ICAEW
REPRESENTATION 100/23

DRAFT FINANCE BILL 2023-24

Issued 3 October 2023

ICAEW welcomes the opportunity to provide evidence on the Draft Finance Bill 2023-24 to the House of Lords Economic Affairs Finance Bill Sub-Committee. A copy of the call for evidence made on 13 September 2023 is available from this link.

For questions on this response please contact our Tax Faculty at taxfac@icaew.com quoting REP 100/23.

This response of 3 October 2023 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 166,000 chartered accountant members in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

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GENERAL COMMENTS

1. Our following recent submissions provide further detail:
   - Tougher consequences for promoters of tax avoidance
   - R&D tax reliefs reform: consultation on a single scheme draft finance bill 2023 legislation
   - Draft finance bill: change to data HMRC collects from customers

ANSWERS TO SPECIFIC QUESTIONS

DEALING WITH PROMOTERS OF TAX AVOIDANCE AND INCREASING THE MAXIMUM PRISON TERM FOR TAX FRAUD

Question 1: How effective are the criminal offence for promoters, the power to seek disqualification of directors of relevant companies and the doubling of the maximum prison term for tax fraud likely to be in deterring the promotion of tax avoidance and tax fraud?

2. It is difficult to know for certain how effective these measures will prove to be. Certainly, any extension of measures designed to expand the consequences of failing to comply with a stop notice or acting as a director of a tax avoidance promoter will send a clear message to those individuals and entities involved in this activity. However, there are limitations on how effective these measures could be.
3. In particular, we are unsure how effective a criminal offence would be in deterring promoters based overseas. We have asked for HMRC's comments on whether it believes the offence could be applied to overseas promoters and we have not received an answer. If the measure does not prove effective, the impact could be to drive promoters overseas, which would be the opposite effect of what HMRC is trying to achieve.

Question 2: What approach to prosecution is needed to support these measures? And is HMRC adequately resourced for the work involved?

4. We believe that a balanced approach is required. In principle we support measures designed to prevent promoters from circumventing stop notices, but at the same time we want to make sure that innocent entities and individuals are not penalised. We talk more about this in our response to the next question.
5. If a criminal offence is introduced for non-compliance with a stop notice as proposed, we believe that such notices should be issued by a body that reflects the seriousness of a criminal offence measure. For example, it could be added to the list of responsibilities of HMRC's Tax Dispute Resolution Board (or the Tax Assurance Commissioners). This would ensure that greater oversight is needed before a notice is issued.

Question 3: Are there sufficient safeguards and appropriate governance around the criminal offence/disqualification measures? How necessary are these additions to HMRC powers?

6. We do not believe that sufficient safeguards are being put in place, based on the draft legislation. We are concerned that the proposed offence could result in a person being successfully prosecuted for failing to comply with a stop notice despite that stop notice subsequently being struck down by the tribunal.
7. We believe that additional safeguards should be included to prevent this, for example that the criminal offence case is referred to the crown prosecution service when the person doesn't comply with the stop notice, but if the person wins their appeal against the notice, then the criminal case is not taken to court.

8. An alternative would be to extend s227A (3) of the draft legislation to specifically state that a person has a reasonable excuse if they successfully appeal against the stop notice. Then that person knows that if they lose their appeal against the stop notice the offence is still relevant, so it would still have potential deterrent effect.

Question 4: What evidence have you seen of people being recruited as directors to "front" companies involved in promoting tax avoidance in return for payment? How can the legislation allowing HMRC to apply for the disqualification of directors best be focussed on directors who have real control and influence over the companies' activities?

9. We do not have any direct experience of this so cannot comment either way as to the extent of any such "shadow directors" being used for this purpose, although we have heard anecdotally that some companies do appoint directors to conceal the identity of the persons involved in the promotion activity.
10. We believe that disqualification should only apply to individuals who were directors of the company concerned at the time that tax avoidance promotion activity was carried out and who had knowledge of this activity. The draft legislation ensures that a court can only make a disqualification order if a person was a director or manager of a company at a time that it was carrying on promotion of tax avoidance and has subsequently been wound up. However, it does not require that the director or manager was involved in or had knowledge of that activity.
11. We therefore suggest that the draft legislation includes a further safeguard to protect directors of companies who were not involved personally in tax avoidance. Such a safeguard could allow directors to demonstrate that they had no knowledge of the promoter activities of the company concerned. We will leave those witnesses with a greater experience of criminal law to comment on the practicality of being able to demonstrate this in a court of law.

Question 5: How should "the public interest" be interpreted in the context of the decision whether to prosecute these offences?

12. This is a difficult question to answer, which highlights the difficulties that HMRC Officers may face in applying this term to individuals.
13. One possible approach could be for the Officer to assess whether the ability of the individual concerned to become a director of another company would cause a material cost to the Exchequer through reduced tax receipts or increased cost of investigating tax avoidance schemes. However, the measure prevents the individual becoming a director of any company, not just one carrying on the promotion of tax avoidance. We would recommend that guidance is worked up and that to inform this a review is undertaken of any existing public interest material which may be relevant. However, we recognise that any guidance would be non-exhaustive.

R&D REFORMS: A POTENTIAL MERGED R&D SCHEME AND ADDITIONAL RELIEF FOR R&D-INTENSIVE SMES

Question 1: How much of a tax simplification would a merger of the two existing R&D schemes be?

14. Our members have told us that while amalgamating the two schemes should, in theory, reduce complexity, as it stands the rules proposed do not simplify matters. The introduction of a separate regime for 'R&D intensive' SMEs means that there will still be two schemes. At present, those schemes relate to SMEs and large companies respectively. Going forward, they would relate to R&D intensive SMEs and other companies. The extension of the

'subsidised' expenditure rules to the merged scheme would also create new complexity for companies currently claiming under RDEC.

15. The existing rules on 'subsidised' expenditure are a significant cause of disputes between taxpayers and HMRC, as evidenced by the recent case of *Quinn (London) Limited* [2021] TC08321. Extending the rules to a merged scheme will arguably make the complications more widespread. For example, it is not clear from the wording of s1138 CTA 2009 whether a project which is only partially funded by way of a grant or subsidy will, in its entirety, be ineligible for R&D tax relief (or only to the extent that the expenditure is so funded).
16. It is vital that these complications are addressed in any merged scheme, both in the interests of simplicity and to provide certainty for businesses that wish to use the scheme. Uncertainty in the application of the rules contributes to making the UK less attractive for R&D activities compared to other jurisdictions, so we would suggest that implementation of a new scheme is postponed until HMRC has had sufficient time to consult on the impact of these issues.

Question 2: How easy will it be for SMEs to adjust to a single RDEC-based scheme for R&D?

17. Some SMEs will already be using the RDEC to claim credits for R&D expenditure, such as where:
    - they undertake certain research and development as a subcontractor;
    - their expenditure is subsidised (and therefore does not qualify under the SME scheme); or
    - the total amount of the aid (e.g. SME credit and vaccine relief) on any one project exceeds state aid or subsidy control rules.

18. However, the majority of claimants will be unfamiliar with RDEC. As the tax credit element of the merged scheme will be modelled on RDEC, SMEs will need time to get up to speed. This should not be insurmountable, but an education campaign will be required which is likely to require longer than is possible under an April 2024 commencement date.
19. Some SMEs will also need to adjust by recognising the tax credit in a different place in the income statement in their accounts than at present. We explain more about this in our response to the next question.

Question 3: If the Government decides to merge the two existing R&D schemes, it has said the merger will take effect from 1 April 2024. What are your views on this timetable? How prepared are businesses, particularly SMEs, for these changes? What help and support will they need?

20. We believe that 1 April 2024 is too early for the merger of the two R&D schemes. There are a number of differences between the SME and RDEC schemes and we believe that further consultation is required to ensure that any difficulties or complexities involved in merging the two schemes are considered properly.
21. Guidance will also need to be drafted to help advisers and companies understand the newly merged scheme so that it is published in advance of the commencement date. Sufficient time will need to be allowed for consultation and review of this guidance also.
22. Many R&D projects involve long-term contracts, spanning several years. This means that there will be some projects which span an existing R&D tax relief scheme and the merged scheme. In some cases, the entity entitled to relief under the contract concerned will change, especially where R&D work is sub-contracted. For example, if a large company subcontracts R&D work to another entity, that other entity is entitled to the tax credit under RDEC. If the

merged scheme awards relief to the principal in such circumstances, that would mean that it switches to the other party.

23. For businesses carrying out R&D activity, certainty and stability in the R&D tax regime is key. Ideally, existing contracts would continue to be dealt with under existing rules, or the entity currently entitled to the relief would continue to do so for the length of the contract. These are the sort of complications that will need to be addressed before the merged scheme is introduced.

24. Existing proposals suggest that the new rules apply to expenditure on or after a given date (currently 1 April 2024). However, for many businesses this approach will result in a 'split year' being created when moving between the two regimes.

25. This is a problem because the nature of the scheme determines whether the tax credit is treated as being 'above the tax line' in the company's accounts. If a company transitioned from the SME scheme part-way through its accounting period, this could cause part of its credit to appear above and part below the tax line in the transitional year. This would increase complexity for the affected businesses. January may be a more appropriate point from which to apply the new rules, due to the significant number of businesses using a December year end. On this basis we think the earliest start date would therefore be 1 January 2025 and ideally a year after that.

Question 4: Are HMRC's estimates of the costs to businesses of adjusting to these changes realistic? How costly is it likely to be for businesses to adapt?

26. The policy paper on the merged scheme states: "The impact on businesses and civil society organisations will be estimated following the final scope and design of the policy." This is unacceptable if the scheme is to be introduced from April 2024. Stakeholders need time to assess the final design and the likely cost impact to advise the government on whether the scheme is good value for money. This suggests again that the commencement date should be deferred until that process is completed.

Question 5: What are your views on how a merged R&D relief scheme should deal with the treatment of subcontracted R&D?

27. We have heard input from a variety of members who deal with a variety of claimant company clients. Any decision on how sub-contracted expenditure is dealt with under the merged scheme will advantage one population over another and therefore it will be impossible to find a solution that suits everyone affected.

28. For example, some members act for organisations in the supply chain as the 'subcontractor' (eg parts manufacturers) entitled to the RDEC who will not be able to claim the relief going forward. This could have a significant impact on the UK's manufacturing and tech industries, predominately based in the UK's industrial heartlands (the Midlands and North of England) and therefore could run counter to the government's 'levelling up' agenda.

29. By contrast, members mainly advising SMEs on their own R&D projects would advocate for the principal to be entitled to the tax credit.

30. The subcontracted R&D rules are likely to necessitate the sharing of information between principal company and subcontractor, for example for the purposes of determining the amount of qualifying expenditure incurred by the subcontractor. This may be difficult to enable in practice and may increase the amount of administration required by the companies involved, as well as HMRC in the event of an enquiry. HMRC may need to apply existing or new powers to obtain information held by third parties in these cases.

31. We understand that if the merged scheme follows a 'subcontractor claims' regime HMRC wishes to ensure that the two companies in such arrangements do not claim relief for the same expenditure. This situation could be prevented by requiring the principal to notify the subcontractor in writing that it cannot also claim the R&D tax credit for subcontracted work.

Question 6: What are your views on the proposed R&D scheme for R&D intensive SMEs? Has Government listened to business, as it said it would be doing, in designing this new scheme?

32. As explained in our response to question 1, we agree with the need to provide greater support to those businesses involved in R&D work that most need it, but we believe that setting up a completely separate scheme outside of the merged scheme creates unnecessary complication.
33. This would be a particular problem for companies transitioning between the merged scheme and the scheme for R&D-intensive companies. Not only will such companies need to apply a new set of rules each time they transition, they may have carried forward amounts from the merged scheme that it is difficult to know what to do with.
34. The measure was announced unexpectedly in the 2022 Autumn Statement without any prior public consultation. There has been little change to the proposed regime since then, other than to provide more clarity in determining whether a company is R&D-intensive.
35. We do not believe that the level of R&D intensity of a company is a good measure of whether it deserves more support from the government or not.
36. Support would probably be of most use in the early-stage years of a company before it has had time to develop an established customer base. Such companies may or may not be R&D-intensive under the definition used in the legislation.
37. We are also in the peculiar position that the R&D-intensive scheme applies to expenditure on or after 1 April 2023 but companies cannot claim under that scheme yet because the legislation implementing it is not in place. This is a further indication of the speed with which this measure was announced without the accompanying consultation.

Question 7: Is the additional support for R&D intensive SMEs appropriately targeted to incentivise the types of innovation the Government wants to encourage?

38. It is difficult to know what type of innovation the government wants to encourage. The policy paper published on Budget Day 2023 stated: "The government recognises the value of R&D intensive SMEs to the UK's wider innovation ecosystem, and the particular difficulties such SMEs face when raising capital – for example, in their pre-revenue phase – to support innovation." We agree that early-stage companies need to be supported the most and so would benefit from obtaining larger tax credits. However, this could be determined with reference to their position in the company life cycle, rather than their level of R&D intensity.

ADDITIONAL HMRC DATA REQUIREMENTS

39. Our comments in this section are focussed on the proposed requirement to provide details of employee hours worked. We have fewer concerns around the requirement for the self-employed to provide details of the start of their business (albeit this can sometimes be difficult to define precisely) and shareholders splitting their dividend income information between portfolio holdings and those derived from close companies.

Question 1: How straightforward will it be for businesses to provide this data to HMRC?

40. Most employers do not currently collect data on actual hours worked by employees. Although most salaried employees have a set number of contractual hours per week or month, they will often work more or less than that due to work pressures, holiday etc.

41. Additionally, employee's contractual hours are likely to change more often than in the past due to increasingly flexible working arrangements being offered by employers. Hence, if an employer records an employee's hours when they first commence employment with the organisation, this may change subsequently.

42. Data collected for the purposes of the proposed measure are therefore likely to be an estimate based on contractual hours. A preponderance of home working since the pandemic should make it even harder for employees to keep a track of their hours when often work life and home life start to bleed into each other.

43. The proposed measures will place an additional compliance burden on employers without resulting in accurate information being received by HMRC.

Question 2: How accurate are the one-off and continuing costs of implementing the measure? And to what extent are these proportionate to the expected benefits?

44. We consider that the one-off cost is likely to be significantly higher than the total cost of £35m estimated by HMRC. In most cases, employers would need to require employees to complete timesheets or clock in and out of their place of work to collect accurate data which would involve significant additional infrastructure.

45. According to the government's own statistics, there are approximately 1.4m employers in the UK. Based on this figure, the government is therefore estimating that it would cost on average £25 for each business to set up the infrastructure it needs to collect hours worked data. We believe that this estimate is far lower than it will be in practice.

46. There are also likely to be more than 'negligible' ongoing costs for employers in collecting and providing the information. The summary of responses to the measure included comments from software and payroll providers that the expected benefit of the data did not outweigh the burden on business.

Question 3: If this measure is implemented, what should be the timetable?

47. We believe that further consultation is required to demonstrate what need HMRC believes this measure is addressing. We also believe that businesses should be given sufficient time to prepare recording keeping systems. We welcome HMRC's reassurance that this measure would not be implemented until at least 2025-26 and consider that a further two years' preparation time would be appropriate.

Question 4: How confident are you that the measure will deliver the benefits claimed for it?

48. We consider that it is likely that information submitted to HMRC will be based on estimates and therefore will not provide the accurate information that HMRC is seeking. As such we are not confident that introducing a reporting requirement will deliver additional benefits.

49. Furthermore, we are not entirely sure what the intended benefit is for collecting this information. In the original consultation document on employee hours, the government stated; "Having a more detailed understanding of the hours that employees work would help with the analysis of labour market trends across government. It would help improve government interventions in the labour market through increasing our understanding of both voluntary part-time work and underemployment." However, the legislation implementing this

measure states that the information requested must be to facilitate the collection or maintenance of tax. If the latter is not the true reason for collecting the data then it is debatable whether the draft legislation could be enforced.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).