



Finance Bill 2007

Report Stage Briefing

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1. Managed Service Companies (Clause 25, Schedule 3)

(i) 'Involvement' with an MSC

As we have stated throughout the passage of the Finance Bill through Parliament, the ICAEW supports the principle and purpose of the proposed MSC legislation. We remain concerned, however, that the proposed legislation is too widely targeted.

In particular, we understand that the approach of Government is to ensure that employment treatment is applied to those individuals who are not in business on their own account and the mechanism for determining this is whether a managed service company is "involved" with the company.

We are concerned that the definition of involved, as explained by the Financial Secretary to the Treasury in the Finance Bill Public Bill Committee, is difficult to apply in practice. This relies upon the client of the MSC Provider receiving advice rather than a "solution" which the client accepts without fully understanding the consequences. This may be determinable if HMRC were present at the conversation with the client but there will be little evidence that can distinguish between the two situations after the event. For example, the law provides for distinct treatments and therefore it is likely that the majority of clients of the MSC provider will result in the same structure – after the event, it will be very difficult to determine whether this has arisen due to commonalities between the customers (ie. advice) or through a "solution" where the client was "shepherded" into a structure.

We believe that the legislation should draw a distinction between the adviser who offers advice on appropriate structures dependent on the facts (i.e. the bespoke business adviser) and the promoter who has a packaged solution which is the only or main 'product' which they are actively encouraging clients into.

Suggested Amendment

Schedule 3, to new section 61B ITEPA 2003 insert:

Line 42 new sub section (5):

- 'In subsection (2) above involvement does not include independent tailored advice which considers all reasonable options and consequences'

(ii) Debt transfer rules

We remain concerned about how widely the debt transfer rules could be applied and more clarity is needed as to who the debts could be transferred to if the MSC closes down and tax is left outstanding. We welcomed the government's amendments that addressed the issues faced by recruitment agencies, which could have been potentially exposed to a liability whilst having limited ability to avoid such an exposure. We also welcomed the Government amendment to remove 'facilitated' from 688A section 2(c), but believe that the legislation is still widely targeted.

Technically, non-shareholding ordinary employees of a MSC could still be caught by the third party liability rules. We understand this is not the intention of the legislation and this may be included in guidance but this is an item that should be clarified in the legislation.

Interest is due on the debt even if becomes payable by a third party. Interest is perceived by HMRC as restitution for the loss of the use of the money but there is a significant difference between transferred debt to other parties and the normal circumstance of ordinary late payment. In the former case the third party may have no previous knowledge that there was a debt outstanding. Hence, the interest charge looks like a penalty in these circumstances.

Another possibility is to draw a distinction between the adviser who offers advice on appropriate structures dependent on the facts (i.e. the bespoke business adviser) and the promoter who has a packaged solution which is the only or main 'product' which they are actively encouraging clients into.

A further confusion is that the exemption for accountancy and legal services used for the definition of an MSC Provider differs from the exemption from the debt transfer rules.

Suggested amendments

Amendments are required as follows:

1. To clarify that non-shareholding ordinary employees of a MSC are not caught by the third party liability rules, we suggest the following amendment to Schedule 3 to new section 688A ITEPA 2003:

Insert new sub clause (9)

- '(9) A person does not fall within subsection (2)(d) merely by being an employee but not a director.'
2. That interest does not run on debts transferred to a third party unless that person was involved in promoting the MSC and knew, or should have known, that the debt had not been paid
3. In order to maintain consistency between the exemption for accountancy and legal services for the definition of an MSC Provider and the exemption from the debt transfer rules, we recommend the following amendment in para 6 of Schedule 3 to new section 688A ITEPA 2003:

in line 22

- replace 'advice' with 'services'

so that the sub-clause will read as follows

'A person does not fall within subsections (2)(c) merely by virtue of providing legal and accountancy services in a professional capacity,'

4. In order to ensure that the debt transfer rules do not apply to those who might otherwise be loosely connected with a managed service company, we recommend the following amendment in para 6 of Schedule 3 to new section 688A ITEPA 2003:

in line 17

- after 'encouraged,' insert 'actively'

so that the sub-clause will read as follows

'a person who (directly or indirectly) has encouraged, actively facilitated or otherwise been actively involved in the provision by the MSC of the services of the individual, and'

5. New section 688A(7) gives the Treasury the power to amend by way of regulations section 688A (1) to (6), subject to the need to lay the regulations and have them approved by Parliament (as set out in section 688A(8)). This gives Treasury a very wide-ranging power to, in effect, completely rewrite section 688A. We do not think Treasury should be given such an unfettered power. We think that this power should be amended and made more targeted.

We propose that the power of Treasury should be limited only to adding to the list of persons under section 688A(2).

in line 35

- delete 'this section' and insert 'the list of persons set out in subsection (2) above'
- delete the words in brackets at the end of section 688A(7)

so that sub clause 7 will read as follows:

- 'The Treasury may by order amend the list of persons set out in sub-section (2).

2. Restriction on trade loss relief available to partners (Clause 26, Schedule 4)

This clause and schedule restricts tax relief for losses arising to non-active or limited partners. Tax relief is limited in the following two circumstances:

- where capital contributions are made by a non-active partner where the main purpose, or one of the main purposes, is for the partner to obtain a tax deduction by way of sideways loss relief; and, additionally
- the amount of trading losses sustained as a non-active is limited to a maximum limit of £25,000 a tax year (referred to as a 'cap').

The measure is being introduced in respect of concerns over certain marketed tax avoidance schemes. The Treasury is rightly concerned about such schemes and the first of the above two measures (set out in paragraph 2 of Schedule 4) is a suitably targeted measure that appears to address the issue.

However, the ICAEW believes that the second of the two measures, namely the overall £25,000 limit on sideways loss relief and capital gains tax relief for non-active partners (set out in paragraph 1 of Schedule

4) looks to low. The limit applies regardless of whether the sole or main purpose of the investment was to generate a tax loss. The key condition is that the investment was made by a non-active partner. The measure is not targeted solely at tax avoidance schemes and is therefore much more widely targeted. The result is that the measure will impact upon many small businesses being set up with substantial investment in the early years.

In the Finance Bill Standing Committee debates, the Chief Secretary explained that this limit was set because *'In practice, more than 90 per cent of losses incurred by people in the partnership population who are not motivated by tax avoidance are lower than £25,000.... An annual limit of £25,000 strikes the right balance between allowing non-avoiders access to sideways loss relief, while preventing avoiders from abusing it.'*¹

However, this statement makes it clear that the limit will apply in a certain number of cases to partners where there was no intention of tax avoidance. Given this statement and the concern that the measure will impact upon small businesses, we remain of the view that the limit should not be introduced, but if it is then we think that the limit should be higher and indexed.

Suggested amendments

1. Paragraph 1 of Schedule 4 should be deleted from the Bill, with consequential renumbering of the following sections.

2. If this amendment is not accepted, then the cap should be raised to a more reasonable level. We suggest a cap of £100,000. Accordingly, we suggest:

- In line 11 on page 99, substitute '£25,000 for '£100,000'

3 The limit should be subject to automatic indexation on an annual basis, raising it in line with the retail process index.

3. Extension of restrictions on allowable capital losses (Clause 27)

We have supported consistently the Government's aim of countering the use of artificially created capital losses to avoid capital gains tax, but we remain concerned about the breadth of the wording used in clause 27. We appreciate that the FA 2006 legislation, which applies only for the purposes of corporation tax, uses the same wide wording. However, the tax affairs of individuals/ trustees/ personal representatives are very different to companies and in this particular situation we do not think that one set of rules works for all of these types of taxpayers.

The approach that has been adopted is to enact widely targeted legislation that will catch many transactions, but then to cut down the scope of the provision through detailed guidance published by HMRC. In other words, the guidance will clarify which transactions are to be caught by the new legislation and which are not to be caught. We disagree with this approach and are concerned about whether, following the *Wilkinson* case [2005] UKHL 30, HMRC has the power to publish guidance that appears to cut down the clear intention of legislation passed by Parliament., We think that this is an unacceptable delegation to HMRC of the powers of the legislative, and we do not think that ministerial statements and assurances during the passage of the Bill are sufficient to remedy what we believe is a fundamental flaw in the Bill.

We do not think that HMRC guidance provides adequate protection to taxpayers and we remain of the view that clarifications of how the legislation applies should be enshrined in legislation in some form. Ideally, this would be by way of secondary legislation but it could also be achieved by tertiary legislation. For example, certain VAT notices, or sections within VAT notices, have the force of law as tertiary legislation under the Value Added Tax Act 1994.

¹ Rt Hon Stephen Timms MP, Chief Secretary to the Treasury, Finance Bill Committee, 15 May 07, Col 204

Most of our concerns over clause 27 would be allayed if the clause 27 is amended so as to give the guidance the force of law.

The latest guidance reflects some improvements following comments made by us and other professional bodies, although we remain concerned that not all the points we raised have been addressed. We believe that further consultation is needed to produce guidance that the professional bodies agree with.

4. Abolition of industrial and agricultural buildings allowances (Clause 35)

We recognise that the changes to the capital allowances rules are part of a balanced package that has also seen the headline rate of corporation tax reduced from 30% to 28%. Nevertheless, we have many concerns about the proposed changes and the underlying policy, particularly given that smaller businesses will not benefit from the 2% cut in the main rate of corporation tax.

In addressing the impact of these changes on smaller businesses in committee, the Chief Secretary argued that the new Annual Investment Allowance (AIA) would more than compensate the smaller businesses for the loss of any allowances under the existing regime. Whilst we recognise that on paper the AIA is likely to be generous, it will not assist businesses that have already invested.

We remain concerned that the withdrawal of allowances is likely to impact upon a number of the UK's business sectors, including manufacturing base, farming and capital intensive sectors such as the hotel trade, which is currently anticipating the need for capital investment prior to the forthcoming Olympics. The changes will impact upon the profitability of those businesses (particularly if they do not pay corporation tax at the full rate) and may cause problems with existing loan covenants.

The measure will cause considerable upheaval for businesses in the relevant sectors at considerable cost and note that the revenue increase as per the 2007 Budget 'Red Book' is relatively modest at £75m for 2008/09 and £225m for 2009/10 (although we recognise that it will continue to increase until 2011/12).

Suggested amendment

We think that the clause should be withdrawn from the Finance Bill so as to allow further time for more detailed consultation and consideration of the proposed policy. We remain of the view that the impact of this change on small business would be alleviated by grandfathering existing assets.

Further information

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