TAX PROFESSIONALS' FORUM

FIFTH INDEPENDENT ANNUAL REPORT

DECEMBER 2016

Contents

Executive Summary 3

1. Introduction 4
   - 1.1 The role of the Forum 4
   - 1.2 The Government's approach to Tax Policy Making 4
   - 1.3 The role of this Report 5
2. Findings this year 6
   - 2.1 Lesson 1: Ensure that the first stage on consultation is properly undertaken 6
   - 2.2 Lesson 2: Allow the tax system to settle 7
   - 2.3 Lesson 3: Ward against complexity 8
   - 2.4 Lesson 4: Reinforce the links between policy makers 8
   - 2.5 Lesson 5: Do not place too much reliance on guidance 9
3. Comments on lessons from previous reports 10
   - 3.1 Update 1: Integrate international reform into the UK's consultation framework 10
   - 3.2 Update 2: The policy development process needs to be flexible, both in timing and outcome 10
4. Specific areas of comment - Retrospection and Protocol on Unscheduled Announcements 11
   - 4.1 Examples of legislation introduced outside the normal timetable 11
   - 4.2 Unscheduled announcements made with immediate or retrospective effect 11
   - 4.3 Recommendations to changes to the Protocol 11
5. Summary of recommendations 13

A Forum members 14

B Summary outlines of the consultations mentioned in this report 15
   - B.1 Entrepreneurs Relief 15
   - B.2 Changes in Land Tax 15
   - B.3 Restrictions for amortisation relief on acquisitions of goodwill and similar intangibles 15
   - B.4 Royalty withholding tax measures 16
   - B.5 Making Tax Digital 17
   - B.6 Corporate Tax rate/roadmap 18
   - B.7 Business Rates 19
   - B.8 Annual Investment Allowance 19
   - B.9 Apprenticeship Levy 20
   - B.10 Post implementation review 20
   - B.11 Pensions 21
   - B.12 Capital Allowances 21
   - B.13 Carried interest 22
   - B.14 Company distributions in a winding up – clause 35 Finance Bill 2016 (now s35 FA 2016) 22

C Summary of conclusions from previous reports 24

TAX PROFESSIONALS' FORUM

FIFTH REPORT OF THE INDEPENDENT MEMBERS OF THE FORUM

EXECUTIVE SUMMARY

The independent members of HM Treasury's Tax Professionals Forum welcome the continued commitment of the Government to the tax policy making process and to ensuring that this applies to all policies. We consider that the targets of greater stability, predictability and effective consultation enshrined in the Treasury's "Tax Policy Making: A New Approach" document remain both appropriate and achievable.

This is our fifth Report and builds from our previous reports. As with all such reports, it is very easy to focus on the negatives as these exceptions stand out and draw attention. Indeed, this report identifies a number of additional lessons that can be learned from the policies that could have been delivered in a better way and lessons from past reports that still have to be learned. However, we also note that these attract attention because we have now become used to many other policies proceeding according to plan, with the Government taking the opportunity to engage and address concerns raised in consultation, resulting in better policies and better legislation.

This year's crop includes some controversial policies that are of a longer term nature, and will feature in our next report (for example Making Tax Digital) and we hope that the lessons identified here can help to influence the behaviour and choices made as these, as well as future, policies develop.

Our key points of note for Government are to:

- Lesson 1: Ensure that the first stage on consultation is properly undertaken
- Lesson 2: Allow the tax system to settle
- Lesson 3: Ward against complexity
- Lesson 4: Reinforce the links between policy makers
- Lesson 5: Do not place too much reliance on guidance

In addition, we have reflected on the lessons we have raised in previous reports and are concerned that some of these lessons have not yet been learned. Furthermore, we remain of the view that the protocol on the use of retrospection and unscheduled announcements still needs to updated, although recognise that we have seen limited use of retrospection/unscheduled announcements in the last few years.

The independent members trust that this Report contains helpful feedback to HM Treasury and HMRC and assists the Government in the process of tax policy making, thereby ensuring that tax reforms are increasingly responsive to the needs of taxpayers.

1. INTRODUCTION

This Report covers the period from 1 April 2015 to 15 September 2016 (being the date of Royal Assent of Finance Act 2016). All comments in this report relate to this period unless otherwise stated.

The consultation programme during this period has been constant, wide and varied. It includes two Budgets, two Finance Acts and an Autumn Statement.

1.1 The role of the Forum

The remit of the Tax Professionals' Forum[1] is to identify improvements to the way in which tax policy is made. This includes:

(a) the way in which policy is developed;
(b) the way in which policy and changes to policy are communicated; and
(c) the way in which policy is legislated and implemented.

The Forum was established to assist with the prioritisation of improvements and the monitoring and implementation of these improvements to ensure that they have the intended effect. The Forum also has a role in providing contemporaneous feedback on whether the Government's stated principles and the new approach to tax policy making are being followed in practice.

1.2 The Government's approach to Tax Policy Making

The new approach to policy making was set out in March 2011 "The Government's Tax Consultation Framework: Summary of Responses and Finalised Framework" ("the Framework"). The Framework requires early and continuing engagement on tax changes and the exploration of new ways of broadening public engagement with the development of the tax system. Except in the case of tax avoidance, five stages are to be followed in the development and implementation of tax policy:

(a) Setting out objectives and identifying options
(b) Determining the best option and developing a framework for implementation including detailed policy design
(c) Drafting legislation to effect the proposed change
(d) Implementing and monitoring the change
(e) Reviewing and evaluating the change

The Framework states that, where possible, the Government will:

- engage interested parties on changes to tax policy,
- minimise the occasions on which it consults only on a confidential basis,
- set out its strategy for consultation (including informal discussions) and
- set out clearly at each stage of the consultation:
    - the policy objectives,
    - any relevant broader policy context,
    - the scope of the consultation,
    - its current assessment of the impact of the proposed change and

[1] Details of the Forum and its members are set out in Appendix A.

- which department and official is leading the consultation.

To enable legislation to be properly scrutinised, draft clauses for the Finance Bill will be published for scrutiny at least three months before the Bill is introduced to Parliament and the period for comment will be at least eight weeks.

It was also stated:

> "The Government will generally not consult on straightforward rates, allowances and threshold changes or other minor measures. It may also not consult on revenue protection or anti-avoidance measures."

The Government has, in addition, published a Protocol on Unscheduled Announcements which deals with changes to tax law outside the framework of the Budget process including retrospective tax legislation[2] (the "**Protocol**").

1.3 The role of this Report

This report is one way in which the Forum fulfils its role in policing the extent to which the policy making aspirations set out in this section are complied with. The Report contains the views and conclusions of the Independent Members of the Tax Professionals' Forum on the way in which policy has been developed and legislation has been made over the period referred to in paragraph 1; and contains some suggestions and recommendations for change. References to the Forum in the rest of this Report are to the Independent Members of the Forum.

[2] "The Protocol on Unscheduled Announcements of Changes in Tax Law", replacing the Rees Rules, which appeared in Chapter 4 of "Tackling Tax Avoidance", published by HMT and HMRC in March 2011.

2. FINDINGS THIS YEAR

In order to make progress towards greater efficiency and clarity in the policy development procedure, the Government needs to acknowledge inefficiencies and to take clear and deliberate actions to improve the process. The evidence over the period covered by this report, 1 April 2015 through to 15 September 2016, indicates areas where the Government has made improvements, but also instances where further efforts need to be made to make the tax policy development procedure effective and impactful.

During this period, we saw many successful consultations, drawing on the now well established policy process. Consultation has served to improve outcomes – indeed it is good to note that the concerns raised in last year's report on the consultation on Entrepreneurs' Relief have been addressed through positive engagement this year (see B.1).

Beyond the specific consultations themselves, the early publication on Legislation Day of draft Finance Bill clauses provides a very valuable opportunity for policies that have not previously been fully articulated or recognised to be considered, armed with the clarity provided by draft legislation. The ability for the Government to reconsider before passing the law to Parliament reduces the need for last minute changes and provides a welcome checkpoint along the way to policy implementation.

Details of the consultations are included in Appendix B. They have been analysed to produce four new lessons which are outlined in greater detail below.

2.1 Lesson 1: Ensure that the first stage on consultation is properly undertaken

In a repeat of the messages delivered in the third and fourth report, this report re-emphasises the importance of utilising all the stages of consultation. This year's crop includes a number of examples of where the final outcome has been complex due to the fact that consultation has started only part way through the policy development process. This is particularly evident in the following:

- Changes in Land Tax – as described further in B.2, the changes to Stamp Duty Land Tax and interest deductibility for buy to let properties were introduced with minimal consultation. Given the considerable discussion in relation to the issues from the growth of second home ownership, there was plenty of opportunity for the Government to consult on potential changes in the system. This did not fall within the exception for anti-avoidance but is a wide policy change. Furthermore, the ability to consult on this issue was made evident by the consultation carried out elsewhere in government on 'Financial Policy Committee Powers of direction in the buy to let market 17/12/15'.

- Restrictions in amortisation relief on acquisition of goodwill and similar intangibles – This measure (see B.3) removes the tax relief that is available when structuring a business acquisition as a business and asset purchase. It is a fundamental change in the treatment of intangibles and its removal could well have knock on consequences for business acquisitions and wider economic implications. Given the complexities and the fact that this denies relief for a genuine cost of business, the measure would have benefitted from consultation, enabling a better understanding of the rationale for the removal of a relief and the opportunity to consider alternatives.

- Royalty withholding tax measures – The Government's changes to this area (see B.4) included the broadening of the application of UK withholding tax to outbound payments connected with intellectual property and the application of UK withholding tax to outbound intellectual property payments connected with the activities of a UK Permanent Establishment. HMRC's stated view may be that the expansion of the definition of intellectual property payments and bringing payments connected with the activities of a UK PE into this scope were made in order to bring the UK legislation in line with the definition in various other territories. However, given these changes have a wide impact, we would have expected a formal consultation process.

- Making Tax Digital – The Government launched this consultation (see B.5) already at Stage 2 of the consultation process, omitting Stage 1 completely. This has been a very controversial consultation, partially due to the starting point of the Government. It would have been far better to have honoured the policy framework and started at Stage 1, rather than seek to forge straight through to Stage 2.

This observation is concerning as it is the third time that the Forum has raised this issue. The Government needs to make sure that the timetable is sufficient to allow for greater consultation at the early stages, to ensure that there is clarity over the intent of the policy and that the best delivery mechanisms are fully evaluated. Failure to undertake stage 1 of the process means that consultation occurs within a fixed framework which may be sub-optimal. In some cases, this can lead to the policy having to "go back to the drawing board" at a late stage, with the result being that the final policy is rushed through with too little time to consider all the issues.

The use of a Corporation Tax Roadmap by the previous Coalition Government helped to ensure that consultation was planned and hence that Stage 1 occurred. The Government should look again at the role for a wider Business Tax document, expanding the far more short term document issued during this period (see B.6).

It is also important that consultation is undertaken based upon the proper assumptions. For example, the consultation undertaken in this period on Business Rates (see B.7) stipulated a revenue neutral requirement, when the Government ultimately implemented an overall reduction in the tax burden, something that would have enabled other options to be considered and consulted upon.

2.2 Lesson 2: Allow the tax system to settle

Tax policy reform seems to come in cycles as Chancellors focus on a particular activity across multiple Budgets. This year has continued the ongoing focus on tackling the promotion of tax avoidance. Whilst the measures may be well intended, policies introduced in one Budget need to have time to work and to change the environment. However, instead of evaluating the impact of newly introduced measures, we have seen the development of new measures in the same area that seek to supplement the original measures.

Instead of adding further complexity to the tax regime, the Government should allow its policies to "bed in" and for taxpayers to adapt to the changed environment. In order to assist in this, the Government should undertake a Post-Implementation Review that can inform policy makers and avoid excessive legislation.

One example of change has been the variability in the Annual Investment Allowance (see B.8), which has ranged from £25,000 to £500,000 over the last decade. Further examples are the changes to the Pension regime (see B.11), with frequent adjustments to parameters, contribution caps, pension fund caps and fine-tuning the impact of the legislation, together with complex transitional rules, resulting in taxpayer confusion and genuine risks that taxpayers will inadvertently trigger adverse tax consequences that they have not identified. We consider that further changes to these pension rules and contribution caps ought only to be considered where there is an overriding and fiscally essential driver to introduce them.

2.3 Lesson 3: Ward against complexity

One natural outcome of failing to undertake stage 1 consultation (as discussed in 2.1 above) is that the legislation becomes complex to operate. Whilst it is recognised that a level of complexity is required by the need to ensure that the tax system operates in a suitable manner (e.g. does not discriminate between two otherwise similar transactions), the government should be aiming for the tax system to operate in as simple a way as is consistent with the policy intent. If policy is changed late in the process, the "fixes" will generally be complex.

A good example of this is the development of the rules on the taxation of Carried Interest (see B.13). These rules have iterated over the last two years, without sufficient understanding of how the rules are currently applied. In this situation, the Government needs to be able to go back to the design stage.

The government needs to build in a system to deter (and penalise) complex legislation, particularly where simpler mechanisms could have been adopted. It appears that, once there is a deadline for delivery, any semblance of concern for the complexity of the solution is lost and complexity is accepted as an unfortunate necessity.

Such an outcome is clearly suboptimal.

2.4 Lesson 4: Reinforce the links between policy makers

In considering tax policy changes, it is important that the Government reviews the interaction of policies from the position of the taxpayer, rather than considering each item in isolation or indeed each tax on its own. The interaction of policies can result in behavioural responses that are not what the Government intends. For example:

- During the period, the HMRC opened a consultation on restricting the tax effectiveness of salary sacrifice for benefits in kind, other than a few benefits that the government excluded. One non-excluded benefit in kind was company cars. On the same day, HM Treasury opened a consultation on reforming the incentives within the benefit in kind regime to encourage company car drivers to opt for ultra-low emission vehicles. The operation of the first consultation would eradicate any positive incentive delivered by the second.

- A further example is the approach adopted to the Changes in Land Tax – as described further in B.2 and above in 2.1. The fact that action was being taken elsewhere in government could have mitigated the need for changes in tax law. There was no evidence that this had been given consideration.

In order to address such "silo thinking", we would recommend that consultations are considered by a central team. That team would be able to spot the inconsistencies of approaches in consultations, as well as to provide a quality control function to the whole consultation process. Whilst we might expect this to be in place today, experience would indicate that this is not happening appropriately.

Such a team should also challenge whether consultations are being launched at the right stage, addressing the concern raised in Lesson 1, and ensure that each consultation is ready for, and indeed warrants, release. Given concerns of "consultation fatigue", this review function could act as a further constraint on unwarranted policy change.

2.5 Lesson 5: Do not place too much reliance on guidance

We remain concerned by the increasing use of guidance to seek to disapply tax legislation. The aim of the consultation process is to provide time for the legislation to be sufficiently refined and clear that guidance should not need to remove some of the unwarranted excesses and uncertainties. Whilst there is a role for guidance, guidance can be changed without reference to Parliament and such changes can undermine the fairness of the tax system.

In this period, we saw changes to the rules applying to company distributions on a winding up (see B.14), where the Targeted Anti-Avoidance Rule was not made clear in the legislation but instead was left unclear with "clarity" to be added by guidance.

3. COMMENTS ON LESSONS FROM PREVIOUS REPORTS

This section provides an update on the lessons that were identified our previous reports. A full list of the recommendations are available in Appendix C.

3.1 Update 1: Integrate international reform into the UK's consultation framework

The Fourth Report noted that the Government should consult in the UK in relation to commitments that it would make in international fora about areas of taxation where the UK would have consulted had the tax decision been made solely by the UK. The example put forward in the last report was the range of decisions being made by the Government to support the G20/OECD Base Erosion and Profit Shifting project. The Forum considered that consultation at the OECD did not remove the benefit of consulting within the UK (or indeed set aside the commitment in the Government's approach to consultation).

During the current period, there has been significant discussion on the implementation of BEPS within the European Union and discussion of the merits of particular approaches. Given that many of these elements will only be implanted through unanimous agreement of the Member States, the approach taken by the UK government will be critical in shaping the final provisions. Yet, here again the Government has chosen not to consult on the approach that the UK should adopt.

In the view of the Forum, this remains an important area upon which the government would benefit from consultation.

3.2 Update 2: The policy development process needs to be flexible, both in timing and outcome

The extent of reform being undertaken by HMRC and HMT is such that the Members are concerned that this may extend beyond the ability of the government to deliver within the timescale. We would recommend that the government considers the extent of work that is likely to be involved in implementing the current amount of policy change, the future policies that the Government wishes to introduce and the consequential work that will arise in preparation for the exit of the UK from the European Union. It will be important to prioritise proposals and to consider where lies the limit of deliverability.

4. SPECIFIC AREAS OF COMMENT - RETROSPECTION AND PROTOCOL ON UNSCHEDULED ANNOUNCEMENTS

As noted in Section 0, in addition to commenting on the tax policy making process, the Protocol expressly requires the Forum to review any unscheduled announcements and provide Ministers with a view on how the Protocol is being observed in practice. It also states that the Forum may recommend changes to the Protocol.

The Protocol states that:

> "2. Such changes to tax law will normally only be announced other than at Budget where:
> - there would otherwise be a significant risk to the Exchequer;
> - significant new information has emerged to identify the risk or indicate its scale; and
> - changing the law immediately is expected to prevent significant losses to the Exchequer."

The Protocol also states:

> "In particular changes to tax legislation where the change takes effect from a date earlier than the date of the announcement will be wholly exceptional".

The Protocol therefore encompasses two types of change:

- changes made immediately from the date of a Parliamentary Statement, and
- changes made that apply from a date earlier than the date of announcement (retrospective legislation).

The Forum endorses the stance taken in the Protocol that:

- there have to be sound reasons for announcing a change outside the ordinary Budget timetable, and
- as a general principle, retrospective legislation is to be avoided.

4.1 Examples of legislation introduced outside the normal timetable

During the period, the new rules applying to Royalties withholding tax (see B.4) were included in Finance Act 2016, but were introduced in advance of Royal Assent. This was due to the delay in Royal Assent following the EU Referendum. Whilst this circumstance is unique, it does fall outside the normal timetable.

4.2 Unscheduled announcements made with immediate or retrospective effect

None identified.

4.3 Recommendations to changes to the Protocol

The second report of the Forum recommended change to the Protocol. These changes have not been made and we remain at the view that these should be introduced. The full text of this section from the Second Report is included below.

> “Whilst the Protocol was only published in March 2011 and is detailed on procedure, it says nothing about the circumstances in which retrospective legislation might be

adopted. Aside from the reference to "wholly exceptional" circumstances, it does not identify when retroactive legislation might be appropriate. Some greater clarity would provide helpful reassurance. (Reference is made here only to retroactive legislation that imposes a charge to tax where none previously applied or a charge at a higher rate than previously applied. We use retroactive as meaning a change which affects the tax treatment of income profits or gains arising for periods earlier than the date of the legislation).

Members of the Forum acknowledge that there can be occasions when a retroactive change to tax law is justified, appropriate and lawful. But they are rare. Any retroactive change must be compatible with the Human Rights Act and in this respect the jurisprudence of the European Court of Human Rights offers some guidance on the identification of such circumstances. Based on that jurisprudence, the members of the Forum would consider it appropriate that the Protocol adopt an approach under which an unscheduled announcement might envisage retroactive legislation in any of the following cases:

- tax avoidance schemes have come to the attention of HMRC which are highly abusive and involve such a large budgetary risk that the Government considers it appropriate to legislate to cancel the effect of the schemes with retroactive effect (and not simply to announce the reversal of those schemes from the date of the announcement and/or challenge those schemes under existing law, including any general anti-abuse rule). The existence of disclosure rules (enabling the Government to take swift action to close down abusive schemes) and, from 2013, of a GAAR should ensure that there is little scope for retroactive action on this account.

- it has become clear (usually, but not exclusively, as a result of a court decision) that a generally understood tax treatment (understood in common both by HMRC and by the profession, and not by one group only) is not as it was previously understood to be, and the impact is likely to be significant in budgetary terms or in terms of the impact on existing arrangements;

- to rectify a manifest error in legislation, not merely an issue concerning construction which could be addressed by a court case, where again the impact is likely to be significant in budgetary terms or in terms of the impact on existing arrangements;

and

- (in all three situations) the public interest in retroactive legislation outweighs the private interests of the taxpayers adversely affected by the retroactive change.

The Forum members present for consideration that the Protocol might be amended to reflect these criteria."

5. SUMMARY OF RECOMMENDATIONS

The strands which we would draw from the above are as follows:

1. The Protocol on Unscheduled Announcements should, in our view, be amended as described in section 4 of this Report.
2. The lessons drawn from this report should be built into the government's consultation process, namely:
    - Lesson 1: Ensure that the first stage on consultation is properly undertaken
    - Lesson 2: Allow the tax system to settle
    - Lesson 3: Ward against complexity
    - Lesson 4: Reinforce the links between policy makers
    - Lesson 5: Do not place too much reliance on guidance

A FORUM MEMBERS

The Forum was announced by HM Treasury on 16 July 2010. It stated that:

> The Government has committed to reforming the framework for developing tax policy and making tax law. To oversee implementation of this new approach, the Government has established a forum of tax professionals to be chaired by the Exchequer Secretary. The Forum will meet bi-annually.

The current membership (as subsequently updated) is set out below:

- Malcolm Gammie CBE QC – Research Director for the IFS Tax Law Review Committee
- Vincent Oratore CTA (Fellow) – former president of the Chartered Institute of Taxation
- Chris Sanger – Global Head of Tax Policy at EY and Chairman of the Tax Policy Committee of the ICAEW's Tax Faculty
- Jane McCormick – Global Head of Tax at KPMG
- Richard Stratton – Partner at Travers Smith LLP and former Chairman of the Law Society's Tax Committee
- Philip Baker OBE, QC – Field Court Tax Chambers and Oxford University
- Stephen Herring – Head of Taxation, Institute of Directors
- Andy Richens – Policy Advisory, Office of Tax Simplification
- Anita Monteith – Technical Lead & Senior Policy Advisor, Tax Faculty of the Institute of Chartered Accountants in England and Wales
- Jonathan Riley – Head of Tax, Grant Thornton UK LLP

The remit and membership of the Tax Professionals' Forum is reviewed every two years. It was last reviewed in 2016, following the appointment of Jane Ellison MP as Financial Secretary to the Treasury, and the remit retained.

B SUMMARY OUTLINES OF THE CONSULTATIONS MENTIONED IN THIS REPORT

This section sets out more background to the consultations that are referred to in the Report.

B.1 Entrepreneurs Relief

The Tax Professionals' Forum's previous report of December 2015 mentioned the significant changes to Entrepreneurs' Relief introduced in Finance Act 2015 without respecting the consultation process, which resulted in increasing stakeholder uncertainty over the applicability of the sections and several unintended consequences. Three sections: s41 (Associated disposals), s42 (Exclusion of goodwill in certain circumstances), and s43 (Trading companies), were amended with no period of consultation. Additionally, s41 (Associated disposals) and s43 (Trading Companies) did not adhere to the eight week scrutiny period, and s42 (Exclusion of goodwill in certain circumstances) was introduced with immediate effect for disposals on/after 3 December 2014, with the draft legislation subject to technical consultation (stage 3).

It is pleasing that a constructive engagement by stakeholders, led by the Chartered Institute of Taxation and the Institute of Chartered Accountants in England and Wales, with HMRC, has resulted in the unintended consequences outlined above being corrected, by way of sections 84 to 86 Finance Act 2016 (which were themselves subject to further engagement on features considered to have a potentially adverse retroactive effect, corrected by draft amendments published 23 June 2016). All amendments will take effect from the dates of the original 2015 measures. However, this illustrates the importance of adhering to the Government's own processes and procedures regarding consultation. This experience created an uncertain environment for businesses to operate in until the matter was finally corrected.

B.2 Changes in Land Tax

The changes to Stamp Duty Land Tax ("SDLT") and interest deductibility for buy to let properties were introduced with minimal consultation. While it is recognized that the change had a political imperative, the process is in stark contrast to that adopted elsewhere. This is in contrast to the consultative document on 'Financial Policy Committee Powers of direction in the buy to let market 17/12/15.'

This document (which related to powers to impose minimum loan to value given higher defaults in the buy to let market) was very thoughtful and looked not only at the macroeconomic and pro cyclical nature of the buy to let market but also referred to other measures which would impact the market including the revised BCBS charge on mortgages and the increased SDLT charge.

Anecdotally, the buy to let changes have caused a substantial number of queries from taxpayers both to agents and HMRC. This could have been much reduced by more extensive consultation.

B.3 Restrictions for amortisation relief on acquisitions of goodwill and similar intangibles

This was first announced at the Summer Budget July 2015, effective from 8 July 2015 with draft legislation published on the same date. There was no public consultation or discussion.

In accounting terms, purchased goodwill is the balancing figure between the purchase price of a business and the net value of the assets acquired. Goodwill can therefore be thought of as representing the value of a business's reputation and customer relationships.

This measure removes the tax relief that is available when structuring a business acquisition as a business and asset purchase. This treatment differs from that given to companies which purchase the shares of the target company. HMRC's stated policy objective for this measure at the time of publication was that

> "*the current rules allow corporation tax profits to be reduced following a merger or acquisition of business assets and can distort commercial practices and lead to manipulation and avoidance. Removing the relief brings the UK regime in line with other major economies, reduces distortion and levels the playing field for merger and acquisition transactions."*

We would note that there is an alternative interpretation in that goodwill is a real purchase, representing a range of items that have not been separately identified. It is clearly something that the buyer has paid for, and is a wholly business expense. While the policy itself is not the subject of this report, it is clear that this measure is not an anti-avoidance measure but this is a fundamental change to the taxation treatment of intangibles as it moves away from a "follow the accounting" approach to intangibles that has been in place since 2002. This change was preceded by similar restrictions on amortisation of goodwill, etc, on incorporations of businesses, which were effective from Autumn Statement 2014.

As a fundamental change in the taxation of intangibles and not an avoidance measure, this would appear to be a taxation policy change which should be been consulted upon, rather than an immediate change. This is particularly important since the change of tax treatment on the acquisition of goodwill could well have knock on consequences for business acquisitions and thus have wider economic implications.

B.4 Royalty withholding tax measures

The following royalty withholding tax measures were announced in Spring/Summer 2016:

(1) Anti "treaty shopping" provisions,
(2) broadening of the application of UK withholding tax to outbound payments connected with intellectual property, and
(3) application of UK withholding tax to outbound intellectual property payments connected with the activities of a UK Permanent Establishment ("PE").

HMRC published a Technical Note on 16 March 2016 and at the same time published the corresponding draft legislation in respect of the three measures. The new anti-treaty shopping provision was intended to have immediate effect for payments made on or after 17 March 2016. This was also the date that the provisions had effect including in relation to pre-existing arrangements.

The broadening of the definition of royalties to which UK withholding tax applied and the measures to apply UK withholding tax to IP payments connected with the activities of a UK PE were originally intended to come into effect for payments on or after the date of Royal Asset to the Finance Bill 2016. However, as a result of delays in scrutinising the Finance Bill 2016, there were delays in receiving Royal Assent. The draft legislation was amended at the Public Bill Committee stage such that it became effective upon Royal Assent, but would apply to payments made on or after 28 June 2016.

Whilst a formal consultation process was not undertaken, companies and advisors were given the opportunity to provide comments. However, the process of receiving comments was informal. There was no transparency in the process and no response was published on the comments received.

The stated policy objective was that

> *"the measures will align the UK deduction of tax at source regime in respect of royalties with the UK taxing rights over such income and counteract contrived arrangements that are used by groups (typically by large multi-national enterprises) that result in the erosion of the UK tax base."*

The anti-treaty shopping provision can be considered to be an anti-avoidance measure and thus in line with the existing policy of no consultation before implementation. However, whilst the stated policy objective was an anti-avoidance measure, it is clear that the measure goes much further than this.

This lack of consultation on the merits and rationale of the proposal, both in terms of principle and mechanism, is regrettable. The policy itself would have benefited from greater articulation as concerns exist, such as for example the imposition of withholding tax on IP rights is not just restricted to related party situations. It is not clear why a targeted approach was not taken. The new measure impacts any third party arrangement involving periodic payments for IP rights by a UK business. This may impose contractual costs on UK business (for example UK businesses which have "gross up" clauses in existing contracts under which royalties are paid to third parties).

The other two measures (2 and 3) are not in the nature of anti-avoidance measures. HMRC's stated view may be that the expansion of the definition of intellectual property payments and bringing payments connected with the activities of a UK PE into this scope were made in order to bring the UK legislation in line with the definition in various other territories. However, given these changes have a wide impact, we would have expected a formal consultation process.

B.5 Making Tax Digital

Making Tax Digital (MTD) in its current form was announced in December 2015 when HMRC published, Making Tax Digital[3]. At that time, the government set out its intention to transform the tax system over the course of the present Parliament, but although this implied radical change to the system, few details were given. We note that outline plans badged as Making Tax Easier, together with proposals for simpler payment, were originally contained in Budget 2015, but contained still less information. Neither of these publications were consultations.

It is rare that wholesale changes are made to both the rules for taxing business and also to the system of administrating tax within the same short time frame, yet this is what MTD proposes to do. The proposals are currently at the consultation stage and in Making Tax Digital: Bringing business tax into the digital age[4].

HMRC states

> *'This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for*

[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/484668/making-tax-digital.pdf
[4] https://www.gov.uk/government/consultations/making-tax-digital-bringing-business-tax-into-the-digital-age

implementation of a specific proposal, rather than to seek views on alternative proposals.'

The 12 week consultation into what is already at stage 2 of implementation started on 15 August 2016 when six consultation documents, containing 243 pages, were published simultaneously, and closed on 7 November 2016. The 2016 Autumn Statement announced that, in order to consider the large number of responses received, the government will publish its response to the consultation in January 2017 (rather than on Legislation Day, as would be expected). However, even with this delay, it is difficult to see how this package can do more than pay lip service to the government's tax consultation framework[5], which requires early and continuing engagement on tax changes, together with the exploration of new ways of broadening public engagement with the development of the tax system.

Furthermore, the consultation is only asking for views on the design and how it should be implemented, not on alternatives. This limits considerably its scope which is not within the spirit of the framework, particularly for a policy for which there is little evidence that the cost of administration for UK businesses has been estimated accurately.

Personalised digital tax accounts for businesses and individuals are a key component of MTD, and yet there remains a considerable amount of development work outstanding, in particular concerning access by agents and other third parties. A key component of the MTD requirement is that most businesses, self-employed people and landlords will need to keep their business records digitally using software or apps and provide quarterly updates to HMRC.

Implementation is scheduled to begin in April 2018, so legislation will need to be implemented by Finance Act 2017. Draft clauses for Finance Bill 2017 were due to be published on 5 December. This would have given rise to two problem:

- With just four weeks between the consultation closing and draft Finance Bill 2017 legislation being released, there was a concern that the consultation response, which is expected to be considerable, could not be processed and feedback reflected adequately in the draft Finance Bill 2017 legislation.

- The draft Finance Bill 2017 clauses will be open for consultation for just eight weeks, which will include the Christmas period and a very busy self-assessment period for accountants and tax advisers.

The delay in launching the response clearly provides the Government with more time to assimilate the responses but, unless the implementation timetable adjusts, does so at the cost of time for consultation. Overall, the timetable for implementing a package of policy changes of this magnitude is extraordinarily short and we caution government to reflect fully on the responses to its consultations and take the time to get it right.

B.6 Corporate Tax rate/roadmap

In 2010 the Coalition government released its Corporate Tax Road Map. This set out the government's aim for taxation of business following the financial crisis in order to provide certainty for businesses with the aim of increasing investment in the UK.

[5] The Government's Tax Consultation Framework: Summary of Responses and Finalised Framework, March 2011

In the run up to the Budget, the Treasury indicated that the Roadmap would cover six areas (being the Implementation of BEPS outcomes, the outcome of the Business rates review, the review of energy taxes, tax administration, making tax digital and the Tax Policy making framework). In the event, the Roadmap omitted the last item and focused on a description of the past and immediate policy decisions.

A roadmap is a very helpful tool and the Government would be well advised to update the current version into a more forward looking document.

B.7 Business Rates

In Autumn Statement 2014, the government announced that it would be reviewing non-domestic rates ("Business Rates"). The government initially stated that any changes that were made as a result of the review would need to be fiscally neutral and was consistent and insistent on this throughout the consultation process. In March 2015, it released its consultation on business rates.

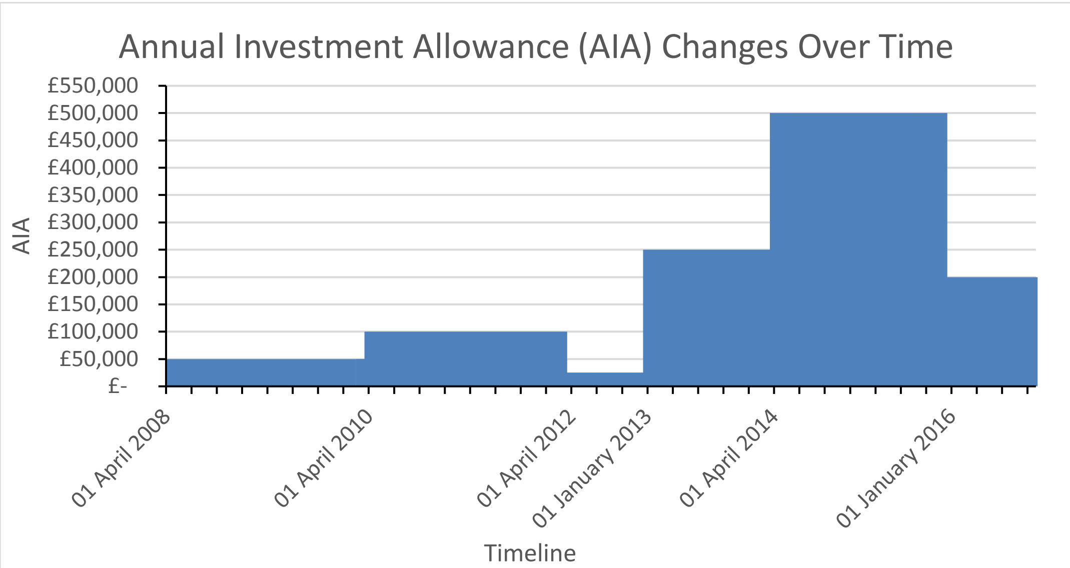
The responses received from the consultation were therefore framed within the "revenue neutral" constraint, with little focus being given to alternative options outside of this paradigm.

However, in Budget 2016, the Government abandoned the revenue neutral constraint and cut Business Rates by £6.7 billion over the next five years. By excluding such options from consultation, the Government lost the opportunity to receive a range of alternative options that might have delivered a better and more sustainable position for Business Rates.

B.8 Annual Investment Allowance

Almost all tax commentators regard the Annual Investment Allowance ("AIA") as the key tax relief incentivising the acceleration of capital expenditure by mid-market companies. As an incentive, it benefits from clear and consistent messages from government.

The fixed AIA cap for expenditure has varied significantly:



It was reduced to £200,000 for capital expenditure incurred from January 2016 by Section 8, Finance (No.2) Act 2015. Frequent temporary changes to tax reliefs cascades confusion to business taxpayers and thereby reduces the impact of the intended incentive. We would expect such frequent changes to be avoided and a clear message given as to the reasons for any such changes.

Separately, the reduction in the cap from £500,000 to £200,000 was portrayed in the Budget speech and the accompanying announcements as an increase from £25,000. Although this presentation might have been correct in strict tax technical terms, understandably some businesses misunderstood that the cap was being reduced by 60% from its 2015 level.

B.9 Apprenticeship Levy

The introduction of the Apprenticeship Levy requires the businesses, charities and other organisations affected to ensure that the necessary data are collected and, perhaps even more importantly, the courses envisaged be devised and approved in a short a timeframe. This represents a real challenge for many medium sized organisations within the Apprenticeship Levy, and consultations could have focused on this risk.

The period of the Levy's introduction has been, and continues to be, too compressed to secure a smooth and sufficiently problem-free introduction. Key concerns about the levy include:

- Employers needed earlier clarity on the direction of the levy and to provide them with adequate time to prepare. This uncertainty was compounded by the delayed publication of the levy guidance. Without the logistical information, employers could not plan and put structures in place in order to use the levy and help government to reach its three million starts target.

- It is our understanding that the Digital Apprenticeship Service ("DAS") IT system needed to process and administer the Levy has not been developed sufficiently at this late stage – this will cause similar problems to the lack of auto-enrolment software for employers and could do lasting damage to many employers willingness to engage with the levy system. Planning future employment levels is very difficult for employers, particularly at a time of heightened uncertainty, so calculating how much Levy to pay will be difficult given some apprenticeships are three or four years long. It is therefore imperative that the DAS IT system is fully ready and functioning before the levy is introduced.

B.10 Post implementation review

One of the continuing themes in the improvement of tax law is review of the effect of a measure over the initial period of its operation. A good example of the effectiveness of this policy is the ' Scottish Fiscal Commission Outturn Report 2015-16 ' published September 2016. At paragraph 2.1 it points out the lower than expected yield from Land and Buildings Transactions Tax ("LBTT") and indicates that this may reflect a long term impact on certain parts of the market.

This kind of feedback, and the need to monitor problem areas, is critical to understanding not only the tax take but also the macro economic implications of tax changes.

As a more general matter, there is an emerging view that the rigorous compliance with the tax policy timetable means that:

1. HMRC is treating it increasingly as a box ticking exercise which means many of the initial documents are of very poor quality, and

2. There is just not enough time to take into account and think through the feedback. This results in comments being ignored.

Furthermore the timetable is insufficient to enable proper initial, interim and final consideration.

B.11 Pensions

The Lifetime Allowance for pensions was reduced by Section 19 Finance Act 2016 from £1.25m to £1m for 2016/17 and 2017/18 and a provision was introduced for it to be adjusted if the Consumer Price Inflation is higher in future tax years. This follows a significant number of other restrictions and reductions to the tax relief for pension contributions in recent years. Unfortunately, none of these changes has been simple to introduce and the legislation is much more complex than might have been anticipated when the reform was announced. Section 19 Finance Act 2016 and Schedule 4 are not exceptions to this position. The legislation includes complex provisions with regard to benefit-crystallisation events including, for example, where a death has occurred between 6 April 2014 and 6 April 2016. Schedule 4 includes similarly complex provisions concerning 'fixed protection', 'individual protection 2016', 'pre-April 2006 rights', 'permitted transfers', and, inevitably, the relevant transition rules.

Section 20-21 introduce changes to so-called bridging pensions and dependents'' pensions whilst Section 22 and Schedule 5 make amendments to the previously enacted pension flexibility rules. Again, these are complex provisions and most individual taxpayers would require professional advice on the impact upon their accumulated pension funds.

Our comment on these changes is that too frequent adjustments to parameters, contribution caps, pension fund caps and fine-tuning the impact of the legislation together with complex transitional rules, will result in taxpayer confusion and genuine risks that taxpayers will inadvertently trigger adverse tax consequences that they have not identified. Whilst we accept that such consequences might be avoided if appropriate professional advice is obtained, tax legislation should not make such advice essential where an individual is neither in business nor has unusually complex financial affairs. The latter should include an individual merely having accumulated a significant pension fund over many years. We consider that further changes to these pension rules and contribution caps ought only to be considered where there is an overriding and fiscally essential driver to introduce them.

B.12 Capital Allowances

Section 72 Finance Act 2016 repeals the allowance for replacement and alteration of tools (the 'renewals' allowance, s68 ITTOIA2005 and s68 CTA2009). The HMRC Policy Paper dated 16 March 2016 set out that some businesses were claiming for large and expensive items, for which the section was not intended. It should be noted that the non-statutory renewals allowance, on which such expenditure may have been claimed, was abolished from April 2013, which may have prompted businesses to use this section. The Paper explains that alternative provisions may be claimed for relief on such expenditure and, for non-property income, this would be under the capital allowances code.

To obtain similar relief, it will be necessary to create short life asset pools for these replacements, which will increase complexity and the administration burden for these businesses, contrary to tax policy making objectives.

B.13 Carried interest

Since the initial draft rules dealing with disguised investment management fees ("DIMF") were first produced in December 2014 there have been many further changes. The DIMF rules were themselves altered in the second draft of the Finance Bill 2015 on 24 March 2015, there were then further amendments at report stage of the Finance (No.2) Bill 2015 and further amendments in the first and second drafts of the Finance Act 2016 published on 9 December 2015 and 24 March 2016. Some of these amendments were critical, in particular a central point of the DIMF charge was when the charge arose, this was provided to occur when an amount "arises" from an investment scheme. The concept of "arise" was not defined under the legislation. HMRC stated that it was sufficient to adopt a broad approach which would look through intervening vehicles. While this approach was itself questionable, it also left the law in a state of complete uncertainty. In October 2015 provisions were introduced which defined in detail the concept of "arising", including in the case of intervening vehicles. There were also a number other significant changes including the change to the definition of "collective investment scheme" which brought a greater variety of structures within the charge and the omission from the scope of the charge of the requirement for there to be a partnership involved in the structure.

The DIMF rules defined what was "carried interest" and accordingly not subject to the DIMF rules. The first draft of what became the Finance (No.2) Act 2015 on 8 July 2015 introduced rules to charge amounts arising from carried interest to capital gains tax at 28%. These rules were themselves amended seven days later on 15 July 2015 and then further at report stage on 22 October 2015. It is provided that an amount of carried interest is deemed to give rise to a chargeable gain. There is then double taxation relief to avoid two charges, so that amounts of the carry that are in fact income are taxable accordingly and are not charged to CGT.

Finally, following a consultation which indicated a rather isolated issue with some hedge funds arguing that carry in those funds should be charged to CGT, the "income based carried interest rules" were introduced on 9 December 2015, amended (significantly) on 24 March 2016 and included in the Finance Act 2016 following minor amendments at report stage made on 28 June 2016.

The result of these changes over this 18 month period has meant that the law applying to remuneration of investment managers has been constantly changing; it has often not been clear what the law actually is. The income based carried interest rules are particularly difficult to interpret. During a somewhat informal consultation process on these, HMRC realised that the original draft of the rules, which provided a limited safe haven for private equity funds, did not treat many other funds fairly and accordingly introduced a number of safe havens of various types. The rules have followed the normal modern pattern that all amounts received are treated as falling within the rules and caught unless an exemption applies. The safe havens are all subject to a number of particular requirements which may not fit with developments in the industry. [It is difficult to see how legislation of this degree of complexity was required to address the concern raised in the original consultation].

B.14 Company distributions in a winding up – clause 35 Finance Bill 2016 (now s35 FA 2016)

In December 2015, the government consulted on changes to the taxation of distributions in a winding up in. Draft legislation was later included in Finance Bill 2016, which received Royal Assent on 15 September 2016.

The clause introduced a new targeted anti-avoidance rule (TAAR) so that, where certain conditions are met, a receipt during a winding up can be taxed as income rather than capital. This measure has been introduced to combat phoenixism, where the government is concerned that a number of taxpayers could otherwise exploit the rules by dissolving their company in order to extract value taxable to capital gains tax rather than income tax, perhaps several times in succession.

The Institute of Chartered Accountants in England & Wales, the Chartered Institute of Taxation and other professional bodies raised concerns about this TAAR with HMRC directly when the draft clauses were first published, as the concern was that the new legislation could apply more broadly than the policy intends. There was particular concern around the drafting used in the four conditions, A to D set out in clause 35(2) Finance Bill 2016, which, if met, mean the TAAR will apply.

Phrases such as ‘involved in’ carrying on a trade and ‘similar’ in relation to occasions where a person goes on to set up a new trade create uncertainty and leave the interpretation of law to HMRC’s guidance.

Through briefing notes and face to face meetings, the professional bodies requested that the draft legislation was amended to make the targets of this TAAR explicitly clear. However the clause was passed unamended.

As there is no clearance procedure available, there was a flurry of liquidations in the weeks before 6 April 2016, with individuals asking their advisers to liquidate their company before the new rules came in “just in case” they were affected.

HMRC has stated that detailed guidance will be published by the end of financial year 2016/17, but this remains yet another example of being taxed by legislation and untaxed by guidance.

This legislation is now enacted as s396B ITTOIA 2005.

C SUMMARY OF CONCLUSIONS FROM PREVIOUS REPORTS

The following have been the findings from our past reports.

Lessons from previous reports

2015 – Tax Professionals' Forum - Fourth Annual Independent Report

1. Deliver on promises or provide explanations when not delivered
2. Do not rush through complex legislation in a pre-election finance bill
3. Clearly define the role of the OTS in the consultation and policy development process
4. Integrate international reform into the UK's consultation framework

2014 – Tax Professionals' Forum - Third Annual Independent Report

1. Long periods of consultation can help to build consensus and understanding
2. Feedback is essential to building consensus and understanding
3. The policy development process needs to be flexible, both in timing and in outcome
4. Set the stage for post implementation reviews and future work
5. Avoid conflicts between reform and revenue protection
6. All stages matter and should be given sufficient time

2013 – Tax Professionals' Forum - Second Annual Independent Report

1. Consulting on proposed legislation and going through all five stages of the policy process.
2. More thought needs to be given to the timetable for the legislative process
3. Taking the opportunity during a Consultation in a "Summary of Responses" document to set out in detail the Government policy in a particular area

2012 – Tax Professionals' Forum - First Annual Independent Report

1. Constant change: lack of stability
2. Lack of predictability
3. Inadequate and poorly designed consultation