aspects that have been raised with us deserve review:

- The abolition of the 5% rule for shareholders, as this can lead to additional administrative burdens, additional complexity and unfairness (could this be dropped and balanced by a strengthening of the 'employee' requirement for example);
- The disparity between the sale of incorporated and unincorporated businesses, to just have one set of rules for both, and increase fairness; and
- The lifetime limit, which makes the calculation more complex, and does not fit with the original rationale of encouraging entrepreneurship.

[44] HMRC Capital Gains Tax Manual CG64090

B Employment related

B.1 Generally where benefits are provided by an employer to its employees, the benefit is subject to income tax on the employee and class 1A NIC on the employer. However there are a number of exemptions to this, of which some are reviewed below.

Employer supported childcare

B.2 Employers can provide up to £55 per week of childcare vouchers to their employees without tax or NIC[1]. There are a number of qualifying conditions, but the major ones are:

- The child (or stepchild) of the employee must be maintained (wholly or partly) at the employee's expense and must live with the employee[2];
- The childcare must be by a qualifying childcare provider[3]; and
- The scheme is available to all employees[4].

B.3 If the childcare is provided in a nursery or play scheme on the employer's premises which is managed or financed by the employer, the entire benefit will be free from tax and NIC.

B.4 Many employers provide this benefit through salary sacrifice arrangements, whereby an individual gives up salary that is subject to income tax and national insurance and receives a benefit in its place. This provides tax and NIC savings for the employee and NIC savings for the employer.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.5 This relief was introduced in 1999 to help parents to re-enter or remain in work by making childcare more affordable for working families and to engage employers with the issue of childcare.

B.6 In 1981, less than 25% of women with children under 5 were employed or seeking employment; this has now increased to 53.1%[5]. Although this relief does provide an incentive for parents to return to work after the birth of a child, and is likely to encourage this, there has been a long term trend for more parents to continue working, and it is unclear how much of an impact on behaviour childcare vouchers have.

[1] ITEPA 2003 ss270A, 318 and 318A; SSCR 2001 Sch 3 Part 5 para 7
[2] ITEPA 2003 s270A(3)
[3] ITEPA 2003 s270A(4)
[4] ITEPA 2003 s270A(5) – note that it is proposed in FB 2011 that this condition will be relaxed where the vouchers are provided under salary sacrifice arrangements and there are employees at or near the national minimum wage.
[5] Westminster Advisers Ltd "Employer Supported Childcare" November 2010

Taxpayer take up and awareness

B.7 The relief is available to most employees in the country with children and it is estimated that 450,000 individuals[6] use a scheme, yielding savings of approximately £900 p.a. for a basic rate taxpayer, towards the average cost of childcare of £5,028p.a. in England based on 25 hours of nursery care per week[7].

B.8 83% of users of the scheme are basic rate taxpayers[8] (although based on different assumptions this may be 60%[9]), with the best represented group being manual and unskilled workers.

B.9 The total cost of the relief is approximately £600million p.a.[10].

Complexity, compliance costs and administrative burden

B.10 The largest administrative cost is generally in setting up a scheme, for example arranging for a voucher provider and updating the employee communications, etc.

B.11 On an ongoing basis, records need to be kept to verify that the qualifying conditions are met, including:

- Evidence that the scheme is offered to all staff where appropriate;
- Details of the children using the childcare, for example their name and date of birth;
- Details of the child carer(s) used including their registration or approval numbers and, if appropriate, when their approval expires; and
- Evidence that the participating employees are required to inform the employer of any changes in the registration or approval status or the child carer.

B.12 In most cases, this information, once entered into the HR system, will require little monitoring or updating.

B.13 If the relief is delivered through salary sacrifice (which in most cases it is[11]) it will also be necessary to make changes to employment contracts. However the NIC savings available to employers generally far outweigh the administrative cost of the scheme.

B.14 This relief eases the reporting requirements for employers that provide this benefit, as there are no reporting requirements (on either form P11D or P9D) unless it exceeds £55 per week.

B.15 Childcare vouchers provide a guaranteed income stream for nurseries, and therefore help them to manage their funding arrangements. An analysis of the nursery sector in 2010 stated that "corporate funding of the sector has been the engine of growth in recent years, bolstering demand for nursery services"[12].

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[6] HMRC estimate
[7] http://www.daycaretrust.org.uk/pages/rapid-rise-in-childcare-costs-adds-to-family-finance-woes.html 9 February 2011
[8] "Childcare vouchers; who benefits? An assessment of evidence from the family resources survey" p6
http://www.smf.co.uk/assets/files/SMF_Childcare_vouchers_FINAL_WEB.pdf
[9] HMRC figure
[10] HMRC estimate
[11] HMRC information
[12] Laing and Buisson "Children's Nurseries UK Market Report 2010"

B.16 From April 2011, the income tax relief available will be restricted to 20% for all new entrants to the childcare scheme. The aim of this change is to ensure that all claimants receive the same benefit from the scheme, and to make the scheme fairer and more progressive.

B.17 In order to identify employees affected by this, a Basic Earnings Assessment ("BEA") needs to be completed each year by the employer. The process has been designed to be a light touch, but will obviously introduce an additional administrative burden.

Summary

B.18 The policy rationale of encouraging people to go back to work remains valid, and was backed up in the Government's 2010 Spending Review[13]. In addition, the relief reduces the administrative burden for many employers as, after the initial set up, there is very little ongoing work, other than the new element of the BEA. The relief seems to have been successful

B.19 We therefore recommend that this relief be retained.

Cycles and cyclists' safety equipment

B.20 Employers are able to lend or hire cycles and cyclists' safety equipment to employees with no taxable benefit, as long as certain conditions are satisfied[14]:

- The offer must be made to all employees; and
- It must be used mainly for the employee's commute to work.

B.21 Many employers provide this benefit through salary sacrifice arrangements, whereby an individual gives up salary that is subject to income tax and NIC and receives a benefit in its place. This provides tax and NIC savings for the employee and NIC savings for the employer. In certain circumstances, the employer can also recover the VAT on the cycle.

B.22 In most cases, at the end of the loan period, the cycle and equipment is sold to the employee. If this sale is at less than market value, the difference is a taxable benefit.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.23 This relief was introduced in 1999[15] as part of a key policy objective on sustainable transport for the Department for Transport, and the Department of Health's policy on fitness. This rationale continues to be valid.

B.24 The relief continues to achieve the rationale; a recent survey found that 76% of users would not have purchased a bike without a cycle to work scheme and 87% of participants had noticed improvements in their health since joining the scheme[16].

Taxpayer take up and awareness

B.25 The relief is available to almost all businesses in the UK, although, as there are no reporting requirements if the conditions are met, the number of users is unknown. However the schemes

[13] 20 October 2010
[14] ITEPA 2003 s244; SSCR 2001 Sch3 Part 5 Para 5A(c)
[15] FA 1999 s50
[16] Cycle to Work Alliance: Behavioural Impact Analysis; January 2011

are heavily promoted by both accountancy firms and specialist providers especially under salary sacrifice schemes, as large tax and NIC savings can be made by both the employee and the employer.

B.26 The scheme is therefore widely known and we are aware of a large number of businesses that use it.

B.27 We understand that around 73% of claimants are basic rate taxpayers[17].

Complexity, compliance costs and administrative burden

B.28 As with many employee benefits, the majority of the administrative burden is incurred in setting up a scheme.

B.29 On an ongoing basis there is very little work required by the employer as there are no reporting requirements, and vouchers for the equipment are sent directly to the employee from the voucher provider.

B.30 If the scheme is provided under salary sacrifice, although changes to the employment contracts will be required, the NIC savings will more than cover this and the other costs of the scheme.

Summary

B.31 The original policy remains valid, there is little administration on behalf of the employers or employees and the scheme is well used.

B.32 We recommend that this relief be retained. In view of the advent of the bike hire scheme introduced recently in London, it would be logical to extend the relief to cover support given by employers to employees who use those cycles.

Cycle to work days – provision of meals

B.33 Generally, when an employer provides meals to employees they are a taxable benefit. However, if meals (usually breakfast) are provided on a designated 'cycle to work' day in order to encourage employees to participate, this meal is not subject to tax or NIC[18].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.34 This relief was introduced in 2002[19] as part of the cycle to work scheme (see above) and part of the sustainable transport initiative of the Department for Transport.

Taxpayer take up and awareness

B.35 This relief is available to all businesses in the UK, but the actual take up is unknown.

B.36 We have received a number of representations that take up of this relief is very low. In addition, given the value of each breakfast, the total tax savings from this relief will be negligible.

[17] Cycle to Work Alliance: Behavioural Impact Analysis; January 2011
[18] SI 2002/205
[19] SI 2002/205

Complexity, compliance costs and administrative burden

B.37 The relief is simple to operate as there are no reporting requirements, the conditions to be met are well defined, and no changes would be necessary to employment contracts.

B.38 However an employer would need to publicise the cycle to work day and arrange for the meal to be provided either at a work canteen or bought in from outside.

Summary

B.39 As the value of this benefit is very low, the value of the relief is often outweighed by the time and cost to the employer in providing it, and the take up is low.

B.40 We would therefore recommend that it be abolished, but potentially replaced with a de minimis level for benefits, as noted in Chapter 2 above.

Repair and maintenance of work equipment

B.41 ITEPA 2003 s367 provides that a deduction may be allowed for a fixed sum representing the average annual expenses incurred by a class of employees in relation to the repair and maintenance of work equipment. The deduction may only be claimed where the expense itself would be deductible, where the expense falls on the employee and is not reimbursed by the employer. If the expense is reimbursed in part by the employer the fixed sum deduction is reduced accordingly.

B.42 Examples of current allowances[20] are:

- Agricultural workers: £100; and
- Pattern makers £140.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.43 This relief was introduced to ensure that employees who are necessarily obliged to incur expenses in relation to their work equipment are not disadvantaged in comparison with those whose employers meet the expense directly.

B.44 Per HMRC Employment Income Manual[21] most employers will provide the necessary equipment and so the fixed sum deduction will not be necessary; consequently the original rationale may not be as valid as it was when introduced.

B.45 However, removal of ITEPA 2003 s367 would create an additional administrative burden for both taxpayers and HMRC, as taxpayers would have to access relief under ITEPA 2003 s336, which requires more detailed record keeping and HMRC's agreement.

Taxpayer take up and awareness

B.46 This relief is currently aimed at 34 different industries[22] and so is widely available.

[20] HMRC Employment Income Manual EIM 32712
[21] HMRC Employment Income Manual EIM 32710
[22] HMRC Employment Income Manual EIM 32712

B.47 Even though many employers provide the requisite equipment, and so the fixed sum deduction is not necessary[23], over 10,000 taxpayers currently take advantage of this relief[24].

Complexity, compliance costs and administrative burden

B.48 This relief relieves administrative burden, and therefore the costs to HMRC of the relief are likely to be minimal; the alternative would be to allow the actual sums incurred. As it is also a simplification for HMRC, any detriment to the yield would be, at least partially, offset by the administrative savings.

B.49 For taxpayers who have to bear such costs themselves this relief is a simplification as there is no need to maintain records of the actual sums incurred. It is not complex for claimants and representative bodies to explain the entitlement to their members. Relief is allowed through the tax coding, which further eases the administrative burden for the taxpayer, although this will reduce the benefit to HMRC.

B.50 The current rates were those that took effect in 2008/09 and are only slightly higher than those published in the early 1990s. As these amounts are not negotiated regularly, it is not likely to take up a substantial amount of HMRC time.

B.51 It may be possible to implement a single flat rate for all the affected industries rather than 34 different ones. Even though this would be a simplification, it would be difficult to arrive at a figure that is acceptable to HMRC and all individuals affected. In addition, it would mean a change for many people, which in itself is a cause of complexity.

Summary

B.52 This relief is a simplification for the individuals concerned and for HMRC, it is available to a wide variety of industries and it ensures employees are not disadvantaged as a result of the policy and practices of their employers.

B.53 We would therefore recommend that this relief be retained. Consideration could also be given to extending this relief to other industries and encouraging employers and unions to mount an awareness campaign among employees to encourage take up among those who are eligible.

Exemption from benefit charge for late night taxis

B.54 Generally, where an employer reimburses any costs of travel for non business purposes (which includes an employee's ordinary commute) it is a taxable benefit for the employee. However, providing certain conditions are met[25], where an employer provides a taxi in order for an employee to travel home after work, it is not treated as a taxable benefit.

B.55 In summary, these conditions are that the number of such journeys in the tax year is no more than 60, and there has either been a failure of car sharing agreements, or all the following conditions are satisfied.

- the employee is required to work later than usual and until at least 9pm;

[23] HMRC Employment Income Manual EIM 32710
[24] HMRC estimate
[25] ITEPA 2003 s248

- it occurs irregularly; and
- by the time the employee ceases work, either public transport has ceased, or it would not be reasonable to expect the employee to use public transport.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.56 The policy rationale is that in specified circumstances, where an employee is required to work late and where public transport has ceased or it would be unreasonable for the employee to use public transport (e.g. because of the lack of reliability of the service), it would be unreasonable for the cost of an employer provided taxi to be treated as a benefit[26].

B.57 Due to changing work patterns since 1987 when the relief was introduced, in some cases, it may be difficult to continue to justify the rationale for this relief. Also, employers can now enter into PAYE Settlement Agreements ("PSA") for certain benefits (including late night taxis) provided to employees, under which the employer settles the income tax and NIC liability.

B.58 We have also received anecdotal evidence of abuse of the system with some individuals claiming more than 60 taxis a year and some claiming the relief after an evening out, rather than after work.

Taxpayer take up and awareness

B.59 This exemption is available to all UK employees, and so is very widely targeted. However, we understand that it is used predominantly by those who work late in large cities, particularly London, as elsewhere employees are more likely to drive to work. Due to the very small amounts involved, and the fact that they are not reported, it is not possible to calculate the number of beneficiaries.

B.60 However, the rules do not apply to shift workers or those who regularly work late, and so for example the police, broadcasters, a nurse or office cleaner would not be eligible.

B.61 We understand that the cost to the Exchequer of the relief is unknown as it is not possible to quantify the number of users.

B.62 We understand that one of the major law firms orders around 25,000 'late night' taxis p.a. and they have estimated that the total additional tax cost of this would be around £150,000 if there were no exemption. For such a large business, this is not a significant sum.

Complexity, compliance costs and administrative burden

B.63 As there are a number of defined conditions set out in the legislation, this exemption should not be complex for businesses to understand and should not create a significant burden in complying with the rules. However due to some of the conditions requiring qualitative decisions (e.g. what is a "usual" time to leave the office), there is some ambiguity and evidence of businesses having arguments with HMRC over which trips qualify.

B.64 Although there are requirements to show that the taxi fare has been treated correctly for the purposes of tax and NICs, this is no different to the requirements for any other benefit or expense provision. Where an employer believes that the exemption applies, necessary management checks must be in place and sufficient records kept to be able to show that the

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[26] IR Press release 25/9/87

conditions are satisfied in all cases. These checks and records should be present in most businesses for all expenses, so this is not likely to be a significant additional burden.

B.65 In the past representations have been made to HMRC that the restriction is too tightly drawn, and that the conditions should be relaxed[27]. Therefore it may not be as well used as it could be.

B.66 There is no need to account for the amounts on a form P11D, which reduces the administrative burden for both the employer and HMRC.

B.67 Abolishing the relief might increase burdens on employees, as they would have to report the benefit on a form P11D – although the employer could avoid this by entering into a PSA with HMRC. As the vast majority of the taxi fares will be charged by the taxi firm to a central account, with the individuals name on, the figures would be readily available. In the case of professional services firms, this is no more onerous than the burden of charging the individual taxi amounts to a particular client.

Box B.1: Example (provided by OTS)

X LLP is a London law firm in which staff generally leave between 6 and 7pm. However on one occasion, when they were working on a potential acquisition by one of their clients, there was a need to remain at work until 2am. One trainee lawyer (a basic rate taxpayer) usually takes the train home but by that time there were no trains running, and so she took a taxi costing £120. Because of the exemption there were no issues, however without it she would face a tax charge of £24, which would need to be reported on her P11D.

In the same firm the cleaners work night shifts between 6pm and 2am. Due to disruption on public transport, a cleaner (who is a basic rate taxpayer) takes a taxi home, incurring a £120 fare. This will either be have to be paid for out of taxed income or, if refunded by her employer, would result in a tax charge of £24 which would be reported on her P11D.

Summary

B.68 The policy rationale is not as strong as when the relief was introduced due to the way affected employees will be likely to work late regularly and the fact that a significant proportion of the workforce who might benefit cannot do so because they work shifts or permanent late hours. Even though this is a simple relief to operate, if abolished, for many there would be virtually no additional administrative burden as the costs are easily collated (and in many cases are collated already for other purposes).

B.69 We therefore recommend that this relief be abolished.

B.70 We would expect that virtually all the employers would continue to offer the facility of taxis home when late working is required. The tax cost could be settled through a PSA.

[27] HMRC comment

Trade union subscriptions and police organisations

B.71 If part of a subscription paid to a trade union[28] or police organisation[29] is used to provide superannuation, death benefits or funeral expenses tax relief is available for that part.

B.72 The maximum relief is a tax deduction of £100. Tax is therefore saved at the marginal rate of tax (i.e. 20%, 40% or 50%, depending on the income of the individual).

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.73 The relief in respect of trade unions was introduced in 1978[30] and that for police organisations in 1981[31]. The 1978 legislation was an amendment to a revised system for giving relief in respect of qualifying life assurance policies in 1976[32]. The trade union relief was put on a statutory basis in 1978 but we understand had been allowed by concession "for very many years"[33]. We understand that this concession may date back to 1915 and may be as early as 1893[34]. At the time there were few pension arrangements, and this was the only way to obtain any cover for death in service.

B.74 However as pension arrangements now generally include all of these benefits (including a lump sum to a widow(er) in addition to a pension) we believe that this relief is obsolete.

Taxpayer take up and awareness

B.75 There are around 48,500 claimants, of which 2,500 make the claim through self assessment and 46,000 have a PAYE coding adjustment. The total tax saving is around £45k for self assessment and £330k though PAYE[35].

Complexity, compliance costs and administrative burden

B.76 For the individual there is very little administrative cost. The majority claim through the PAYE code, and for those that complete a self assessment return, there is a box to tick to claim the relief.

Summary

B.77 The policy rationale is now obsolete; there is no continuing rationale as the costs are now generally covered by pension arrangements. The benefit is a maximum of between £20 and £50 each year (and is usually £20).

B.78 We would therefore recommend that it be abolished, but potentially replaced with a de minimis level for benefits, as noted in Chapter 2 above.

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[28] ITA 2007 s457
[29] ITA 2007 s458
[30] FA 1978 Sch 3 para 12
[31] FA 1981 s33
[32] FA 1976 Sch 4
[33] HMRC comment
[34] Trade Union (Provident Funds) Act 1893
[35] HMRC estimate

Luncheon vouchers – daily relief for first 15p

B.79 Generally, where an employer provides vouchers that are readily convertible to cash, including meal vouchers, these are a taxable benefit on the employee. However, where a meal voucher is provided, the value of the taxable benefit is reduced by 15p for each working day[36], where the following conditions are met:

- the vouchers must be non-transferable and used for meals only;
- they are to be used on a day the employee is at work; and
- where any restriction is placed on their issue to employees, they must be available to lower-paid staff.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.80 This relief was originally introduced in 1946 when food rationing was in place, to help employees afford reasonable meals. It was targeted at employees working for companies without workplace canteens, who did not benefit from the separate exemption available for free or subsidised meals provided by an employer in a workplace canteen. At the time of introduction the imperial equivalent was a meaningful sum, which would cover the cost of a proper cooked lunch and, whilst workplace canteens were widespread in large industrial concerns, smaller firms could not afford to have a canteen. Consequently it was the employees of these smaller firms who tended to be the beneficiaries of this relief.

B.81 Even though the policy of ensuring individuals are able to afford reasonable meals remains valid in principle, the benefit of the relief has been eroded by inflation.

Taxpayer take up and awareness

B.82 This exemption is potentially available to all employees in the country, and so is very widely targeted.

B.83 We understand that there is no information available on the number of employees benefiting from the relief but only 145 businesses use the scheme[37].

Complexity, compliance costs and administrative burden

B.84 HMRC has no separate record of its costs in administering this relief.

B.85 If a voucher for 15p were to be provided, the administrative burden would be minimal, however, in the majority of cases, higher values of vouchers are provided and the 15p must be deducted from the value of the vouchers to arrive at the correct amount to report on the form P11D. As such, this is an added minor complication for employers in completing the form, for very little benefit to the employer or employee.

Summary

B.86 This exemption no longer achieves a clear objective and as the value of the exemption has remained unchanged since 1946[38], the benefit to employers and employees has been eroded. It

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[36] ITEPA 2003 s89
[37] HMRC estimate
[38] Parliamentary debate 12 July 1979: http://hansard.millbanksystems.com/commons/1979/jul/12/luncheon-vouchers-tax-concessions

also causes an additional administrative burden to the employer in calculating the taxable benefit to be included on form P11D.

B.87 As the value is so small (a maximum of less than £55 pa), and in real terms its value is reducing over time, the additional administration of claiming is disproportionate to the benefits.

B.88 We would therefore recommend that it be abolished, but potentially replaced with a de minimis level for benefits, as noted in Chapter 2 above.

Miners' coal and allowances in lieu of coal

B.89 Free coal (or smokeless fuel in smoke control areas) received by miners, reasonable sums in lieu of, or amounts received for the surrender of any part of the free coal to which they are entitled under their agreements are not subject to income tax or NIC[39].

B.90 This exemption applies to a person employed at a colliery, other than clerical, administrative or technical staff[40], and it is limited to an amount of coal (or payment in lieu) that does not exceed the amount reasonably needed for personal use.

B.91 A similar exemption is available for retired miners and miners' widows[41].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.92 The free coal scheme was introduced in the 1950s as a result of deals struck between the unions and the coal industry. We have been unable to ascertain when the relief was introduced or its rationale, but prior to 2003, it was by concession[42].

B.93 Since 2003, the benefit would have formed part of the terms and conditions of the employment, with a reasonable expectation that it be tax free.

B.94 If this relief were repealed, where coal is provided the tax charge would be based on the marginal cost to the employer of providing it, which is likely to be small (assuming the employer still operates a coal mine).

Taxpayer take up and awareness

B.95 This allowance is available to all current and former miners or their widows. Given the significant reduction in the number of working mines since the miners' strike in 1984 - 85[43], it is likely that the benefit is now mainly provided to retired miners or widows of miners. As at December 2010 there were 48 mines with 6,020 employees[44].

B.96 The average recipient receives 4 tonnes of coal per year, which is estimated to be worth £1,375[45]. Assuming a basic rate taxpayer, where a sum is received in lieu of the coal, this equates to a tax saving of £275; where the coal is provided, it is likely to be much lower, as the

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39 ITEPA 2003 s306; SSCR 2001 Sch 3 Part 10 Para 14
40 ITEPA 307(4)
41 ITEPA 2003 s646
42 ESC A6
43 National Union of Miners 79 collieries have been closed and 100k miners jobs lost (http://www.num.org.uk/page/History-NumHistory-The-Struggle-Goes-On)
44 http://www.coal.gov.uk/media/EB0/9B/Production-and-Manpower-Returns-Oct-Dec-2010Q4.pdf
45 The Star (South Yorkshire newspaper) website: http://www.thestar.co.uk/news/Attack-on-miners39-free-coal.6632989.jp (November 2010)

benefit would be based on the cost to the employer (assuming they are still involved in coal production).

B.97 Around 84,000 people are provided with this benefit, from around the country, mainly in Northern England and the Midlands. Of this number, 68,733 currently receive payments[46] and 15,400 receive coal[47].

B.98 Generally it is claimed by elderly people, often widows[48] and so may be covered by the personal allowance.

Complexity, compliance costs and administrative burden

B.99 As it is an exemption, it is a simplification for the employer providing the benefit as there is no need to account for the tax and prepare P60s, P35s or P11Ds; employers should be familiar with the processes and have all the necessary information to hand to account for tax.

B.100 Without the relief, any recipient who was not an employee may need to prepare a tax return to account for the tax, which would be minimal. The employer could pay the tax under a PAYE Settlement Agreement.

B.101 For HMRC it is a simplification, as there is no need to adjust coding notices.

Summary

B.102 Even though the tax savings are relatively small, and the number of claimants is reducing as coal mines close, this benefit was part of the terms and conditions when the individual started working in the mine and it is a major simplification for both the employer and the employee.

B.103 It is however questionable whether the policy rationale, such as it is, is still valid, especially as the majority receive payments in lieu of coal, the tax savings are relatively small and the number of claimants is reducing due to reduction in the number of miners and the likely age profile of the recipients.

B.104 We recommend that this relief be abolished. We think that could be achieved by a one-off gross up/uplift of the existing cash benefit with those who still receive coal being moved to a cash benefit.

Divers and diving supervisors – NIC Class 4 Exemption

B.105 Any diver or diving supervisor ("diver") who is employed and performs the duties in the UK or in UK waters is treated as self employed for income tax purposes[49]. For all other purposes (including NIC) they are treated as employed.

B.106 Therefore the divers are subject to Class 1 NIC, and this exemption ensures that they are not subjected to Class 4 as well[50].

[46] The Star (South Yorkshire newspaper) website: http://www.thestar.co.uk/news/Attack-on-miners39-free-coal.6632989.jp (November 2010)
[47] The Northern Echo website http://www.thenorthernecho.co.uk/news/8679775.Miners____free_coal____a_relic_and_should_be_scrapped___/
[48] The Star (South Yorkshire newspaper) website: http://www.thestar.co.uk/news/Attack-on-miners39-free-coal.6632989.jp (November 2010)
[49] ITTOIA 2005 s15
[50] SSCR 2001 Reg 92

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.107 This relief is a fundamental part of the special regime for divers as it prevents double taxation and therefore cannot be reviewed in isolation. However it may be appropriate to review the regime as a whole.

B.108 The regime was introduced in 1978[51] to ensure fairness amongst divers of all nationality and employment status when engaged on the UK continental shelf. This is because at that time, the divers had to pay their costs themselves, and therefore being taxed as self employed ensured they were able to obtain relief for these expenses.

B.109 However since then, we understand that many employers have made agreements with the trade unions that they will cover these costs. It would therefore appear that there is no ongoing rationale for this regime to be retained.

B.110 It should also be noted that due to the development of double taxation treaties since that time, even though non UK resident divers remain liable to UK NIC, this regime means that they are not liable to UK income tax. In addition, as many do not spend 183 days in their home country, they are not subject to tax anywhere.

Taxpayer take up and awareness

B.111 There are around 1,300 divers who are impacted by these rules[52], although in some years this can be as low as 800[53].

Complexity, compliance costs and administrative burden

B.112 This regime introduces complexities for the divers as they need to prepare self assessment returns and keep records.

B.113 In addition, we understand that a number of divers have been declared bankrupt as they were unable to pay their tax[54]. If these individuals had been treated as employed, all tax and NIC would have been taken at source under PAYE.

B.114 The regime also creates complexity for HMRC, as there is a need to process and review tax returns and ensure that payments are made, whereas under PAYE there would be fewer returns prepared by the employers.

B.115 Repealing the regime is unlikely to create a significant administrative burden for the employing companies, as much of the standing data is already held due to the NIC requirements and many of the annual and monthly returns to HMRC are already filed for NIC purposes.

Summary

B.116 The original policy rationale for the regime is no longer valid and it creates much more complexity for the individuals concerned. In addition, it may also lead to many individuals avoiding tax.

[51] FA 1978 s29
[52] Representation from the National Union of Rail, Maritime and Transport Workers ("RMT")
[53] Representation from RMT
[54] Representation from RMT

B.117 We would therefore recommend that the regime in ITTOIA 2005 s15 be repealed. As a consequence of this, the relief for Class 4 NIC will become redundant.

B.118 A further issue that this relief highlights is the disparity between the base for income tax and NIC. During our work, a consistent theme that has arisen in meetings with taxpayers and advisers is the issue of aligning income tax and NIC, as there are a number of areas where the rules are different, and this is a major cause of complexity. This is explored further in Chapter 2 of this report.

Payments as reward for assistance with lost or stolen credit cards

B.119 If an employee (e.g. of a bank or a retailer) assists in identifying or recovering lost or stolen credit cards, debit cards, cheque guarantee cards or charge cards in the course of their employment, they may receive a reward from the card issuer.

B.120 This payment is subject to income tax under PAYE by their employer; however it is not subject to NIC[55].

B.121 This relief does not extend to employees of the card issuer.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.122 This relief prevents employees being liable to NIC charges on payments over which they have no control. Prior to its introduction in 2001, NIC was not charged, however a review at that time determined that, as these payments were treated as earnings, NIC should have been levied. This relief was introduced to provide certainty[56].

Taxpayer take up and awareness

B.123 It is unknown how often this relief is used (or indeed how often such a reward would be made) as it is an exemption and therefore not reported; we believe that a typical payment would be around £50[57].

B.124 The relief is available to any individual, anywhere in the UK, who could come into contact with lost or stolen credit cards. The majority of individuals are likely to work in retail, (which employs around 2.9million people[58]) or in bank branches (of which there are 11,220)[59].

Complexity, compliance costs and administrative burden

B.125 The relief reduces the administrative burden for the employer as there is no need to keep records of payments made to their staff.

Summary

B.126 The rationale of simplification for the employer is less valid, as the payment needs to be recorded to enable PAYE to be deducted, and with the IT systems in place for most employers, there is little administrative saving. In addition, the value per reward is negligible.

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55 SSCR 2001 Sch 2 Para 15 Part 10
56 Inland Revenue Bulletin 54: The Social Security (Contributions) (Amendment No 5) Regulations 2001
57 Inland Revenue Bulletin 54: The Social Security (Contributions) (Amendment No 5) Regulations 2001
58 http://www.prospects.ac.uk/industries_retail_overview.htm
59 http://www.telegraph.co.uk/news/uknews/7549591/Banks-have-closed-434-branches-in-three-years.html

B.127 We recommend that it be abolished, but potentially replaced by a de minimis level for benefits, as noted in Chapter 2 above.

B.128 This relief does highlight however a further complication that can arise due to income tax being based on an annual earnings period, but NIC on a weekly period, and abolition would help to align the rules.

Employment related securities for disabled employees

B.129 Generally, where a benefit is received by an employee, or an associated person, in connection with an option over shares, the benefit will be taxable as employment income (subject to the various HMRC-approved schemes).

B.130 In practice, this is most likely to occur when an employee leaves their job and receives compensation, as some of this compensation would relate to the options.

B.131 However, where this benefit is received due to any disability of the employee, it is not subject to income tax[60].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.132 We are unable to locate the original policy rationale.

Taxpayer take up and awareness

B.133 There is no information available.

Complexity, compliance costs and administrative burden

B.134 There is no information available.

Summary

B.135 Due to a lack of information, we are not able to reach a conclusion as to whether this relief should be retained or abolished. The lack of evidence or representations do suggest it is little used but it may be best to consider it in the context of a general review of share schemes taxation.

Welfare counselling

B.136 Generally, the provision by an employer of counselling facilities to an employee is a taxable benefit, however certain services are exempt[61].

B.137 Examples of these are counselling for stress, problems at work, debt problems, alcohol and other drug dependency, bereavement, ill-health, harassment and bullying and personal relationship difficulties.

[60] ITEPA 2003 s477(5)
[61] SI 200/2080

B.138 Specific exclusions from the exemption are medical treatment of any kind, advice on finance (other than debt problems), tax, leisure or recreation, or legal issues.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.139 This relief was introduced in 2000[62] as part of a number of minor changes brought in following the extension of Class 1A NIC to all taxable benefits.

B.140 Even though prior to this relief such services were taxable, in practice, if they were available to all employees the assessable benefit per employee may have been small and tax may not have been charged[63]. This relief was brought in to simplify the taxable benefits calculation, by exempting a negligible benefit.

Taxpayer take up and awareness

B.141 As it is an exemption there are no figures available for the number of businesses and individuals affected. However, it is most likely to be used by larger employers.

Complexity, compliance costs and administrative burden

B.142 The definition of qualifying counselling is tightly drawn and well defined; consequently if an employer only offers these specific services then it will be simple to operate. However, welfare counselling is often provided by employers as part of a general employee assistance programme which includes services not covered by this relief. Difficulties are sometimes encountered in understanding which services are covered, as well as the status of the whole assistance programme when some are covered and some are not.

B.143 Expanded guidance was issued in 2008 surrounding these issues and this has resolved some of these difficulties[64]. This guidance states that a common sense approach should be taken by Inspectors, for example where a programme "consists substantially of facilities that satisfy the terms of the exemption" the entire scheme could be exempt[65].

B.144 If the relief were abolished, it would be straightforward to calculate the benefit, but would increase the number of P11D entries for small amounts and is likely to include a number of employees who do not currently submit a P11D.

Summary

B.145 The policy rationale of simplification remains valid as in most cases the benefit per employee is small, and following the 2008 guidance, the relief remains a simplification.

B.146 However, as the benefit is negligible we recommend that this relief be abolished, and as an alternative, consideration could be given to replacing it with a de minimis level for benefits as noted in Chapter 2 above.

[62] SI 2000/2080
[63] IR Press release 19 Nov 1999
[64] HMRC information
[65] HMRC Employment Income Manual EIM 21845

Loans to employees where interest qualifies for tax relief

B.147 Generally, if an employer makes a loan (greater than £5,000) to an employee on which interest is either not charged or is charged at a low rate, the difference between that and HMRC's official rate of interest (4% for 2010/11[66]) is a taxable benefit.

B.148 However, there will not be a benefit where the loan was taken out for a qualifying purpose, such as to buy a life annuity, to acquire assets or shares in a partnership or company, or where the interest (had it been paid) would be deductible in computing profits of a UK business carried on by the borrower[67]. Tax relief is available for interest on loans for these purposes.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.149 This relief was introduced to be an administratively simple method of providing relief on interest payments for qualifying loans. In the absence of this relief, the employee would pay tax on the beneficial loan and then have to claim relief on the interest payments. With this relief, both are treated as exempt.

Taxpayer take up and awareness

B.150 The number of users of this relief is unknown.

B.151 There is not expected to be any savings from this relief, as it is purely for administrative ease.

Complexity, compliance costs and administrative burden

B.152 This relief is a simplification, as it means that an employer does not have to report a taxable benefit and the employee does not need to claim relief.

Summary

B.153 The policy rationale remains valid, and the relief is a simplification for the employee, the employer and HMRC (as the P11D entries and tax return claim do not need to be processed).

B.154 We therefore recommend that this relief is retained.

Security expenses

B.155 Where an employee or director faces a threat to their personal physical security, provision of security assets or services by the employer may not be subject to tax or NIC[68].

B.156 In order to obtain the relief, there are a number of conditions to be met, of which the main ones are[69]:

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[66] http://hmrc.gov.uk/rates/interest-beneficial.htm
[67] ITEPA 2003 s178
[68] ITEPA 2003 s377; SSCBA 1992 s10(7A)
[69] ITEPA 2—3 s377(1)

- the security asset or service is provided for or used by the employee to meet a special threat to his or her personal physical security;
- that threat arises wholly or mainly because of the employment; and
- the sole intention behind the provision of the asset or service is the employee's safety.

B.157 The relief is intended for people whose work exposes them to a very real threat to their physical safety from terrorists, extremists and others who may resort to violence. No relief is allowed for general security measures that anyone may face or security for property.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.158 This relief was introduced in 1989[70] when there was a special threat from terrorism, particularly from the IRA, towards certain individuals. An example was the fatwa declared on Salman Rushdie in 1988, following the publication of "The Satanic Verses".

B.159 The original rationale remains valid as there continues to be a threat towards certain individuals from, for example animal rights protestors[71].

Taxpayer take up and awareness

B.160 The relief is very tightly targeted and so the number of users is expected to be very small. There have been representations made that the conditions should be relaxed and it should apply to any security asset or service.

Complexity, compliance costs and administrative burden

B.161 The rules are very tightly drawn and therefore it is generally simple to confirm whether or not the relief applies. As the benefit is not subject to tax, there is no need to complete a P11D or deduct tax through the payroll.

B.162 A relaxation of the rules would lead to uncertainty as to exactly which assets and services could be included, although consideration could be given to an exemption for other specifically employment related threats.

Summary

B.163 For the individuals and employers involved, the relief is simple to operate, and as the threat arises solely due to the employment, it would be unfair for this to be taxed.

B.164 We recommend that it is retained.

NICs – disregard for certain apprentices and students coming to the UK

B.165 Generally, Class 1 NIC will be payable by all employees if resident or present in the UK. However, an individual who is not ordinarily resident in the UK and meets one of the following criteria, will not be liable for Class 1 NIC for the first 52 weeks[72]:

[70] FA 1989 ss50-52
[71] See for example http://www.bbc.co.uk/news/uk-england-11600398 concerning Huntingdon Life Sciences

- The UK employment is during a vacation from a course of full time studies outside the UK, and the employment is of a nature related to the course of studies (the "student exemption"); or
- The UK employment is related to an apprenticeship which the individual is serving under a person outside the UK and it began before he was 25 (the "apprentice exemption").

B.166 The exemption does not apply to individuals from within the EEA or from countries with which the UK has a Reciprocal Agreement or Double Contribution Convention.

B.167 Income tax will be due if the earnings in the UK exceeded the personal allowance.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.168 The student exemption was originally introduced to enable students from the British Empire to come to the UK to do temporary work without having to join the UK social security scheme. It was maintained in order to assist farmers in obtaining cheap casual labour.

B.169 It is less relevant now given the new immigration rules prioritising EU nationals, although it may still be relevant in the NHS where certain foreign medical students can obtain paid work during vacations to develop their skills.

B.170 The apprentice exemption was originally aimed at ensuring that certain apprentices who had to come to the UK temporarily as part of their apprenticeship did not have to join the UK social security system. The rationale was that apprentices from elsewhere in the British Empire could learn their trade here and then return home with their skills.

Taxpayer take up and awareness

B.171 As noted above, the student exemption remains used in a few limited cases. It is not known how many apprentices benefit from this exemption, but it is not estimated to be a large number.

Complexity, compliance costs and administrative burden

B.172 This is straightforward legislation and results in a reduced administrative burden for employers as there is no need to account for NIC or report to HMRC on the employees in question. However, in the context of the employer already operating a payroll and reporting to HMRC, as all those affected by this relief will almost certainly do, it actually adds a layer of complexity through having to apply different procedures to different employees.

Summary

B.173 Given the limited use and the fading rationale, we would recommend that this relief be abolished. However, prior to this, consultation may be required with the NFU, the Home Office and Department of Health and possibly the Department for Work and Pensions.

B.174 Again, this relief highlights confusion that can occur due to differences between income tax and NIC, in particular due to income tax being based on an annual earnings period, but NIC on a weekly period.

[72] SSCR 2001 Reg 145(3)

Exemption from Class 1A NICs on certain payments by way of securities

B.175 The following payments by way of, and gains arising from, securities, restricted securities, and restricted interests in securities, are exempt from Class 1A NIC[73]:

- Grant of an option to acquire securities;
- An allocation of shares in priority to members of the public;
- A payment deducted from earnings under a partnership share agreement;
- An award of shares under a share incentive plan; and
- An acquisition of securities, unless they are readily convertible assets ("RCA"). In broad terms an RCA is a security that can easily be traded (e.g. a share in a listed entity).

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.176 This relief was introduced to mirror the tax exemption on the same payments and encourages employers to incentivise employees by way of shares.

B.177 If this relief (and the tax exemption) were removed, share incentive schemes would become much less attractive.

Taxpayer take up and awareness

B.178 As this is an exemption, it is unknown how many people use it.

Complexity, compliance costs and administrative burden

B.179 The legislation is relatively straightforward and, as it is automatic and limits the number of chargeable events, is a simplification as the individual and employer only need to consider NIC in much more limited, tightly defined circumstances. Generally it is limited to times when the employee has received readily monetisable value, with which to pay any tax.

Summary

B.180 As this is a simplification and ensures there is no tax charge until such time as the employee is able to acquire cash with which to pay the tax, we would recommend that this is retained.

B.181 However an issue that this relief does raise is the number of different reportable events that can occur in respect of share schemes. We would recommend that the whole area of employee share schemes be reviewed with a view to simplification, due to the plethora of different schemes in existence with slightly different benefits, conditions and tax impacts.

[73] SSCR 2001 Sch 3 Paras 3, 5, 6, 7, 7A, Part 9 and Reg 40(2)(c)

Disregard for benefits subject to unauthorised payment charge

B.182 The government provides tax relief for saving through registered pension schemes and certain overseas schemes. This relief is given on the basis that the pension is taxed when it is taken.

B.183 However, where a scheme makes a payment that is not authorised the payment is subject to an "unauthorised payment charge"[74] i.e. an increased income tax charge.

B.184 This relief ensures that unauthorised payments are not subject to Class 1 NIC[75], so there is no NIC liability for the employer, scheme or individual in addition to the unauthorised payment charges.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.185 The rationale behind the relief is to ensure that employer contributions will not attract NIC liabilities, which, when considered together with the unauthorised payment charge may be considered to be excessive.

B.186 It is considered that the policy rationale is still relevant, the measure achieves the objective and there is no cost effective alternative method to achieve the same objective.

Taxpayer take up and awareness

B.187 There are millions of individuals who are members of pension schemes; however this measure only affects those who receive unauthorised payments. Whilst the number of taxpayers receiving unauthorised payments is not known, HMRC consider that the level of the unauthorised payment charge acts as a significant deterrent to a pension scheme from making such payments.

B.188 As the income tax charge acts as a deterrent to unauthorised payments, the revenues lost from this exemption are not considered to be significant[76].

Complexity, compliance costs and administrative burden

B.189 The legislation is not considered to be complex.

B.190 There are no compliance costs or administrative burdens arising as a result of not charging NICs on unauthorised payments, apart from its being another example of the general difficulties caused by differences between income tax and NIC rules.

Summary

B.191 The relief is still relevant and should be retained.

[74] FA 2004 s208
[75] SSCR 2001 Sch 3 Part 6 Paras 2(b)(ii) and 3(1)(e)
[76] HMRC

Contracted-out rebate occupational schemes

B.192 The state pension is currently provided in two distinct parts – a basic flat rate amount and an additional amount based on earnings

B.193 For employees with earnings above the lower earnings limit for Class 1 NICs (£5,044 in 2010/11[77]), it is possible to opt out of the additional state pension and join a private pension scheme instead. This is 'contracting out'. It is not possible to leave the basic state pension.

B.194 If an employee chooses to contract out by joining the employer's occupational pension scheme, both the individual and the employer pay reduced rate NIC[78]. On retirement, the second pension will be the employer's scheme and not the additional State Pension.

B.195 It is also possible to contract out with a stakeholder pension or a personal pension. Rather than pay reduced NIC, an annual rebate is paid directly to the pension by HMRC.

B.196 The rebates are intended to provide benefits broadly the same as the additional State Pension given up.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

B.197 This relief was introduced in 1961. It is unclear what the original policy rationale was.

B.198 The rules for contracting out of the additional State Pension will change in 2012, and from that time, it will not be possible to contract out through either of the following schemes:

- a defined contribution occupational pension scheme ; and
- a personal pension or a stakeholder pension.

B.199 It will still be possible to contract out through a defined benefit scheme; however, this may be reviewed in the future.

Taxpayer take up and awareness

B.200 In 2010/11 the total tax savings from this relief are estimated to be £9.1billion[79].

Complexity, compliance costs and administrative burden

B.201 The decision of whether to contract out needs to be reviewed each year, which will depend on attitude to risk, as the additional state pension is likely to be lower risk but have less potential for growth. For many people, this means that financial advice is required each year.

Summary

B.202 This relief is being withdrawn from 2012 for most pensions and is now only relevant for defined benefit schemes.

B.203 We recommend that the relief be abolished for all schemes from 2012, as this would align the treatment of all schemes and provide a simplification for employers and employees that participate in more than one scheme.

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[77] http://hmrc.gov.uk/paye/rates-thresholds.htm
[78] SSCBA 1992 s8(3); PA 1993 s41(1) - (1D)
[79] HMRC estimate

C Capital allowances

C.1 Capital allowances allow businesses to write off the cost of certain capital assets, including plant and machinery, against their taxable income and so take the place of accounting depreciation. For the majority of plant or machinery assets, capital allowances are available at 10% for long life assets, or 20% for the plant and machinery pool (to be reduced to 8% or 18% respectively from April 2012[1]), both on a reducing balance basis.

Annual investment allowance

C.2 The Annual investment allowance ("AIA")[2] allows a tax deduction equal to the lower of:

- Total expenditure on plant and machinery and integral features (with some exceptions, for example cars) in a period; or
- £100,000 for 2010/11[3] (pro rated for periods longer or shorter than a year).

C.3 Any expenditure in excess of £100,000 is eligible for the usual writing down allowances of 20% or 10%.

C.4 In April 2010, the allowance was increased from £50,000 to £100,000; however from April 2012 it is being reduced to £25,000[4].

C.5 The £100,000 allowance is split between members of a group and businesses under common control.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

C.6 This relief was introduced from April 2008 "to target support on all businesses that are investing for growth"[5], to simplify the tax affairs of businesses, especially smaller ones and also to provide an incentive to invest in capital assets, thus allowing for business expansion.

C.7 From April 2012 when the AIA reduces to £25,000 it is expected to cover all the qualifying expenditure of 95% of UK businesses[6] and so for those businesses the simplification rationale appears to be achieved. We do have to record that this 95% figure has been regularly questioned in our meetings with businesses and advisers. It has also been frequently pointed out that £25,000 does not cover a wide range of the single-machinery purchases undertaken irregularly by small businesses, for example farmer. Finally, we also have to record that unincorporated businesses have not seen an equivalent reduction in tax rates as have those subject to corporation tax – something that has been stressed as giving compensation for the reduction in allowances. We return to this point in our Small Business report.

[1] 22 June 2010 Budget, Red Book, para 2.75
[2] CAA 2001 ss38A, 38B
[3] FA 2010 s5(1)
[4] 22 June 2010 Budget, Red Book, para 2.76
[5] 21 March 2007 Budget, Red Book, para 3.23
[6] HMRC estimate

C.8 There is no evidence to suggest that the AIA has provided an incentive to invest in plant and machinery and most investment decisions are based on a commercial need for the asset. For small businesses it is likely that when making the decision to invest in capital assets the tax relief is taken into account.

Taxpayer take up and awareness

C.9 This allowance is available to all businesses in the UK and we understand it is widely used.

Complexity, compliance costs and administrative burden

C.10 For smaller companies, especially those with lower capital spend the AIA is a simplification as it removes the need to allocate fixed asset additions to capital allowance pools, for which separate records need to be maintained. It can also impact adversely on cash flow, as one year's profits are artificially reduced, but no allowances are available in later years. Some accountants have suggested that capital allowances should follow the accounts depreciation.

C.11 However, for larger groups with high capital expenditure it can be considered a complication as it is an additional column in the analysis of fixed asset additions, and the maximum additional tax relief in the first year for companies of £25,200[7] (to be £5,980[8] from 2012) is negligible. In most of these cases, rather than considering the most appropriate entity to allocate to, the relief is all allocated to one company for simplicity. It must be noted though, that the relief is optional, so this complication can be avoided.

C.12 For companies and groups with smaller amounts of capital expenditure, the AIA adds further complexity, as consideration needs to be given as to which companies should receive the allowance, as it may not all be usable by one entity. The reduction in limits may simplify matters for such groups as it is more likely to be usable by one of the companies and so there is no need to decide how to allocate it between group members.

C.13 A particular problem for groups is that if, during preparation of the tax return, the eligible amount in one company changes, there is often an impact on other companies around the group, resulting in further amendments to tax returns. In particular, where some group members are loss making, the impact on, and interaction with, group relief adds a further layer of complexity.

C.14 According to representations made to us by tax advisers, the greatest complexity has arisen from the changing limits; since its introduction in April 2008, the maximum allowance changed in 2010 and is due to change again in 2012. The complexity is exacerbated for businesses with accounting periods other than those coinciding with the end of the tax year, as the allowance has to be pro-rated, leading to more complex calculations.

Summary

C.15 We recommend that the relief is retained but that the limits are fixed and remain unchanged for a number of years, before being increased to take into account inflation. We will also be commenting on this in our Small Business report.

[7] (£100k x 28%) – (£100k x 28% x 10%) = £25,200. 28% being the current main rate of corporation tax, and 10% being the current special capital allowances rate.

[8] (£25k x 26%) – (£25k x 26% x 8%) = £5,980. 26% being the main rate of corporation tax in 2012/13 and 8% being the special capital allowances rate in 2012/13.

Capital allowances – short life assets

C.16 In order to simplify plant and machinery allowances, the majority of assets are combined into one 'pool' on which allowances are calculated each year. When an asset is disposed of the sales proceeds are deducted from the relevant pool, thus reducing the balance and future allowances. If an asset is sold for less than its tax written down value, a balance of unrelieved expenditure in respect of that asset will remain in the pool against which allowances will only be available on a reducing balance basis.

C.17 Alternatively, it is possible to make a short life asset ("SLA") election so that the asset is treated as an individual asset rather than part of a pool[9]. This individual asset is retained for a maximum of four years, and the allowances available are identical to those that would have been claimed had it been in a pool. If the asset is sold or scrapped within those four years, after deduction of the sale proceeds, the balance of the expenditure is available as a deduction, or balancing allowance, in the year of sale, thus accelerating the tax relief. If the asset is not sold or otherwise disposed of in that time, the balance of the expenditure is transferred to the plant and machinery pool and it is treated as though the election was never made.

C.18 If the asset is sold within the four years for an amount greater than the tax written down value, a tax charge will arise.

C.19 This election is primarily used for computers that typically have a useful life of less than four years, at which point they have nil or negligible value.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

C.20 This relief was introduced in 1985[10] following representations from businesses concerned about the cashflow implications of being unable to write off the full cost of assets with a short life for tax purposes.

C.21 In the absence of the SLA election, it would take approximately 11 years to obtain relief for 90% of the cost of the asset.

C.22 The AIA means that 95% of businesses do not need to be concerned with the SLA rules; however the SLA election is still important for larger businesses.

Taxpayer take up and awareness

C.23 This relief is available to all UK businesses as it can apply to any capital expenditure on plant and machinery. The estimated tax savings for businesses from the SLA election are unknown.

C.24 In 2005, around 150,000 businesses made the election[11], although this is likely to have reduced following the introduction of the AIA (although no data on this is available).

Complexity, compliance costs and administrative burden

C.25 The election is available for any asset that is eligible for plant and machinery allowances (apart from cars) and so it is not complex to confirm which assets qualify. The election is simple to make as it can be made by a statement in the tax return and the relief is based on the facts

[9] CAA 2001 ss83 – 89
[10] FA 1985 s57
[11] HMRC Standard Cost Model

(i.e. the actual use) rather than on an expected life of the asset that has to be that is estimated when the election is made. If the actual life is in fact more than four years, there is no lost relief.

C.26 Anecdotal evidence is that the election is popular (especially with those businesses investing heavily in computers and information technology) as it enables a business to obtain tax relief more in line with commercial depreciation for short life assets.

C.27 Identifying and tracking the assets involved can present problems. If a business only has a few assets there is less of a problem, but for a business that acquires many short life assets each year, it is often difficult to confirm exactly which asset is disposed of and when it was acquired. In addition, if an SLA election is made for all assets acquired the tax return can be very lengthy. We understand that a number of businesses that could benefit from this relief do not make the election due to the record keeping requirements and, as it is only a timing difference, it is not worth the improvements necessary in their record keeping systems.

C.28 HMRC have issued a statement of practice[12] under which it is possible to aggregate fixed asset additions in a year into classes of assets (e.g. "computer equipment") rather than maintaining details of separate assets (the "aggregation method"). The statement of practice describes the calculation that should be followed if all assets in a pool are not all disposed of at the same time. The requirement is that records are kept to show that assets can be tracked; however it also recognises that it is not always reasonable to keep track of each separate asset and agreements can be reached with HMRC over the extent to which assets can lose their identity.

C.29 The estimated tax savings from the SLA election are unknown. However, as this relief is a timing difference, as it only accelerates the tax allowances available, rather than providing additional relief, the actual savings for each company is therefore the cost of capital for the company concerned.

C.30 The estimated compliance costs were £4million p.a. in 2005[13]; however this is likely to be less after the introduction of AIA (although no data is available).

Summary

C.31 The rationale remains valid, especially with the reducing rate of capital allowances from April 2012. Whilst it is likely to be used less following the introduction of the AIA, it remains important for many businesses.

C.32 For those businesses where records may not be sufficient to identify every asset, and where it is not feasible to use the aggregation method, the election is not applicable. Therefore for those entities, repealing the election would not be a simplification.

C.33 We recommend that it is retained. Consideration could be given to specifying the types of asset which qualify to increase clarity for all those involved and allow advance claims.

C.34 This relief, and the preceding Annual Investment Allowance, does raise the question of whether capital allowances should be replaced with tax-deductible depreciation. That is clearly a major subject but it is one that has been suggested to us many times; equally, we have heard from many people that no such change should be made. We will be commenting further on this issue in our Small business report, but it is a topic that would need a major study before reaching a proper conclusion.

[12] Statement of Practice SP 1/86
[13] HMRC Standard Cost Model

Capital allowances – enhanced capital allowances for energy and water efficient technologies

C.35 Enhanced capital allowances ("ECAs") enable a business to claim 100% first-year capital allowances on their spending on qualifying plant and machinery. There are five schemes but only two are subject to review here:

- Energy-saving plant and machinery[14]; and
- Water conservation plant and machinery[15].

C.36 The others are very low CO_2 emission cars[16] (see below), gas refuelling equipment[17] and zero emission goods vehicles[18].

C.37 ECAs enable a business to obtain a tax deduction for all of the capital expenditure on qualifying technologies against taxable profits of the period during which the investment is made.

C.38 The qualifying technologies and products are specified in either the Energy Technology List or the Water Technology List[19]. The lists also contain the energy and water efficient criteria that have to be met for inclusion in the scheme. The products on the lists have been approved as meeting these criteria. In some cases expenditure on certain technologies, for example combined heat and power systems, must be certified by DECC[20] or Defra[21] as meeting the criteria.

C.39 In 2008 a payable tax credit was introduced, for an initial five year period, to complement the scheme and to address concerns that the scheme was only of benefit to profitable companies. This allows loss making companies to surrender losses attributable to ECAs in return for a payable tax credit equivalent to 19% of the cost of the asset.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

C.40 This relief was introduced as part of a package of measures "to reward businesses investing in energy saving improvements"[22]. The relief was designed to support the Government's programme to manage climate change by encouraging businesses to acquire 'green' assets rather than more polluting alternatives.

C.41 The UK has a legally binding commitment to reduce carbon emissions by 20% by 2020 compared to 1990 levels and 80% by 2050[23]. The Carbon Reduction Commitment ("CRC")[24] is designed to improve energy efficiency by large private and public sector organisations. The Government's stated aim is to be the 'greenest government ever'[25] and create a greener tax system. Therefore the relief has a continuing rationale; however, as it is almost ten years since

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[14] CAA 2001 s45A
[15] CAA 2001 s45H
[16] CAA 2001 s45D
[17] CAA 2001 s45E
[18] F(No 3)A 2010 s18
[19] http://www.eca-water.gov.uk
[20] Department of Energy and Climate Change
[21] Department for Environment, Food and Rural Affairs
[22] Budget speech, 7 March 2001: www.webarchive.nationalarchives.gov.uk/20100407010852/http://hm-treasury.gov.uk/bud_budget01_speech.htm
[23] 22 April 2009 Budget
[24] Climate Change Act 2008
[25] David Cameron, speech to DECC civil servants,14 May 2010

the scheme was introduced[26], it does seem appropriate to question how successful it has been in achieving the policy objective.

C.42 Encouraging behaviour through the tax system remains a policy objective, and there are a number of other tax incentives designed to encourage behaviour to reduce environmental impacts, for example, the role of CO_2 emissions in the taxation of company cars.

C.43 Whilst the annual investment allowance ("AIA") means that the great majority of businesses do not need to be concerned with the scheme, it is still important for larger businesses.

C.44 It could be argued that the AIA has led to the tax system being incoherent, as this provides the same cashflow benefit as ECAs, even if the asset is damaging for the environment.

Taxpayer take up and awareness

C.45 This relief is available to the entire range of UK businesses, as it could apply to a wide range of capital expenditure, although the payable tax credits are only available to loss making incorporated businesses.

> Box C.1: Example (provided by our Consultative Committee)
>
> Company X, which manufactures products that could qualify for ECAs, believes the process for getting its products recognised under the scheme is too bureaucratic, expensive and time consuming. In addition, having a product on the list of equipment that qualifies for ECAs provides little economic benefit for the company, as a general lack of awareness of ECAs limits the demand impact. As a result, the company does not get the products listed.
>
> Therefore, in this company's experience, the relief is not acting as an incentive to invest. However, there are other businesses that do find it worthwhile to get products accredited.

C.46 We understand that certain major retailers with corporate social responsibility ("CSR") policies that include energy saving objectives are now using ECAs as a metric to measure improvements.

C.47 Through discussions with tax advisers and businesses, we understand that the relief has very little impact on the decision of which asset to buy. In addition, the cash payment alternative for loss making companies has had minimal impact as the assets on the list are considered to be more expensive than alternative assets, even taking the tax credit into account, although companies generally want to invest in the most fuel efficient assets to keep utility costs down.

C.48 An evaluation of the scheme by HMRC in 2007 indicated that there is some impact on investment decisions made by businesses, but other factors may play a greater role[27].

C.49 By 2007, a total of 7,000 claims had been made[28], which is considered low by HMRC. However, the introduction of the AIA in 2008 is likely to have adversely affected the impact of the scheme. As it is estimated that the current AIA threshold of £100,000 per company/ group[29] covers the full cost of most plant and machinery investment for 98% of businesses (and even the

[26] FA 2001 s65
[27] http://www.hmrc.gov.uk/research/report-54.pdf
[28] HMRC estimate
[29] FA 2010 s5

planned reduction to £25,000 from April 2012[30] will cover the investment of the majority of businesses), it will now primarily be larger businesses that use ECAs.

C.50 If the scheme were to be abolished, it is possible that large energy and water consuming businesses would be adversely affected and it may also adversely affect the low-carbon industry sector, contrary to the Government's objectives in this area.

Complexity, compliance costs and administrative burden

C.51 One of the major problems is that the list of assets that are eligible for the scheme is very specific, in that it details qualifying products, manufacturers and product serial numbers. In certain cases the listed qualifying products are components in larger items, for example a motor in a conveyor belt. To avoid apportionment difficulties, the scheme provides that a particular claim value be attributed to that product.

Box C.2: Example (provided by our Consultative Committee)

Company X is a metal treatment firm that is concerned about energy efficiency because of rising energy costs; however the firm only uses ECAs on a very limited scale. While its applications for ECAs were approved, the company found the process cumbersome and administratively intensive. In the firm's view, unless it has changes in large items of equipment, it is not worth its while and its accountants don't see any merit in it.

C.52 The value is identified using claim value tables. For example a £100,000 conveyor belt might incorporate a motor that attracts a 100% allowances. The list will value that motor at £10,000 and that is the value that will qualify. The remaining £90,000 of the machine qualifies for normal writing down allowances.

C.53 We have received a number of examples from Defra of larger taxpayers for whom the relief on water saving technologies has provided significant benefits. For some of these entities that purchase a large number of assets (e.g. urinal controls), it may be possible to agree with HMRC that, say, 85% of their purchases will be of a type that qualify. Thereafter, rather than analyse each asset, 85% of expenditure on those types of assets will qualify.

C.54 Even though many businesses will not have a need for the scheme due to the AIA, some small or medium sized businesses can still use it, however they are much less likely to than a larger business, as the administrative burden of ascertaining whether one asset is on the list is the same as checking whether 1,000 of the same assets are on the list, and so the administrative cost per asset is much higher.

C.55 We also understand that when an office or factory is fitted out, it is not always known whether there are any eligible assets, as the contractor is not always aware of the scheme and the separation of the purchasing and tax functions means that it is not always brought to the contractor's attention. To find out about the scheme would mean the taxpayer contacting the supplier, and often there may be no direct contact. Therefore, unless specialist capital allowance advice is sought during the early stage of a project, it is difficult to ascertain either the qualifying spend or qualifying assets.

C.56 One common criticism that we are aware of is the lack of frequency of updating the list so that the most efficient assets are not listed; by the time an asset is added it has been superseded by new technology. In addition, assets are often removed from the list without notice and so

[30] Red Book 1.61 – Budget 22 June 2010

claims may be made that are invalid. However we understand from The Carbon Trust that product applications can be processed in 10 days[31].

C.57 Given the number of products on the list, many manufacturers do feel it is worth the additional administrative burden to ensure a product is certified. However, this is a commercial decision and we have received anecdotal evidence that some manufacturers feel that it is not a driver of sales.

C.58 The estimated savings from of the ECA scheme is £80million per annum[32]. However, as the scheme only accelerates the tax allowances available for profitable companies, this is only a timing difference and does not provide additional tax relief. The actual savings for each company is therefore the cost of capital for the company concerned.

C.59 There is also a cost to DECC and Defra of ensuring the lists are up to date, but this is estimated to be only £3million p.a.[33] in total.

C.60 For HMRC, there would be minor administrative savings, as there would be no need to risk assess or check the validity of claims.

Summary

C.61 Even though the policy rationale remains valid, and it is widely targeted, it is complex and there is a significant administrative burden involved. We recommend that this relief be simplified.

C.62 Potential suggestions include:

- A system that looks at the energy efficiency of a project as a whole rather than individual components;
- A 'kite mark' system, so that it is easy to identify assets that contain a "green" component. We understand that a similar system has been introduced by The Carbon Trust (the Energy Technology List symbol). As this is not on all assets, its absence does not mean an asset cannot qualify. However, it has been raised that there are many different labels at present (e.g. The Carbon Trust, Fair Trade) and therefore a further one may cause confusion;
- Use of the A-G rating that is currently used for many appliances already, for example if an appliance achieves an A++ rating then it can qualify. However we understand that the rationale for the Energy Technology List is to remain ahead of the European standards;
- An improvement of the search tool on the website, to make it more intuitive, would help many businesses be able to identify whether an asset qualifies. The cost of this to DECC and Defra could be investigated; and
- Self certification by manufacturers was raised as a potential solution; however this would remove a good deal of rigour from the system and lead to a much greater cost of policing the system.

C.63 There are also a number of possible alternative methods to achieve the same policy objective, more simply, such as:

[31] The Carbon Trust "Response to the Questions 9 and 10 of the Office of Tax Simplification Review of Tax Reliefs: Interim report"
[32] HMRC estimate is £100m, which does not take into account the standard capital allowances that would be available, at up to 20%.
[33] £2.5m for DECC and around £400k for Defra

- Incentives in the form of grants for the purchase of 'green' equipment. However these may be at least as burdensome as the current system;
- Adaptation of schemes such as the Feed in Tariffs, the Renewable Heat Incentive ("RHI") or the Green Deal, to aid the installation of some energy saving and water efficient technologies by businesses. Indeed the RHI already has some overlaps with some ECA qualifying technologies;
- To give an additional allowance to the manufacturer of 'green' equipment. This would help to achieve the aim by encouraging production of relevant assets, and reducing the cost to consumers. This approach would remove the purchasers' burden of identifying qualifying assets (although the allowance would still have to be targeted at particular equipment). If the tax relief were factored into a reduction in price, it may also encourage purchases of these assets. However such a special allowance is likely to raise issues around EU State aid and would not be straightforward; and
- A generally wider basis for the relief; there are certainly issues as to whether it covers all the items that it should. We have received representations that expenditure on the fabric of buildings, such as living roofs and energy generation equipment, could be included. By excluding these assets, there is a risk that procurement decisions are distorted, and the regime can work against innovation in building design, and often these do more for the environment than plant and machinery.

100% first-year allowance for cars with low CO_2 emissions

C.64 Electric cars and those with CO_2 emissions of 110g/km or less are eligible for 100% capital allowances in the year of acquisition[34].

C.65 This only applies to expenditure incurred between 17 April 2002 and 31 March 2013.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

C.66 This relief was introduced in 2002 to influence businesses to choose cleaner cars. It was introduced as part of a package of measures designed to support the Government's programme to manage climate change by encouraging businesses to acquire 'green' assets rather than more polluting alternatives.

C.67 Cutting road transport CO_2 emissions is a key element in tackling climate change and achieving the required emissions reductions in the UK carbon budget. In 2009 there was a major reform of the capital allowances treatment of business cars; as well as taking cost into account, the treatment is now based on emissions, and this relief is a part of that reform.

C.68 As stated in C.40 above, the UK has a legally binding commitment to reduce carbon emissions by 20% by 2020 compared to 1990 levels and 80% by 2050 and the Government's stated aim is to be the "greenest government ever"[35] and create a greener tax system; therefore the relief has a continuing rationale.

C.69 The original relief was introduced in 2002, and extended in 2008, at which point the qualifying emission threshold was reduced from 120g/km to 110g/km, and as the figures below

[34] CAA 2001 s45D

[35] David Cameron, speech to DECC civil servants,14 May 2010

suggest, the number of cars in the scheme continues to increase. It would therefore appear to be achieving the policy aim.

C.70 In conjunction with the favourable company car benefit charges for lower emitting cars and a CO_2 based Vehicle Excise Duty, a number of employers are reviewing their entire car fleet and only offering green cars, or limiting the non-green ones to, for example, senior management.

Taxpayer take up and awareness

C.71 When the scheme was first introduced it was estimated that 7,000[36] cars a year would qualify. By 2006 there were 38,000[37] qualifying cars, and in 2009 around 45,000[38] eligible cars were purchased by businesses, although part of this increase is due to a wider choice of eligible cars on the market.

C.72 It is estimated that the tax saving given by this relief is around £80million for 2009-10[39]. However, as the scheme only accelerates the tax allowances available, rather than providing additional relief, this is only a timing difference. The actual savings for each business is therefore the cost of capital.

Complexity, compliance costs and administrative burden

C.73 This is a simple relief to claim as the qualifying criteria are well defined and easy to understand; and the CO_2 emission level of a car is are readily available from the registration document, and is also required for other purposes in the business (e.g. P11D). For smaller businesses with very few cars, it is an easy task and, along with the annual investment allowance, it means that the business may not have to worry about ongoing capital allowances claims. For larger entities, the relevant details are often entered into the fixed asset register, thus the information to prepare the computation is easily accessible.

Summary

C.74 The relief is due to be reviewed in 2013 when the current scheme expires. As the policy rationale remains valid, the relief appears to achieve it, and it is simple to operate, we recommend that the relief be retained.

C.75 Thought could be given to once again lowering the qualifying criteria to encourage both businesses to use greener cars and manufacturers to develop them.

Research and development allowances

C.76 100% research and development allowances ("RDAs") are available for expenditure incurred on assets that are used for carrying out research and development, or for providing facilities for carrying out research and development, including oil and gas exploration[40].

C.77 The definition of research and development ("R&D") for this purpose is similar to that for R&D tax relief, i.e. it is defined as taking place where there is a project that seeks to achieve an advance in science or technology, through the resolution of scientific or technological uncertainties.

[36] HMRC estimate
[37] HMRC estimate
[38] HMRC estimate
[39] HMRC estimate
[40] CAA 2001 ss441–451

C.78 For any assets that are used partly for R&D and partly for non R&D, the amount eligible for RDAs is a reasonable proportion.

Box C.3: Example of apportionment for RDAs

Company X acquires land and buildings for £1million. The amount attributable to the land is £300k. There are 100 staff working in the building, of whom 95 are engaged in qualifying R&D activities.

The amount eligible for RDAs is £665k[41].

C.79 When the asset is disposed of, there will be a clawback of relief equal to the sale proceeds of the asset (thus the total relief claimed will be equal to the loss in value of the asset between acquisition and sale). If the use of the asset changes after the end of the first year, there is no clawback of the relief.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

C.80 This relief (previously called scientific research allowances) was introduced in 1944 to support and encourage the development of new technologies, innovations, inventions and R&D knowledge in the UK.

C.81 We understand that the relief achieves this rationale and is useful in helping to justify projects investigating new areas of technology[42].

Taxpayer take up and awareness

C.82 In 2005, around 6,000 businesses were claiming RDAs[43] but there are no figures available for the current number of claims.

C.83 The relief is claimed by a broad cross section of businesses, from oil and gas (where it is very important for exploration and appraisal activities) to telecommunications and pharmaceutical companies. It also covers businesses of all sizes, from some of the UK's largest companies to very small businesses.

Complexity, compliance costs and administrative burden

C.84 The total administrative burden was estimated to be around £100,000 in 2005[44].

C.85 For companies that solely perform R&D, RDAs represent a significant simplification, because, apart from a few specific exclusions (e.g. land) 100% allowances are available on all fixed assets and there is no need to consider with the other capital allowances rules.

C.86 Even for a company where R&D is only a part of the business, this is not complex as it is generally known by the company which assets are used by the R&D department and it is therefore usually easy to determine which assets used wholly in R&D (and thus eligible for RDAs), which are not used at all for R&D (eligible for the usual allowances) and which are used partly for R&D. This latter category can be split according to a reasonable method, which in many cases is easy to determine and calculate (e.g. floorspace, headcount etc).

[41] The cost of the building is 700k (£1m less £300k). This is apportioned by headcount (i.e. 95/100)
[42] Representation from the Utilities Tax Group
[43] HMRC Standard Cost Model
[44] HMRC Standard Cost Model

Summary

C.87 The Government has said that encouraging innovation continues to form a key part of its aims for the tax system[45] and so the policy rationale remains valid. The calculation is not complex and there is no additional administrative burden other than defining whether the activities being carried out qualify as R&D for tax purposes.

C.88 In the 22 June 2010 Budget the Chancellor announced that the Government would consult with business to review the support that R&D tax credits provide for innovation. The resulting consultation document on "The taxation of innovation and intellectual property"[46] (published on 29 November 2010) recognised that the cost of claiming R&D tax credits and the associated information obligation acts as a barrier to companies claiming R&D the relief as well as imposing administrative costs. The consultation document asks for comments on improvements to the claims process to make it more streamlined and certain for companies[47].

C.89 We recommend that this relief be simplified but as the main complexities surround the definition of R&D for tax purposes (which is covered by the consultation above) we do not propose to consider this further.

Business premises renovation allowance

C.90 100% capital allowances are available on expenditure on converting or renovating unused business premises in a disadvantaged area, incurred between 11 April 2007 and 11 April 2012[48]. It was approved for five years as a State aid and an extension may be sought from the European Commission.

C.91 The conditions that must be met include:

- the expenditure is incurred on renovating or converting a commercial building or structure into premises used, or available for letting for use, for a trade, profession or vocation or as offices; and
- the building is situated in a disadvantaged area and has been unused for at least a year immediately before the conversion or renovation begins. The last use must have been a business use and the building must not have been used as a dwelling.

C.92 Expenditure on acquiring land, extending a building or developing land next to a building does not qualify for business premises renovation allowance ("BPRA").

C.93 If the building is disposed of, or a long lease granted for a premium within 7 years of the first use of the building after conversion or renovation, there is a balancing adjustment.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

C.94 This relief was introduced to foster physical and social regeneration in deprived areas, to increase private investment, enterprise and employment in those areas, and to reduce pressure on greenfield sites. After an in-depth investigation of its economic rationale, it was approved by the European Commission as a regional State aid and was introduced in 2007.

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[45] "Corporate Tax reform: delivering a more competitive tax system" Part IIB p47
[46] "Corporate Tax Reform: delivering a more competitive system" Part IIB
[47] "Corporate Tax Reform: delivering a more competitive system" Part IIB p59
[48] CAA 2001 ss360A–360Z4

C.95 We understand that this relief has encouraged redevelopment of disused property, for example the renovation of an empty office block into a hotel[49]. The need for regeneration in deprived areas of the UK and for incentives to increase enterprise and employment still remains.

C.96 Grants have been looked at rather than a tax relief, but were rejected due to:

- a modest fiscal incentive tends to ensure that projects remain subject to market disciplines and so may contain less potential for market distortions;
- tax incentives such as BPRA tend to be more transparent and less discretionary; and
- they can be more bureaucratic from both a public and private perspective.

C.97 In addition grant finance is less certain than incentives given through the tax system.

Taxpayer take up and awareness

C.98 The relief is available to almost any business that wishes to renovate a relevant property, but is deliberately targeted at specific areas of the UK.

C.99 In 2007-8 there were 1,020 claims[50] and in 2008-09 there were 540 claims[51]. The total value of the relief is approximately £20million p.a.[52].

Complexity, compliance costs and administrative burden

C.100 It is straightforward to determine whether or not a particular property is in a relevant area, as there is a postcode search tool[53].

C.101 The qualifying spend is generally well defined but complications can arise, for example in determining what is renovation and what is an extension.

C.102 As allowances are available at 100%, there is no need to carry forward any unrelieved expenditure for capital allowances purposes.

Summary

C.103 The policy rationale remains valid, and it is relatively straightforward to determine which properties and expenditure qualify. However, it is questionable whether or not BPRA is achieving the necessary incentive; it has a small impact with an estimated value of £20million.

C.104 We recommend that this relief be abolished from 2012.

Flat conversion allowances

C.105 100% flat conversion allowances (“FCA”) are available on expenditure incurred on the conversion of empty or underused space above shops and other commercial premises for residential use[54].

C.106 There are a number of conditions that must be satisfied[55] in order to be eligible for relief. Broadly the major conditions are:

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[49] Example provided by HMRC
[50] HMRC estimate
[51] HMRC estimate
[52] HMRC estimate
[53] http://www.dtistats.net/regional-aa/aa2007.asp
[54] CAA 2001 Part 4A
[55] CAA 2001 ss393A – 393L

- The property must have been built before 1980, have no more than 4 storeys above the ground floor and each flat must have no more than four rooms;

- The ground floor must be solely for business use and, when the property was constructed, the floors above the ground floor were primarily for residential use. These upper floors must have been either unoccupied, or used only for storage, for at least one year before the conversion work starts;

- The flats must be suitable for letting as a dwelling and be available for short-term letting (but cannot be let to someone connected with the person who incurred the conversion or renovation expenditure); and

- The flats created must not be high value. This is calculated by reference to a table of notional furnished rent, and the figures have remained unchanged since 2001.

C.107 There are also many minor conditions, for example in determining the number of rooms, some can be excluded, if they are smaller than $5m^2$.

C.108 If the flat is sold or ceases to be held for letting out within seven years, all allowances claimed in excess of the sale proceeds are clawed back, and the person to whom it is transferred cannot claim FCA.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

C.109 This relief was introduced in 2001 as part of a package of regeneration measures responding to the recommendations of the 1999 Urban Task Force. It is intended to encourage the conversion of empty or under-used space above shops to increase the housing supply and reduce the need for new housing developments on greenfield sites.

C.110 There is still a shortage of affordable residential accommodation in many towns and cities and considerable public opposition to housing developments on greenfield sites; thus the policy rationale would appear to remain valid.

C.111 A grant scheme was run by what was then the Department of the Environment ("DoE") between 1991 and 1994 but had low take up. Under that scheme, grants met about 50% of the conversion costs.

C.112 We have received representations that the relief does not influence behaviours and that the work would be carried out anyway for commercial reasons.

Taxpayer take up and awareness

C.113 We understand from both HMRC and anecdotal evidence that take-up of this measure (which was always envisaged as being modest in its effect), has been lower than expected, and it appears that it may not have achieved its objectives to any significant extent. The reasons for this are unclear but it could be that commercial landlords are often reluctant to take on residential tenants because of the perceived risks and "hassle factor". In addition, potential properties are often subject to leases so that it can prove difficult to secure agreement between all parties. There can also be issues of security, insurance and access, which may act as barriers to the greater take-up of this relief.

C.114 In 2005 it was estimated that around 1,000 businesses[56] were claiming, but extrapolation from information on returns indicates that current take-up is lower than this.

[56] HMRC Standard Cost Model

C.115 The tax savings from this relief for businesses are estimated to be less than £3million p.a.[57] However as it is only a timing difference, the actual saving is the taxpayer's cost of capital.

Complexity, compliance costs and administrative burden

C.116 The main complexity is the sheer number and detail of the conditions that must be met, in the twelve sections of legislation. To ascertain whether the project involves a qualifying building and a qualifying flat, there are 21 separate conditions to be met.

C.117 Thus the administrative burden of ensuring that all of the conditions are complied with is relatively high compared with the benefit.

C.118 In addition, as there are notional rent limits, which have remained unchanged for ten years, it may be better from a commercial point of view to not claim the relief in order to obtain greater rents.

Summary

C.119 Even though the original policy rationale remains valid, due to the large number of conditions that must be satisfied, and the lack of take up of this relief, this is unlikely to be the best way to achieve the objective.

C.120 We recommend that this relief be abolished.

Mineral extraction allowances

C.121 Mineral extraction allowances ("MEAs") provide capital allowances at special rates depending on the type of expenditure[58].

C.122 The MEA code is available to businesses carrying on a trade of mineral extraction, including sand and gravel extraction, hard rock mining, the oil industry and geothermal energy.

C.123 A 100% allowance is available for oil extraction expenditure.

C.124 A rate of 10% applies in respect of the acquisition of a mineral asset for example a licence (including an interest in mineral deposits, or land containing such deposits).

C.125 A rate of 25% applies in respect of expenditure on

- Mineral exploration and access;
- Construction of certain works in connection with the working of a source of mineral deposits, being works which when the source is no longer worked, are likely to be of little or no value to the person working the source immediately before this activity ceases; and
- Unsuccessful planning applications.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

C.126 A relief for mineral extraction was originally introduced in 1945, and the current form of the relief was introduced in 1986 following consultation.

[57] HMRC estimate
[58] CAA 2001 ss394 – 436

C.127 Mineral extraction is an important and expensive activity for UK companies and is of significant importance to the UK economy. High commodity prices for oil, coal and other minerals make the extraction of UK minerals and resources potentially more important in the future. This is a long-standing relief that recognises the legitimate and necessary capital expenditure of an important industry.

Taxpayer take up and awareness

C.128 The relief is used by the majority of mining companies in the UK[59] that wish to exploit the UK's onshore and offshore minerals and by UK companies exploiting minerals elsewhere. Use of the relief depends on the level of extraction going on at any one time, but the oil industry, for example, spends billions every year[60] on oil exploration, extraction and decommissioning.

Complexity, compliance costs and administrative burden

C.129 There is a greater administrative burden than for normal capital allowances as a necessary part of the relief is that each asset is dealt with separately. However in practice, apart from a few exceptions (e.g. individual sources and all 10% expenditure), it is possible to pool some expenditure to ease this burden.

Summary

C.130 The policy rationale remains valid, and even though there is a greater administrative burden than for normal capital allowances, this relief enables relevant companies to obtain relief for necessary expenditure.

C.131 We therefore recommend that the relief be retained.

[59] HMRC estimate
[60] HMRC estimate

D Corporate – general

Corporation tax – small profits rate

D.1 The main rate of corporation tax for Financial Year ("FY") 2010 is 28%[1] for a company with taxable profits in excess of £1.5million[2] ("the upper limit"), and for a company with profits below £300,000[3] ("the lower limit") the small profits rate ("SPR") applies, which is 21% for FY 2010[4].

D.2 The Chancellor of the Exchequer announced that the SPR was to be maintained in the 2010 June Budget[5]. The rate for FY 2011 will be 20% and this will be included in Finance Bill 2011[6].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.3 The rationale behind the relief, which was introduced in 1972[7], was to enable small companies to have increased retained profits from which to finance investment aimed at growth[8].

D.4 The policy rationale is considered to be less valid with the differential between the main rate and the small profits rate decreasing. However, in the 2010 June Budget[9] the Chancellor of the Exchequer announced his decision to retain the SPR and the rate for FY 2011 was announced as 20%[10] and this will be included in Finance Act 2011. The UK is not alone in having a small profits rate as there a number of other jurisdictions that have similar provisions, for example China has a lower rate of company income tax for small-scale enterprises, Spain has a lower rate for SMEs, as do Belgium and Japan.

D.5 The Mirrlees Review described the small profits rate as an anomaly as it is "not clear that the lower corporation tax rate for small firms has much impact on the share of economic activity conducted by small businesses"[11] and further suggested that "the case for retaining the small companies' rate of corporation tax does not appear to be compelling"[12]

[1] FA 2009 s7(2)(a)
[2] CTA 2010 s24(2)
[3] CTA 2010 s24(2)(a)
[4] FA 2010 s3
[5] 22 June 2010
[6] HMRC/HMT "Overview of draft legislation for inclusion in Finance Bill 2011", December 2011, para 1.24
[7] FA 1972 s95(1)
[8] FA1974 s10(2)
[9] 22 June 2010
[10] Budget 22 June 2010 PN1 part 2
[11] The Mirrlees Review "Reforming the Tax System for the 21st Century" Vol II "Tax by Design" Chap 19 "Small business taxation", p8 (http://www.ifs.org.uk/Mirrleesreview/design/Ch19.pdf)
[12] The Mirrlees Review "Reforming the Tax System for the 21st Century" Vol II "Tax by Design" Chap 19 "Small business taxation", p16 (http://www.ifs.org.uk/Mirrleesreview/design/Ch19.pdf)

Taxpayer take up and awareness

D.6 The measure is not targeted at any specific industry and is available to all companies with taxable profits not exceeding £300,000[13]. It is estimated that there are 830,000 companies eligible for SPR[14].

D.7 The cost to the Exchequer for 2010/11 is estimated to be £2.5billion[15].

D.8 We are aware through our work that a number of businesses have incorporated over the past decade to take advantage of the small profits rate (which has varied over that time from 0% to 21%). Therefore having this lower rate can lead to distortions in business decisions about whether to operate through a limited company or an unincorporated entity.

Complexity, compliance costs and administrative burden

D.9 The legislation is not complex where there is a single company, as it is based on the facts.

D.10 Where there is a group of two or more "associated companies", the £300,000 limit (and the £1.5million limit) is divided by the number of associated companies[16], thus reducing the limits. Broadly two companies are associated if one is under the control of the other or both are under common control[17]. This rule, which is designed to prevent groups fragmenting their businesses into a number of small companies qualifying for the SPR, can create complexity as associated companies includes both UK and overseas companies and in a large group it can be difficult to determine the exact number of associated companies, especially if there is doubt over the nature of the foreign entity, e.g. whether it is a corporate structure or a partnership. In addition when calculating control, all connected persons must be taken into account (including family members or partners in a partnership) as well as any companies that they control.

D.11 There are also rules[18] (close investment companies or "CICs") that deny the SPR for (in effect) many small non-trading companies.

Summary

D.12 Abolishing the small profits rate would be a simplification and would also mean that there would be no need for either the revised rules on associated companies to be included in FB 2011[19], nor the CIC rules.

D.13 However, in the light of the commitment to retain the small profits rate in the 22 June 2010 Budget it is recommended that this relief be retained, but consideration be given to reviewing the relief in the future, perhaps aligning it with the main rate of corporation tax.

Corporation tax marginal relief

D.14 The main rate of corporation tax applies to companies with taxable profits exceeding £1.5 million[20]. For companies with profits below £300,000[21], a lower rate applies - the SPR[22]. For FY 2010 the rate is 21%[23].

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[13] CTA 2010 s24(2)(a)
[14] HMRC
[15] HMRC Ready Reckoner
[16] CTA 2010 s24(3)
[17] CTA 2010 s25(4)
[18] CTA 2010 s18(b) & s34
[19] HMRC/HMT "Overview of draft legislation for inclusion in Finance Bill 2011" December 2010 para 1.31
[20] CTA 2010 s24(2)(b)
[21] CTA 2010 s24(2)(a)
[22] CTA 2010 s18 (previously ICTA 1988 s13(1)
[23] FA 2010 s3(1)

D.15 For a company with taxable profits between the upper and lower limits, marginal relief is available[24] to reduce the effective rate on tax on profits to a rate between the main rate of tax and the small profits rate. The company's taxable profits are taxed at the main rate of corporation tax but marginal relief reduces the tax due.

D.16 The relief ensures a smooth progression of tax rate on profits between the lower and upper thresholds (i.e. between the two rates).

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.17 The policy objective for the relief, which was introduced in 1972[25], was to avoid a "cliff edge" change in tax rate for profits at the threshold between CT small profits rate and main rate.

D.18 The policy rationale is considered to be less valid with the differential between the main rate and the SPR decreasing. Currently there is a difference of 7 percentage points between the rates but by 2014 when the main rate is expected to have decreased to 24%[26] (and assuming no changes to the FY 11 SPR of 20%) the differential will be 4 percentage points.

D.19 A potential alternative would be to have separate bands, at 20%, 21%, 22% etc. However, this could be more complex and would lead to several smaller cliff edges rather than a gradual change.

Taxpayer take up and awareness

D.20 Companies in all industries are able to take advantage of the relief where taxable profits fall between £300,000 and £1.5million[27] in an accounting period.

D.21 There are approximately 38,000 companies claiming marginal relief at an estimated cost of £350 million to the Exchequer in 2010/11[28].

Complexity, compliance costs and administrative burden

D.22 The legislation is not complex for a single company. There is a minor complexity in calculating the amount of marginal relief but where software packages are used to compute tax liability this is dealt with by the software.

D.23 However there is increased complexity where there are a number of associated companies and this is as set out in D.10 above.

Summary

D.24 It is considered that whilst there is a main rate of tax and a SPR, marginal relief will be required and therefore this relief should be retained.

D.25 The relief should be reviewed along with the SPR. Abolishing both the small profits rate and the marginal rate of tax would be a simplification.

[24] CTA 2010 s19 , previously ICTA 1988 s13(2)
[25] FA 1972 s95(2)
[26] Budget 22 June 2010, PN02, p8
[27] CTA 2010 s24(2)
[28] HMRC estimate

Land remediation relief

D.26 This relief, which is in CTA 2009 Part 14, was introduced for accounting periods ending on or after 1 April 2001[29], and it was extended in 2009[30].

D.27 The relief is a relief from corporation tax for qualifying expenditure (both capital and revenue) incurred by companies in cleaning up land acquired from third parties in a contaminated state.

D.28 The relief is, subject to certain conditions being met, a deduction of 100%[31] plus an additional 50%[32] of qualifying expenditure.

D.29 Land is contaminated if, as a result of industrial activity, there is contamination present that causes or could cause "relevant harm" (i.e. significant adverse impact on the health of humans or animals or damage to buildings that would impact on the way that the building is used). The 2009 extension to derelict land covers land that is not in productive use and cannot be put into productive use until buildings or other structures are removed. The 2009 amendments to the relief also included provisions that are narrowly circumscribed and cover removing contamination from radon, naturally occurring arsenic and Japanese knotweed.

D.30 In addition to the enhanced 50% deduction, loss making companies are able to surrender part of the loss attributable to land remediation relief in return for a tax credit (cash payment) from the Government. The maximum tax credit is 16% of the qualifying land remediation loss for the accounting period[33].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.31 The original policy rationale was to address a market failure by giving enhanced relief to developers to bring back into use land that has been contaminated by previous industrial use that would otherwise remain unused, or land on which there are derelict structures that are so expensive to remove that the land has become long term derelict land.

D.32 Following a consultation in 2007[34] changes were made in Finance Act 2009[35] to address issues that were considered to be preventing the relief from operating as intended.

D.33 There is a concern[36] that the measure has failed to deliver its policy objective; the perceived market failure has not existed in every case as the remedial work would have been done irrespective of the availability of the relief and some sites remain undeveloped as they are in the "wrong place".

D.34 In our experience, when land is acquired for development there is usually an element of decontamination as part of the site preparation. As this would have taken place in any event, it is clear that the relief does not always influence behaviour but in many cases is seen as a tax bonus for work that would have been done in any event.

Taxpayer take up and awareness

D.35 The relief is not sector specific and there were 1,190 claims for the relief in 2007/08[37].

[29] FA 2001 s70 and Sch 22
[30] FA 2009 Sch 7 paras 1 and 2
[31] CTA 2009 s1147(6)
[32] CTA 2009 s1149(8)
[33] CTA 2009 s1154
[34] HMRC "Tax incentives for development of brownfield land" 21 March 2007
[35] FA 2009 s26 and Sch27
[36] HMRC
[37] HMRC estimate

Complexity, compliance costs and administrative burden

D.36 The cost to the Exchequer was approximately £40million in 2007/08[38].

D.37 The changes to the legislation in FA 2009 were designed to minimise the administrative burden by aligning the relief with work that companies would normally carry out as part of the planning process. HMRC have received feedback from companies that these changes have simplified the legislation. However, the need to ensure that only genuine blight caused by the previous industrial user before the relief can be claimed (thus ensuring that the "polluter pays" and preventing abuse of the relief) results in some complexity.

Summary

D.38 The policy rationale is still valid and it is not complex to claim. However it is not a driver of behaviour and is not cost effective; it is being claimed for work that would have been carried out irrespective of the availability of the relief.

D.39 We recommend that this relief be abolished.

D.40 Whilst reviewing this relief it has become apparent that there are several different rates of loss surrender within the tax system, for example 16% here, 14% for R&D tax credits and 19% for enhanced capital allowances (see Annex C above). This causes confusion amongst advisers and taxpayers, and consideration could be given to reviewing whether there is an optimum percentage and aligning the rates.

Unrelieved surplus advance corporation tax

D.41 Prior to 1 April 1999, companies had to account to the Inland Revenue (as it was then) for advance corporation tax ("ACT") calculated by reference to qualifying distributions made in the period. Subject to certain limitations, ACT was available for set off against a company's liability to corporation tax on its profits for the period. Any unused or surplus ACT being available to be carried back or carried forward[39] and offset against earlier or future corporation tax liability, again subject to certain limits. It could also be surrendered within a goup.

D.42 Following the abolition of the ACT regime with effect from 1 April 1999, no ACT is payable on distributions. However at 1 April 1999 there were many companies with unrelieved surplus ACT and the "shadow ACT" regime was introduced to maintain companies' expectation of recovering ACT in respect of dividends paid[40] as if the ACT regime had continued.

D.43 For dividends paid after 1 April 1999, a notional amount of ACT ("shadow ACT") is calculated. Surplus ACT is offset against the corporation tax liability for the period, subject to a maximum of 20% of taxable profits. However the offset of surplus ACT is limited, as shadow ACT must be offset first, although, as a notional amount, this does not reduce the liability.

[38] HMRC estimate
[39] ICTA 1988 s14
[40] FA 1998 S32 and the Corporation Tax (Treatment of Unrelieved Surplus Advance Corporation Tax) Regulations (SI 1999/358)

Box D.1: Example of shadow ACT (ignoring SPR and marginal SPR for simplicity)

Company X has £2million of ACT brought forward in its year ended 31 December 2010 and has not paid any dividends since before 1999. It makes a taxable profit of £600k in the year.

The ACT available is limited to the lower of 20% of the taxable profit (£120,000) or £2million.

Therefore the tax payable is £48,000[41].

Company Y has £2million of ACT brought forward in its year ended 31 December 2010 and it paid a dividend in the year (its first since before 1999) of £200,000. It makes a taxable profit of £600k in the year.

The ACT available is limited to the lower of 20% of the taxable profit (£120,000) or £2million, and this figure is then reduced by the shadow ACT of £50,000[42].

Therefore the tax payable is £98,000[43].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.44 The shadow ACT regime was introduced to maintain the expectations of companies with unrelieved surplus ACT at 1 April 1999 that this would be available for offset against future corporation tax liabilities on the same basis as the original regime and not in a more beneficial manner.

D.45 Subject to affected companies having sufficient taxable profits, and thus sufficient corporation tax liability, to use this surplus, the policy rationale remains valid. However in the light of the recent recession it is unlikely that for some of these companies profits will rise above the dividend level and so it may be some time before the surplus ACT is utilised, if at all.

D.46 Consideration might be given to other alternatives that give value to the company for the ACT, maintain the expectations of the companies affected as well as potentially enabling affected companies to remove ACT from their computations and simplify their compliance.

D.47 It is not possible to estimate the cost of abolition as this is dependent on companies' profits.

Taxpayer take up and awareness

D.48 There is estimated to be approximately £1.5billion surplus ACT held by companies[44], eleven years after the abolition of the ACT regime.

D.49 The surplus ACT has declined since 1999 when ACT was abolished. Around 30 groups are estimated to hold 2/3 of the surplus ACT[45], one of which holds £182million which it expects to recover in the foreseeable future[46].

D.50 There are around 30 claims a year in excess of £50,000[47] each.

[41] £600,000 x 28% = £168,000. This is then reduced by ACT of £120,000
[42] £200,000 x 25%
[43] £600,000 x 28% = £168,000. This is then reduced by the net ACT which is £120,000 less the shadow ACT of £50,000
[44] HMRC estimate
[45] HMRC estimate
[46] Representation from Rolls-Royce plc

Complexity, compliance costs and administrative burden

D.51 The legislation is considered to be complex in order to minimise avoidance opportunities and to ensure that relief for ACT is not accelerated and relieved more quickly that it would have been before the abolition of ACT. It is considered that the costs of compliance are likely to be high in the groups affected due to this complexity[48].

D.52 However for companies that are not making distributions, there is little complexity as there will be no shadow ACT and an amount of carried forward surplus ACT equivalent to 20% of taxable profits offset against the liability each year.

D.53 It is not possible to estimate the cost of abolition as this is dependent on companies' profits.

Summary

D.54 Whilst the policy rationale remains valid in theory, it is questionable whether, in the current economic circumstances, and nearly twelve years after the abolition of the ACT regime the surplus ACT will be utilised in the short to medium term. However to abolish the regime and not allow further offset of surplus ACT would be contrary to companies expectations, would be an unwelcome retrospective tax, and would be unfair, as this is tax that the companies have paid to HMRC in the past.

D.55 We would therefore recommend that the relief be simplified.

D.56 Possible alternatives that have been suggested to us are:

- Abolish the shadow ACT regime, so that companies no longer have to work out a notional amount and can instead offset surplus ACT up to 20% of their taxable profits. This could be combined with the abolition of ACT at a future date; or
- Abolish ACT and explore compensation via alternatives that give value to the company for the ACT.

Purchase of own shares

D.57 In general, payments made by a company to its shareholders are treated as distributions and are subject to income tax. However, if a company repurchases its shares, subject to certain conditions being met, the payment is treated as a capital gain in the recipient's hands[49], thus attracting the annual exemption and the lower rate of capital gains tax in the case of individual shareholders.

D.58 The conditions that must be met include the following:

- The company must be an unquoted trading company[50];
- The repurchase must be wholly or mainly for the benefit of the trade[51];
- The seller must have owned the shares for five years prior to the repurchase[52];

[47] HMRC estimate
[48] HMRC
[49] CTA 2010 s1033, previously ICTA 1988 s219(1)
[50] CTA 2010 s1033(1)
[51] CTA 1033(2)
[52] CTA 2010 s1035

- The percentage holding in the company after the repurchase must be less than 75% of the percentage prior to the purchase[53]; and
- The seller must not be connected with the company after the repurchase[54] (i.e. must hold less than 30% [55] of the shares).

D.59 Capital treatment is also given to a repurchase of shares where the whole, or substantially the whole, of the payment is used to pay an inheritance tax liability of an individual within two years of death, that could not otherwise be paid without undue hardship[56]

D.60 The relief is used in situations where, for example, there is a genuine commercial purpose such as a minority shareholder wanting to withdraw the investment in a company but where there is no market for the shares without incurring disadvantageous tax consequences. e.g. in the case of a boardroom dispute.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.61 The rationale is to exempt bona fide share sales from being taxed as a distribution, by providing for a more advantageous capital gains tax treatment.

D.62 The distributions legislation was enacted in 1965 but a purchase of own shares was only possible after Companies Act 1981[57], and the original distribution rules were not amended at the time to take into account purchases of own shares.

D.63 The policy rationale remains valid, given the difference between the highest rates of income tax on distributions (36.11% effective rate for additional rate taxpayers for 2010/11) and a 28% top rate of capital gains tax (which may be reduced to 10% by virtue of entrepreneurs' relief).

Taxpayer take up and awareness

D.64 The level of taxpayer take up is not known. Transactions in which the relief is claimed are returned to the local Inspector, but HMRC does not maintain central records. There are around 2,000 to 3,000 clearance applications a year[58]; however, there are many more transactions that claim the benefit of the relief and do not apply for clearance.

Complexity, compliance costs and administrative burden

D.65 The legislation is complex to ensure that only targeted companies can benefit and to ensure that the relief is not abused. There are complex rules on pre and post transaction shareholdings as well as connected persons, but these are considered to be necessary to ensure that the relief is allowed only where shareholder leaves the company and does not intend to return.

D.66 It is possible to obtain certainty of treatment through an advance clearance process[59]; however this will usually involve assistance from an adviser, whose fees will reduce the tax benefit available.

D.67 There is no information available on the compliance and administrative burden, but there is no cost until a specific transaction is considered.

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[53] CTA 2010 s1037
[54] CTA 2010 s1042(1)
[55] FA 1965 s47
[56] CTA 2010 s1033(3)-(4)
[57] CA 1981 s46
[58] HMRC estimate
[59] CTA 2010 s1044

Summary

D.68 The relief is structural, the policy rationale remains valid and the relief is believed to be well used.

D.69 Due to the complexities in the rules and the facts that advisers are generally required to assist with the advance clearance, we recommend that the administration of the relief be simplified. Possible simplifications could include:

- An online questionnaire guiding taxpayers though the conditions (e.g. how many shares do you know own, when did you acquire them, how many will you own afterwards, etc); or
- Making agreed, anonymised clearance applications available on HMRC's website which could be used in situations where the reason for the repurchase is straightforward (e.g. there has been a board dispute and a dissenting shareholders wants to leave). This will still need verification by HMRC and may also require the involvement of an adviser, but should reduce costs.

Demergers

D.70 Businesses that are grouped within a single company could often be run more efficiently if they were under independent management and ownership. Splitting these businesses into separate companies is known as a demerger.

D.71 The demerger provisions[60] are designed to facilitate the division of trading activities carried on by a company or group so that they are carried on by two or more companies not belonging to the same group or by two independent groups[61], without a taxable distribution arising (i.e. the transaction gives rise to an exempt distribution[62]).

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.72 The rationale behind the relief is to ensure that businesses can be split without any adverse tax implications. Such a split may be necessary for operational reasons, or due to a breakdown in relations between shareholders.

D.73 The policy rationale is still valid for individual shareholders who are exempt from income tax (and usually capital gains tax) on the transaction.

D.74 There are alternative methods of demerging e.g. the liquidation procedure under the Insolvency Act 1986 s110, or a capital reduction demerger under the Companies Act 2006, which are less restrictive but more costly for companies.

Taxpayer take up and awareness

D.75 Companies of all sizes and types can demerge their activities and companies making use of the demerger provisions range from small private companies to some of the UK's largest public companies.

[60] CTA 2010 Part 23 Chap 5 (previously ICTA 1988 s209)
[61] CTA 2010 s1074
[62] CTA 2010 s1075

D.76 The number of taxpayers using this relief is not known. Although there is an advance clearance procedure[63], fewer than 1,000 applications a year are received[64]. Clearance is not granted in every case and also clearance will not be applied for in every case.

Complexity, compliance costs and administrative burden

D.77 The legislation is complex as result of the anti avoidance aspect to counter the conversion of income into capital. There are various conditions in the legislation that must be met that add to the complexity, for example the demerger must be "wholly or mainly for the purpose of benefiting some or all of the trading activities"[65] and must not form part of "a scheme or arrangement the main or one of the main purposes is tax avoidance"[66].

D.78 The conditions are necessary to ensure that the relief is allowed only in intended situations. Were the conditions to be relaxed (and hence the legislation simplified) the risk of tax avoidance would be increased.

D.79 One of the conditions is that the demerger cannot be undertaken in contemplation of a sale[67].However this can lead to unfairness in certain situations, for example a business can be demerged with a potential purchaser appearing subsequently. If the purchase takes place, this could invalidate the tax treatment of the demerger, as HMRC could deem it to be in contemplation of a sale. The 'chargeable payments' system helps police this for a five year period subsequent to the demerger.

D.80 We also understand that there have been instances of clearance applications being queried by HMRC with taxpayers being asked why the transaction was not being structured in a different, less tax favourable manner. We understand that this approach has led to a number of applications being withdrawn, despite being fully within the rules.

D.81 The administrative burden only applies once a specific transaction is under consideration; however as advisers are usually involved to advise taxpayers significant professional fees can be incurred.

Summary

D.82 The policy rationale remains valid and the relief is structural. The complexities in the rules are to prevent tax avoidance and, as the legislation is only used in specific circumstances, they do not affect taxpayers widely. However for those taxpayers that do use the relief, it can be very costly.

D.83 We therefore recommend that the relief is simplified, for example:

- The use of a checklist or flowchart approach, with a step by step guide to making an application and what information HMRC will require to reach a decision. This is similar to the approach taken by the Australian Tax Office[68] ("ATO"); or
- Successful, anonymised clearances could be published on the HMRC website to assist taxpayers making clearance applications. Again, this is something that is published on the ATO website.

[63] CTA 20010 S1092
[64] HMRC estimate
[65] CTA 2010 s1081(3)
[66] CTA 2010 s1081(4)-(5)
[67] CTA 2010 s1081 s(5)(d)
[68] http://ato.gov.au/businesses/content.asp?doc+/content/63409.htm&page=1&H1

Intangible assets – exemption for regional development grants and equivalent grants in Northern Ireland

D.84 This relief[69] provides that certain grants (e.g. regional development grants ("RDGs")) received in relation to intangible fixed assets are ignored for the purposes of the intangible fixed assets legislation[70].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.85 The policy intention was to bring the 2002 intangibles regime in line with the capital allowances regime. We have not been able to verify the original rationale; however we believe it was to avoid government grants being taxed. If this were to happen, the grant would need to be increased to cover the tax. Therefore this exemption is a simplification.

D.86 We are unable to verify if RDGs or their equivalent in Northern Ireland still exist, following the Regional Development Grant (Termination) Act 1988.

Taxpayer take up and awareness

D.87 There is no information available on taxpayer take up and awareness.

Complexity, compliance costs and administrative burden

D.88 The relief adds a small layer of complexity for the taxpayer as there is a need to increase the level of amortisation that is tax deductible from the value in the accounts; however the amount relating to the grant is easy to calculate.

D.89 As noted above, the relief is a simplification for HMRC, as if the grant was taxed, it may be necessary to increase the grant to cover the tax.

Summary

D.90 We are unable at this stage to form a conclusion on this relief.

Tax reserve certificates issued by HM Treasury

D.91 Tax reserve certificates ("TRC") were introduced in December 1941 and were used as a means of paying certain taxes on account by both individuals and companies[71].The scheme was withdrawn from 31 December 1971[72] and replaced from October 1975 by Certificates of Tax Deposit ("CTD")[73].

D.92 Interest on TRCs is paid when the certificates are used to settle a tax liability. There is no liability to corporation tax or income tax on this interest[74].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.93 TRCs were replaced with CTDs but can still be used to settle tax liabilities.

D.94 The legislation was last reviewed by the Tax Law Rewrite Committee.

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[69] CTA 2009 s853
[70] CTA 2009 Part 8
[71] http://www.bankofengland.co.uk/about/history/archive/archguide.pdf
[72] The London Gazette, 17 December 1971
[73] http://www.bankofengland.co.uk/mfsd/iadb/notesiadb/natdebt_inst.htm
[74] CTA 2009 s1283 and ITTOIA 2005 s750 (previously ICTA 1988 s46(2))

D.95 The use of TRCs is still valid. Consideration could be given to exchanging TRCs for CTDs but this would impose an additional administrative burden on HMRC, and it is not known how many TRCs are still held by taxpayers. The legislation itself is a simplification.

Taxpayer take up and awareness

D.96 It is not known how many TRCs are still held by taxpayers.

Complexity, compliance costs and administrative burden

D.97 The legislation is not complex.

Summary

D.98 TRCs have been withdrawn for over 40 years, and therefore it is unlikely that there are many left. However as they can still be used to settle tax liabilities, it would be unfair for their use to be denied.

D.99 We would however recommend that they be abolished, but with a grace period in which they could be exchanged for CTDs, in a similar way to the process adopted when a new currency is introduced into circulation.

Authorised unit trusts and open ended investment companies – reduced rate of tax

D.100 Authorised investment funds comprise a number of different funds, including authorised unit trusts and open ended investment companies ("OEIC")[75] both of which are authorised and regulated by the Financial Services Authority.

D.101 An authorised unit trust is authorised under Financial Services and Markets Act 2000 s243. The aim of the tax regime for authorised unit trusts is to achieve effective tax transparency at the level of the unit trust[76]. Whilst a unit trust is a transparent entity, it is deemed to be a company for corporation tax purposes, so the trust has a separate legal personality for tax purposes and is within the charge to corporation tax.

D.102 An OEIC is a company to which Financial Services and Markets Act 2000 s236 applies i.e. it is a collective investment scheme which owns and manages investments to give its members the benefit of spreading investment risk and the benefit of the management of funds by or on behalf of the company[77].

D.103 The rate of corporation tax for both an authorised unit trust and an OEIC is the rate at which basic rate income tax is charged for the relevant financial year[78].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

D.104 The reduced rate of tax is set at the basic rate of income tax and serves to align the taxation of investors in these collective investment schemes with that of investors investing directly in the underlying assets. This maintains the tax neutrality objective of the schemes and is part of the structure of the tax system, rather than a relief as such.

[75] CTA 2010 Part 13 Chap 2
[76] Simon's Taxes, Binder 6: Company reconstructions; special classes of companies; other transactions in securities/Part D8 Investment schemes/ Division D8.1 Collective investment schemes/ Authorised investment funds/ D8.110 Definition
[77] HMRC Company Taxation Manual CTM48125
[78] CTA 2010 ss614 and 618

Taxpayer take up and awareness

D.105 There is no information available on the usage of these vehicles.

Complexity, compliance costs and administrative burden

D.106 The legislation is not complex and the users understand the rules, although regulations[79] do provide some more complex alternative treatments to ensure neutrality of tax treatment for investment in collective investment funds for a variety of different asset types.

D.107 There are no additional costs of administration and compliance as this is merely a different tax rate.

Summary

D.108 As this reduced rate of tax is a structural part of the tax system, ensuring equality of tax treatment for individual investors investing in assets directly or through an investment vehicle, we recommend that this relief should be retained.

[79] Authorised Investment Funds (Tax) Regulations, SI 2006/964

E Personal – general

Blind person's allowance (“BPA”)

E.1 If an individual is certified blind and is on a local authority register of blind persons (in Scotland or Northern Ireland, the individual must be unable to perform any work for which eyesight is essential), an allowance is available that is generally added to their personal allowance in calculating taxable income[1]. For 2010/11 this allowance is £1,890 p.a.[2].

E.2 Unlike the personal allowance though, if any part of it is unused, it can be transferred to a spouse or civil partner, regardless of their eyesight.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

E.3 This allowance was introduced in 1962[3] to provide blind people with additional assistance through the tax system to recognise the difficulties they can experience in the workplace due to their lack of sight.

E.4 Prior to the introduction of the BPA, there was consideration of a form of tax relief for the disabled; this was rejected for a number of grounds, including the fact that the disabled received social benefits. However, it was recognised that the blind were a clearly defined special class who often tried to work in certain professions (e.g. as musicians) but the tax system operated to tax “... him or her like a sighted person, although their taxable capacity must be in some degree lessened by their blindness”[4] and the purpose of the BPA was to “encourage blind persons to take the bold step of going out into the world and seeking to earn their living in the open market”[5].

E.5 This rationale remains valid; however this is currently the only disability benefit to be paid through the tax system. It would be logical to consider whether it is more cost effective to pay this through the benefits system, particularly in the context of the development of Universal Credit. Doing so would allow the tax relief to be abolished and simplify the tax system.

Taxpayer take up and awareness

E.6 Around 44,000[6] individuals benefit from this relief, with around 40,000[7] claiming through the PAYE code and around 8,000[8] through a tax return (there is a degree of overlap between these). We understand that 70% of claimants earn less than £20,000 pa (i.e. a total saving of £378 per person)[9]. In total the savings are around £12million p.a.[10].

[1] ITA 2007 ss38–41
[2] http://www.hmrc.gov.uk/rates/it.htm
[3] FA 1962 s9
[4] Henry Brooke MP, Hansard HC Deb 2 July 1962 vol 662 c231
[5] Henry Brooke MP, Hansard HC Deb 2 July 1962 vol 662 c231
[6] Royal National Institute of Blind People (“RNIB”)
[7] RNIB
[8] RNIB
[9] 20% x £1,890
[10] HMRC estimate

E.7 Available figures suggest that BPA is only taken up by about one third of those eligible for it[11]. That would suggest that considerably more than £12million is available for taxpayers, though undoubtedly a good number do not claim the relief because of lack of taxable income.

E.8 The major reason for this is that most blind people have insufficient income to claim the allowance, but other potential reasons include:

- We understand that up to 40,000 people each year become blind or severely sight impaired ("SSI")[12]. A further reason for the low take up is that for many of these people it occurs later in life and therefore the BPA is not known about, and tax is low down the list of priorities when an individual is coming to terms with being blind;
- Most of these individuals are over 75 and, as they may also have other disabilities, they may receive certain other benefits. Few of these individuals are likely to have sufficient taxable income to utilise BPA;
- However this may change in the future as more individuals who are part of occupational defined benefit pension schemes become older and more likely to become SSI. It is therefore possible that BPA will become more relevant; and
- Of all the blind people of working age, only around one third are employed[13] (and most of these are partially sighted rather than SSI) which further reduces the number of individuals with sufficient income.

E.9 It has been suggested that BPA is badly targeted as it only benefits those with sufficient income (or who have spouses with sufficient income). Meanwhile those on the lowest (or nil) incomes gain no benefit from the additional relief and presumably have to recourse to other benefits.

E.10 It is not possible for associations for the sight impaired to promote the scheme to those who need it as they do not have access to the local authority register and are only in contact with around one third of blind and partially sighted people[14]. However as blind and partially sighted people is one of the targeted groups for the digital switchover, we understand that the register of blind persons has been shared with Digital UK. It may therefore be possible to share the information with other third parties, such as these associations, so they could promote the relief.

Complexity, compliance costs and administrative burden

E.11 In order to claim the relief the individual must be registered blind with the local authority, and then send the certificate to HMRC. This certification system is in the process of transitioning to an electronic version.

E.12 There is a HMRC helpline that received around 380 calls a month two years ago[15] when the Royal National Institute of Blind People ("RNIB") last promoted it, although this is likely to have reduced as it has been promoted less recently.

E.13 Once an individual is registered with HMRC for BPA, there is no need to register again, as there are virtually no improvements in the sight, and most actually worsen. On an ongoing basis, the allowance is added to the personal allowance and for blind employees it will be added to the PAYE code.

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[11] RNIB
[12] RNIB
[13] RNIB
[14] RNIB
[15] RNIB

E.14 In order to transfer the allowance or surplus to a spouse, there is a simple election[16].

E.15 For many blind people it can be difficult to claim the relief as they have difficulty in completing the forms.

Summary

E.16 The policy rationale remains valid in principle, in that it does give a tax benefit to blind persons. It is a simple relief to claim, but the take up of the relief is low. It is of no benefit to many of those who are eligible.

E.17 It may be possible to increase the take up by local authorities sending a certificate direct to HMRC, and so the allowance could be automatically available rather than the onus being on the taxpayer to claim; with an electronic version, this could be made easier. This would be an additional burden on HMRC, but it would remove the need for the helpline and would remove the burden from the individual. This would deliver a useful piece of administrative simplification where it is most needed – to sight impaired taxpayers.

E.18 However, given the fact that most blind people do not earn sufficient income to make use of the allowance we have to question whether the relief is really achieving its policy objective. It seems to us from our work that it would be better to replace the allowance with grants that are targeted at those theoretically eligible for the relief. This could be done as a component of the new Universal Credit. Fundamentally we think that the tax system does not appear to be the optimal method to achieve the policy objective.

E.19 Accordingly, we recommend that the relief is abolished, but strictly on the basis that the funds theoretically available for the relief are directed to potential claimants via other routes.

Sea walls

E.20 This relief[17] gives a landlord or tenant relief for expenditure on constructing a sea wall or embankment to protect any let premises against the sea or a tidal river. Whilst expenditure on the repair and maintenance of a sea wall would generally qualify as an allowable expense, the construction of a wall is capital and, in the absence of this relief, would not qualify for any tax relief. The relief is given over 21 years.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

E.21 The rationale behind this relief is to assist property rental businesses that are threatened by the sea. In addition, the construction of a sea wall may provide a wider public benefit, as it will also protect neighbouring land and property.

E.22 We have received a representation that the protection of sea walls can be critical to national security interests and that not only should the relief be retained, but that it should be extended to deductions from trading, as well as property, income.

E.23 The rationale remains valid and it is considered that this tax relief is the most cost effective way of delivering the objective.

[16] ITA 2007 s39

[17] ITTOIA 2005 ss315–318

Taxpayer take up and awareness

E.24 Taxpayers who use the relief are owners of property letting businesses located in coastal areas and liable to flooding by the sea. There is, however, no information as to the number of users, as there is no requirement to separately identify information on sea walls on the tax return.

Complexity, compliance costs and administrative burden

E.25 The legislation is not complex and even though there will be a compliance cost of ensuring that the deduction is claimed over the twenty one year period this is unlikely to be substantial.

E.26 The tax savings from this relief are not known.

Summary

E.27 The rationale for this relief is still valid and it is not complex to claim. We recommend that it be retained.

E.28 Consideration should be given to extending the relief so that the deduction is against trading income and not limited to property income.

Finance leasing arrangements – various reductions

E.29 These measures were introduced to counter leasing avoidance schemes prevalent at one time where either what would normally be income was being received in a capital form or arrangements had been entered into which skews taxation of the rental income. The legislation[18] works as a whole to ensure the correct amount of income is taxed at the correct time.

E.30 Various reductions are provided for to avoid a double tax charge.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

E.31 The rationale for the relief is to avoid double taxation, and as such remains valid.

E.32 If the entire regime were removed, there is likely to be an increase in avoidance schemes and therefore that part of the regime also remains valid.

Taxpayer take up and awareness

E.33 The number of users is unknown.

Complexity, compliance costs and administrative burden

E.34 The legislation is complex in order to counter complex avoidance schemes. We understand that a project looking at the taxation of leasing transactions has commenced due to proposed changes to the accounting for leases.

E.35 As part of that project, complex anti avoidance legislation such as this will be reviewed to ascertain whether it is still required within any new legislation and, if so, whether it will be possible to simplify it without putting revenue at risk. Our work has undoubtedly endorsed the need for such a review.

[18] ITA 2007 ss614BG, 614BK, 614BL and 614BN

Summary

E.36 As the regime is being looked at separately, we do not recommend looking into this relief any further.

Mineral royalties

E.37 Any mineral royalties received by a landowner are treated as 50% income and 50% capital, and this applies to both individuals[19] and companies[20].

E.38 Qualifying royalties are those received under an agreement under which minerals are being, or are to be, worked in the UK, and only payments relating to getting at the minerals and getting them out of the ground are eligible.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

E.39 This provision was originally enacted in 1970[21] and broadly provides relief for land owners to encourage them to make their mineral assets available to the nation. In so doing the relief contributes to the UK economy.

E.40 Prior to this, landowners were faced with a choice of either releasing their minerals for a negligible after tax sum (due to very high income tax rates) or retaining them. To address this barrier to mineral exploitation, this relief provides that 50% of the mineral royalty is to be treated as subject to capital gains tax (and thus at a lower rate, and subject to annual exempt amounts), while the other 50% remains subject to income tax.

E.41 The current highest rate for income tax (50% for 2010/11) is much lower that the rates in the 1970s, and so there is a case for arguing that the original rationale no longer exists; i.e. that there is no longer a market failure in relation to incentives for landowners to exploit their land. Also, to the extent that the relief is capable of driving landowner behaviour, much of this impact could be expected to have occurred already, given the length of time the relief has been in existence.

E.42 Mineral bearing land has always been considered to be a wasting asset, in that it cannot be replaced once it has been worked out. However, to the extent that mineral extraction reduces the value of the land, relief is available if or when the land is sold, in the form of reduced capital gains or capital losses on the sales proceeds. Allowing special relief for the income as well could be viewed as providing double relief.

Taxpayer take up and awareness

E.43 We understand that there are around 1,200 leased mineral quarries in England. Land owners with mineral rights, and the mineral extraction industry, would lose out if this relief did not exist.

Complexity, compliance costs and administrative burden

E.44 This relief is not complex as the income is split 50:50 rather than involving detailed calculations. However, the relief is more complex than simply treating all of the proceeds as income.

[19] ITTOIA 2005 s157 and TCGA s201
[20] CTA 2009 s258 and TCGA s201
[21] FA 1970 s29

Summary

E.45 Even though the relief is relatively simple, the rationale for the relief has reduced as the highest rate of income tax is somewhat lower than at the time the relief was introduced. The differential does remain significant (50% v 28%) though.

E.46 We recommend that the relief be retained for the present, but it is a candidate for abolition if the 50% additional rate is removed at some future date.

Post cessation trade relief

E.47 The relief allows a person who has ceased trading within the last seven years to claim relief for certain payments made, or certain losses on debts, where the payments would be allowable if the trade had not ceased[22].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

E.48 As post cessation receipts are taxable, the original rationale for the relief is to provide fairness and symmetry of treatment.

E.49 This rationale remains valid and achieves the objective.

E.50 It may be possible to reduce the seven year time limit; however, this cannot be achieved without a similar reduction in the time for post cessation receipts.

Taxpayer take up and awareness

E.51 It is not possible to obtain an accurate number as the information on the tax return is for "post cessation losses and certain other losses". The total number of returns with such an entry for 2008/09 was 2,700[23]. Therefore it is expected that the total number of individuals claiming the relief is less than that.

E.52 The total cost to the Exchequer is less than £5million p.a.

Complexity, compliance costs and administrative burden

E.53 The relief is not complex to claim, primarily as there are likely to be few such payments. In addition, the criteria for a payment are well defined and easy to follow, as they are the same as would have been applicable when the individual was carrying on a trade.

Summary

E.54 The original rationale remains valid, as it provides fairness and symmetry.

E.55 We recommend that this relief be retained. Consideration should be given to reducing the limit for both this relief and the time for post cessation receipts to simplify administration by delivering earlier closure.

[22] ITA 2007 ss96 - 100
[23] HMRC estimate

Compensation for mis-sold personal pensions

E.56 Compensation received in respect of poor personal pension advice, is exempt from capital gains tax if the advice was given wholly or partly between 19th April 1988 and 30 June 1994.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

E.57 We have been unable to verify the original policy rationale; however it is likely to have been introduced for fairness.

E.58 The compensation payments were made to enable the individual to be in the same position as if the poor advice had not been given, and was therefore effectively an additional pension contribution. If the original contributions had been made, they would not have been subject to tax and therefore for fairness the compensations should also be exempt for tax purposes.

E.59 All cases were supposed to be registered by 31 March 2000[24], although cases registered after that date may be reviewed[25].

Taxpayer take up and awareness

E.60 There is no data to establish the current take up of the relief, although it is still being marketed[26].

Complexity, compliance costs and administrative burden

E.61 The relief is a simplification as there is no need to consider income tax or capital gains tax.

Summary

E.62 The policy rationale remains valid, as there may be individuals who have not yet registered. However, it is now 11 years since the deadline, and therefore we suggest that subject to an appropriate notice period, the relief should be abolished.

[24] http://www.fsa.gov.uk/Pages/Library/Communication/PR/2000/022.shtml
[25] http://www.claimsfinancial.co.uk/mis-sold-pensions/how-to-claim-compensation-for-your-mis-sold-pension.aspx
[26] http://www.claimsfinancial.co.uk/mis-sold-pensions/how-to-claim-compensation-for-your-mis-sold-pension.aspx

F Capital gains tax

Capital gains tax relief on disposal of private residence

F.1 Gains accruing to individuals on the disposal of their only or main residence, including land forming the garden or grounds, are wholly exempt from capital gains tax[1]. This is principal private residence relief ("PPR").

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

F.2 The relief ensures that an individual can replace their home with another without the proceeds of sale from the first home being diminished by a charge to capital gains tax. When the relief was introduced in Finance Bill 1965 it was seen as an important concession for owner-occupiers, not only to encourage home ownership as an attractive investment but also to assist both social and labour mobility[2].

F.3 The rationale for the relief remains as valid today as in 1965, if not more so, as not only is the measure a simplification for many taxpayers but we would expect that without this relief the residential property market could stagnate.

F.4 The repeal of this relief would potentially bring everyone who sells their main home within the charge, which could lead to an additional 800,000 individuals[3] completing a self-assessment tax return (although some of these may already file a return).

F.5 It would be difficult for HMRC to estimate the additional tax yield from the removal of this relief. We would need to understand fully the impact on individual behaviour, the housing market and wider consequences for other taxes such as Stamp Duty Land Tax ("SDLT") yields.

Taxpayer take up and awareness

F.6 The total number of houses sold in 2009/10 over £40,000 was almost 900,000[4], however this figure varies year on year depending on the state of housing market. We understand that there are no figures for which of these are main residences, but assuming that around 85-90% of these transactions do relate to main residences, then around 800,000 residences are sold each year.

Complexity, compliance costs and administrative burden

F.7 This relief is a significant simplification for the vast majority of taxpayers, as it prevents them from being within the scope of capital gains tax.

F.8 In certain cases we understand that this relief can be complex to apply as there are numerous conditions that need to be met, especially where there have been periods in which the house has not been a main residence, or has been let out. However there is no evidence that

[1] TCGA 1992 s222
[2] Hansard, 27 May 1965, Vol 713 col 997
[3] HMRC estimate
[4] HMRC estimate

the relief itself is complex; rather the number of conditions leads to complexity and areas of uncertainty. Consequently it may simply be a case of these conditions being rewritten in an easier to understand format, for example as a checklist or a flowchart.

F.9 There must be scope for revising the various exemptions, testing how many are still necessary or valid and whether they can be replaced by simpler, more pragmatic rules. There is also the issue of the 'last three years' relief[5], which is there for the sensible reason that a taxpayer who finds himself unable to sell his old house is not penalised for having bought his new house on schedule. However this supports the practice of 'flipping', and it is questionable whether the period is too long.

F.10 In any event, it would be sensible to develop some minimum criteria for a property to qualify as a PPR – minimum period of residence, appropriate evidence etc.

F.11 We have received several representations that the relief be replaced with a deferral relief, such that the tax is not due if reinvested in another property, with a lifetime exemption that would cover downsizing or a final sale. Whilst this would prevent much of the abuse, it would be a complication for many people as tax would need to be calculated (even if not payable) and records kept, potentially for a lifetime.

Summary

F.12 There is a continuing rationale, and abolition could have an adverse effect on the housing market. It is also a significant simplification for the majority of those selling houses, however in anything other than straightforward cases it can be very complex, due to the number of different conditions.

F.13 We would therefore recommend that the relief be simplified. As the main complexity arises from the conditions, it is proposed that these conditions be

- Rewritten in a simpler format;
- Reviewed to test which are still appropriate; and
- Researched to see whether any can be streamlined.

F.14 We also recommend that minimum criteria are developed for a property to qualify as a PPR, such as a minimum period of residence in the property with appropriate evidence (such as utility bills etc).

F.15 We also suggest that the whole relief could be replaced, for example with a form of rollover relief, with a lifetime exemption, so any gain crystallised when downsizing or on death is covered for most people. However we do not believe that this would be a simplification and this cannot be looked at in isolation, without looking at the whole rationale and design of capital taxes.

Indexation allowance - share pooling rules

F.16 When calculating capital gains for companies, relief is available in the form of an indexation allowance, which takes inflation into account. For individuals, indexation was replaced by taper relief in 1998 and by the flat rate of 18% from 2008 (which was increased again in 2010 for higher rate taxpayers to 28%[6]). However for companies indexation is still relevant.

[5] TCGA 1992 s223

[6] F(No2)A 2010 Sch 1 para 1

F.17 Share pooling is a method whereby acquisitions of shares in a company are added to a pool, with the pool being treated as a single asset[7]. Indexation is added to the pool each time an acquisition or disposal is made. In the pool each share loses its identity and an average cost per share is calculated.

F.18 When shares are disposed of, there is a prescribed order for disposals as follows:

- Acquisitions on the same day;
- Acquisitions in the previous 9 days;
- Shares in the pool;
- Shares held prior to 1982 (the date indexation was introduced);
- Shares held in 1965 (the date capital gains tax was introduced); and
- Subsequent acquisitions.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

F.19 The rules governing the operation of the pool (and the order of disposal) are very prescriptive, and ensure consistent and uniform treatment, as a number of approaches could be taken in the absence of the rules.

Taxpayer take up and awareness

F.20 This relief is applicable to all entities subject to corporation tax, but is of greater relevance to investment companies that hold, and make regular disposals of, shares.

F.21 Since the introduction of the substantial shareholding exemption in 2002[8], and provided that certain conditions are met, including that a company has a holding of more than 10% of the ordinary share capital of another company, any gain is exempt and any loss is not available for offset.

Complexity, compliance costs and administrative burden

F.22 Without any pooling, when a disposal is made, the original acquisition details are needed, including the cost and date. If the pool is updated each time there is an acquisition, this issue is removed. In addition, the pooling rules remove the need to identify which shares have been disposed in a part disposal (which in many cases would be impossible).

F.23 However, in many cases, the pool is only updated when there is a disposal, and therefore the only simplification is avoiding the need to identify shares.

F.24 We have received representations from advisers and stakeholders that the calculation of chargeable gains in companies should be reviewed. The rules are seen as complex and the two separate chargeable gains regimes (as there is no indexation for individuals) can cause confusion for smaller advisers and taxpayers.

F.25 Removing the relief for indexation would make computations simpler and reduce administrative costs for companies and for HMRC.

[7] TCGA 1992 s110
[8] FA 2002 s44 and Sch 8 (inserting TCGA 1992 Sch 7AC)

Summary

F.26 Whilst the relief itself is very prescriptive, and easy to follow, we would recommend that rather than looking at this relief in isolation, the whole system of indexation should be reviewed and potentially abolished. Consideration should be given to replacing indexation with a lower rate of corporation tax on gains, to reflect the inflation element.

Chattels exceeding £6,000 in value (marginal relief)

F.27 If a chattel with an original cost of less than £6,000 is sold for less than £6,000, the gain is exempt from capital gains tax[9].

F.28 If the original cost is less than £6,000 and it is sold for an amount greater than £6,000 then rather than the full gain being chargeable, it is limited to the lower of[10]:

- the actual gain made; and
- five-thirds of the difference between the sale proceeds and £6,000.

Box F.1: Example of marginal relief[11]

Mr X sells an antique table for £7,000. The table cost £2,900 two years ago. Without any relief, the gain would be £4,100 (i.e. £7,000 - £2,900).

However, with marginal relief the gain is as follows:

5/3 x (£7,000 - £6,000) = £1,667

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

F.29 This relief was introduced to prevent a 'cliff edge' liability where proceeds exceed the £6,000 limit by a small amount, and this rationale remains valid.

F.30 However the limit of £6,000 could be reviewed. It was £1,000 when capital gains tax was introduced in 1965[12], and increased in stages to its current level in 1989[13]; if it had increased in line with the RPI index, it would now be almost £11,600[14].

Taxpayer take up and awareness

F.31 There is no data on this relief, however it is estimated that there are around 1,000 beneficiaries[15] each year, with total savings in the low millions[16].

F.32 It is a well known relief and is easy to find in HMRC's Capital Gains Tax Manual[17].

[9] TCGA 1992 s262
[10] TCGA 1992 s262(2)
[11] http://www.taxationweb.co.uk/tax-articles/general/capital-gains-tax-and-antiques.html
[12] FA 1965 s30
[13] FA 1989 s123
[14] (216.9-112.3)/112.3 = 0.931. £6,000 x (1+0.931) = £11,586. RPI at April 1989 = 112.3. RPI at December 2010 = 216.9
[15] HMRC estimate
[16] HMRC estimate
[17] HMRC Capital Gains Tax Manual CG76500subc etc seq

Complexity, compliance costs and administrative burden

F.33 The relief adds some complexity as it requires two calculations to be performed, however both are straightforward.

Summary

F.34 The policy rationale remains valid and the impact of the relief on complexity is negligible, and we would therefore recommend that this relief be retained.

F.35 However, we would also recommend that the £6,000 value for chattels be updated. This would lead to many more disposals being removed from the capital gains tax net, and would therefore be a simplification for large numbers of individuals.

Superannuation funds

F.36 There is no CGT charge on the disposal of[18]:

- rights to certain payments from a superannuation fund if the fund was established solely or mainly for persons employed in a profession, trade, undertaking or employment, and their dependants; or
- certain annuities or annual payments due under unsecured covenants.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

F.37 The relief was introduced in 1965[19] in order to avoid the need to take account of minimal profits or losses on short term covenants[20].

F.38 We have not been able to obtain any information as to why superannuation funds were exempted and thus are not able to conclude whether or not the policy rationale is still valid.

Taxpayer take up and awareness

F.39 There is no information available.

Complexity, compliance costs and administrative burden

F.40 There is no information available.

Summary

F.41 Due to lack of information, we are not able to reach a conclusion as to whether this relief should be retained or abolished. However, that lack of information and representations may indicate a relief that is little used and so could be abolished.

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[18] TCGA 1992 s237
[19] FA 1965 Sch 12 para 7
[20] *Rank Xerox Ltd v Lane 53 TC 185*

G Inheritance tax

G.1 In the initial list of 1,042 reliefs that was originally published on 8 November 2010, 89 inheritance tax ("IHT") reliefs were identified. In our interim report, published on 13 December 2010, we committed to consider 6 in Annex A, with a further 21 for consideration in Annex B.

G.2 IHT succeeded capital transfer tax ("CTT"), which was an integrated lifetime transfer and estates tax; the legislation was in the Capital Transfer Tax Act 1984. This was renamed the Inheritance Act 1984, when IHT replaced capital transfer tax with effect from 25 July 1986.

G.3 Receipts from IHT for 2008/09 were £2.8 billion, with the 2009/10 estimate set at £2.4 billion and the 2010/11 projection £2.3 billion[1]. The cost of three major IHT reliefs is as follows for 2009/10[2]:

	£'m
Agricultural property[3]	185
Business property[4]	190
Exemptions of transfers to charities on death[5]	335

G.4 Many of the reliefs in respect of IHT (for example potentially exempt transfers) are integral to the operation of the tax and define what is taxed and when. In addition there are also a number of complex and small reliefs.

G.5 An example of a relief relates to monetary gifts on the occasion of a marriage or civil partnership; this provides that gifts of up to the following amounts can be made exempt from IHT[6]:

- Parents can gift up to £5,000 each
- Grandparents can gift up to £2,500 each
- Any other person can gift up to £1,000

These limits have not increased since the introduction of CTT in 1975[7].

G.6 Similarly the annual allowance of £3,000 has not increased since 1981[8].

G.7 It would clearly be sensible as a simplification move to uprate the small monetary reliefs, for example the annual exemption would now be almost £6,000[9]. But it would equally be fair to consider the reliefs in the context of subsequent developments, in particular the impact of PETs and the transferable nil rate band.

[1] Red Book Budget 24 March 2010, Appendix C Table C.6
[2] HMRC Ready Reckoner
[3] IHTA 1984 Part V Chap I
[4] IHTA 1984 Part V Chap II
[5] IHTA 1984 s23
[6] IHTA 1994 s22(1)
[7] FA1975 s29 and Sch6
[8] FA1981 s94(1)
[9] (216.9-74.07)/74.07 = 1.928. £3,000 x (1+1.928) = £5,784. RPI at April 1981 = 74.07. RPI at December 2010 = 216.9

G.8 It was estimated in 2009 that the average annual number of deaths is 560,000 and the number ofestates paying IHT in 2009 would be 12,000, the lowest since records began in 1938[10] (for IHT and predecessor taxes).

G.9 On the basis of the low number of estates caught by IHT and the useful, but relatively low revenues (after reliefs) that it raises, we consider that a more appropriate approach may be to review the whole of IHT rather than to consider individual IHT reliefs. Such a review may also encompass a review of capital gains tax and we envisage this as a longer term project.

[10] Guardian 11 October 2009 http://www.guardian.co.uk/money/2009/oct/11/inheritance-tax-labour-decrease-propertynnex C Table C.6

H Stamp duty

Partial relief for company acquisitions

H.1 Where one company acquires the whole or part of the undertaking of another company, subject to certain conditions being met, FA 1986 s76 provides for a rate of stamp duty at 0.5%[1] to be claimed.

H.2 Broadly the conditions are:

- That the consideration consists of or includes the issue of non-redeemable shares in the acquiring company to the target company, or to its shareholders[2]; and
- The only other element of consideration is cash not exceeding 10% of the nominal value of the shares, or the assumption or discharge of liabilities of the target company[3].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

H.3 Between 1986 and 2003 the rate of stamp duty charged on instruments transferring land was between 0% and 4% (depending on the value or amount of consideration and the date of transfer), and 0.5% for transfers of stock and marketable securities[4].

H.4 This relief charged acquisitions involving land at the stamp duty rate for share transfers rather than at the rate applicable to land transfers.

H.5 From 1 December 2003 stamp duty only applies to instruments relating to shares and securities[5], and the rate of stamp duty is 0.5%, so the policy rationale of having a "reduced rate" of stamp duty is no longer relevant. There are equivalent SDLT relief in FA 2003 Sch 7 para 8.

Taxpayer take up and awareness

H.6 The relief has no current application.

Complexity, compliance costs and administrative burden

H.7 The relief has no current application.

Summary

H.8 As the policy rationale is no longer relevant we recommend that this relief is abolished.

[1] FA 1986 s76(4)
[2] FA 1986 s76(3)(a)
[3] FA 1986 s76(3)(b)
[4] FA 1986 s64(1) (repealed by FA 1999)
[5] FA 2003 s125

Exempt instruments

H.9 Certain instruments that would otherwise be chargeable to £5 fixed stamp duty are exempt if they are specified in regulations and certified[6]. The specific instruments are in the Stamp Duty (Exempt Instruments) Regulations 1987[7].

H.10 The regulations give details of the certification requirements as well as specifying instruments that are to be exempt, which are those executed on or after 1 May 1987[8] and include:

- The vesting of trust property in the trustees on the appointment of a new trustee[9];
- The conveyance or transfer of property forming part of an intestate estate to the person entitled on intestacy[10]; and
- The grant of a servitude for no consideration in money or money's worth[11].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

H.11 The policy rationale behind this relief was to streamline the stamp duty system allowing certain instruments specified by HM Treasury to bypass the Stamp Office thereby saving costs and reducing the administrative burden both for HMRC and the taxpayer as well as allowing the Stamp Office to concentrate on those documents liable to ad valorem duty[12].

H.12 Fixed charges were abolished from March 2008[13] and so the Regulations have no effect.

Taxpayer take up and awareness

H.13 The relief has no current application.

Complexity, compliance costs and administrative burden

H.14 The relief has no current application.

Summary

H.15 This exemption no longer has any application and we therefore recommend that it is abolished.

Instruments relating to National Savings

H.16 This relief provides that "instruments made or executed for the purpose of any savings committee, savings group or other body affiliated to the National Savings Committee, or the Scottish Savings Committee"[14] are exempt from stamp duty[15].

[6] FA 1885 s87(2)
[7] SI 1987/516
[8] SI 1987/516 Part 2
[9] SI 1987/516 Reg 4A
[10] SI 1987/516 Reg 4C
[11] SI 1987/516 Reg 4K
[12] HMRC internal briefing
[13] FA 2008 s99
[14] FA 1953 s31(1)
[15] FA 1953 s31

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

H.17 Prior to Budget 1953 National Savings instruments were not stamped, as it was assumed that they were exempt in a similar fashion to instruments in relation to the Post Office Savings Bank[16] and the Trustees Savings Banks[17]. However, following an enquiry, it was found that some of the affected instruments should have been subject to stamp duty and the National Savings Committee requested a statutory exemption which was included in Finance Act 1953.

H.18 These instruments are no longer chargeable to stamp duty. From 1 December 2003 stamp duty was abolished except on instruments relating to stock or marketable securities[18]. The definition of "stock or marketable securities" does not include instruments relating to National Savings[19].

Taxpayer take up and awareness

H.19 The relief has no current application.

Complexity, compliance costs and administrative burden

H.20 The relief has no current application.

Summary

H.21 As stamp duty no longer applies to National Savings instruments, the policy rationale is no longer valid and we recommend that this relief should be abolished.

Transfer to registered social landlords

H.22 Transfers of interests in land by registered social landlords ("RSLs") in the following circumstances are exempt from stamp duty[20]:

- Where the RSL is controlled by its tenants;
- Where the vendor is a central or local government body or social housing provider; or
- Where the purchase is funded by the assistance of a public subsidy.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

H.23 This measure was introduced in Budget 2000 to "promote social housing"[21].

H.24 The policy rationale is still valid but, following the introduction of stamp duty land tax from 1 December 2003, the provision has been replaced by FA 2003 s71which provides for an exemption from stamp duty land tax.

H.25 Theoretically the relief is still applicable and has not expired as the stamp duty provisions still apply to transactions that are resting on contract. However, as noted above, there is no tax driven reason to "rest on contract", and it is therefore considered unlikely that there will be any outstanding claims in relation to this relief.

[16] By virtue of Post Office Act 1908
[17] By virtue of Trustee Savings Bank Act 1863
[18] FA 2003 s125
[19] SA 1891 s122
[20] FA 2000 s130
[21] Budget 2000 Rev 5, 21 March 2000

Taxpayer take up and awareness

H.26 We have not been able to verify the usage, but it is expected to be nil[22].

Complexity, compliance costs and administrative burden

H.27 It is unlikely that there is any current complexity as the usage is expected to be nil.

Summary

H.28 This exemption no longer has any practical application and we therefore recommend that it be abolished, subject to an appropriate notice period for taxpayers to organise their affairs.

Certain leases granted by social landlords – FA 2003 ss128-129

H.29 Certain tenancy agreements entered into by registered social landlords ("RSLs") are exempted from stamp duty[23] . This relief was introduced in 2003 and applied retrospectively to agreements entered into after 1 January 2000.

H.30 With the introduction of stamp duty land tax from 1 December 2003, this relief was replaced by FA 2003 Sch 3 para 2.

H.31 Theoretically the relief is still applicable and has not expired, as the stamp duty provisions apply to contracts entered into but not completed before the introduction of SDLT on 1 December 2003.

H.32 Not proceeding to completion was a common way of avoiding stamp duty. However, if there is no stamp duty to pay, there is no tax driven reason to rest on contract, and it is therefore considered unlikely that there will be any outstanding claims in relation to this relief and we recommend that the relief should be repealed, subject to an appropriate notice period for taxpayers to organise their affairs.

Disadvantaged area relief (FA 2001 ss92 – 92B and Sch 30)

H.33 This relief provided an exemption from stamp duty on land transactions in certain disadvantaged areas.

H.34 With the introduction of stamp duty land tax from 1 December 2003, this relief was replaced by FA 2003 s57 and Sch 6 "Stamp duty land tax: disadvantaged areas relief".

H.35 The relief in FA 2001 still applies to contracts entered into before 1 December 2003 but not completed. However, we understand from HMRC that it is unlikely that there are any outstanding claims for this relief and we recommend that the relief should be repealed, subject to an appropriate notice period for taxpayers to organise their affairs.

H.36 There is little evidence that disadvantaged area relief (either under the stamp duty or stamp duty land tax provisions) is, or has been, a significant factor in purchasing decisions[24] and also that the definition of qualifying areas is based on outdated indices of deprivation[25]. Consideration should be given as to whether the successor to this relief in FA 2003 s57 and Sch 6 should be reviewed.

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[22] HMRC estimate
[23] FA 2003 ss128 - 129
[24] HMRC
[25] HMRC

Shared ownership schemes (FA 1980 s97)

H.37 These provisions gave relief from stamp duty and applied to shared ownership transactions. The policy rationale was to encourage home ownership by those on lower incomes.

H.38 With the introduction of stamp duty land tax from 1 December 2003, these provisions were replaced by FA 2003 s70 and Sch 9 "Stamp duty land tax: right to buy, shared ownership leases etc".

H.39 This relief still applies to contracts entered into before 1 December 2003 but not completed. However we understand from HMRC that it is unlikely that there are any outstanding claims for this relief and we recommend that the relief should be repealed, subject to an appropriate notice period for taxpayers to organise their affairs.

Visiting forces and allied headquarters (FA 1960 s74)

H.40 This provision exempted any contracts made with a view to building or enlarging barracks or camps etc by a visiting force of a designated country from stamp duty. The provision was introduced to comply with international obligations

H.41 It was replaced by FA 1960 s74A "Visiting forces and allied headquarters (stamp duty land tax exemption)" with effect from 1 December 2003 when stamp duty land tax was introduced.

H.42 This still applies to contracts entered into before 1 December 2003 but not completed. However, we understand from HMRC that it is unlikely that there are any outstanding claims for this relief and we recommend that the relief should be repealed, subject to an appropriate notice period for taxpayers to organise their affairs.

Private finance initiatives and public private partners

H.43 Certain transactions involving public or educational bodies (i.e. public private partnerships ("PPP") or private finance initiatives ("PFI") transactions dealing with infrastructure) have a partial relief from stamp duty land tax[26].

H.44 The transactions that are exempt are broadly where[27]

- There is a grant or transfer of a lease of land by a qualifying body (e.g. a public body or further education corporation[28] to a non qualifying body;
- In consideration of the transfer the non qualifying body leases back the land to the qualifying body;
- The non qualifying body provides services to the qualifying body; and
- Some or all of the consideration given by the qualifying body for those services is money.

[26] FA 2003 Sch 4 para 17
[27] FA 2003 Sch 4 para 17(1)
[28] FA 2003 Sch 4 para 17(2)

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

H.45 The policy rationale was to prevent a double charge to stamp duty land tax where works are paid for out of public funds. It was recognised that PFI and PPP initiatives have "an important role to play in the investment and development of the country's infrastructure"[29] and the provision is designed to ensure that private contractors entering into PPP/PFI agreements can ignore stamp duty land tax for the purpose of their costings, after the initial land transfer.

H.46 The policy rationale is still valid.

Taxpayer take up and awareness

H.47 It is not known how many users there are of this relief as there is no requirement to specify the relief being claimed.

Complexity, compliance costs and administrative burden

H.48 As the relief ensures that private contractors can ignore stamp duty land tax after the initial land transfer, this relief is a simplification.

Summary

H.49 The policy rationale remains valid and this relief is a simplification.

H.50 We recommend that this relief is retained.

Nationalisation schemes

H.51 Transfers to the Crown or Crown appointed bodies in connection with nationalisation schemes are exempt from stamp duty[30].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

H.52 The policy rationale was to ensure that where an industry was being nationalised no liability to stamp duty would arise on the Crown or Crown appointed bodies on transfers to them.

Taxpayer take up and awareness

H.53 It is not known how well used the relief is, but it is expected to be negligible[31].

Complexity, compliance costs and administrative burden

H.54 As the usage is expected to be very small, the complexity is likely to be minimal[32].

Summary

H.55 The rationale remains valid and the relief is a simplification.

H.56 We recommend that this relief be retained.

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[29] Paul Boateng MP (Chief Secretary to the Treasury), Finance Bill Committee, Hansard session 2002/03 col 373, 5 June 2003
[30] FA 1946 s52
[31] HM Treasury
[32] HMRC estimate

I

Charities

I.1 This annex details three reliefs that relate to charities. The first two involve relief for certain donations and have been dealt with together as they are similar. The other was considered in our interim report and deals with VAT zero rating on supplies to and sales by charities.

Gifts of qualifying investments to charity

I.2 In general terms, if an individual or company disposes of the whole of an interest in a qualifying investment to a charity, tax relief can be obtained on the value of the gift (plus any costs of disposal)[1]. The relief is reduced if any benefit is received, and there are special rules if the asset is sold to the charity at an undervalue.

I.3 A qualifying investment includes[2]:

- Listed shares (including AIM and PLUS);
- Units in an authorised unit trust;
- Interest in an offshore fund; and
- Freehold or leasehold (if for a specified length of time) land.

Gifts of trading stock to charity

I.4 If a sole trader, partnership or company donates an item of finished stock, that would usually be sold as part of the trade, to a charity, no receipt needs to be brought into account for tax purposes[3].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

I.5 We have not been able to confirm the policy rationale for this relief but understand that it was to encourage giving to charities.

Taxpayer take up and awareness

I.6 There is no information available.

Complexity, compliance costs and administrative burden

I.7 These reliefs are both simplifications for the donor, as they mean there is no need to sell the item and subsequently donate the cash.

I.8 For the charity it is also a simplification if the item is one that could be used by the charity. If the charity preferred to have the cash and so would have to sell the item in order to realise the

[1] ITA 2007 s431 and CTA 2010 s203
[2] ITA 2007 s432
[3] ITTOIA 2005 s108 and CTA 2009 s105

value, the relief adds complexity. However, the assets covered by the relief are those with a ready market and so the additional complexity is minimal.

I.9 We have had it suggested that the relief could be simplified by extending it to cover all assets, in particular unquoted shares. Whilst that would be a simplification for the donor, it would add a burden to the charity which would have to find a market; it would also raise questions of valuation of assets without a ready market. We do not, therefore, support such a move.

Summary

I.10 As the likely rationale remains valid and the relief is a simplification, we recommend that it is retained.

VAT: supplies to charities/ sales by charities

I.11 Sales by charities of donated goods and some supplies to charities are zero rated under VATA 1994 Sch 8 Group15.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

I.12 The zero rating of, inter alia, supplies to charities was negotiated by the UK prior to entry into the EU in 1973. If a category of zero rating is amended or abolished it will be subject to the standard or reduced rate of VAT thereafter.

I.13 Other zero-rated supplies for charities include: the construction of certain buildings to be used for charitable purposes[4]; supplies to charities of lifeboats and their repairs and maintenance, for providing rescue or assistance at sea[5]; and supplies to charities of talking books and wireless sets for the blind[6].

I.14 On 19 October 2010, the Exchequer Secretary to the Treasury stated in Parliament that the Government was committed to retaining those zero rates which charities currently benefit from[7].

Taxpayer take up and awareness

I.15 This relief is available to all charities in the UK of which there are in the region of 250,000[8]. The number of charities benefiting from this relief is not known.

Complexity, compliance costs and administrative burden

I.16 The Exchequer cost of the supplies to charities relief is estimated to be over £200m[9], however we understand that there are no available figures for the sales by charities of items covered by the relief.

I.17 We understand that this zero-rating is sometimes a complex relief for the charities to claim, owing to the need to determine whether certain goods or services are eligible for relief. Zero-rating does increase the administrative burden of accounting for VAT on the sale of such goods, because a record must be kept of why the supply was zero-rated. However the savings in VAT help to preserve charities' income.

[4] VATA 1994 Sch 8 Group 5
[5] VATA 1994 Sch 8 Group 8
[6] VATA 1994 Sch 8 Group 4
[7] Hansard, 19 October 2010, Vol 516 col 925
[8] HMRC
[9] HMRC estimate. In addition, this includes the impact of charity building relief (no. 996 in our original list) and sea rescue relief (no. 1026 in our original list)

Summary

I.18 There is a current commitment to retaining the charities zero rates and these provide significant benefits to the charity sector.

I.19 We therefore recommend that this relief be retained; however the guidance could be revised and clarified to simplify the administrative burden.

J

Maritime

J.1 As an island nation the UK has been dependent on its merchant fleet and seamen, not only for trade, but also to assist the Royal Navy in times of conflict (e.g. the 1982 Falklands conflict and the 1991 Gulf War). The tax system recognises the strategic importance of the UK retaining both its merchant fleet and its maritime skills base.

Tonnage tax

J.2 The tonnage tax regime is a low tax regime introduced in Finance Act 2000[1] to support the shipping industry.

J.3 It is an optional regime under which taxable profits are calculated by applying a standard daily profit rate to the net tonnage of each ship operated (i.e. owned or chartered) by a shipping company and multiplying this by the number of days operated. The tonnage tax replaces the tax adjusted commercial profit or loss on a shipping trade and the chargeable gains or losses made on tonnage tax assets. The tonnage tax profits are then aggregated for all ships in the company's fleet.

Box J.1: Tonnage tax example[2]

A shipping company operates a 250 ton supply vessel for 365 days a year.

The standard daily profit rate for each complete 100 net tons up to 1,000 is £0.60

The tonnage tax profit is 2 x 0.6 x 365 = £438

Thus corporation tax at 28% is £123

J.4 The tonnage tax legislation also has a training requirement[3] that requires a shipping company or group to meet certain minimum requirements in relation to training seafarers[4] as a condition of entry into the tonnage tax regime. This ensures the delivery of training of officer cadets to preserve the UK maritime skills base.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.5 The regime was introduced following a review into the state of the British shipping industry in 1998[5], and this was followed by another report "British Shipping: Charting a new course"[6] in December 1998, which gave the Government's strategy for reviving the shipping industry. This

[1] FA 2000 s82 and sch 22
[2] HMRC Tonnage Tax Manual TTM 01010
[3] FA 2000 Sch 22 Part IV
[4] FA 2000 Sch 22 para 23
[5] DETR White paper "The Future of Transport", 1998
[6] Department of Transport strategy paper, December 1998

paper committed the Government to discussing "the fiscal options with the shipping industry …"[7].

J.6 Other jurisdictions had previously introduced tonnage tax regimes for similar reasons e.g. the Netherlands, and on 12 August 1999 Lord Alexander of Weedon published his report "Independent enquiry into a tonnage tax". This recommended a tonnage tax system modelled on the Netherlands regime, with some modifications:

Box J.2: Tonnage tax enquiry

"The tonnage rate is generally set so that notional profits, and hence actual corporation tax paid, are minimal. The mechanism seems to be an ingenious device for obtaining virtual tax exemption compatible with international tax treaty obligations. It departs from normal corporation tax principles of taxing actual profits to introduce a notional basis which bears no relationship to actual profits earned." [8]

"If the shipping industry is to be revived, a package of measures is necessary, as is recognised in *Charting a new course*. It is obviously important to examine sympathetically the case for other potential measures which may improve the competitiveness of the UK shipping industry, such as extending the Foreign Earnings Deduction and expanding the Crew Relief Costs Scheme. But I believe that a form of tonnage tax is fundamental to this package."[9]

J.7 The policy rationale is still valid as it enables the UK to compete on broadly the same basis as its competitors, and prevents the loss of key shipping sectors to overseas territories. The training requirement also ensures that the maritime skills base is preserved.

J.8 If tonnage tax were to be abolished there is a danger that, in a highly mobile industry where shipping companies can migrate from the UK and register their ships in foreign jurisdictions at short notice, companies would abandon the UK.

Taxpayer take up and awareness

J.9 At 1 October 2010 84 groups had elected to use the tonnage tax regime[10]. This represents a fleet of 903 ships with a combined tonnage of 26,064,952 gross registered tons[11].

J.10 During the year ended 1 October 2010 2,077 individuals received training under a tonnage tax training commitment[12].

J.11 Tonnage tax currently raises approximately £4.1million per annum[13]. Were the regime to be abolished the theoretical additional Exchequer revenues would be reduced by the geographical mobility of the shipping industry.

J.12 In the absence of a tonnage tax regime there would be additional tax raised of around £170million[14].

Complexity, compliance costs and administrative burden

J.13 The administrative burden for companies who elect into the tonnage tax regime is estimated to be around £1million[15].

[7] "British shipping: charting a new course" Department of Transport December 1998, Chapter 5 "Implementation and conclusions"
[8] Lord Alexander of Weedon QC, "Independent inquiry into tonnage tax", August 1999, para 27
[9] Lord Alexander of Weedon QC, "Independent inquiry into tonnage tax", August 1999, executive summary para xiv
[10] HMRC
[11] HMRC estimate
[12] HMRC estimate
[13] HMRC estimate
[14] HMRC estimate

J.14 There are 49.5 pages of legislation devoted to this regime[16], although the basic calculation itself is relatively simple. The complexity arises from a special regime that applies to a specified industry sector; as it is a State aid the legislation has to comply with the European Commission guidelines on State aid for maritime transport[17]. Additional complexities have arisen to prevent the abuse of the low tax regime and there have also been a number of amendments to address attempts to obtain relief in situations outside the policy intentions.

J.15 We understand that when the regime was originally designed, consideration was given to the treatment of balancing charges on the disposal of ships owned at the time of entry into the regime. Whilst industry favoured a clean break with no future liability to balancing charges, the Government was concerned about allowance "harvesting" and drew up an elaborate set of rules.

J.16 There are some inequalities in the anti avoidance aspects of the regime, including the apportionment of interest payable between tonnage tax and non-tonnage tax activities; whilst interest receivable is all allocated to non-tonnage tax activities, the similar treatment of intra-group interest and finance costs adjustments which only work against the taxpayer.

Summary

J.17 We consider that this relief should be retained as it enables the UK shipping industry to compete effectively with overseas shipping industries subject to other generous maritime regimes. To abolish it would be detrimental to the UK shipping industry.

J.18 Consideration should be given to seeking to simplify the legislation, but this may not be possible until further European Commission guidelines allow simplification.

J.19 Consideration should also be given to amending the inequalities that arise due to the different treatment of interest receivable and payable, and adjustments in relation to finance costs under the tonnage tax regime.

Seafarers' earning deduction

J.20 ITEPA 2003 s378-385 provides 100% tax relief on earnings where duties as a seafarer are carried out wholly or partly outside the UK in an eligible period. A seafarer is an employee (other than a Crown employee) whose duties consist of "the performance of duties on a ship or of such duties and others incidental to them"[18].

J.21 Subject to certain conditions being met, the relief exempts a seafarer from liability to income tax on his earnings as a seafarer, provided that at least half of the qualifying period of 365 days is spent outside the UK, and that no more than 183 consecutive days are spent in UK during that period.

J.22 A further condition was that the claimant must be ordinarily resident in the UK, however the 22 June Budget 2010[19] provided that the residence condition would be extended so that the relief covers seafarers resident in the EU or EEA[20] from 2011/12.

[15] HMRC Standard Cost Model
[16] Tolley's Yellow Tax Handbook 2010/11, Part 1a
[17] Council Regulation (EC) No 1540/98
[18] ITEPA 2003 s384(1)
[19] Budget 22 June 2010 BN 31
[20] F(No 3)A 2010 s4

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.23 The reason for the relief is that the maritime industry is exceptionally competitive and international. The UK faces competition from a number of other shipping centres, particularly those in the Far East, Middle East and elsewhere in Europe and each of the territories are actively promoting their maritime interests[21]. The industry is highly mobile: registration of ships and the operating base of shipping companies can be moved away from the UK at short notice. Ships may be part of the UK fleet but may never come to the UK. Over the years Government policy and EU State aid policy has been to introduce measures to mirror the conditions in international markets for other fleets.

J.24 Seafarers have had special tax rules for many years due to the competitive nature of the industry, the requirement of a supply of seafarers for strategic reasons and the fact that they are often out of the UK for long periods of time. SED was introduced to provide an inducement for UK personnel to work at sea to secure the country's future maritime skills and ensure a supply of seafarers would be available to serve the UK in times of conflict. It has existed in its current form since 1991 when, in his Budget speech, Norman Lamont extended the scope of the existing SED so that more seafarers could benefit in the light of the 1991 Gulf War[22]:

Box J.3: Norman Lamont, 1991 Budget speech extract

"The Gulf hostilities have reminded us of the important contribution which our merchant navy can make to our defence. I recognise that there is a strategic case for measures to encourage shipping companies to draw their crews from seaman in the UK who would be willing and able to serve in time of war"

J.25 In 1998 the SED was reviewed, when the income tax relief on foreign earnings was withdrawn for all employees other than seafarers[23], thus recognising that the strategic aims of the SED were still relevant.

J.26 Representations from relevant stakeholders indicate that the concession is one of the advantages of being at sea, reflects the fact that seamen work away from home and that, as an island nation, the maritime industry is vital to the country. It is considered vital that the UK's seafaring heritage is maintained by encouraging more UK nationals to join the merchant navy, an industry with a variety of interesting jobs. At a time when the Government is actively seeking employment opportunities, the removal of the concession is not considered appropriate.

J.27 Many other European countries offer tax concessions for seafarers, albeit in different forms, e.g. Denmark has reduced rates of income tax, France reimburses all social charges for seafarers to employers and the Netherlands does not levy income tax and social security on personnel of Dutch-flagged ships if the operating company is based in the Netherlands[24].

J.28 It could be argued that the policy aim of encouraging UK crews on UK owned deep sea vessels for use in times of crisis or conflict remains of importance, especially in the light of the cuts in the Royal Navy. In the future, protection of the Falkland Islands and other overseas dependencies would be dependent on ships taken up from trade ("STUFT") as well as the Royal Fleet Auxiliary[25].

[21] Chamber of Shipping Memorandum to OTS, 11 January 2011
[22] Hansard HC Deb 19 March 1991, vol 188, col 173
[23] FA 1998 s63
[24] http://www.nautilusint.org/Campaigns/pages/SED%20in%20Other%20Countries.aspx
[25] http://www.royalnavy.mod.uk

J.29 However, whilst over 50 British flagged merchant vessels were taken up in 1982 in the Falklands conflict[26], only five were taken up in the 1991 Gulf War[27]. This indicates that the strategic aspect of the British merchant fleet is less significant than previously.

J.30 The UK shipping industry regards supporting the UK merchant fleet to be of continuing importance. A combination of the SED and tonnage tax has led to the revival of the UK shipping industry; in the period from 1980 – 2000 there was a reduction of 505 in the number of UK officers and ratings in the merchant navy but since 2000 the officer trainee intake has more than doubled from 450 to over 900 in 2010[28]. If SED were to be repealed, it is likely that this number would fall as the industry would be less attractive to new entrants, and existing mariners may relocate overseas to territories with a more favourable regime.

Taxpayer take up and awareness

J.31 It is considered that the take up is wide by a specific population as it applies irrespective of where a ship is registered and is not dependent on the nationality of the owner. It may also be claimed by a qualifying seafarer involved in any industry which requires duties to be performed on a ship wholly or partly outside UK territorial waters. There is no data on the sectoral impact available.

J.32 In 2008/09 17,000 seafarers claimed SED[29].

Complexity, compliance costs and administrative burden

J.33 The legislation is not generally considered to be complex, but some of the definitions no longer fit with the shipping industry in 2011, which leads to different interpretations and handling difficulties with a disproportionately adverse impact on HMRC resources. In addition there are different definitions of what constitutes a "ship" in different parts of tax legislation and these differ from the definition adopted by the Maritime and Coastguard Agency.

J.34 The relief is considered to be simple for taxpayers as there are relatively few conditions that have to be met in order to be eligible for it. SED is claimed by individual employees and a small number of employers operate NT ("no tax") codes for employees entitled to SED, but generally employers operate PAYE/NICs as normal with the responsibility for claiming the repayment of tax the responsibility of the employee.

J.35 Some complexity has been introduced into the legislation as a result of anti avoidance measures e.g. to ensure that those who were not originally intended to benefit (e.g. certain workers on vessels engaged in oil exploration) are excluded. There is no statutory definition of a ship, but case law provides that a ship must be "capable of navigation and is used in navigation"[30]. "Offshore installations", as defined in ITA 2007 s100, are specifically excluded from the definition of ship for SED purposes[31]. However, this exclusion introduces an inequality as such installations have a number of genuine seafarers who perform functions such as navigation and engine room watches, and these individuals do not benefit from the relief. This area has been further complicated by a case in January 2008[32] in which the Special Commissioners applied a wide definition of offshore installation which resulted in many seafarers losing the SED relief, and, although this definition has been modified by the First Tier

[26] http://www.hmforces.co.uk/training/articles/1624-the-falklands-conflict-op-corporate-part-1
[27] Hansard HL Deb 2 May 1991 vol 528 c859
[28] Representation from Chamber of Shipping
[29] HMRC estimate
[30] *Perks v Clark and others 74 TC 187*
[31] ITEPA 2003 s385
[32] *Torr and Others v CIR SpC 00679*

Tribunal in a subsequent case[33] the following year, there are still a number of issues surrounding the meaning of offshore installation.

J.36 The total Exchequer cost of SED in 2008/09 was £180million[34] and HMRC estimate that the extension to EU/EEA seafarers from 2011/12 will increase this by £5million[35].

Summary

J.37 SED is considered by stakeholders to be vitally important to underpin the future of the UK merchant fleet that provides professional maritime jobs and supports a wider service cluster. It maintains the competitiveness of the UK in an international market.

J.38 There is clearly scope to simplify the operation of the relief. Such simplification might also target the relief more tightly. The particular areas that we have suggested are based on recommendations from stakeholders and include which individuals serving on which type of vessel should be eligible for the relief. This could be done by:

- modifying the legislation so that it is dependent on the work performed by an individual; and
- possibly the type of vessel served on. Representations have been made that those claiming SED based on oil related platforms should be excluded from the regime and that this could be achieved by excluding vessels that do not have a designated speed of at least 10 knots.

J.39 In addition to revising the conditions relating to the relevant vessels, the legislation could also include criteria based on the position of a person (e.g. to qualify for the relief an individual must hold a document listed in the Standards of Training, Certification and Watchkeeping international legislation).

J.40 Whilst the policy rationale is still valid, we do have to note that in a more internationally mobile employment environment it is difficult to justify a 100% tax relief for one class of employee (50% of whom are higher rate taxpayers[36]) where one visit in a year to a foreign port qualifies a seafarer to SED for the full year. This does, inter alia, give scope for abuse of the relief, although we would make it clear that we have seen no evidence of widespread abuse.

J.41 On simplification grounds, there is no reason to abolish the relief, although as we note above, if it is retained it should be better defined to make it easier to administer. It would clearly be possible to carry out a separate policy exercise to consider whether an alternative method could ensure that the UK is not disadvantaged in the maritime industry, which could allow the relief to be abolished.

Payments to mariners to be disregarded for class 1 NIC

J.42 This is a long standing relief[37] that provides for NIC exemption for payments to or in respect of mariners in the following circumstances:

- Interim payments to mariners by way of an advance;

[33] *Spowage and Others v CIR TC00110*
[34] HMRC Ready Reckoner
[35] Red Book, Budget 22 June 2010, p55 Table 2.4
[36] HMRC
[37] SSCR 2001 Reg 123

- Payment to some other person of any part of such a mariner's earnings as allocated by him to that person; and
- A payment of a special payment whilst sick abroad (as defined by the National Maritime Board)[38].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.43 The circumstances in which NIC relief would be granted all relate to situations which we understand are now no longer current in practice. The interim payment of earnings referred to an advance of earnings typically paid at the end of the voyage (when the liability to NIC would arise), and the original rationale was to deal with circumstances where mariners would be paid in cash whilst at sea on account of wages. Before electronic communications it would not have been practical to have accounted for NIC on such advances.

J.44 The reference to payments to some other person is understood to refer to situations where mariners used their own wages to make disbursements to others on a vessel; this practice is understood to have disappeared from the industry.

J.45 The reference to special payments whilst sick relates to an industry wide employment condition administered by the National Maritime Board. The National Maritime Board, and the payments that it defined, was abolished in 1990[39] and consequently this relief is no longer relevant.

Taxpayer take up and awareness

J.46 As this is an exemption, details do not have to be submitted to HMRC when it applies, but HMRC's understanding is that the exemption is no longer relevant.

Complexity, compliance costs and administrative burden

J.47 Costs of compliance and administration are nil as the exemption is no longer used, and the legislation is straightforward.

Summary

J.48 As the exemption applies to practices that are out of date and the exemption is no longer used we recommend that, after consultation with the British Chamber of Shipping to confirm our understanding, this exemption should be abolished.

Stamp duty exemption for certain assignments by seamen

J.49 This legislation[40] dates from the Second World War and relates to assignments of wages in payments of contributions to certain bodies representing the interests of, or providing benefits to, seamen. Such payments are exempt from stamp duty.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.50 The policy rationale is unclear but it is thought that this was an emergency wartime measure.

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[38] SSCR 2001 para 123(1)
[39] "A brief history of the Chamber", http://www.british-shipping.org
[40] FA 1944 s45 and Defence (General) Regulations 1939 ("DGR") Reg 47D

J.51 HMRC are unable to determine when stamp duty on such assignments was abolished; it may have been in 1999 when the stamp duty charging provisions were restated and limited to conveyances on sale and conveyances other than on sale. In addition, following FA 2003, stamp duty is abolished except on instruments relating to stock or marketable securities[41], such assignments are no longer chargeable to stamp duty.

Taxpayer take up and awareness

J.52 The current take up is nil as the relief has no current application.

Complexity, compliance costs and administrative burden

J.53 The relief is not complex as the relief has no current application.

Summary

J.54 As the underlying transactions that it exempted from stamp duty are no longer chargeable, it is no longer relevant.

J.55 We therefore recommend that this relief be abolished.

Transfers in relation to ships and vessels – stamp duty exemption

J.56 This legislation[42] exempts from stamp duty "instruments for the sale, transfer, or other disposition (absolutely or otherwise) of any ship or vessel or any part, interest share or property of or in a ship or vessel".

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.57 The policy rationale is not known but, following FA 2003, stamp duty is abolished except on instruments relating to stock or marketable securities[43]. Therefore such assignments are no longer chargeable to stamp duty and the policy rationale no longer applies.

Taxpayer take up and awareness

J.58 The relief has no current application.

Complexity, compliance costs and administrative burden

J.59 The relief has no current application.

Summary

J.60 As the policy rationale is no longer relevant we recommend that this relief is abolished.

Capital allowances – dredging

J.61 Dredging allowances were introduced in 1956[44] and the current legislation is in CAA 2001 Part 9. The regime applies to capital expenditure on dredging, incurred on the "maintenance or

41 FA 2003 s125
42 FA 1999 Sch 13 para 24(b)
43 FA 2003 s125
44 FA 1956 s17

improvement of the navigation of harbours, estuaries or waterways"[45]. Writing down allowances are given on a 4% straight line basis[46], and there is no other tax relief for this expenditure.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.62 The policy rationale, which is still relevant, is that as an island nation the dredging of ports and waterways (which naturally silt up) is an essential prerequisite to facilitate trading and the transport of UK imports and exports. The tonnage and draught of modern container ships is increasing and deeper waterways are required.

J.63 The relief is structural and provides capital allowances on essential capital expenditure incurred on a business activity that is important to the UK economy. In the absence of this relief, dredging operations could become uneconomic and could decrease.

Taxpayer take up and awareness

J.64 In 2005 it was estimated that approximately 12,500 businesses were claiming this allowance[47].

J.65 The relief is mainly used by businesses that manage docks and ports or are responsible for the operation of waterways used by shipping. We understand that a number of ports are currently undertaking or planning major dredging projects to accommodate larger ships. An example of this is the London gateway project which will be the UK's first major deep sea container port and Europe's largest logistics park providing deep sea shipping access to the world's leading businesses and facilitating the UK's engagement in global trade[48].

J.66 Such projects are costly, create many new jobs and are environmentally friendly (as moving goods by sea saves CO_2 emissions), and it is likely that the capital allowances are taken into account in the financial planning for the project.

Complexity, compliance costs and administrative burden

J.67 HMRC have not reported any issues about the complexity of the legislation from either taxpayers or advisers.

J.68 In 2005 it was estimated that the compliance burden associated with the allowance was £220,000[49], indicating that this is low for each affected business.

Summary

J.69 This relief is structural and recognises the necessary capital expenditure involved in dredging activities that are necessary to the UK's water and maritime transport capacity.

J.70 We recommend that this relief be retained.

Capital allowances – ships

J.71 This legislation[50] was introduced in 1985[51] as an optional, and more generous, regime for certain ships to give shipping businesses additional flexibility over capital allowance claims.

[45] CAA 2001 s484(2)
[46] CAA 2001 s487(3)
[47] HMRC standard cost model 2005
[48] http://www.londongateway.com
[49] HMRC standard cost model 2005
[50] CAA 2001 Part 2 Chapter 12
[51] FA 1985 s58 and Sch 16

Expenditure on a qualifying ship is allocated to a single asset pool, writing down allowances are claimed but these can be postponed and taken in a later accounting period, providing that the qualifying activity is still being carried on. It is also possible for balancing charges arising on the disposal of ships to be deferred by setting them off against expenditure on new ships.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.72 This flexible relief was introduced following representations from the shipping industry, and was welcomed as profits can vary over the economic life of a ship. Also there are strategic considerations as there was considered to be a need to maintain a UK merchant fleet in the event of naval conflict (e.g. the Falklands conflict in 1982). As an island nation, the UK cannot be dependent on the import of shipping services from other countries.

J.73 The rationale is considered to be valid, although the majority of shipping businesses have opted into the tonnage tax regime[52], which takes them out of the capital allowances regime[53]. However the regime continues to provide the flexibility that the industry required for those shipping companies that have not opted into the tonnage tax regime.

J.74 The regime has EU State aid approval under the rules for the maritime industry[54].

J.75 There is not considered to be an alternative method to providing this incentive.

Taxpayer take up and awareness

J.76 The relief is specifically targeted at the shipping industry, although there are no details of the numbers of users.

J.77 There are at least two large shipping companies that have significant amounts of postponed allowances[55] and the amount of postponed allowances is in the order of £200 million for each of these companies[56].

Complexity, compliance costs and administrative burden

J.78 The legislation is not considered to be complex and the administrative burden and compliance costs are low. In addition, the regime is optional.

Summary

J.79 The policy rationale remains valid, as flexibility in terms of the funding it offers remains important to the shipping industry, and the relief is not complex. Its value has reduced as rates of capital allowances have reduced.

J.80 We recommend that this relief be retained.

Harbour reorganisation schemes – general

J.81 There are a number of reliefs that relate to harbour authorities and harbour reorganisation schemes.

J.82 A harbour reorganisation scheme is "any statutory provision providing for the management by a harbour authority of any harbour or group of harbours in the United Kingdom"[57]. The

[52] FA 2000 s82 and Sch 22
[53] HMRC
[54] Council regulation (EC) No 1540/98
[55] HMRC
[56] HMRC

concept was introduced into legislation by Harbours Act 1964 as a means to "securing the efficient and economical development of a group of harbours each of which is being improved, maintained or managed by a harbour authority"[58].

J.83 The special rules apply where a body corporate (that is not a limited company) transfers its trade to a harbour authority by or under a certified harbour reorganisations scheme under which the transferor is dissolved[59].

J.84 The specific reliefs are as follows:

- TCGA 1992 s221 provides that any assets transferred to a harbour authority in relation to a certified harbour reorganisation scheme shall be on a no gain/ no loss basis;
- CTA 2010 s991 provides that the trade is not treated as permanently discontinuing nor is a new trade commenced and thus trading losses are available to be carried forward against future trade profits[60];
- CTA 2010 s992 provides that the transfer of any trade assets will not give rise to a balancing allowance or charge and the transferee will take on the tax written down values of the assets as per the transferor's computation for capital allowance purposes; and
- CTA 2010 s993 provides that any capital losses accruing on the transfer of the trade pass from the transferor to the transferee.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.85 The measure provides a similar relief to that which applies to a corporate reconstruction involving the merger or demerger of trades where a trade will continue under different ownership and consideration for the transfer is settled in shares.

J.86 The general policy for Harbour Authorities lies with the Department of Trade and this legislation is part of a larger policy objective. It is not known whether there are likely to be any further harbour reorganisation schemes.

Taxpayer take up and awareness

J.87 The legislation is specifically targeted at harbour authorities.

Complexity, compliance costs and administrative burden

J.88 The legislation is not complex, and the relief is a simplification in most cases. We do have to note that the existence of a scheme separate from general tax reorganisation reliefs does add complexity and we would have thought it should be possible for harbour reorganisations to be covered by the general system.

J.89 The costs of compliance and administration are not known.

Summary

J.90 These reliefs cannot be considered in isolation and must be reviewed in the light of the general policy surrounding harbour reorganisation schemes.

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[57] CTA 2010 s995(3)
[58] Harbours Act 1964 s18(1)
[59] CTA 2010 s991(1)
[60] CTA 2010 s45

Harbour reorganisation schemes – stamp duty exemption

J.91 This legislation is in FA 1966 s45 and provides that no stamp duty is paid on any contract or agreement for any transfers under a certified harbour reorganisation scheme (see harbour reorganisation schemes generally above).

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

J.92 The policy rationale is not known but it is thought to have been introduced to provide a similar relief to that which applies to a corporate reconstruction involving the merger or demerger of trades where a trade will continue under different ownership.

Taxpayer take up and awareness

J.93 Not known.

Complexity, compliance costs and administrative burden

J.94 Not known.

Summary

J.95 As noted above, this relief should be reviewed in the light of the general policy surrounding harbour reorganisation schemes.

Shipbuilders' relief – relief from duty

J.96 This legislation was repealed by Finance Act 2004 s323 as a result of EU rules on State aid to the shipbuilding industry[61]. The Regulation required that State aid be abolished with effect from 31 December 2000 and HM Customs and Excise (as it was at the time) agreed to honour claims for contracts signed on or before that date[62]. FA 2004 s323 gives effect to the EU rules for contracts made on or after 1 January 2001 (or 13 January 2004 in certain cases)[63]. We have been unable to locate any further information on this relief and so are unable to arrive at a firm conclusion.

[61] Council Regulation (EC) No 1540/98
[62] John Healey MP (Economic Secretary) WMS 12 Jan 2004 (HC Deb 12 Jan 2004 c20WS)
[63] FA 2004 s323(1)

K

Oil and gas

Capital allowances: first year capital allowances in ring fenced trades

K.1 If plant or machinery is purchased for use solely in a ring fenced trade, capital allowances will be available at 100%[1].

K.2 A ring fenced trade consists of oil extraction activities or oil rights in the UK and UK Continental Shelf, and is treated for corporation tax as a separate trade to any other activities being undertaken by the company.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

K.3 This measure was introduced in the 2002 Budget[2] as part of a reform of the North Sea oil regime. Whilst the Government was committed to maintaining an active oil and gas sector, the regime at the time failed "to strike the right balance between promoting investment and taking a fair share of revenue derived from a national resource"[3]. In addition to the 100% first year allowance for capital expenditure in the ring fence trade, a 10% supplementary charge on North Sea profits was also introduced.

K.4 The rationale is still valid.

Taxpayer take up and awareness

K.5 There are around 130 businesses benefiting from the relief with total savings of around £650million p.a. However as this is only a timing difference, the actual saving for each company is the cost of capital.

Complexity, compliance costs and administrative burden

K.6 We understand that this is simple to operate as the assets used in each ring fence trade are easily identified.

Summary

K.7 The relief is simple to operate and the policy rationale remains valid. We recommend that it is retained.

[1] CAA 2001 s45F
[2] 17 April 2002
[3] Budget, 17 April 2002, Red Book Chap 5 "Building a Fairer Society", para 5.81

Marginal relief for companies with ring fence profits from oil related activities

K.8 The main rate of tax on ring fence profits (i.e. those from oil extraction activities or oil rights), where the profit exceeds £1.5million is 30% for 2010/11[4]. For ring fence profits below £300k the rate is 19%[5].

K.9 This relief reduces the tax on a company's profits from ring fence activities of an accounting period (at the main rate of ring fence corporation tax), thereby ensuring a smooth progression of tax rate on profits between the £300k and £1.5million[6].

K.10 These rates are reduced where the company is 'associated' with any others. In general terms, this includes all companies in the same group with direct or indirect 50% control, and all companies under common control (e.g. by the same shareholders even if not part of the corporate group). This includes all companies wherever situated in the world.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

K.11 The policy objective is to avoid a "cliff edge" change in tax rate for profits at the threshold between the two rates, and it mirrors the relief for mainstream corporation tax.

K.12 The policy rationale remains valid given the differential between the two rates, and there is no alternative method to achieve the same objective.

Taxpayer take up and awareness

K.13 This relief is available for companies in the oil industry where taxable profits fall between £300,000 and £1.5million in an accounting period.

K.14 There are only 10 companies claiming this relief[7] and the total savings are negligible.

Complexity, compliance costs and administrative burden

K.15 The legislation is not complex as it is a simple formula, and where software packages are used to compute the tax liability this is dealt with by the software.

K.16 Complexity can arise in determining the number of associated companies, as noted in D.10 above, as the entire worldwide group needs to be looked at, however in most cases this information is readily available.

Summary

K.17 It is considered that whilst there is a main rate of tax and a small profits rate, marginal relief will be required and therefore this relief should be retained.

K.18 However, given the very small number of users, and negligible savings, consideration could be given to abolishing the small profits rate for ring fenced trades and only having the main rate of tax, currently 30%.

[4] FA 2009 s7(2)(b)
[5] FA 2009 s8(1)(b)
[6] CTA 2010 ss20-21
[7] HMRC

Capital allowances – mining and oil industries

K.19 Generally, where capital expenditure is incurred before a company has a trade then no allowances are available[8]. In addition, allowances are generally not available on expenditure incurred on amendments to plant and machinery to make them available for reuse (i.e. decommissioning costs)[9].

K.20 However, where the asset is used for the purposes of mineral exploration or access, and it is still owned on the first day of trading, then allowances are available at that point.

K.21 Where, for the purposes of oil extraction activities, plant and machinery consisting of, in broad terms, offshore installations (e.g. oil rig) or pipelines, are decommissioned, capital allowances will be available on the costs of doing so.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

K.22 The rationale is to avoid disadvantaging businesses, such as oil companies, that have to incur a large amount of costs in exploring for minerals that is necessary in order to commence a trade but the trade is not treated as commencing until minerals have been found.

K.23 In addition, at the exhaustion of a mineral field, the infrastructure needs to be decommissioned. The relief therefore gives an allowance for this necessary expenditure.

K.24 This legislation, in so far as it related to decommissioning expenditure, was reviewed and strengthened in Finance Act 2009[10] as it was considered that the previous legislation was open to abuse.

Taxpayer take up and awareness

K.25 The relief is available to all mineral extraction businesses, including the oil companies. There are around 130 businesses benefiting with total tax savings for offshore oil and gas decommissioning of £160million[11]. There are no available costs for pre trading or onshore mining.

Complexity, compliance costs and administrative burden

K.26 We understand that the relief is not complex as all the costs are recorded as part of a project and it is well understood by both businesses and HMRC which costs are eligible.

Summary

K.27 The policy rationale remains valid and the relief is simple to operate. We recommend that the relief is retained.

[8] CAA 2001 ss160-161
[9] CAA 2001 ss161A-161D
[10] FA 2009 s84 and Sch 38
[11] HMRC estimate

L Sport related

Capital allowances – safety at sports grounds

L.1 Generally plant and machinery capital allowances are not available for expenditure on buildings or fixed structures. However they are available if the expenditure is incurred on taking required safety precautions in respect of sports grounds or regulated stands at sports grounds[1].

L.2 The sports ground must have total capacity of at least 10,000 spectators[2] (5,000 for Football League clubs) or have a covered stand seating over 500 spectators[3].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

L.3 The Safety at Sports Grounds Act ("Safety Act") was introduced in 1975, following the Ibrox disaster in 1971. The requirements of the Safety Act meant that occupiers of sports grounds faced substantial unanticipated costs to upgrade their grounds to meet the required safety standards, and the relief was introduced to enable allowances to be claimed on specific safety expenditure. Following the fire at Bradford City football ground in May 1985, the Safety Act was reviewed and rewritten as the Fire Safety and Safety of Places of Sport Act 1987 ("Fire Safety Act").

L.4 The policy objective has been successful but as existing stadiums are largely up to required standards[4] it can be argued that it is redundant. New stadiums (to which the relief does not apply) must meet the required safety criteria in order to obtain planning control and building regulations.

L.5 There is also the potential for grant support from the Football Foundation to make improvements[5] to football grounds.

Taxpayer take up and awareness

L.6 Usage is believed to be low as most grounds are now up to the standard required by the Safety Act or the Fire Safety Act. However, it is possible that a club newly promoted to the Football League could become subject to the requirements of the Fire Safety Act for the first time (although they would not necessarily need to make any improvements as they could, for example, leave the stand empty). In addition, these clubs may also be eligible for the Football Foundation grant funding for improvements.

L.7 It is not known whether there are any sports stadiums that do not meet the required standard; however, as it has now been over 35 years since the Safety Act and almost 25 years since the Fire Safety Act, we doubt that there will be many and for those that do not meet the required standard, it must be questioned why the local authority has not issued a certificate setting out the work that is required to improve the ground.

[1] CAA 2001 ss30–32
[2] Safety at Sports Grounds Act 1975 s1(1)
[3] The Fire Safety and Safety of Places of Sports Act 1987
[4] HMRC information
[5] http://www.footballfoundation.org.uk/about-us/

Complexity, compliance costs and administrative burden

L.8 The present system requires a local authority to issue a certificate to the football club setting out the work that needs to be carried out to improve the ground and it is expenditure on this work that qualifies for the relief. It is therefore easy to define the qualifying expenditure, and as it is a 100% relief, the calculation is simple.

L.9 However we understand that consultation has been proposed that could remove the certification criteria and move towards a self assessment system. This would increase complexity for the taxpayer in identifying the costs to be included and for HMRC in verifying the claims.

Summary

L.10 As we believe that the vast majority of stadiums are up to standard, and new ones do not qualify for the relief, this relief is likely to only be of use to

- stadiums that remain unsafe almost 36 years since the introduction of the legislation; and
- new clubs promoted to the Football League.

L.11 If there are stadiums in the first category, the question must be asked why the work has not been undertaken already, and this might indicate that the tax system has not been a driver to encourage safety improvements. For clubs in the second category, it should be noted that the improvements do not necessarily need to be made. It would then be commercial factors that would require the club to undertake the improvement works.

L.12 We recommend that this relief be abolished.

Income tax relief for the UEFA Champions League Final 2011

L.13 If a sportsperson who is not UK resident performs in the UK, then, in general, he or she is taxable on amounts received in respect of the time spent in the UK[6]. In addition to the earnings from the performance, it is also a percentage of other income, such as image rights etc. However there is a specific exemption in FA 2010 s63 and Sch 20 from this rule for any employee or contractor of an overseas team competing in the UEFA Champions League Final, to be held in London in May 2011.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

L.14 This relief was introduced in FA 2010 for the UEFA Champions League Final 2011and was a key part of the bidding process in order for London to win the right to host the final.

L.15 The rationale behind introducing this relief remains valid and a similar exemption has been introduced for participants and officials at the London Olympic Games in 2012[7].

L.16 As set out below, there is no tax loss, and this event is likely to bring significant additional revenues to the UK with over 50,000 additional visitors.[8]

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[6] ITA 2007 ss965-970

[7] FA 2006 s68

[8] Based on likely ticket allocations to the competing teams

Taxpayer take up and awareness

L.17 This relief is very specifically targeted and at most it will benefit two football clubs, neither of which can be members of the various UK football associations[9].

Complexity, compliance costs and administrative burden

L.18 The relief will simplify the tax affairs of the competing teams, in that they will not need to consider UK income tax when paying their players. It will therefore significantly reduce the time and cost for the teams concerned.

L.19 The Exchequer costs are estimated to be zero as it may not have been possible to host the event without the relief.

Complexity

L.20 It is very simple to operate and is designed to simplify the tax affairs of the teams concerned.

L.21 Reliefs of this type could become complex if they were to be made more widely available, as there may be lack of clarity as to which sporting events were to be covered and they would need to cover a range of different circumstances. We would therefore recommend that the use of similar exemptions be restricted to those necessary for very high profile events, or where there is a necessity as part of the bidding process for the right to hold the event.

Summary

L.22 Even though the usage of this relief is highly restricted, the policy rationale remains valid, and it was promised during the bidding process. It also simplifies the tax affairs of those affected, and does not add complexity for anyone else.

L.23 The loss to the Exchequer is zero, and there would be an overall advantage from the revenues created by additional visitors to the UK.

L.24 We therefore recommend that the relief be retained, but it should be abolished once the event has passed. We would also recommend that it should be reviewed for its effectiveness – has it met the original design principles and 'paid back'?

Pool betting duty payments related to safety improvement at football grounds or support for the arts

L.25 CTA 2009 s138 enables a pools company to obtain tax relief for certain payments made should pool betting duty be reduced.

L.26 Eligible payments are those made for:

- capital expenditure incurred in improving the safety or comfort of spectators at a football ground; and
- support for athletics or the arts.

[9] FA 2010 Para 6 Sch 20

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

L.27 The rate of pool betting duty was reduced in 1990 following the Hillsborough disaster in 1989 with a requirement that the difference between the old and new rates was paid to the Football Trust (replaced by the Football Foundation in 2000), which applied it to improving safety in sports grounds. In 1991 duty was further reduced on the condition that the difference was paid to the Foundation for Sports and the Arts. It was reduced for a third time in 1995, with the difference being paid to the two bodies equally.

L.28 The Foundation for Sports and the Arts is to close in 2012[10] and it ceased to take new applications from March 2009, however as noted above in L.5 the Football Foundation continues to assist in sports grounds safety.

L.29 The legislation[11] was originally introduced to ensure these payments were deductible for tax purposes, so that a business paid the same level of tax that it would in the absence of the arrangements. If the relief were to be repealed, there could be unfairness as pools companies would be required to make payments but would not necessarily be able to obtain corresponding tax relief.

Taxpayer take up and awareness

L.30 There are very few pools companies in the UK, especially since 2007 when the three main companies - Littlewoods, Vernons and Zetters - merged to form The Football Pools Ltd.

L.31 The savings from this relief are not known.

Complexity, compliance costs and administrative burden

L.32 It is likely that the expenditure will be deductible in any case, on the basis that the payments are made to charities and therefore there would be little impact if the relief were to be repealed.

L.33 The relief is a simplification in that the businesses affected do not need to consider the nature of the expenditure in determining whether to obtain tax relief.

Summary

L.34 Even though the number of taxpayers affected is very low, there is unlikely to be any significant change in deductible amounts, and there would be virtually no impact in repealing the legislation, the legislation extends the same treatment to payments following any future reduction in duty. On those occasions it is possible that the payments are not made to charities and this relief will prevent any unfairness.

L.35 We therefore recommend that this relief be retained.

L.36 We also recommend that, if payments are no longer being made to the Foundation for Sports and the Arts, the current level of pools duty should be reviewed.

[10] The Foundation for Sports and the Arts Annual Report 2009
[11] Now in CTA 2009 s138

M Insurance

M.1 From the 19th Century to after World War 2, life insurance policies in various forms were the main long-term savings vehicle for the future rather than pensions. Tax relief was given for premiums paid to encourage such savings (policies over 10 years and with regular premiums), and any profit made on these policies was exempt from income tax (although the policy had in fact suffered standard rate tax in the hands of the insurance company).

M.2 In the 1960s there were a substantial number of investment polices of a shorter term nature marketed to compete with other forms of investment and it was considered equitable to tax these, and due to the short term nature, as income rather than capital gains. The insurance company pays corporation tax at a rate equal to the basic rate of income tax of 20% (for 2010/11) on profits it makes that relate to the policies each year, under the special basis of charge known as the I minus E basis (income minus expenses). This acts as a payment on account of income tax for the policyholder. Gains occur when the policy matures, is surrendered or assigned, and where part only of a policy is surrendered a gain arises on that part calculated in a special way – the 5% rule.

M.3 As a general observation, we have to comment that the taxation of the life insurance industry and its products is one of the most complex areas of the tax code. It would be a clear candidate for an overall review with a view to simplification. But we do, equally, have to point out that the number of insurance companies is small, most have expert tax teams and extensive IT system to assist them; and there would be a concern that any simplification might impact adversely on the considerable number of policyholders.

Life insurance policies - 5% rule

M.4 The aim of the life insurance policy legislation is to tax the overall profits made from the policies, which in general is calculated as the proceeds received less the premiums paid. However, if part of a policy is surrendered, without the 5% rule a complex "part disposal" calculation would be required and the profit on each part of the policy would need to be identified.

M.5 This relief provides that there is no income tax charge if the proceeds of part surrender are less than 5% per year of the premium paid. Therefore if the part surrender proceeds are less than the 5% allowance, there is no need to perform a complex part disposal calculation for a small part disposal. Instead the tax charge is deferred until the policy is fully surrendered or matures[1].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

M.6 This relief was introduced in the 1970s in order to simplify the administration of partial withdrawals from life insurance policies[2]. Before this, the calculation required following a part

[1] ITTOIA 2005 ss498–514
[2] HMRC

disposal of a policy was similar to the current part disposal rules for capital gains tax, which was very time consuming at the time, before the use of software packages for tax.

M.7 At the time of its introduction, rates of interest were much higher than they are now, and 5% was seen as the de minimis figure. In the current climate, the 5% exemption may be seen as an advantage for a higher rate taxpayer with a life policy, compared with other investments.

M.8 The rationale of simplification remains valid and the relief continues to achieve it; however it could be argued that there is less of a need for the relief due to the availability of sophisticated software packages to perform part disposal calculations.

Taxpayer take up and awareness

M.9 The number of users is unknown but is estimated to affect tens of millions of policies[3], as a feature of most modern policies is the ability for the policy holder to make a small part disposal.

Complexity, compliance costs and administrative burden

M.10 Calculating the gain on a partial surrender without the 5% rule would be complex and in many cases it would only lead to small amounts of tax, which would have to be returned on the self assessment return, and taxpayers who might not otherwise complete returns might have to do so. In addition, the calculation on a final surrender may be more complex, as it would need to take into account all previous part disposals. Therefore this relief is a simplification.

M.11 As noted above, the calculation of partial surrenders could be carried out automatically, however this may involve significant investment in the IT systems of insurers.

M.12 The relief allows amounts of cash to be extracted with no tax charge until later and, at the time of the cash extraction, the beneficiary could be a higher rate taxpayer, but a basic rate taxpayer when the tax charge crystallises on maturity. This gives insurance products an advantage over some other products.

M.13 However it should be noted that under the I-E calculation, corporation tax at 20% is paid each year on the policies, and therefore it is effectively only the excess over the basic rate band that is deferred. In addition, as the policy is all taxed at the marginal rate of income tax, it is not as advantageous as other investments, for example ISAs that are tax free and open-ended investment companies ("OEICs"), gains on which are taxed as capital gains.

Summary

M.14 Ignoring the impact of sophisticated IT packages, the original policy rationale is still valid. The relief is a substantial simplification for HMRC, individual investors and insurance companies, and any replacement is likely to be at least as complex.

M.15 We recommend that this relief be retained.

Life insurance policies - top-slicing relief

M.16 Generally a life insurance policy is taxed on a realisation basis, and all tax is paid at the end of the policy or on a partial surrender, even though the gains accrue or are, in the case of part surrenders within the 5% rule, realised during the policy's life.

M.17 If, as a result of including a gain as the top slice of a policyholder's income in the year in which the policy ends, the policyholder becomes a higher rate taxpayer when they otherwise

[3] Representation from the Association of British Insurers ("ABI")

would not be, the gain is recalculated in a complex way which has the effect of reducing the tax in the final year, often by the entire amount[4]. A similar reduction may apply on a part surrender.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

M.18 This relief was introduced in around 1968[5] when the highest rate of tax was 91.25%[6].

M.19 The relief was introduced in order to address unfairness that may arise for some individuals because they become liable to income tax in a single year on gains that may have accrued over a number of years.

M.20 This rationale remains valid, even though the highest rate of income tax is now 50%. If the relief were repealed insurance products would be disadvantaged when compared to other savings products.

M.21 However, this relief is not available to reduce the impact of the effective 60% tax rate for incomes between £100,000 and £112,950 or to individuals claiming the married couples' allowance.

Taxpayer take up and awareness

M.22 The number of users is unknown but is believed to be extensive[7]. Given the reduction in the higher rate threshold from April 2011 to £42,475, the number of people affected may decrease as more will be higher rate taxpayers before policy gains.

Complexity, compliance costs and administrative burden

M.23 We understand that the principle of this relief is readily understood by policyholders[8]. In addition, even though the mechanics can be complex, as the self assessment software completes it all automatically, there is minimal administrative burden for the tax payer.

Summary

M.24 The policy rationale remains valid, and as systems are currently in place at both HMRC and the insurers to automate the process, it is simple for taxpayers.

M.25 We recommend that this relief be retained.

Life assurance premium relief

M.26 For policies entered into after 13 March 1984, no relief is available for premiums paid when calculating the taxable profit.

M.27 However, for policies entered into before that date, relief is available at 12.5% of the premium up to a maximum of £1,500 p.a. or one sixth of the individual's total income for the year[9].

[4] ITTOIA 2005 ss535–537
[5] Representation from the ABI
[6] Standard rate of 41.25% plus supertax of 50%.
[7] Representation from the ABI
[8] Representation from the ABI
[9] ICTA 1988 ss266, 268-272, 274, 278 and Sch 14; SI 1997/1143; SI 1977/1144; SI 1978/1159; SI 1980/1947; SI 1980/1948

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

M.28 This relief was first introduced in 1799[10] to encourage people to make provision against death, to leave money for their dependents. Later it was used to encourage saving, through life insurance policies, for retirement or for a 'rainy day' in the absence of comprehensive private pension provision.

M.29 If this relief were to be repealed, the policyholders would have to pay higher premiums, or reduce the level of cover, and it would involve insurance companies contacting all policy holders unless the insurer was to fund the excess.

Taxpayer take up and awareness

M.30 There are currently estimated to be around 1.5m legacy policies in existence[11], with total tax relief of around £18million[12]. These figures are projected to decrease by around 13% p.a.[13].

M.31 The average tax saving is around £14p.a.[14].

Complexity, compliance costs and administrative burden

M.32 For the policyholder there is virtually no administrative burden to claim this amount.

M.33 The insurer must make the calculations for each policy holder and claim the relief from HMRC. IT systems are generally in place to determine the relief for each policy and claim this from HMRC. However we understand that separate systems are required to be maintained for policies still attracting life assurance premium relief.

M.34 In addition, we understand that for insurers the "tax at stake is usually very small but requires a huge amount of effort as the pre 1984 policies are now the exception rather than the rule. Keeping staff and procedures manuals up to date for the two systems is a burden out of proportion to the amount of tax at stake"[15]. For some insurers though, the cost savings may be outweighed by a potential fall in policy holder numbers.

M.35 For HMRC there is little administrative burden as the insurance companies make bulk claims, rather than each individual claiming a small amount.

Summary

M.36 The savings for each policyholder is negligible, and we understand that this relief does create additional administrative burden for the insurer.

M.37 We would therefore recommend that this relief be abolished; however there should be consultation with the insurance industry to confirm our understanding.

Life assurance premiums paid by employers under E-FRBS

M.38 This relief extends the life assurance premium relief (see above) to individuals whose employer made payments into an employer-financed retirement benefits ("E-FRB") scheme[16].

[10] HMRC Insurance Policyholder Taxation Manual, IPTM 1300
[11] HMRC estimate
[12] HMRC estimate
[13] HMRC estimate
[14] HMRC estimate
[15] http://www.hmrc.gov.uk/better-regulation/part14.pdf (para 5.1.4)
[16] ICTA 1988 s266A

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

M.39 We understand that this relief was introduced in 1948[17] when premiums paid under a life insurance policy by an employer in order to provide death or retirement benefits to an employee (or their spouse, widow(er), children or dependants) were taxed as a benefit on the employee unless the scheme was an approved one. This relief extends life assurance premium relief to employees, as if the employee were actually the person taking out the insurance and making the payments under the policy.

Taxpayer take up and awareness

M.40 There are currently estimated to be very few legacy policies in existence as it does not relate to any policies taken out since 1984, and, as it is company specific, the policy holder must still be employed by the same company as they were 27 years ago.

M.41 The total savings are estimated to be negligible[18] and at a maximum of £12.50 p.a.[19] per person for the provision of retirement benefits.

Complexity, compliance costs and administrative burden

M.42 The complexities are generally the same as those noted under M.31 – M.34.

Summary

M.43 As this relief is an extension to life assurance premium relief, our recommendation is therefore that the relief should be abolished.

Payment for the benefit of family members

M.44 Income tax relief is available for contributions made to provide for the spouse or children of the individual[20].

M.45 The maximum relief is a tax deduction of £100. Tax is only saved at the basic rate of tax, i.e. a total maximum of £20 p.a.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

M.46 We understand that this relief was introduced in 1853[21] at a time when there were few pension arrangements, and this was the only way to obtain any cover for death in service. However this has been now been overtaken by pension relief and so the relief is becoming obsolete.

Taxpayer take up and awareness

M.47 There are around 750 claimants[22].

[17] HMRC
[18] HMRC estimate
[19] HMRC estimate
[20] ITA 2007 s459
[21] HMRC
[22] HMRC estimate

Complexity, compliance costs and administrative burden

M.48 For the individual there is very little administrative cost. The majority claim through the PAYE code, and for those that complete a self assessment return, there is a box to tick to claim the relief.

Summary

M.49 The rationale for this relief is becoming obsolete, there are very few claimants and the value is negligible.

M.50 We therefore recommend that this relief be abolished.

Long term business – insurance premium tax

M.51 All contracts of insurance are liable to insurance premium tax ("IPT") unless specifically exempted. There are a number of exemptions, one of which is long term business[23].

M.52 Long term business includes one or more of the following, but specifically does not include medical insurance[24]:

- Life and annuity;
- Marriage and birth;
- Linked long term;
- Permanent health (must be for a minimum of 5 years)
- Tontines (a type of life insurance held by groups of people where the benefits are shared among remaining members of the scheme when a participant dies);
- Capital redemption contracts;
- Pension fund management;
- Collective insurance; and
- Social insurance.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

M.53 The policy rationale is to avoid taxing the savings element within, for example, the premium for life assurance policies, and therefore discriminating against one particular means of saving.

M.54 If the relief were to be repealed, policyholders would face IPT on their saving and pension contributions, and would be disadvantaged when compared to other forms of savings.

M.55 Whilst it does achieve the objective and the rationale is still valid, not all insurance falling within the exemption constitutes a form of savings and some 'protection only' insurance is also covered. This type of policy, such as term assurance is indemnity insurance, like all forms of general insurance to which IPT applies.

[23] FA 1994 Sch 7A Part 1 para 2
[24] Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, Sch 1 Part II (SI 2001/544)

M.56 Consideration could be given to excluding long term business from the IPT exemption. However this would raise complications such as distinguishing protection only elements within mixed contracts, addressing potential avoidance (and possibly adding a number of new insurers to the IPT register).

Taxpayer take up and awareness

M.57 There are currently 233 insurers regulated to provide long term insurance[25]. However because insurers generally pass the cost of any IPT onto the policyholder, it is the holders of such policies who would be affected, of which there are around 69million[26]. There are no figures for the number of individuals affected but it is expected to be a large proportion of the country[27].

M.58 The savings due to this exemption are around £8billion p.a.[28] if both existing and new policies were taxed. Extending the scope by removing protection only insurance from the exemption could lead to additional tax of £300-400million p.a.[29] if both existing and new policies were taxed, however behavioural changes could reduce this significantly.

Complexity, compliance costs and administrative burden

M.59 Life insurers are not currently registered for IPT so taxing long term insurance would bring many new insurers onto the IPT register, with the associated administrative burden costs for both the industry and HMRC.

M.60 It would be technically complex to tax all long term insurance products, (especially if an attempt was made to retain the exemption for savings only products as this would potentially create a new borderline that would be difficult to police).

Summary

M.61 The original policy rationale remains valid, the relief is simple to operate and there are many taxpayers affected. It would be possible to remove the protection only insurance but this may create complexity. Additionally, the relief is a simplification.

M.62 We therefore recommend that this relief be retained.

Exemption from tax on profits from new Lloyd's insurance funds.

M.63 A special reserve fund is held within the premiums trust fund of a member by Lloyd's, on behalf of the member. It is built up by setting aside a proportion of past profits and funds can only be withdrawn from it in the event of either

- the payment an overall underwriting loss; or
- or on the death or resignation of the member following the closure of all years of account which he underwrote.

M.64 All profits or losses from assets in the fund are exempt from income tax and capital gains tax[30].

25 HMRC estimate
26 HMRC estimate
27 HMRC estimate
28 HMRC estimate
29 HMRC estimate
30 FA 1993 Sch 20 Para 9

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

M.65 The new style funds replaced a similar special reserve funds that we understand dates back to the 1950s, and both were designed as profit-smoothing vehicles in recognition of the very volatile nature of the profits from membership of Lloyd's. It allows members to set aside profits in good years (and transfers into the fund count as deductions from trading income), which will then be moved out of the fund in bad years (when the transfer is treated as trading income). Profits on assets within the fund are brought into tax. The exemption reflects this and is a simplification as it removes the administrative burden of trying to split out original transfers in from investment growth within the fund when money is transferred out.

M.66 Given the increased focus on bank capital since the financial crisis began in 2009, even in a different sector of the market, a rationale to provide additional cover for losses remains valid.

Taxpayer take up and awareness

M.67 As this is an exemption, it is not known how many beneficiaries there are for this relief, however it will decline each year as Lloyds does not permit new individual names to operate in the market.

Complexity, compliance costs and administrative burden

M.68 This relief is a simplification for members concerned.

Summary

M.69 Members cannot withdraw funds unless there is an underwriting loss or the member has died or resigned. The relief is also a simplification.

M.70 We recommend that the relief is retained.

N Other sector specific

N.1 There are a number if reliefs aimed at certain industry sectors, some of which fall under the EU provisions for State aid.

Film tax relief

N.2 The "new" film tax relief ("FTR") came into effect from 1 January 2007. The legislation is found in CTA 2009 Part 15.

N.3 The relief applies special tax rules to all film production companies, to determine how the taxable profits of film making activities are to be calculated and how any losses may be applied.

N.4 Some films are eligible for FTR which can increase the amount of expenditure that is allowable as a deduction for tax purposes or, if the company makes a loss, can be surrendered for a payable tax credit.

N.5 The films that qualify for the relief are British films that are intended to be shown commercially in cinemas and of whose total production costs at least 25% relate to activities in the UK. To be British, a film must meet the cultural test[1] (or qualify by virtue of an internationally agreed co-production treaty). The UK Film Council administers qualification as a British film on behalf of the Department for Culture, Media and Sport ("DCMS").

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

N.6 There has been film tax relief in the UK since 1992[2]; it was introduced as a means of supporting the UK film industry. The recasting of the original provisions with effect from 1 January 2007 indicates the importance that the British film industry attaches to the relief.

N.7 The British film industry contributes £4.6billion to GDP and £1.2 million to the Exchequer (gross of tax relief and other support)[3]. Without film relief it has been suggested that the industry would be 75% smaller[4], leading to a potential reduction in GDP and revenue to the Exchequer.

N.8 The policy rationale of the new scheme is to promote the sustainable production of culturally British films and to replace the previous regime that was open to abuse.

N.9 The Government has stated that it will continue to support the film industry. On 21 October 2010 Jeremy Hunt (Culture Secretary) stated "we are retaining support for film and the film tax credit"[5]. Both David Cameron and Ed Vaizey (Minister for Communication, Culture and Creative Industries) have given their support to the British film industry and the retention of the film tax credit regime. In the wake of the £100million investment in the Leavesden Studios by Warner

[1] The Films (Definition of "British Film") (No 2) Order 2006 SI 2006/3430
[2] F(2)A 1992 ss40A–40D (and ITTOIA 2005 ss134–135 for individuals)
[3] "Economic contribution of the UK film industry" Oxford Economics, June 2010
[4] "Economic contribution of the UK film industry" Oxford Economics, June 2010
[5] Jeremy Hunt MP Written Ministerial Statement "DCMS: Spending Review Settlement" 21 October 2010

Bros, David Cameron stated that "we are committed to continuing with the tax credits"[6]. Ed Vaizey stated that a key element of support to the UK film industry is "the film tax credit [which is] working exceptionally well"[7].

N.10 The film industry could be supported by other means, for example by grant finance, which might achieve the same policy objective. However, unlike FTR, grant finance is uncertain and could not be built into film companies' projected costings for films.

Taxpayer take up and awareness

N.11 Whilst the relief is narrowly targeted at a specific industry, it is widely used by that industry and is considered to be not only vital to the industry, but is also simple to understand and straightforward to apply for[8].

N.12 In the period 2006/07 – 2009/10 720 film productions have been eligible for FTR, and 455 production companies have made 700 claims for a total of £340million[9].

Complexity, compliance costs and administrative burden

N.13 Claims for FTR are dealt with by a dedicated HMRC unit in Manchester that enables specialists to focus on the work and to provide assistance to claimant companies. In the period 2006/07 – 2009/10, 98% of payments made were made within 6 months of HMRC receiving the return[10].

N.14 The cost to the Exchequer of the relief is approximately £110million per annum[11].

N.15 The relief is considered to be simple to administer and apply for. There is a points system and to qualify as a British film, a film has to qualify for a minimum of 16 points[12]. The regime is considered to be simple for the film industry to understand. Whilst other jurisdictions have similar regimes for their domestic film industry, the UK system is considered to be one of the best and simplest to use[13].

Summary

N.16 Our methodology suggests that the relief is fit for purpose. The policy rationale remains valid and the relief is widely used by the film industry. It is seen as a key factor in supporting the British film industry and, in the absence of the relief, film production in the UK may decline.

N.17 We therefore recommend that this relief be retained.

N.18 The relief is an approved EU State aid and the European Commission must be re-notified of the relief by 2012. We understand that it is currently being evaluated prior to the re-notification process.

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[6] David Cameron, Prime Minister's Questions, 17 November 2010
[7] Ed Vaizey "The Future of the British Film Industry" 29 November 2010
[8] DCMS
[9] HMRC "Film tax relief summary" August 2010
[10] HMRC "Film tax relief summary" August 2010
[11] "Economic contribution of the UK film industry" Oxford Economics, June 2010
[12] Films Act 1985 Sch 1 paras 4A – 4C (as amended by The Films (Definition of "British Film") (No 2) Order 2006 SI 2006/3430)
[13] DCMS

Real estate investment trusts

N.19 The Real Estate Investment Trusts ("REITS") regime[14] was introduced with effect from 1 January 2007. It exempts from corporation tax the profits and gains of the property business of REITs that elect into the regime.

N.20 A REIT is an investment vehicle that manages a portfolio of real estate and earns profits for its shareholders. It allows investors to receive broadly similar returns from their investment as if they had invested directly into property. REITs are Stock Exchange listed companies that must invest mainly in property and pay out 90% of the profits of their property rental business to the shareholders. Essentially the taxation on the profits of the property business is moved from the corporate level to the investor level.

N.21 A UK company entering the REIT regime will pay a 2% entry charge based on the value of property assets joining the regime, and for non UK companies, the charge will be 2% of the value of their UK property assets. As long as conditions are satisfied, the REIT is exempt from corporation tax on the income and gains of its property business. In the hands of shareholders, dividends are generally taxable at their marginal rate as profits of a UK property business. Gains arising on the disposal of shares in REITs are chargeable to tax under the normal share disposal rules.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

N.22 The measure was announced in Budget 2006[15] to "attract more capital into house building"[16] and the idea was developed from the US model[17]. There are also similar investment vehicles in other territories (e.g. Germany, Canada and Australia).

N.23 The policy objectives were to[18]:

- Improve the quality and quantity of finance for investment in property;
- Expand access to a wider range of savings products on a stable and well regulated basis;
- Ensure that a fair level of taxation continues to be paid by the property sector; and
- To support structural changes in the property market.

N.24 These policy aims are still valid as the REITs regime continues to allow investors access to property income in a liquid and regulated manner. In addition, as there is no tax at the fund level, the regime levels the playing field between the tax treatment of direct and indirect property investment.

N.25 Doug Naismith, a managing director of European Personal Investments for Fidelity International, stated that "the expansion of existing REITs markets and formation of new ones could make the REITs industry grow to $1trillion" in 2010[19]. New markets, especially in Asia are continuing to open up to REITs and the regime may still be valid to ensure that the UK can operate on a competitive footing with other territories.

[14] CTA 2010 Part 12 (originally enacted as FA 2006 Part 4)
[15] 22 March 2006
[16] Hansard 22 March 2006, Vol 444, col 293
[17] Hansard 22 March 2006, Vol 444 col 293
[18] HMRC
[19] 2nd Annual REIT Pacific Philippine Summit 2010, 27 July 2010 (http://reit.ph/angarakey.php/)

N.26 When the REITs regime was originally under consideration, other property investment vehicles were also considered and Property Authorised Investment Funds ("property AIFs") were introduced[20], of which there is currently one[21].

Taxpayer take up and awareness

N.27 In 2010 there were 22 REITs (and 19 at the end of 2009)[22] with a total market capitalisation of £20billion[23]. Most large qualifying property companies have joined the regime. UK REITs have raised £4.5billion of capital in the 15 months from 1 January 2009[24].

Complexity, compliance costs and administrative burden

N.28 The legislation is lengthy at 36 pages[25]. The complexity arises from the conditions of the regime that were developed in association with the property industry to ensure that the scheme is revenue neutral, investors are protected and the regime is restricted to property investment companies.

N.29 Specific issues that have been raised by stakeholders include the close company condition. Not only can this cause problems where a family company wishes to become a REIT, but it also imposes an administrative burden as the shareholders have to be monitored throughout the life of the REIT. The focus on voting power gives some anomalous results for pension funds.

N.30 The listing requirement[26] increases costs and complexity.

N.31 The burdens of demonstrating that the conditions of the regime are met are accepted by those companies that elect to join the regime.

N.32 The estimated yield if corporation tax were to be reintroduced on the taxable profits of REITs for 2009/10 is £40 million[27]. However this is subject to two unknown factors; how the reintroduction of corporation tax on REITs would be achieved and also the tax yield on gains. Were REITs to be brought within the tax system, it is likely that the conversion charge would have to be repaid. Were this to be done at the end of 2010/11, the repayment would be in the order of £1 billion[28]. Also it is possible that the abolition of the regime would lead to existing UK REITS either seeking to dispose of property before the abolition or emigrating; in both cases, gains would be nullified.

N.33 HMRC have a REITs team that provides support and advice to REITs and potential REITs where uncertainty exists.

N.34 The regime was designed to be revenue neutral[29] and this is achieved by the distribution requirement and entry charge.

Summary

N.35 As the policy rationale is recent rather than historic, and the regime is the optimal method for achieving the objective, we recommend that the regime should be retained; ending the REITs regime would be contrary to Government policy[30] and would put the UK at a competitive disadvantage with other regimes with favourable property investment vehicles. Additionally,

[20] The Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964) Part 4A
[21] HMRC
[22] HMRC estimate
[23] HMRC estimate
[24] Representation on behalf of the Property Industry Alliance
[25] Tolley's Yellow Tax Handbook 2010/11 Vol 1c
[26] CTA 2010 s528(3)
[27] HMRC estimate
[28] HMRC estimate
[29] HMRC
[30] HMRC

abolition could result in REITs moving offshore which would potentially destabilise the UK property market, as well as reducing revenue to the Exchequer.

N.36 However, we recommend that the regime should be simplified. The legislation was rewritten as part of the Tax Law Rewrite project, but we understand that there are ongoing discussions with the property industry in relation to the conditions to be met, but no decisions have been taken to date.

N.37 Possible simplifications that have been suggested include:

- Widening the scope of REITs beyond listed companies; and
- Modification of the close company restriction.

Farmers' averaging of profits

N.38 Farmers' averaging of profits[31] provides relief for farmers affected by fluctuating profits due to the weather (which may affect yields as well as the cost of inputs such as feed), disease and epidemics, and commodity prices over which the farmer has no control. In the absence of the averaging provisions, these fluctuations could result in a farmer paying higher rate tax in one year and no tax at all in the following year.

N.39 Broadly the relief applies where the profits of two consecutive years differ by more than 30%. In this case the farmer may make a claim to be taxed on the average of the profits in each of the two years. Marginal relief is also available where the difference between the two years' profits is between 25% and 30% of the higher year's profits.

N.40 The relief was originally introduced in FA 1978 s28 and applied from 1977/78.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

N.41 The rationale behind the relief recognised that farmers are in a "unique position, partly because the weather can produce substantial fluctuations in their income"[32].

N.42 The relief smooths farmers' profits and consequently their tax liability, thus enabling better management of cash flow. The policy rationale is still relevant and there is unlikely to be another means of achieving the same objective outside the tax system.

N.43 We understand that other jurisdictions have similar reliefs (e.g. the US[33]); thus the policy objective has global recognition.

Taxpayer take up and awareness

N.44 Taxpayer take up is not known as the relevant box on the self assessment return is also used by creators of literary and artistic works and market gardeners.

N.45 It is estimated that there was a maximum of 7,000 claims in 2008/09[34], totalling no more than £10 million[35] for all categories of averaging.

[31] ITTIOA 2005 ss 221- 225
[32] Denis Healey MP, Budget 11 April 1978, Hansard, Vol 947 col 1201
[33] http://www.irs.gov.uk/publications/p125/ch03.html#en_us_publink1000217858
[34] HMRC estimate
[35] HMRC estimate

Complexity, compliance costs and administrative burden

N.46 The legislation is not considered to be complex, but no details of the administrative and compliance burden are available. In any event, the relief is well established and stable, and is well known to the industry and its advisers.

Summary

N.47 The original rationale remains valid and the relief provides a degree of protection for farmers, particularly in the current economic climate, from effects of the vagaries of the UK climate and commodity prices that are outside farmers' control.

N.48 We therefore recommend that the relief should be retained.

Literary and creative artists' profits

N.49 Literary and creative artists can be affected by fluctuating profits which could result in tax being paid at the higher rate in one year and no tax in the following year. In 2001 a system of averaging was introduced, based on the farmers' averaging regime[36].

N.50 Broadly the relief applies where the profits of two consecutive years differ by more than 30%. In this case the individual may make a claim to be taxed on the average of the profits in each of the two years. Marginal relief is also available where the difference between the two years' profits is between 25% and 30% of the higher year's profits.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

N.51 The relief smooths literary and creative artists' profits and consequently their tax liability, thus enabling better management of cash flow.

N.52 The relief was introduced as this sector, was considered to suffer from variable cashflows more regularly than other sectors[37]. It also enabled the individual to spread the tax charge over the time the profits were earned. However we understand from tax agents representing taxpayers in this sector that in most cases now, the individuals receive advances from agents, followed by further royalties. Therefore to some extent, the averaging is achieved outside the tax system.

N.53 We also have to note that many other self-employed taxpayers will have cashflows and profits that vary considerably.

Taxpayer take up and awareness

N.54 Taxpayer take up is not known as the relevant box on the self assessment return is also used by farmers and market gardeners.

N.55 It is estimated that there was a maximum of 7,000 claims in 2008/09[38], totalling no more than £10million[39] for all categories of averaging.

[36] ITTOIA 2005 ss221-225 (previously FA 2001 s71 and Sch 24)
[37] HMRC
[38] HMRC estimate
[39] HMRC estimate

Complexity, compliance costs and administrative burden

N.56 The legislation is not considered to be complex, but no details of the administrative and compliance burden are available. The administrative burden is on taxpayers (or on their advisers) but they receive a clear payback in reduced tax bills and improved cashflow. We have not seen any evidence that the possibility of claiming the relief is missed by taxpayers because of its complexity or obscurity, although that remains a possibility.

Summary

N.57 Whilst the policy rationale may remain valid in some cases, in many it has been replaced with spreading performed by the artist's agent. Unlike farmers averaging we do not think that there is sufficient justification as to why this sector should receive favourable tax treatment, as the fluctuation of profits is not outside the control of the artist.

N.58 Whilst there are no compelling simplification reasons to abolish this relief, in that it is known and understood by the relevant sector, we cannot really see that it is fully justified. We therefore recommend that this relief should be abolished.

Grants for giving up agricultural land

N.59 This legislation[40] provides that certain payments made to an individual under the Agriculture Act 1967 s27[41] will not be treated as consideration for the disposal of any asset.

N.60 The payments are made by the Secretary of State in accordance with certain schemes and are payments to relinquish occupation of uncommercial agricultural land as part of "an approved amalgamation, arrangements for afforestation or for reshaping agricultural units[42]".

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

N.61 The policy was to ensure that where approved schemes require an individual to relinquish occupation of agricultural land, no adverse tax consequences occur.

N.62 The most recent scheme identified was the Farm Structure (Payments to Outgoers) Scheme 1976[43], and we are not aware of any subsequent schemes. This has now lapsed and although enabling provisions remain in force, we are not aware that any subsequent schemes have been made.

Taxpayer take up and awareness

N.63 The taxpayer take up is not known.

Complexity, compliance costs and administrative burden

N.64 The relief is not complex, and is a simplification ensuring that any payment to give up land does not need to be considered for tax purposes.

Summary

N.65 We currently have insufficient information in order to arrive at a conclusion.

[40] TCGA 1992 s249
[41] "Grants for relinquishing occupation of uncommercial agricultural units"
[42] Halsbury's laws of England/ Agricultural Production and Marketing (Vol 1(2008) 5th edition)/ 12. Administration and Finance/ (6) Grants for farmers/ (iii) Grants under the Agriculture Act 1967/1340.Relinquishment of uncommercial units
[43] SI 1976/2126 (amended by SI 1981/1709 and extended by SI 1983/1882)

Woodlands

N.66 Until 14 March 1988 a person managing woodlands on a commercial basis could elect within 2 years of the end of the year of assessment to be taxed under what was then Sch D Case I rather than Sch B. This election was abolished with effect from 15 March 1988, subject to transitional provisions to 5 April 1993.

N.67 From 15 March 1988 profits or gains arising from commercial woodlands are outside the scope of corporation tax or income tax[44].

N.68 In many cases the cost of planting and managing woodlands may be met by grant finance, and there is no tax deduction for these costs as a woodland is not a trade. In addition there are IHT reliefs for woodlands[45].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

N.69 The policy rationale was to exclude commercial woodlands from the income tax system so that any losses generated cannot be used to shelter any other income from tax.

N.70 HMRC consider that were this relief to be abolished there would be scope for tax avoidance and thus the rationale is still valid. There is not considered to be an alternative method of achieving the same objective that does not involve complex anti avoidance provisions.

N.71 We understand that were the relief to be abolished there would be not only be an adverse economic impact on the sector, but additional complexity would arise as affected taxpayers would have to make a return of profits or gains from woodlands. Also, if the relief were abolished and profits taxed, consideration would have to be given to treating the costs as allowable.

Taxpayer take up and awareness

N.72 The relief is targeted at businesses trading as commercial woodlands. These tend to be concentrated in Scotland, the North of England and parts of Wales, although the taxpayers who are able to take advantage of this relief may be located anywhere.

N.73 The number of taxpayers using this relief is not known.

Complexity, compliance costs and administrative burden

N.74 The legislation is not complex and the compliance costs and administrative burden are expected to be low, as tax does not need to be considered.

Summary

N.75 As excluding commercial woodlands from tax is critical to controlling the risk of tax avoidance, we consider that this relief should be retained. In addition it is not possible to consider this relief in isolation from the rules that apply to commercial woodlands for both inheritance tax and capital gains tax.

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[44] ITTOIA 2005 s768 and CTA 2009 s980, previously FA 1988 Sch 6

[45] IHTA 1984 ss125-130

O International

Inter-American Development Bank securities

O.1 ITTOIA 2005 ss773 and 774 provide an exemption from income tax for non-UK residents on income from certain securities issued by the Inter-American Development Bank ("IADB").

O.2 The IADB was originally established in 1959 to provide finance, policy advice and technical assistance to reduce poverty and inequality in the 26 countries that comprise Latin America and the Caribbean[1]. The UK became a member in July 1976 to further its overseas aid programme and use its position on the Board to influence the distribution of the funds[2].

O.3 The United Kingdom contributed funds to the IADB in excess of £6 million in 1979 and £7million in 1980.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

O.4 The relief was introduced as a prerequisite to the UK becoming a member of the IADB and the policy rationale therefore is closely linked with the policy decision to become a member.

O.5 The relief is subject to an international agreement which is still in force and so the policy rationale is still valid.

Taxpayer take up and awareness

O.6 It exempts non UK residents from a potential UK income tax liability arising on IADB issued securities. There are similar reliefs which extend to other issuing authorities including the European Economic Community and the European Investment Bank.

O.7 It is not known how many taxpayers benefit from this relief; however it is narrowly targeted.

Complexity, compliance costs and administrative burden

O.8 There is no data available on the compliance costs and administrative burden; however for non UK residents this relief is a simplification.

Summary

O.9 The policy rationale remains valid and the relief is subject to international agreements required as part of the UK's obligations as a member of the IADB.

O.10 We recommend that this relief be retained.

[1] http://www.iadb.org
[2] http://www.theyworkforyou.com/wrans/?id=1981-10-20.105.6&s=%22inter+american+development+bank%22

Issue of bearer instruments by Inter-American Development Bank

O.11 Instruments issued by the Inter-American Development Bank ("IADB") are exempt from stamp duty[3].

O.12 Further details regarding the IADB are in O.2 – O.3 above.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

O.13 The relief was introduced as a prerequisite to the UK becoming a member of the IADB and the policy rationale therefore is closely linked with the policy decision to become a member.

O.14 The relief is subject to an international agreement which is still in force and so the policy rationale is still valid.

Taxpayer take up and awareness

O.15 It is not known how many taxpayers benefit from this relief, however it is narrowly targeted.

O.16 The tax impact for 2010/11 is likely to be negligible[4].

Complexity, compliance costs and administrative burden

O.17 There is no data available on the compliance cost or administrative burden of this relief, however as it exempts the instruments from stamp duty it is likely to be a simplification.

Summary

O.18 The policy rationale remains valid and the relief is subject to international agreements required as part of the UK's obligations as a member of the IADB.

O.19 We recommend that this relief be retained.

Reserve Bank of India and the State Bank of Pakistan

O.20 ITA 2007 s 839 gives relief from income tax on income of the issue departments of the central banks of India and Pakistan.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

O.21 The reliefs date from 1934[5] when the UK first granted the exemption to the Reserve Bank of India, and 1951[6] when it was extended to the State Bank of Pakistan.

O.22 The Reserve Bank of India was established on 1 April 1935[7] and from 1949 is fully owned by the Government of India. Its main function is to regulate the issue of bank notes and keeping of reserves with a view to securing monetary stability in India and to operate the currency and credit system of the country. The State Bank of Pakistan fulfils a similar function.

[3] FA 1976 s131
[4] HMRC estimate
[5] FA 1934 s22
[6] FA 1951 s26
[7] Reserve Bank of India Act 1934

O.23 Apart from the distribution of a small fixed dividend to shareholders, the whole of the banks' profits from securities in the UK belong to the respective governments so that any UK tax on the income from investments is a tax on the government's share of the profits. It thus enables the respective governments to obtain full benefit from investments in the UK.

O.24 The policy rationale was to encourage both the Reserve Bank of India and the State Bank of Pakistan to hold currency in reserve in sterling securities in London.

Taxpayer take up and awareness

O.25 This relief is narrowly targeted. It exempts from UK income tax liability income arising to the central banks of India and Pakistan, so as not to impose a levy on the respective governments.

O.26 There is no data available in relation to the cost of this relief.

Complexity, compliance costs and administrative burden

O.27 We have been unable to evaluate the administrative burden of this relief; however it is not expected to be complex.

Summary

O.28 The policy rationale of ensuring that the two banks hold investments in the UK remains valid, and we recommend that this relief is retained.

Transfers of International Bank Stock

O.29 This relief[8] exempts from stamp duty transfers of stock of the International Bank for Reconstruction and Development ("IBRD").

O.30 It was introduced to comply with the agreement that the UK entered into when it became a member of the IBRD.

O.31 The IBRD was formed as a result of the Bretton Woods Agreement that came out of the United Nations Monetary and Financial Conference held in Bretton Woods, USA in July 1944.

O.32 IBRD aims to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and analytical and advisory services. Established in 1944 as the original institution of the World Bank Group, the IBRD is structured like a cooperative that is owned and operated for the benefit of its 187 member countries[9].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

O.33 The relief is required in order to comply with the agreement and remain a member of the IBRD, and the policy rationale therefore remains relevant.

Taxpayer take up and awareness

O.34 There is no data available but it is narrowly focused.

O.35 HMRC believe that the cost to the Exchequer for 2010/11 is negligible.

[8] FA 1951 s42
[9] http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/EXTIBRD/0,,menuPK:3046081~pagePK:64168427~piPK:64168435~theSitePK:3046012,00.html

Complexity, compliance costs and administrative burden

O.36 There is no data available on the compliance cost or administrative burden of this relief, however as it exempts the stock from stamp duty it is likely to be a simplification.

Summary

O.37 The policy rationale remains relevant and the relief is subject to an international agreement.

O.38 We therefore recommend that this relief be retained.

Non-resident central banks – income on securities payable out of the UK public revenue

O.39 This relief[10] exempts from income tax certain income from securities arising in the UK to overseas central banks. It does not extend to income arising in the normal course of the bank's trading operations in the UK.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

O.40 The policy rationale was to encourage overseas central banks to hold currency in reserves in securities in London. The profits from securities in the UK belong to the respective governments so that if there were any UK tax on the income from investments it would be a tax on the government's share of the profits. This relief thus enables the respective governments to obtain full benefit from investments in the UK.

Taxpayer take up and awareness

O.41 There is little data available but it is narrowly focused, and there is no date on the cost of this relief.

Complexity, compliance costs and administrative burden

O.42 There is no data available on the compliance cost or administrative burden of this relief; however as it exempts the securities from income tax it is likely to be a simplification.

Summary

O.43 The policy rationale remains valid and we therefore recommend that this relief be retained.

FOTRA Securities – exemption for overseas residents

O.44 The Free of Tax to Residents Abroad ("FOTRA") securities are issued by the Treasury and are exempt from UK income and corporation tax whilst they are in the beneficial ownership of persons whose ordinary residence is outside the UK[11].

O.45 Before 1998, the exemption only applied to gilts with FOTRA status. However, the rules changed on 6 April 1998[12] and since then all UK Government securities have FOTRA status,

[10] ITA 2007 s840
[11] ITTOIA 2005 s713 and CTA 2009 s1279
[12] FA 1998 s161

irrespective of the terms of issue of the security, and interest payments on holdings of all registered gilts are generally made without deduction of tax.[13]

O.46 FOTRA status was enacted in 1915 and its scope limited by Finance (No 2) Act 1931 that gave the Treasury the power to exempt the interest and profit on the securities held by persons who are not ordinarily resident in the UK.

O.47 In general terms, the exemptions apply to the following securities as long as the beneficial owner is ordinarily resident outside the UK (and for the first two, is also not UK domiciled)[14]:

- FOTRA securities issued before 29 April 1996;
- 3½% War Loan 1952 or after;
- All other government securities issued before 6 April 1998 without FOTRA conditions; and
- All other government securities issued on or after 29 April 1996.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

O.48 The policy rationale is to encourage non-residents invest in UK gilts. If the tax treatment were to change, this is likely to affect the market, lessening demand and making it more difficult for the Government to raise finance.

Taxpayer take up and awareness

O.49 Overseas investors are the largest holders of gilts and, as at October 2010 held almost one third of all Government gilts[15]. The tax relief cost the UK economy £2.5billion in 2008-9[16].

O.50 Since the end of 2003 there has been a sustained rise in the amount of gilts held by overseas investors. Between Q4 2007 and Q4 2008 overseas holdings grew in absolute terms from £156.7billion to £216.6billion (an increase in relative terms from 32.0% to 35.1% of the gilt portfolio)[17]. In 2009, the Debt Management Office ("DMO") indicated that there will be £148billion nominal gilts issued by the UK[18].

Complexity, compliance costs and administrative burden

O.51 The legislation is not complex. Investors make claims using a straightforward form provided by HMRC. Any tax charged in error can also be claimed using a separate HMRC form.

Summary

O.52 The relief is targeted at, broadly, non UK residents. If the relief were repealed, the UK may lose overseas investors who may currently be influenced to invest in UK gilts because of the tax relief.

O.53 As the policy rationale for the relief is valid, we recommend that it is retained.

[13] http://www.hmrc.gov.uk/cnr/fotra_sec.htm
[14] www.lexisnexis.com
[15] http://www.ftmandate.com/news/fullstory.php/aid/2474/UK_gilts:_pensions_and_SWFs_get_lion_92s_share.html (October 2010)
[16] HMRC Tax Ready Reckoner and Tax Reliefs 2009 Page 17
[17] Debt Management Office 2009
[18] DMO Report, June 2009 Page 8

Issue/transfer of securities issued by designated international organisations

O.54 This relief[19] exempts the issue and transfer of securities issued by certain designated international organisations from stamp duty and stamp duty reserve tax.

O.55 The designated international organisations are broadly those where the UK is a member of an international organisation and there is an agreement as part of the conditions of membership that requires such an exemption from tax[20].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

O.56 The purpose of the relief is to comply with agreements entered into when the UK became a member of the relevant organisation.

O.57 If the relief was abolished, the UK would be in breach of these international agreements.

Taxpayer take up and awareness

O.58 There is no data available on the take up; however the relief is narrowly targeted at international organisations where the agreement requires the tax exemption.

Complexity, compliance costs and administrative burden

O.59 There is no data available on the compliance cost or administrative burden of this relief, however as it exempts the stock from stamp duty, it is likely to be a simplification.

Summary

O.60 The policy rationale remains relevant and the relief is subject to an international agreement.

O.61 We recommend that this relief be retained.

[19] FA 1984 s 126
[20] FA 1984 s126(1)

P Other

Exemption for repayment supplement and interest on repayments made by HMRC

P.1 This exemption excludes from the charge to income tax any repayment interest paid by HMRC on overpayments of tax (income tax[1], capital gains tax[2], corporation tax[3] and VAT[4]). It provides fairness and consistency, as any late payment interest paid to HMRC on underpayments of tax and is not deductible in computing taxable income.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.2 The policy rationale is still valid and there is no other method to achieve the same objective.

Taxpayer take up and awareness

P.3 This relief has application to the whole taxpaying population, as every repayment of overpaid tax issued by HMRC carries accrued interest.

Complexity, compliance costs and administrative burden

P.4 The legislation is not complex and it is not considered to impose an administrative burden on either taxpayers or HMRC.

Summary

P.5 The rationale for this relief is to maintain fairness in the tax system as interest payable is not deductible, and if it were to be abolished, it would impose an administrative burden on taxpayers as details of this interest would have to be included on their tax returns.

P.6 We recommend that this relief be retained.

Angostura bitters

P.7 Angostura bitters are concentrated cocktail bitters made with water, 44.7% alcohol and natural flavourings. They are used in both cooking and in drinks in small quantities (being unpalatable in isolation). The sole producer is Angostura Limited in Trinidad. They compete with other flavourings (whether or not containing alcohol) and the alcohol content is not integral to the end use, but is essential to maintain the ingredients in solution[5].

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[1] ITTOIA 2005 s749(a)
[2] ITTOIA 2005 s749(b)
[3] ITTIOA 2005 s749A
[4] ITTOIA 2005 s777 and CTA 2009 s1286
[5] Representation from Angostura Limited

P.8 Angostura bitters are exempt from excise duty and therefore can be sold from unlicensed shops, like other flavourings. Angostura bitters are also exempt from customs duty, and this was a specific derogation negotiated by the UK[6].

P.9 This legislation is the Alcoholic Liquor Duties Act 1979 s1(7) and also Alcoholic Liquor Duties Act 1979 s6; this latter section gives the Commissioners the power for the purposes of duty on spirits to treat Angostura bitters (an "aromatic flavouring essence") as not being spirits.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.10 Representation had been made by UK importers and Trinidad for a number of years prior to 1970, that Angostura bitters should be exempt from duty as its main use is as a flavouring. In 1969 the possibility of an exemption from duty was debated and rejected. The arguments for an exemption were that the export of Angostura bitters was important to Trinidad, and that by 1972 the UK would be the only major country in Western Europe treating the product as an alcoholic beverage and charging duty[7]. The exemption was given in Finance Act 1970 on the basis that although the exemption was a breach of the general system of spirits duty, there was little risk of misuse of duty free bitters[8] as it would not be drunk in isolation.

P.11 The exemption is a benefit to Trinidad which is one of the least developed Commonwealth countries; at the time the exemption was introduced it supported the economy of Trinidad as there was a high level of unemployment[9]. However, the exemption creates an inequity with other cocktail bitters that are not exempt from duty.

P.12 Angostura bitters is also exempt from VAT and customs duty. For the latter its classification code[10] is "aromatic bitters of an alcoholic strength by volume of 44.2 to 49.2% vol containing from 1.5 to 6% by weight of gentian, spices and various ingredients and from 4 to 10% of sugar, in containers holding 0.5 litre or less"[11].

P.13 The imposition of excise duty would adversely impact on the sales in the UK of this high profile product from the Caribbean[12].

Taxpayer take up and awareness

P.14 One Trinidad based producer benefits from this very specific exemption.

Complexity, compliance costs and administrative burden

P.15 The legislation is not complex. The administrative and compliance costs are considered to minimal[13]. HMRC occasionally receives requests from the drinks industry about the rationale and equity of the exemption.

P.16 It is estimated that removing the exemption from excise duty will increase the retail cost of a bottle by 50% (including VAT which would now apply), resulting in a corresponding drop in sales of 50% (currently 240,000 bottles are sold per annum)[14].

[6] Council Directive 92/83/EEC of 19 October 1992 on the harmonisation of the structures of excise duties on alcohol and alcoholic beverages, Art 28
[7] Hansard HC Deb 16 July 1969 Vol 787 cc 699 - 702
[8] Internal HMRC source
[9] 25% in 1970 (Hansard HC Deb 29 May 1970 vol 801 col 1836
[10] 2103 90 30 00
[11] UK Trade Tariff Chap 21 Heading 2103
[12] Angostura Limited
[13] HMRC estimate
[14] Angostura Limited

Summary

P.17 The inequality that this creates between Angostura and other cocktail bitters should not be prolonged as, inter alia, it gives Angostura bitters a price advantage.

P.18 Consideration must also be given to the fact that were this exemption to be abolished, it would create a difference in the customs and excise duty treatment of Angostura bitters and would also mean that the UK would treat the product differently from other Western European countries as well as Australia, Canada and the US, all of whom provided an exemption in 1970[15] (the current treatment of Angostura bitters in these territories has not been verified).

P.19 If the exemption is to be repealed it may be necessary to consider the corresponding treatment of similar and competing products.

P.20 We recommend that the relief should be abolished, subject to consideration of the wider issues noted above.

Black beer

P.21 Black beer is a drink with a strength of approximately 8.5% a.b.v. and is made from malt or malt and sugar, without the addition of hops or yeast. Its manufacture and consumption is confined mainly to West Yorkshire, where there is only one producer, and it is generally used as a mixer e.g. with lemonade or milk, or for use in cooking.

P.22 Historically black beer was considered to have medicinal (including as an anti-scorbutic) and nutritional properties (30ml provides 25% of the recommended daily allowance of vitamin C). It was also at one time considered to be a "non-intoxicant"[16].

P.23 Black beer is exempt from excise duties. This exemption was originally introduced in FA 1930 s2(1) and is now in the Alcoholic Liquor Duties Act 1979 s1(3)(a). It is also exempt from customs duties by virtue of a derogation negotiated by the UK[17].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.24 The exemption was introduced in 1931 on the basis that if the proposed increase to the beer duty at the time (which was "substantial"[18]) applied to black beer it may have resulted in the end of the production of black beer which was, even then, much diminished[19].

P.25 There is no reason to continue the exemption on the grounds that black beer has medicinal properties; at approximately 8.5% a.b.v. it would not be considered to be a "health product" today.

Taxpayer take up and awareness

P.26 The exemption is focused on one product, Mathers Black Beer, produced by CWF[20].

[15] Hansard HC Deb 27 Mat 1970 vol 801c ol 1836
[16] Hansard HC Deb 23 April 1923 Vol 163, col 711
[17] Council Directive 92/83/EEC of 19 October 1992 on the harmonisation of the structures of excise duties on alcohol and alcoholic beverages, Art 28
[18] Internal HMRC briefing
[19] Internal HMRC briefing
[20] http://www.continental-wine.co.uk/products/Fortified-Aperitif-Drinks.shtml

Complexity, compliance costs and administrative burden

P.27 The legislation is not complex and the costs of compliance and administration are considered to be minimal. HMRC have not had any enquiries regarding the exemption.

P.28 We estimate that if the exemption were to be removed the cost of a bottle of black beer (680ml) would increase by £1[21].

Summary

P.29 The rationale for exemption as a health product is no longer valid, and the exemption is very limited in its application.

P.30 We therefore recommend that this relief be abolished.

Community investment tax relief

P.31 The Community Investment Tax Relief ("CITR") regime[22] was introduced in Finance Act 2002 to encourage investment in disadvantaged communities by giving tax relief to investors in businesses and other enterprises in disadvantaged areas who invest via Community Development Finance Institutions ("CDFIs"). CDFIs are accredited intermediary organisations that invest in enterprises operating in disadvantaged communities.

P.32 Relief is available to both corporate and individual investors in accredited CDFIs, and is worth up to 5%[23] of the amount invested. To qualify for the maximum relief (effectively 25% of the investment) the investment must be held for at least 5 years[24].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.33 The aim of CITR was to encourage the growth of CDFIs and the scheme is run jointly by HMRC and the Department for Business, Innovation and Skills.

P.34 The policy is still valid but consideration should be given to whether the incentive could be provided in another way.

Taxpayer take up and awareness

P.35 Since its introduction in 2004 there are 20 accredited CDFIs, with 1,900 investors[25] and over 1,300 loans have been made to enterprises totally approximately £70 million[26]. HMRC consider that take up of the scheme has been disappointing, and that the relief has not been as successful as anticipated in raising money. However, with grant finance from local authorities under threat in the current economic climate, it is possible that there may be a greater take up of the relief in the future.

P.36 CITR is targeted at businesses in or serving disadvantaged areas.

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[21] HMRC estimate
[22] ITA 2007 Part 7 and CTA 2010 Part 7
[23] CTA 2010 s220(3) and ITA 2007 s335(2)
[24] CTA 2010 s223 and ITA 2007 s338
[25] HMRC estimate
[26] HMRC estimate

Complexity, compliance costs and administrative burden

P.37 The tax cost of the relief to the Exchequer is estimated to be less than £5million for 2010/11[27].

P.38 The administrative and compliance burden is considered to be minimal[28] for both taxpayers and their advisers. A certificate is obtained from the CDFI which is used to adjust the individual's tax code. However we understand that there are some complexities in the legislation, resulting from State aid clearance, which may discourage its use.

Summary

P.39 CITR has EU State aid approval until October 2012. We understand that HMT/ HMRC are currently re-evaluating CITR and considering the future structure of the relief ahead of the re-notification process for State aid beyond October 2012. In the light of this process we do not propose to carry out any further analysis of the CITR regime as this would duplicate the work done by HM Treasury and HMRC.

P.40 However, based on our methodology, we recommend that this relief be abolished, as there is very low take up, negligible savings and certain complexities.

Lease premium relief

P.41 Lease premium relief gives a deduction against trading profits for an annual equivalent of a premium paid on certain leases on property used for business purposes.

P.42 The relief entitles traders and intermediate landlords to claim a tax deduction against trading or property business profits equal to the annual equivalent of the premium which is taxable, paid in each period for which the lease is current. This would otherwise be treated as a capital payment and would not be relievable. This applies to short leases i.e. leases of 50 years or less.

P.43 The legislation is found in ITTOIA 2005[29] and CTA 2009[30]. Whilst not all of the legislation applies to the relief itself, reference must be made to all of it in order to calculate the relief, for example the definition of taxable premium.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.44 The provisions give an annual deduction from the profits of a property business for part of the lease premium, for which there would otherwise be no deduction as a capital item.

P.45 The relief is the mirror side of the charging provision for lease premiums on the recipient. Therefore, to ensure symmetry, the rationale remains valid.

P.46 However, it should be noted that complete symmetry is not achieved – whilst generally the total amounts taxed and relieved are the same, lease premiums receivable are taxed when they are received, however the relief is spread over the term of the lease.

Taxpayer take up and awareness

P.47 There are thought to be in excess of 10,000 beneficiaries from this relief[31].

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[27] HMRC estimate
[28] HMRC estimate
[29] ITTOIA 2005 ss60–67 and 276–307
[30] CTA 2009 ss62–67 and 215–247

P.48 The cost of the relief is not known.

P.49 The relief is widely targeted at tenants or intermediate landlords carrying on property businesses from leased premises, where the lease is a short lease. However, it is not available as a management expense, which reduces the number of potential beneficiaries and is also a source of unfairness.

Complexity, compliance costs and administrative burden

P.50 This relief affects just over 1,000 businesses and results in a total administrative burden to them of around £45,000 per year.

P.51 For businesses, there is a perception that it is a complex relief to claim as the lessee has to first calculate the assessable amount of the lease premium in the lessor's hands (broadly the value of the premium less 2% of the premium for each complete year of the lease after the first year), before the annual deduction for the lessee can be calculated. Once calculated the amount does remain static.

P.52 Practical considerations, which add to complexity, include determining which leases are short leases with respect to break points in the lease agreements.

P.53 Simplification of the relief was considered by HMRC's anti avoidance simplification working group in 2008[32], but following preliminary analysis and review it was decided that simplification of the regime was outside the scope of the anti avoidance simplification project[33].

P.54 It has also been suggested that much relief is given incorrectly by default, as a tax deduction is generally claimed for the amount of rent shown in the accounts, which may include an element of a premium, and no adjustment is made.

Summary

P.55 Even though the policy rationale remains valid, the practical issues and calculations make the relief complex.

P.56 However, as the relief is part of a wider regime addressing the taxation of the premium in the hands of the lessor, it is considered that the relief cannot be considered in isolation and it is the overall regime, rather than the relief itself, that we therefore recommend be simplified.

P.57 A potential simplification that has been suggested in a number of representations would be for the taxation of leases to follow the accounting treatment. This is on the basis that most premiums payable are, in effect, advance rent and a full deduction should be allowed. This will avoid both the unfairness of excluding management expenses and the unfairness of enabling businesses that pay premiums to be disadvantaged with respect to those who purely pay rent.

Entertaining for non-trading and non-property businesses

P.58 The general rule is that there is no deduction against the taxable profits of a business for expenditure incurred in providing entertainment or gifts; however this is subject to some exceptions which ensure that certain activities are not affected e.g. for employees or where entertaining is part of the trade. There are also exemptions for certain gifts (e.g. where the gift is small and includes an element of advertising).

[31] HMRC estimate
[32] "Simplifying anti avoidance legislation" HMRC 12 March 2008
[33] HMRC

P.59 ITTOIA 2005 s867 is not a relief in itself but applies the rules (including the exceptions) that apply to trades[34], property businesses[35] and companies[36] to non-trade and non-property businesses.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.60 The disallowance of non-capital expenditure on business entertaining and gifts was introduced in Finance Act 1965 s15. The provision had its origins in the Second World War when food rationing was introduced apart from in hotels and restaurants, and many businesses relied on business entertaining to maintain goodwill with their suppliers and customers, in the absence of materials and goods to buy and sell. Additionally, high rates of tax meant that the after-tax cost of business entertainment was small. Support for the disallowance gathered momentum following the "Royal Commission on Taxation of Profits and Income" in 1955. A Memorandum of Dissent to the Commission's findings stated that business entertainment expenditure was not always directly or closely associated with trading activity and that often there were[37]:

> "outlays of doubtful value, which it might not have been worth the trader's while to incur in the absence of taxation".

P.61 There was also some concern that were business entertaining expenses to be allowable for tax purposes this would be seen as a "state subsidy" and not a good use of taxpayers' money[38].

P.62 The measure ensures equality of treatment between different types of businesses, ensuring that all businesses are treated in the same way when it comes to entertaining expenses.

Taxpayer take up and awareness

P.63 There is no data available on the number of users. Typical users would be businesses that receive non-trading income from intellectual property and are assessable under ITTOIA 2005 s579; if entertaining expenses are incurred these would be subject to the provisions at ITTOIA 2005 s867.

Complexity, compliance costs and administrative burden

P.64 There is no data available.

Summary

P.65 We recommend that this relief be retained. It would not be possible to simplify the provision in isolation, and, were the relief to be abolished or simplified, a wider review of the parallel provisions that apply to other businesses would need to be undertaken to ensure equality of treatment.

Deduction for expenditure by landlords on energy saving items

P.66 The landlords' energy saving allowance ("LESA") was introduced in Budget 2004[39] to provide tax relief for landlords for the cost of buying and installing energy saving items in rented property. The relief is a maximum of £1,500 per property. The scheme originally applied to

[34] ITTOIA 2005 s45
[35] ITTOIA 2005 s272
[36] CTA 2009 s1298
[37] Memorandum of Dissent to the Royal Commission on Taxation of Profits and Income (1955), para 115
[38] HMRC
[39] Budget PN3, 17 March 2004

cavity wall insulation and loft insulation, and was extended to cover solid wall insulation in April 2005, draught proofing and insulation for hot water systems in April 2006 and floor insulation from April 2007[40]. The scheme is due to end in April 2015[41].

P.67 The scheme is available to both individual landlords (from 6 April 2004[42]) and corporate landlords (from 6 April 2007[43])[44].

P.68 The scheme is available nationwide for qualifying property rental businesses, excluding furnished holiday lettings and property qualifying for rent a room relief.

P.69 It gives relief for energy saving improvements for which landlords would not normally be able to claim a deduction from the profits of a property rental business.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.70 The LESA was introduced as part of a package of measure to "encourage responsible environmental behaviour throughout the UK"[45] and to increase household energy efficiency, i.e. to make the rental housing stock more energy efficient.

P.71 In view of the current Government's commitment to environmental issues and its aim to be the "greenest government ever"[46], the policy rationale remains valid but consideration must be given to whether landlords could be incentivised in other ways to ensure the energy efficiency of rental properties.

P.72 An alternative might be to consider some form of grant finance instead of this incentive in the tax system, but grant finance is uncertain and this provision gives landlords certainty.

Taxpayer take up and awareness

P.73 LESA is claimed in an individual or partnership return; for companies there is no specific LESA entry in the return. For individuals the relief is claimed in the self assessment tax return by entering the costs of buying and installing qualifying items in the "landlord's energy saving allowance" box on the UK property pages or, for overseas property, under "income from land and property abroad". Corporate taxpayers include the costs as allowable business expenditure on the corporate return form.

P.74 In 2008/09 there were approximately 4,500 claims by individuals and partnerships[47]. There is no information of the number of companies claiming this relief. The cost to the Exchequer is estimated to be £5million[48].

Complexity, compliance costs and administrative burden

P.75 The legislation is not complex, but to qualify taxpayers need to ensure that both the property rental business and the expenditure incurred qualify.

Summary

P.76 The policy rationale remains valid, and it is a simple relief to claim.

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[40] The Energy-Saving Items Regulations, SI 2007/3278, which revoked with effect from 6 April 2007, the Energy Saving Items Regulations, SI 2005/1114, the Energy Saving Items Regulations, SI 2006/912, and the Energy Saving Items Regulations SI 2007/831.
[41] ITTOIA 2005 s312(1)(c)/ CTA 2009 s251(1)(c)
[42] ITTOIA 2005 ss312-314
[43] FA 2007 s18
[44] CTA 2009 ss251 - 253
[45] Budget PN3, 17 March 2004
[46] Budget 22 June 2010, Red Book, para 1.75
[47] HMRC estimate
[48] HMRC estimate

P.77 We recommend that it be retained but, prior to the planned expiry of the relief in 2015, a proper review be carried out of its effectiveness.

P.78 However consideration could be given to simplifying the administration of the regime, for example by introducing a flow chart or checklist approach to assist taxpayers in ascertaining that they qualify for the relief.

Eurobond interest

P.79 This relief exempts interest paid on Eurobonds from deduction of tax so that the holder of the Eurobond receives interest gross rather than net of tax.

P.80 A quoted Eurobond is a security, including shares (in particular any permanent interest bearing share), listed on a recognised stock exchange, and carries a right to interest. Some of the major issuers are supranational organisations (such as the World Bank or the European Bank for Reconstruction and Development)[49].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.81 The original policy rationale is to encourage the growth of the UK Eurobond market, as London is one of the centres of the worldwide Eurobond market.

P.82 If it were repealed, it could reduce investment in this area, and also reduce investment in the UK.

Taxpayer take up and awareness

P.83 This relief is targeted at any holder of Eurobonds.

P.84 In the year to November 2010, funds raised through Eurobonds issued on the main UK market totalled £393billion in over 3,300 issues[50].

Complexity, compliance costs and administrative burden

P.85 The relief is a simplification to the taxpayer as it removes the need to account for withholding tax.

Summary

P.86 The policy rationale remains valid and it is a simplification for the holders.

P.87 We recommend that this relief be retained.

Deeply discounted securities incidental expenses

P.88 A charge to income tax on savings and investment income arises when an individual disposes of a deeply discounted security ("DDS"). A DDS is a security where the amount payable on redemption may exceed the issue price by more than 0.5% for each year in the redemption period, up to a maximum of 30 years.

P.89 Where a DDS is disposed of an income tax charge arises on the person making the disposal. For disposals of DDS after 6 April 2005, the profit on disposal is calculated as the

[49] http://www.investinginbondseurope.org/Pages/LearnAboutBonds.aspx?id=6368
[50] HMRC estimate

amount payable on the disposal, less the amount paid to acquire the DDS less any incidental expenses connected with the acquisition of the security incurred before 27 March 2003[51].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.90 The policy rationale is to equate DDS with capital gains where such incidental expenses are allowed. DDS (previously "relevant discounted securities") held on 26 March 2003 are grandfathered and excluded from the rules introduced in FA 2003[52] that were designed to prevent tax avoidance schemes involving the creation of artificial income tax losses. The pre March 2003 rules apply as long as the DDS is held by the person who held them on 26 March 2003.

Taxpayer take up and awareness

P.91 The number of taxpayers affected is not known.

Complexity, compliance costs and administrative burden

P.92 The compliance costs and administrative burden is not known.

P.93 The legislation requires taxpayers to have maintained details of incidental costs of expenditure relation to DDSs acquired before 26 March 2003.

Summary

P.94 This relief is still relevant and should be retained for the time being to protect investor expectations. However, consideration should be given to abolishing this in due course; although due to legacy issues a sufficient notice period will need to be given.

Gilts issued at discount

P.95 See P.90 – P.91 for a description of deeply discounted securities ("DDS") and the tax regime surrounding them.

P.96 This relief provides for income tax relief for losses on the disposal of a DDS that may otherwise be a capital loss[53].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.97 The policy rationale is to ensure fairness and symmetry between the taxation of gains and losses on disposal of a DDS.

Taxpayer take up and awareness

P.98 There is no information available about the take up of this relief.

Complexity, compliance costs and administrative burden

P.99 The relief is not complex as we understand that it is neither difficult to calculate the loss nor make the claim.

[51] ITTOIA 2005 s439(4)
[52] FA 2003 Sch 39
[53] ITTOIA 2005 s446

Summary

P.100 The policy rationale for the relief is still valid, the relief is not complex, and it is required to ensure fairness.

P.101 We therefore recommend that the relief is retained.

Pension contributions – disregard for benefits referable to contributions paid before 6 April 2006 and certain payments made after

FA 2004 Sch 36 para 51, The Taxation of Pension Schemes (Transitional Provisions) Order 2006[54] and SSCR 2001 Part VI Sch 3 para 3(1)(b) and (d) provides for benefits referable to pension contributions paid before 6 April 2006 to a non-UK pension scheme accepted before that date as corresponding to an approved scheme, and also to certain contributions made after that date. The comments below apply to both of the above reliefs.

P.102 Before 6 April 2006 HMRC had the discretion to accept pension schemes established outside the UK as corresponding to a UK approved scheme, and would exercise this discretion if it would have approved the scheme had it been established in the UK. If a non-UK scheme was accepted as a corresponding scheme, contributions to the scheme were given tax relief and were also disregarded in the calculation of earnings for assessing liability to earnings related NICs.

P.103 HMRC's discretion in relation to approved schemes outside the UK ceased from 6 April 2006 unless the schemes were receiving contributions in 2005/06.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.104 FA 2004 Sch 36 para 51 and SI 2006/572 Art 15 provides transitional relief to employers and employees and allows the payment of employers' and employees' pension contributions to attract tax relief, as long as the contributions were being paid with tax relief in respect of that individual for 2005/06. The policy behind the provisions was to allow relief for employers who had set up "approved" international pension arrangements before 6 April 2006, and to allow employees to continue to accumulate new pension rights under those arrangements, without the schemes having to meet the new statutory conditions that served to limit the types of scheme eligible for relief.

P.105 SSCR 2001 Sch3 Part VI para 3(1)(b) gives the same NIC treatment to employer contributions paid to non-UK retirement benefit schemes, accepted as corresponding to a pre 6 April 2006 UK approved scheme, as is given to contributions to a registered scheme. This aligns the NIC and income tax treatment.

P.106 As pension arrangements are long term savings vehicles, the policy rationale is considered to be valid. It may not be possible for an employee to access pension benefits for in excess of 30 years, and this provision gives full relief for contributions paid from 6 April 2006 in respect of non-UK retirement benefits schemes accepted as corresponding to UK schemes before 6 April 2006.

P.107 It will be necessary to retain the transitional reliefs and exemptions for many years in order to ensure that the policy objective is delivered over the life of the arrangements; individuals are entitled to expect that they will not be liable to NICs twice in respect of the same amounts.

[54] SI 2006/572

P.108 The policy objective is still met and it is not considered that there is another method of achieving the objective.

Taxpayer take up and awareness

P.109 Approximately 7,400 non-UK pension schemes have been accepted as corresponding to UK approved schemes (200 since 6 April 2006)[55]. There is no reliable data available on the number of individuals who have taken advantage of such schemes, or the number of individuals for whom new contributions are being paid.

Complexity, compliance costs and administrative burden

P.110 There is no data available on the compliance and administration costs.

P.111 Were the relief to be removed, affected schemes would either have to demonstrate to HMRC that they meet the statutory conditions to receive tax relieved contributions, or the individuals affected would have to transfer to another pension scheme in order to receive UK tax relief on pension savings. Either alternative would create new administrative burdens.

Summary

P.112 The policy rationale remains valid, and removing the relief would result in additional administrative burdens for the schemes.

P.113 We recommend that this relief be retained.

Disregard for benefits from a funded unapproved retirement benefit scheme where attributable to payments made before 6 April 1998

P.114 Prior to 1998, the Department of Social Security ("DSS") advised employers that payments made to funded unapproved retirement benefits schemes ("FURBS") were not employees' earnings, and so no earnings related Class I NICs were due[56]. The position of the DSS changed after taking legal advice, which was that such contributions should properly be regarded as earnings. Thus Class 1 NICs were due.

P.115 Following this change in stance, the DSS stated that employers and employees would be able to rely on the previous advice given and consequently for employer pension contributions paid before 6 April 1998 no NIC contributions would be due in the future[57]. However, future pension contributions would be included as part of earnings and would be liable for NIC.

P.116 The legislation is in SSCR 2001 Sch 3 Part VI para 4.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.117 This relief preserves the reasonable expectations of employees who relied on the advice published by the DSS that no employer or employee contributions would be due when a contribution was paid into a FURBS or when FURBS benefits were received, where the employer had made the contributions prior to 6 April 1998. Thus the provision ensures that the individual's human rights are not contravened.

[55] HMRC estimate
[56] HMRC
[57] HMRC National Insurance Manual NIM 02161

P.118 As FURBS are long term savings vehicles, it may be thirty or more years before the employee can access the FURBS benefits, and thus it will be a long time before it can be assumed that all arrangements operating before April 1998 (that benefit from this relief) are no longer receiving contributions or providing benefits.

P.119 It is considered that the policy rationale is still relevant and that there is no alternative way in which it could be achieved.

Taxpayer take up and awareness

P.120 There is no data available relating to the numbers of taxpayers impacted by this relief.

P.121 HMRC expect that membership of FURBS to which UK employers and individuals were paying contributions before 1998 to be weighted towards those who were higher-earning employees at the time.

Complexity, compliance costs and administrative burden

P.122 The legislation is not considered to be complex.

P.123 The compliance costs and administrative burden are not known.

Summary

P.124 The policy rationale remains valid, and it preserves employers and employees' expectations in relation to FURBS on existence at 6 April 1998.

P.125 We recommend that the relief be retained.

Contracts relating to the Channel Tunnel – exemption from insurance premium tax

P.126 Insurance premium tax ("IPT") was introduced by FA 1994[58] and applies to premiums received on or after 1 October 1994[59]. It is a tax on premiums received under taxable insurance contracts.

P.127 All insurance contracts are liable to IPT unless they are specifically exempted. Insurance related directly to the operation of the Channel Tunnel shuttle and rail services are exempt from IPT[60].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.128 The policy rationale behind this exemption is to ensure equality of treatment between the Channel Tunnel services and cross Channel ferry operations[61], as there is an exemption relating to specific insurance contracts relation to commercial ships[62].

Taxpayer take up and awareness

P.129 The legislation is specifically aimed at a limited population.

[58] FA 1994 ss48–74 and Sch 6A, 7 and 7A
[59] FA 1994 s49
[60] FA 1994 Sch 7A paras 10 – 11
[61] HMRC Notice IPT1 (March 2002)
[62] FA 1994 Sch 7A Para 4

Complexity, compliance costs and administrative burden

P.130 We do not have details on the compliance costs and administrative burden; however, as it is an exemption from IPT, it is unlikely to be complex.

Summary

P.131 In the absence of this exemption there would be an inequality between Channel Tunnel and ferry operators which would create market distortion.

P.132 We therefore recommend that the exemption be retained.

Mining and quarrying waste – landfill tax exemption

P.133 Landfill tax was introduced by FA 1996 Part 3 and is a tax on the disposal of waste. It is levied on all waste, subject to certain exceptions, disposed of by way of landfill at a licensed landfill site.

P.134 One specific exemption[63] applies to waste from commercial mining or quarrying operations, if that waste is naturally occurring material extracted from the earth and has not been subject to any other process or had its chemical composition altered between extraction and disposal[64].

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

P.135 The policy rationale behind landfill tax was to encourage waste producers to produce less waste, recover more value from waste (e.g. by composting or recycling) and to use more environmentally friendly methods of waste disposal[65].

P.136 Waste from mining and quarrying operations typically remains on the sites where it was originally extracted and, without the exemption, an unintended consequence of the landfill tax legislation would have been to impose a tax on such waste. This would have had a distortive effect on the mining and quarrying industries.

Taxpayer take up and awareness

P.137 The exemption is targeted at, and used by, the mining and quarrying industries. This is not an exemption that requires certification, and no details of the numbers of users are available.

Complexity, compliance costs and administrative burden

P.138 As the exemption does not require certification it is considered to be a cost effective way of meeting the policy objective.

P.139 The legislation is not complex and the guidance by HMRC is clear. As there is little interaction with HMRC concerning this exemption[66], other than via the normal returns procedure, this is considered to be a straightforward exemption.

P.140 There is no data available on the administrative burden of the relief and the revenue loss to the Exchequer is less than £1million[67].

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[63] FA 1996 s44
[64] FA 1996 s44(2) – (5)
[65] http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageExcise_ShowContent&id=HMCE_CL_001206&propertyType=document#P4_22
[66] HMRC

Summary

P.141 As the policy rationale is to prevent an untended charge to landfill tax arising in the mining and quarrying industries, and this remains valid, we recommend that this exemption be retained.

[67] HMRC estimate

Q Expired

Class 1A – exemption from prescribed general earnings

Q.1 No liability to pay Class 1A NICs arises on specified payments that are disregarded in the calculation of an employee's earnings. The specified payments are relocation expenses other than removal expenses to which S271 ITEPA 2003 refers. The exemption only applies if the employee started work in a new location before 6 April 1998 and the relocation expenses were agreed before that date.

Q.2 The legislation is in SSCR 2001 Sch 3 Part VIII para 2(2)(b) and Reg 40(4).

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

Q.3 The policy rationale is unclear.

Taxpayer take up and awareness

Q.4 As the exemption does not have to be claimed, there is no data available relating to the numbers of taxpayers impacted by this relief.

Complexity, compliance costs and administrative burden

Q.5 The legislation is a relatively straightforward piece of legislation. The costs of compliance and administration are not known.

Summary

Q.6 We recommend that this relief is abolished as the operative date is more than 12 years ago.

Class 4 NICs – allows deduction in the next tax year of losses incurred in 1989/90 or previous tax year where losses from income other than a trade or profession or vocation

Q.7 Liability to Class 4 NICs is generally determined on the same amount of profits as is used for income tax, and this allows for certain losses to be deducted in calculating the chargeable amount.

Q.8 For 1989/90 there was a provision that applied for certain losses that arose either to a self-employed person, or their spouse, from income other than that from a trade, profession or vocation to be set off against the amount of profits chargeable to Class 4 NICs.

Q.9 Following the introduction of independent taxation of husbands and wives from 1990/91[1], changes were made for 1990/91 onwards so that only the losses of the self employed person (and not their spouse) could be deducted for these purposes.

Q.10 SSCBA 1992 Sch 2 para 3(3) provided that any losses incurred under the previous rules could be carried forward and used against the Class 4 liability.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

Q.11 The relief was a transitional provision and maintained the loss relief determined under previous rules. The loss can be carried forward indefinitely, but must be given against the profits of the earliest year possible.

Taxpayer take up and awareness

Q.12 There is no data available relating to the numbers of taxpayers impacted by this relief.

Q.13 As more than ten years have elapsed since the latest year in which the relevant losses could have been incurred, the use of this relief is likely to be small; however it may still be relevant in certain cases[2].

Complexity, compliance costs and administrative burden

Q.14 The administrative burden is considered to be negligible as the relief is likely to be relevant in only a small number of cases[3].

Q.15 The legislation itself is not complex.

Summary

Q.16 We recommend that the relief should be abolished as the last year in which relevant losses could have been incurred was 1989/90.

Millennium gift aid

Q.17 Millennium gift aid was introduced in FA 1998 to encourage charitable giving ahead of the millennium by widening the scope of donations that qualified for gift aid.

Q.18 The relief enabled UK resident individuals to claim tax relief on cash donations made between 31 July 1998 and 31 December 2000 to participating charities for use in education and anti-poverty projects in the world's poorest countries. The minimum donation qualifying for tax relief was £100, which could be paid in instalments.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

Q.19 This relief extended the scope of gift aid, to enable "British citizens … to contribute more to poverty relief and charitable work in the developing countries… This new tax relief will allow individuals to make their contribution to the reduction of world poverty"[4].

[1] FA 1988 s32
[2] HMRC
[3] HMRC
[4] Budget, 17 March 1998.

Q.20 Even though it remains a valid policy, the relief expired from 31 December 2000. In addition the gift aid minimum donation requirement was removed entirely in 2000, so there is no need for this separate relief.

Taxpayer take up and awareness

Q.21 As the relief has expired, it has no users.

Complexity, compliance costs and administrative burden

Q.22 As the relief has expired, there is no administrative burden.

Summary

Q.23 We would therefore recommend that this relief be abolished.

National Savings Bank: Ordinary Account interest

Q.24 Interest arising on deposits in Ordinary Accounts with the National Savings Bank ("NSB") is exempt from income tax if the interest for the year does not exceed £70[5]. If interest exceeds £70 in any tax year, only the excess above £70 is liable to income tax.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

Q.25 The origin of the National Savings Bank Ordinary Account was the Post Office Savings Bank Ordinary Account, originally set up in 1861 by the Palmerston government, designed to be a simple savings scheme to encourage ordinary wage earners "to provide for themselves against adversity and in health"[6].

Q.26 Even though encouraging savings remains a valid policy, Ordinary Accounts are no longer offered by NSB. Existing deposits were transferred to a residual account, which either does not pay interest at all or pays taxable interest at a rate of 0.1%, and therefore the relief is no longer relevant

Taxpayer take up and awareness

Q.27 The Exchequer impact of this relief is nil as there are no accounts that offer tax free interest.

Complexity, compliance costs and administrative burden

Q.28 For the individual investors there is no additional administrative burden.

Summary

Q.29 We therefore recommend that this relief be abolished.

[5] ITTOIA 2005 s691
[6] http://www.nsandi.com/youandyourmoney/about us/about-ns-and-i

Payroll giving 10% supplement (FA 2000 s38)

Q.30 The payroll giving 10% supplement that was added by the Government to gifts to charities made under a payroll giving scheme was introduced from 6 April 2000[7] (announced in PBR 1999[8]) and expired on 5 April 2004[9].

Q.31 The relief has expired and the legislation should be repealed.

Charities – transitional relief on distributions (F(2)A 1997 s35)

Q.32 Following the abolition of the dividend tax credit in 1997[10], transitional relief for charities and certain other bodies was introduced in F(2)A 1997 s35. The relief covered distributions made in a transitional period ending on 5 April 2004.

Q.33 As the transitional period has expired, this legislation should be repealed.

Approved profit sharing schemes (ICTA 1988 s185)

Q.34 ICTA 1988 s 185 provided that any sum paid by a company to the trustees of an approved profit sharing scheme is deductible by the company. This relief was phased out for payments made before 6 April 2002 by FA 2000 s50.

Q.35 This legislation was repealed by CTA 2009 ss 1322, 1326, Sch 1 paras 1 and 57 and Sch 3 Part 1.

Trustee Savings Banks income from investments with the National Debt Commissioners

Q.36 ICTA 1988 s484 provided that income from ordinary deposits held in the Fund for the Banks for Savings, which is managed by the National Debt Commissioners, is exempt from tax. Therefore, in practice, the ordinary accounts system was free of tax.

Q.37 This legislation was repealed by FA 1996 s104.

[7] FA 2000 s38(6)
[8] PBR 9 November 1999, HMT8
[9] The Charitable Deductions (Approved Schemes) (Amendment No 2) Regulations (SI 2000/2083) and The Charitable Deductions (Approved Schemes) (Amendment) Regulations (SI 2003/1745) amending The Charitable Deductions (Approved Schemes) Regulations 1986
[10] Budget 2 July 1997, Hansard HC Deb 2 July 1997 Vol 297 col 306 - 307