TAX PROFESSIONALS FORUM

THIRD INDEPENDENT ANNUAL REPORT

Covering the period from

30 November 2012 to 10 December 2013

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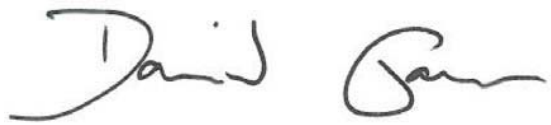
FOREWORD BY THE FINANCIAL SECRETARY TO THE TREASURY

The new approach to policy making which we introduced in 2011 has facilitated the development of a constructive dialogue with tax professionals about the development, design and legislation of new tax proposals. The Tax Professionals Forum has also provided a context for me to engage with senior tax professionals on issues of mutual interest and concern. I welcome the Forum's third report which demonstrates that the new approach is in general working well and highlights best practice. I also welcome the constructive spirit in which the Forum has put forward a number of suggestions for ways in which the process could be further improved. I believe that the new approach has already enhanced the quality of tax legislation but we can always do better. Our approach needs to be flexible and open to continuous improvement in the face of new challenges, and we will continue to engage with the Forum and with the wider tax community to make sure that the policy making process continues to evolve. We will carefully consider the points the Forum has made and I hope that together we can continue to strengthen a productive working relationship.



DAVID GAUKE MP

TAX PROFESSIONALS FORUM

THIRD REPORT OF THE INDEPENDENT MEMBERS OF THE FORUM

1. INTRODUCTION

This Report covers the period from 30 November 2012 to 10 December 2013 when draft legislation to form the Finance Bill 2014 was published ("Legislation Day") and all comments in this report relate to this period unless otherwise stated. This report is based on the information available and actions taken during this period and subsequent changes will be reflected in subsequent reports.

The consultation programme during this period has been constant, wide and varied and includes the 2013 Budget.

1.1 The role of the Forum

The remit of the Tax Professionals Forum 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
- 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 8 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 (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, 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. MAKING TAX LEGISLATION: REFLECTIONS ON THE EXPERIENCE IN THE REVIEW PERIOD

There are five stages put forward in the Framework for the process of making tax legislation. For most consultations, the Forum believes these five stages are both needed and useful. The reasons for this depend on the circumstances. For example, in formulating policy, the Government may have formulated a proposal which goes further than is necessary to achieve the particular policy objective, may be unaware of the effect the proposal may have on other areas, or may not have taken into account other existing legislation. An open formulation of policy allows engagement with and by the taxpayer.

It is pleasing to report that, as set out over the following pages of this report, the period has shown a number of good examples where the five stages have been or are being followed. These have resulted in the taxpayer having a clear understanding of government policy and policies being developed more effectively and efficiently. This report identifies the key factors that made those processes so effective so as to provide a guide for the future.

In contrast, however, in other cases, consultations have fallen short of the aspirational target that the Government has set itself. The Forum's views as to how the policy making process could have been better handled and recommendations as to how to avoid repeating the same mistakes are set out in the next section.

This report does not cover all of the policy changes undertaken in the period, but a selection that the Forum believes serve to demonstrate the range of experience in the period and provide the most opportunities for insight.

3. LESSONS FROM THIS PERIOD'S "CROP"

As noted above, there were examples of good practice in the period. Many times, these pass unnoticed, since the consultation does not rise to the attention of the media and does not become contentious. Whilst some policy changes by their very nature will always create controversy, there is a large scope for many more policy changes to be delivered easily. The report naturally focuses on the areas where improvements can be made and this should not be seen as a criticism of all consultations, many of which followed the approach set out.

Details of the consultations are included in Appendix C. This section brings out the key lessons from the successful and less successful consultations.

3.1 Lesson 1: Long periods of consultation can help to build consensus and understanding

It is notable that the period included three consultations that have spanned multiple years, being:

- Tier Two Capital
- Decommissioning Relief Deeds
- Research and Development Tax Credits

In each case, the consultation started before Autumn Statement 2012 and the actual policies have developed significantly over the period of consultation. These consultations were different, however, showing that successful consultation can improve many types of policy. In some cases, such as Tier Two Capital, the desired outcome and mechanism was relatively clear and the consultation was focused on the means to deliver the desired outcome. In contrast, the consultation on Decommissioning Security was initiated as the tax rate on the industry was increased and sought to address a problem which had been seen as intractable in the past. Finally, in relation to the reform of the Research And Development Tax Credit to being "above the line", the proposals represented benefits to some but difficulties to others. Nevertheless, the extended period of consultation enabled policy makers to understand the key issues, identify which ones Ministers would be minded to address, identify how those issues could be addressed and deliver a successful outcome.

3.2 Lesson 2: Feedback is essential to building consensus and understanding

A key positive from the R&D Tax Credit consultation was the consistent approach to feeding back information from HMT to the industry. This ensured that the industry knew not only what decisions were made but why those decisions had been made. This served to enable members of the industry to "agree to differ" with the conclusions taken by Government, secure in the knowledge that the Government understood the impact of the approach being taken.

Not all of the consultations in the period exhibited this two-way communication. This communication needs to start with the reason for reform. For example, in the consultation on "Simplifying Class 2 National Insurance Processes for the self-employed", it was hard for potential respondents to understand why HMRC had chosen to focus so much emphasis on the relatively trivial matter (for the great majority of Class 2 NICs payers) of whether an annual payment of £140 should be required or the existing monthly payment system should continue.

Lack of transparency was also exhibited in the consultation on "Raising the stakes on tax avoidance". Here, the Government does not appear to have taken into account some of the responses to questions raised in this consultation document. For example, question 29 in the consultation document asked

whether a minimum level in the court hierarchy should be reached before the requirement for taxpayers to amend their tax returns was imposed. Despite respondents having a strong preference for the requirement to be triggered only where the representative case reached the Upper Tribunal or higher, the Government decided to impose the requirement when HMRC win their representative case in the First Tier Tribunal.

Whilst a consultation document is not a referendum and does not bind the Government to follow the responses to consultation, a lack of explanation can threaten to undermine the validity of the consultation process.

3.3 Lesson 3: The policy development process needs to be flexible, both in timing and in outcome

The drivers behind each tax policy vary considerably and there will be some consultations undertaken against strict timetables. However, it is important to consider both the timing and the rationale for action in any policy discussions.

In the period, it was good to see that the Government has accepted that a decision not to change a policy is seen as an acceptable outcome of a consultation process. This was seen in HMRC's consultation on "Reform of Close Company Loans to Participators Rules". This consultation focused on rules that were changed in Finance Act 2013 which, absent those changes, had been largely unchanged for almost fifty years. The intention was to make the rules fairer and simpler, but the conclusion was reached that any further change at that time would be more disruptive.

The consultation on the cash basis for small business shows another example of why the policy development process needs to be flexible, this time in relation to timing. In Budget 2012, the Chancellor welcomed the Office of Tax Simplification's (OTS's) recommendation of adopting a cash basis for small businesses (see Making tax easier, quicker and simpler for small business) and announced that the proposals would be adopted. On 27 March 2012, HMRC launched its consultation, Simpler Income Tax for the Simplest Small Businesses.

Although, the draft legislation was widely criticised for being overly complex, it was passed virtually unchanged seemingly on the basis that the legislation needed to be included in Finance Act 2013. Whilst swift implementation of the cash basis was originally needed in order to align direct tax with the new Universal Credit system for the self-employed, this need fell away but the fixed timetable was retained. It seems clear that implementation from April 2013 could have been deferred until 2014 with no ill effect on business or tax receipts and the utilisation of this time for refinements could have resulted in a better policy and legislative outcome.

In contrast, the consultation on Employee Shares allowed for some adjustments to be made as a result of the consultation before its introduction. The beginning of the new rules was delayed, allowing some further time for further consultation and operational review. Similarly, in relation to the taxation of corporate debt and derivative contracts, the implementation of some of the proposals (notably those in relation to partnerships) was deferred.

3.4 Lesson 4: Set the stage for Post Implementation Reviews and future work

The consultation process is an opportunity to review proposals in detail and provides HMRC and HM Treasury with many views as to the likely responses to any particular measure. Whilst Ministers will take their decisions based on their own views and advice they have received, the views expressed during consultation can provide a useful guide as to what might happen in the future. In this regard,

the consultation process is the right time to set out the programme for reviewing the policy once it is implemented.

In the period covered by this Report, there were a number of consultations that would naturally give rise to a clear commitment to review, including:

- Flat rate allowances

The optional system of flat rate allowances (rather than claiming tax relief for the actual expenses incurred) was implemented from April 2013 for cars, motorcycles and business use of home, together with a set of flat rates which can be used where the owner of a business lives with their family on business premises. We suggest the Government could review how these simplifying options are taken up by business over the course of the next two years and adapt or extend this principle as appropriate to other types of expense and to its use by small companies.

- Disincorporation relief

Following the Government's announcement at Budget 2012, HM Treasury (HMT) published its consultation document on introducing a relief on 7 June 2012. A Response document was published with draft legislation on 11 December 2012, forming s58-s61 of Finance Act 2013. The relief applies only to the capital gains of the company where the value of land and goodwill does not exceed £100,000. The charge on the shareholder remains in all cases.

Relief has been introduced for a limited period of 5 years. We recommend that HMRC should, perhaps after one year, publish the number of companies which have claimed the relief so that it can be assessed whether the relief limits have been correctly set. A post-implementation review at or around the two or three year point would also be beneficial.

- General Anti Abuse Rule (GAAR)

The GAAR was the subject of a long period of consultation. The principal open issue is that of what constitutes an "abusive" transaction. The legislative definition is generally accepted as open to wide interpretation and accordingly real reliance is placed on HMRC guidance. Changes to that guidance are subject to oversight by the GAAR panel which is composed of individuals appointed from time to time by HMRC.

In the case of legislation as novel and potentially far reaching as the GAAR, a post-implementation review is a very necessary step to take after an appropriate interval.

- Pensions tax relief: individual protection from the Lifetime Allowance charge

This consultation highlighted the difficulty of grafting new features onto the already complex tax regime for pension savings. Whilst the draft legislation and guidance appear to achieve the policy objective, there is insufficient clarity on some important points of detail (e.g. the treatment of pension rights on divorce) and, indeed, some technical drafting errors which will hopefully be corrected in the finalised guidance and Finance Bill 2014 before its enactment. Notwithstanding the changes, the consultation has identified areas where further legislative clarity is needed and these should be built into a future delivery plan.

In this regard, we should note that the government undertook a review of the Bank Levy. We believe this review was handled well by HMRC and it is a good example of the Government reviewing and evaluating a new tax.

3.5 Lesson 5: Avoid conflicts between reform and revenue protection

Policy changes occur for many different reasons and those focused on revenue protection will necessarily (in many cases) have a far shorter timescale for delivery than ones that are more about the fabric of the tax system. A risk to the policy making process occurs when these two objectives are combined in a single policy process.

The consultation on the taxation of partnerships, on which two members of the Forum gave evidence to the Economic Affairs Committee of the House of Lords, is a good example of such a "mixed" consultation. The OTS is undertaking a review of the taxation of partnerships and during this period, the Government has chosen to reform the tax treatment of Limited Liability Partnerships, with the consultation itself being outside the remit of the OTS. This was originally designed to "have no impact on those partnerships or LLP members that use partnerships as Parliament originally intended. The original tax policy aim was to place members of LLPs in the same position for tax purposes as partners in a traditional partnership."

However, following the consultation, HMRC produced new disguised salary rules that do not replicate the existing test for employment tax purposes. These are wide ranging changes and would have benefited from more detailed consultation. The change in scope of the provisions on salaried members has meant that respondents did not have the chance to comment on the ambit of these provisions during the initial consultation process, undermining the usefulness of the consultation process.

Whilst there will be a drive to maintain tax revenues, allowing that drive to force through large scale change that has not received full consultation and engagement will inevitably give rise to sub-optimal policy making. Instead, other options for protecting the tax base should be considered and sufficient time given to the reform of the rules. This is likely also to benefit the Exchequer as swiftly implemented, wholesale change can give rise to poor legislation.

3.6 Lesson 6: All stages matter and should be given sufficient time

The policy making process is a valuable process and it is important to ensure that policies are taken through each stage of the process, as skipping any one element can lead to confusion as to the intent and hence to sub-optimal policies.

In the period, HMRC consulted on strengthening the Code of Practice for the taxation of banks. This was a highly contentious proposal, moving from an entirely voluntary Code of Practice to a statutory regime for "naming and shaming" institutions that were considered by HMRC to be non-compliant.

The policy process should provide an opportunity for HMRC to set out the Government's rationale for why it is undertaking a particular policy. Unfortunately this consultation did not deliver a clear articulation or rationalisation of HMRC's position. We recommend therefore that, where proposals are likely to be contentious, there is a separation between stage two and three of the consultation process.

Consultation can also be extremely valuable in the very first stage of policy reform. In the consultation on the Bank Levy, it is encouraging that HMRC stated that it consulted informally to inform the content of the consultation exercise. Although this pre-consultation was not widely publicised, it is nevertheless a welcome pre-curser to a formal consultation exercise.

In contrast, the consultation on the taxation of corporate debt and derivative contracts, which commenced in June 2013, would have benefited from some formal pre-consultation both on the issues being addressed in consultation as well as the timetable for legislative change. The initial consultation document released by HMRC proposed a number of fairly radical options for reforming the corporate debt and derivative contract legislation that did not receive widespread support in initial consultation responses. At one level this shows that the tax policy process is working effectively – it is useful to consider how the legislation could be simplified and modernised and whether taxpayers do not favour significant change. However the consultation exercise could have been better focussed if taxpayers' views were taken into account in designing its terms of reference. Hence for significant consultation exercises we recommend that stage one (setting out objectives and identifying options) is also subject to some prior consultation.

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

As noted in Section 1, 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

In the period, two provisions of the Finance Act 2013 were published as draft legislation outside of the usual Finance Bill timetable, being the restrictions on buying capital allowances enacted in section 71 and Schedule 26 and the corporate loss buying rules enacted in section 34 and Schedule 14.

Although published in draft on 28 March 2013, the provisions were only introduced into the Finance Bill at the Report Stage of the Bill, by which point the Finance Bill had completed the Public Bill Committee stages. The delayed inclusion of the provisions allowed the Parliamentary Draftsman to amend the clauses without the need to introduce to Parliament and then draft amendments, but this had the by-product of denying the Members of the Finance Bill Standing Committee of the House of Commons the opportunity to debate the issue and indeed to put on record any concerns that might arise. This runs counter to the Government's express intention on enhancing legislative scrutiny and therefore, in the view of the Forum, should be avoided whenever possible. The purpose of the current policy making programme is to ensure that sufficient scrutiny is applied to all measures and the creation of an alternative route to implementation ("fast tracking" through Parliament) should be used only for extreme cases.

In this regard, it is notable that some provisions intended for inclusion in Finance Act 2014 are again only being introduced at Third Reading, despite being outlined in the Autumn Statement 2013. Given this, the Forum may wish to return to this item in future Reports.

4.2 Unscheduled announcements with immediate or retrospective effect

There were two unscheduled announcements with immediate effect announced in December 2012 and September 2013:

- The measures announced on 21 December 2012 to counter avoidance through the use of schemes to generate artificial losses from property businesses. This measure had an effective date of 21 December 2012 and the Independent Members consider this change to be proportionate in terms of the Protocol.

- The measures announced on 17 September to counter avoidance through the use of compensating adjustments these measures had effect from the date of the publication of the draft legislation (25 October 2013) and did not apply to interest and service fees accrued before that date. Accordingly the Independent Members consider this change to be proportionate in terms of the Protocol.

In addition, there was an unscheduled announcement on 4 June 2013 relating to measures to counter schemes relying on the Stamp Duty Land Tax ("SDLT") transfer of rights rules. This legislation had effect from 21 March 2012. The Independent Members believe this was within the Protocol as there was a clear warning in the 2012 Budget (21 March 2012) that the Government would legislate with retrospective effect to counter further abuse of the SDLT subsale rules ("prospective retrospection"). One possible criticism is that the Protocol requires that there is a significant risk to the Exchequer. The effect of the change was to deliver the same revenue as estimated in the original TIIN published with the 2013 Budget and therefore it is difficult to identify how much was protected by this change.

4.3 Recommendations on changes to the Protocol

We have previously recommended changes to the Protocol (see the Second Independent Annual Report). Those recommendations still stand and are included as an appendix to this report.

5. CONCLUSIONS

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

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 is set out below:

- Malcolm Gammie CBE QC – Research Director for the IFS Tax Law Review Committee
- Vincent Oratore CTA (Fellow) – Past President of the Chartered Institute of Taxation
- Chris Sanger – Global Director of Tax Policy at EY and Chairman of the Tax Policy Committee of the ICAEW's Tax Faculty
- Jane McCormick – Head of Corporate Tax at KPMG
- Richard Stratton – Partner at Travers Smith LLP and former Chairman of the Law Society's Tax Committee
- Philip Baker OBE, QC – Grays Inn Tax Chambers and Institute of Advanced Legal Studies, London
- Stephen Herring – Head of Taxation, Institute of Directors
- Francesca Lagerberg – Global Leader - Tax Services at Grant Thornton International Ltd
- Andy Richens – Tax Technical Director, Bishop Fleming Accountants (appointed October 2013)
- Anita Monteith – Tax Manager at the Institute of Chartered Accountants in England and Wales (appointed October 2013)
- Stephen Coleclough - Mishcon de Reya and Past President of the Chartered Institute of Taxation (appointed October 2013)

The remit and membership of the Tax Professionals Forum is reviewed every two years. It was last reviewed in 2013 and the remit retained.

B FORUM RECOMMENDATION ON PROTOCOL ON UNSCHEDULED ANNOUNCEMENTS

The Second Report of the Forum included the following recommendation:

"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.

C 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.

C.1 Partnerships: A review of two aspects of the tax rules

This was a consultation which began at Stage 3 as a revenue raising exercise. The changes proposed in the consultation document are wide-reaching and complex. Our view is that an April 2014 commencement date was too ambitious and did not allow enough time usefully to comment on the proposals, particularly in the light of the change in direction of the proposals in December 2013.

The stated policy of this consultation was that it was "about levelling the field. It will have no impact on those partnerships or LLP members that use partnerships as Parliament originally intended… The original tax policy aim was to place members of LLPs in the same position for tax purposes as partners in a traditional partnership."

There seems to have been a very significant shift in direction between the time of the publication of the consultation document and the time of the publication of the draft legislation in December 2013. The new disguised salary rules do not produce a set of tests which have the effect of replicating the existing test for employment tax purposes. The new tests (Conditions A to C) created a new category of individual who, if he "satisfies" all the tests, will be treated as an employee even though he may well remain a member of the LLP for general law purposes.

The change in scope of the salaried members provisions has meant that respondents did not have the chance to comment on the ambit of these provisions during the initial consultation process, undermining the usefulness of the consultation process. Inevitably, if provisions the scope of which have not been fully exposed are circulated in draft less than four months before the Finance Bill is published there will be areas where the rules are not clear and where situations are not properly dealt with. To take one example, it became apparent relatively late in the day that HMRC considered that members of LLPs whose profits were computed on a "cost plus" basis would satisfy Condition A (so that if they did not have significant influence or sufficient capital they would become employees). Time was short for those members and the LLP concerned to adapt, if this was even possible. The scope of the rules has been amplified through guidance which has been altered and reissued as further questions and situations have been raised. Views of particular situations have been modified so businesses have had to restructure at short notice and renegotiate terms with members without full visibility of the provisions. The provisions on mixed membership partnerships are no better as they challenge the use of this business medium and are extremely difficult to apply in the context of international organisations.

This consultation has proved to be hugely controversial. The main issue relates to the alteration in the structure of the proposals manifested in the draft clauses published on Legislation Day which has meant that there has been an insufficiently effective consultation on the wording of the provisions and the situations caught by them. We do not believe the process has been satisfactory, a view echoed by many, including the House of Lords Economic Affairs Committee.

C.2 Community Amateur Sports Clubs

The founding principle of the CASC scheme is to provide financial support to amateur members' clubs set up to provide facilities for, and encourage participation in, an eligible sport across the whole community that would otherwise struggle to survive.

The proposed extension of corporate Gift Aid to gifts to CASCs will undoubtedly be welcome both to the beneficiaries of this extra funding and to those companies which support sport in the community. It also allows sports clubs which rely on funding from an active social section to support their sporting activity, to restructure themselves in a more business friendly manner.

C.3 Cash basis for small businesses - S 17 and Sch 4 Finance Act 2013

In 2010 the Government asked the newly-created Office of Tax Simplification (OTS) to carry out an independent review of tax for small business. During 2011 and 2012, the OTS worked steadily on its proposals for a simpler tax framework for the smallest unincorporated businesses. One of the outcomes of this work was to recommend that an alternative cash basis of accounting for taxable profits should be allowed for the smallest businesses. The OTS was in favour of fundamental changes for the smallest businesses so that, in broad terms, a "cash basis" became the default method of reporting.

Much of the consultation work on this policy was done by the OTS, which published its final report in February 2012. In Budget 2012, the Chancellor welcomed the cash basis recommendation (see Making tax easier, quicker and simpler for small business) and announced that the proposals would be adopted. On 27 March 2012, HMRC launched its consultation, Simpler Income Tax for the Simplest Small Businesses.

It is clear from the number of responses HMRC received, and from the number of meetings held to discuss the detail of the proposals, that a large number of interested parties were involved in this consultation. What is less clear is the extent to which comments were actually taken into account. In particular, many respondents questioned the advisability of allowing the cash basis for larger businesses, that is those with income up to the VAT registration threshold, rather than the £30,000 limit recommended by the OTS, which had supported its recommendations by research.

The draft legislation was widely criticised for being overly complex, yet it was passed virtually unchanged. It seems clear that implementation from April 2013 could have been deferred until 2014 with no ill effect on business or tax receipts. The original reason for swift implementation of the cash basis, to align direct tax with the new Universal Credit system for the self-employed, was no longer in point.

C.4 Flat rate expense deductions - S 18 and Sch 5 Finance Act 2013

The OTS in its February 2012 report also recommended that businesses should be allowed to use a system of flat rate allowances rather than claiming tax relief for the actual expenses incurred in running their businesses.

This suggestion was welcomed by the Government and, after consultation, an optional system was implemented from April 2013 for cars, motorcycles and business use of home, together with a set of flat rates which can be used where the owner of a business lives with their family on business premises.

We suggest the Government could review how these simplifying options are taken up by business over the course of the next two years and adapt or extend this principle as appropriate to other types of expense and to its use by small companies (a post-implementation review).

C.5 Bank Levy Consultation

The Bank Levy was introduced in Finance Act 2011 and the Government committed to undertake a review in 2013. The review of the Bank Levy commenced shortly after most banks had submitted their first returns under the tax and accordingly there was minimal appetite for radical changes to the structure of the levy. In some respects the timing of the review was unfortunate as there are a number of regulatory changes that may impact the Bank Levy methodology but these were not sufficiently advanced at the time of the consultation to inform legislative change. However, the Government was committed to the original timetable and the consultation nevertheless served a useful purpose in confirming that the Levy was broadly operating effectively.

We believe the Bank Levy review was handled well by HMRC and, whilst there are questions as to whether a review in 2013 was necessary, it is a good example of the Government reviewing and evaluating a new tax. The consultation itself did follow the stages one to three of the development of tax policy (legislative changes were included in the 2014 Finance Bill and therefore remaining stages of consultation fall outside the period covered by this report). Indeed it is encouraging that HMRC stated that it consulted informally to inform the content of the consultation exercise. Although this pre-consultation was not widely publicised, it is nevertheless a welcome pre-curser to a formal consultation exercise.

One criticism is that the changes announced at the 2013 Autumn Statement were cast in terms of a broadening of the Bank Levy base. If this was the policy intention this should have been made explicit as part of the consultation process.

C.6 Disincorporation Relief - s58-s61 FA2013

This new relief benefitted from two consultations. Firstly, the Office of Tax Simplification (OTS) published a discussion paper on 28 July 2011 on disincorporation for small companies. Based on the responses to this document, together with survey evidence gathered , the OTS identified a population of businesses that may wish to disincorporate. A final OTS report was published in February 2012 recommending a relief enabling goodwill, land and plant to pass to the unincorporated business with no tax charge arising on the company, nor on the shareholder, as a result of the transfer.

Following the Government's announcement at Budget 2012, HM Treasury (HMT) published its own consultation document on introducing a relief on 7 June 2012. A Response document was published with draft legislation on 11 December 2012, forming s58-s61 of Finance Act 2013. The relief applies only to the capital gains of the company where the value of land and goodwill does not exceed £100,000. The charge on the shareholder remains in all cases.

Despite following the tax policy framework, with two consultations, there is a concern that the resulting relief is too restrictive. The Response Document acknowledged that respondents favoured a relief at least as wide as that proposed by the OTS. In terms of relief limits, for simplicity the OTS had proposed eligibility by reference to an existing definition, and suggested companies up to the EU definition of a micro-company may qualify. The HMT consultation document had suggested a turnover (rather than asset) limit to match the VAT registration threshold and entry limit for the cash basis. To limit by reference to an asset value was therefore unexpected. The Response Paper estimated that 610,000 companies would be eligible at this asset level, but it is not clear how goodwill was valued in these cases to arrive at this figure.

Relief has been introduced for a limited period of five years. We recommend that HMRC should, perhaps after one year, publish the number of companies which have claimed the relief so that it can be assessed whether the relief limits have been correctly set. A post-implementation review at or around the two or three year point would also be beneficial.

Finally, the HMRC published guidance on the new relief and links to the Companies House guidance on closing a company is a positive step, although more needs to be done in forming a one-stop process as proposed in the OTS report.

C.7 The GAAR

The GAAR consultative process was unusual in that views in the private sector were particularly polarised. As the inevitability of the GAAR became apparent, the discussion focused on the technical aspects of the proposed legislation. Some material changes were made, many were not.

It is beyond the scope of this Report to discuss the technical merits of the GAAR. In our view the consultative process and its result were consistent with Government policy.

The principal open issue is what constitutes an "abusive" transaction. The legislative definition is generally accepted as open to wide interpretation and accordingly the real reliance is placed on HMRC guidance. Changes to that guidance are subject to oversight by the GAAR panel which is composed of individuals appointed from time to time by HMRC.

The Independent Members of the Forum consider that, in the case of legislation as novel and potentially far reaching as the GAAR a post-implementation review is a very necessary step to take after an appropriate interval.

C.8 HMRC Consultation on "Simplifying Class 2 National Insurance Processes for the Self Employed"

This twelve week consultation in July-October 2013 was prompted by the OTS recommendation that the Government ought to review the Class 2 NICs processes. The proposition to collect Class 2 NICs through the income tax Self Assessment process was included in the consultation alongside the use of an individual online system.

The Independent Members are wholly unsurprised that the consultation undertaken found that awareness of Class 2 NICs was generally low and that knowledge of the linkage to contributory benefits and the small income exemption was even lower.

We are disappointed that so much emphasis was placed on the relatively trivial matter (for the great majority of Class 2 NICs payers) of whether an annual payment of £140 should be required or the existing monthly payment system should continue.

We accept that the payment issue was identified as a priority by the OTS in its Small Business Tax Review in March 2011 but this was in the context of the overarching need for the integration of income tax and national insurance contributions for businesses:-

"…the OTS recommends that the calculation of Class 2 and 4 NICs could become part of the self assessment process. Over 3.4million taxpayers are estimated to be liable to Class 2 NICs. Data show that, in 2006, 9,195 individuals applied for deferment, 78,000 applied for the SEE2 and 10,400 applications were submitted to have Class 4 NICs repaid."

C.9 HMRC Consultation on "Reform of Close Company Loans to Participators Rules"

The Finance Act 2013 contained changes to the loans to participators rules which were introduced without consultation. The changes were made to counter avoidance of the rules which could occur, for example, through the use of partnerships. The changes made were far reaching and, while countering avoidance, extended the charge to cover a number of commercial arrangements.

It was also announced in the Budget 2013 that there would be a consultation on options to reform the very same provisions which, absent the changes made in the Finance Act 2013, had been largely unchanged for almost fifty years. The intention was to make the rules fairer and simpler. The Consultation Document was published on 9th July 2013 and the consultation ran until 2nd October 2013.

This consultation was inevitably affected by the fact that the rules had just been altered so there was a degree of uncertainty about how the new provisions would apply; it is hard, almost self-defeating, to consult on provisions that have just been altered.

The Independent Members consider that maintaining the status quo should not be considered as an unsatisfactory outcome to a consultation. In this case, we consider that the options presented were not responsive to securing a consensus for reform and simplification. We note that, subsequently, a further informal consultation was announced on alterations to the rules. While a further consideration of the rules is perhaps to be welcomed, it does demonstrate that the consultation process in this area has not gone smoothly.

C.10 Employee shares

Since 1 September 2013 companies have been able to use the new employee shareholder provisions. Employers can give up to £2,000 of shares free of income tax and National Insurance Contributions and employees can acquire up to £50,000 of shares in total – and gains on those shares will be free of Capital Gains Tax (CGT). So, if employees are comfortable with relinquishing certain statutory employment rights, then this plan has ended up as a potentially useful incentive.

Some adjustments were made as a result of the consultation before introduction. The original concept was highly criticised. The main concern was that it appeared an uneven transaction for the employee – give up employment rights for shares on which a typical employee probably would not have incurred a CGT tax liability on, even if they did have a limited gain on their shares. It has instead become an incentive for companies with ambitious growth plans and more senior staff; for whom foregoing employment rights may not be such a significant matter.

The beginning of the new rules was also pushed back which did allow some time for further consultation and operational review.

C.11 Raising the stakes on tax avoidance

The Government has failed to take into account some of the responses to questions raised in this consultation document. This undermines the validity of the consultation process.

For example, question 29 in the consultation document asked whether a minimum level in the court hierarchy should be reached before the requirement for taxpayers to amend their tax returns would be imposed. Despite respondents having a strong preference for the requirement to be triggered only

where the representative case reached the Upper Tribunal or higher, the Government decided to impose the requirement when HMRC win their representative case in the First Tier Tribunal.

It is disappointing that the Government has not given any weight to these concerns raised in response to the consultation document.

C.12 HMRC Consultation on "Pensions tax relief: individual protection from the Lifetime Allowance charge"

The Government announced on 5 December 2012 that the lifetime allowance for registered pension scheme savings would be reduced from £1.5 million to £1.25 million from 6 April 2014. On 10 June 2013, HMRC launched a consultation exercise on an "individual protection" regime to allow individuals to protect existing pension rights.

The underlying Finance Act 2004 tax regime for pensions was specifically intended "to create a simple, stable and fair system" , with a single set of tax rules for all registered pension arrangements. Whilst individual protection is a welcome measure to mitigate the planned reduction in the Lifetime Allowance, the latter nonetheless represents a failure in relation to the three founding criteria cited above.

The individual protection measures are extremely complicated – to the extent that it is very unlikely that a non-specialist could determine whether a claim for individual protection and/or the associated "fixed protection" would be advantageous. Whilst this complexity is, to a large extent, merely a reflection of the underlying complexity of the wider pensions tax regime, it is still a further hindrance to retirement planning.

Even with individual protection, some members will still face lifetime allowance charges in respect of pre-April-2014 savings that they would previously have expected to be within the lifetime allowance. (For example, any increase in fund size through investment growth and income on existing defined contribution savings is likely to generate a lifetime allowance charge.)

Viewed in its own terms (i.e. accepting the context in which it is being introduced), individual protection can be seen as a necessary measure to prevent what would effectively be wholly retrospective tax penalties on savings already accrued at 5 April 2014.

The draft legislation and guidance issued in the light of the consultation appear to have taken on board many of the consultation responses.

However, the consultation does highlight the difficulty of grafting new features onto the already complex tax regime for pension savings. Whilst the draft legislation and guidance appear to achieve the policy objective, there is insufficient clarity on some important points of detail (e.g. the treatment of pension rights on divorce) and, indeed, some technical drafting errors which will hopefully be corrected in the finalised guidance and Finance Bill 2014 before its enactment.

The Independent Members consider that, subject to some drafting points, the individual protection proposals achieve their policy objective (by mitigating the impact of the reduction in the lifetime allowance), but that (as well as the underlying changes that give rise to a need for this protection being harmful to long-term pension planning by employers and individuals) areas remain where further legislative clarity is needed.

C.13 Strengthening the Code of Practice on taxation for banks

The most contentious element of this consultation was a proposal to reinforce an entirely voluntary Code of Practice with a statutory regime for “naming and shaming” institutions that were considered by HMRC to be non-compliant. This raised real issues as to how the administration of the UK tax system is perceived by international investors. Serious concern has been expressed by a number of other industries and communities that they could be next for this treatment if they were to become the next scapegoat for the Government. Fundamental to these concerns is the disregard for the rule of law and natural justice and the independent non judicial appeal, whose decision does not bind HMRC.

Focussing upon the policy process, the code of conduct was first justified on the basis of the colossal amount of taxpayer funding injected in to banks and the banking sector and was a voluntary, but highly controversial, code. A number of banks signed up but on the basis of having clarified it in terms of their understanding. It is understood that rather than there be any policy decision as such, the Government wanted to remove these various different understandings. This was to be done by a statutory regime which is the subject matter of the legislation, backed up by a "naming and shaming" regime, which basically made HMRC prosecutor, judge, jury and executioner. It is clear that the intention is that naming and shaming should cause harm to the bank in question. Many forceful representations were made and the proposal was amended to include an appeal, before being named and shamed, to an independent person. However, even if the appeal determines naming and shaming, HMRC can still go ahead for "compelling reasons" which notably are not limited to tax reasons.

From a policy making perspective, this would indicate that there was some listening to concerns. On the negative side however, that listening did not result in a clear articulation or justification of HMRC's position, save that this is what the Government wants to do.

C.14 Decommissioning relief

The consultation on providing certainty over the tax relief for the costs of decommissioning oil & gas assets in the UK Continental Shelf followed discussions between Government and industry that commenced in early 2011. The consultation involved detailed discussions with the industry, to ensure that the policy delivers the aims, namely of stimulating further investment in the North Sea. The close working enabled the Government to obtain a critical understand of the decision making involved in investment decisions and thereby the impediment created by the fiscal uncertainty.

The detailed consultation on the legislation allowed for the provisions to address the specific areas of concern and to be focused appropriately.

C.15 Research and Development Tax Credit

The Research and Development (“R&D”) Tax Credit consultation process is widely acknowledged within the industry as being a success which has led to the implementation of a regime which is well considered and largely welcomed by industry.

The consultation enabled the regime to be designed to meet the original objectives set by opening up a strong dialogue between industry, advisors and HMT, thereby allowing any potential unintended consequences or nuances from particular industries to be raised at an early juncture.

HMT was engaged and committed to actively driving the agenda and timelines. The level of communication from HMT was exceptional and was welcomed by all parties as it enabled the whole process to be transparent and demonstrated the commitment of HMT to ensuring the successful implementation of the regime. Throughout the consultation process, HMT requested and valued the input from industry as well as advisors. By publishing the results to the consultation throughout the process, HMT demonstrated that the Treasury was open to considering ideas from industry and advisors and, even when HMT disagreed, publishing their reasons for their position on such matters helped industry and advisors to understand the reasoning behind the final decisions.

C.16 Modernising the taxation of corporate debt and derivative contracts

This is a significant consultation exercise that commenced in June 2013 and is likely to continue for the next 18 months. During the period covered by this report the consultation exercise only included stages one and two. We will comment more fully in our next report.

A periodic review of the policy imperatives underpinning the corporate debt and derivative legislation (the "Legislation") is vital for a number of reasons.

- It has been the subject of extensive avoidance, and the resultant anti-avoidance provisions need to be reviewed for efficacy and continued relevance;
- Changes in international accounting standards (e.g. hedging) often create unanticipated results and opportunities for avoidance. The policy underlying modern accounting (e.g. IFRS) is often incompatible with a policy designed for annual tax collection.
- Changes to the Legislation are often made for specific policy reasons to encourage or discourage certain behaviour.

Our initial observation is that this consultation exercise would have benefited from some formal pre-consultation on both the issues being addressed in the consultation as well as the timetable for legislative change. The initial consultation document released by HMRC proposed a number of fairly radical options for reforming the corporate debt and derivative contract legislation that did not receive widespread support in initial consultation responses. At one level this shows that the tax policy process is working effectively. It is very useful to consider how the legislation could be simplified and modernised and, if taxpayers do not favour significant change, that it as useful outcome of the consultation process. However we think that the consultation exercise could have been better focussed if taxpayers' views had been taken into account in designing its terms of reference. Hence for significant consultation exercises we recommend that stage one (setting out objectives and identifying options) is also subject to some prior consultation.

Having said this, early indications are that the consultation process is working well and both HMRC and taxpayers/advisors are devoting significant resource to it. There are four working parties that have been meeting regularly since the summer. It was not possible for all interested parties to be represented on each working party and hence HMRC has sensibly published detailed minutes of each working party discussion so that the wider taxpayer community is informed. A detailed summary of consultation responses was also published at the time of the Autumn Statement. Both are very welcome and are to be encouraged in other consultations of a similar nature.

The consultation is in its early stages. A number of changes were intended to be included in the 2014 Finance Bill This was a very challenging timetable and has inevitably meant that drafting instructions have been given to Parliamentary Counsel before principles have been fully debated in working party

discussions. The decision to defer the implementation of some of the proposals (notably those in relation to partnerships) is therefore to be welcomed.