12 October 2023

House of Lords Economic Affairs Committee - Finance Bill Sub-committee

Draft Finance Bill 2023-24

Evidence from ICAS

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 23,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 11,000 of our members are based in Scotland and 10,000 in England.

2. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.

3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and regulatory system design, and to point out operational practicalities.

General comments

4. We welcome the opportunity to give evidence to this inquiry into the draft Finance Bill 2023-24.

Specific questions

Dealing with promoters of tax avoidance and increasing the maximum prison term for tax fraud

Q1: 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?

5. Our comments only relate to the proposed criminal offence for promoters. We have no evidence on which to base any comments on the other measures.

6. The government and HMRC have taken extensive action over the last two decades to tackle tax avoidance, with considerable success. The element of the 'tax gap' relating to tax avoidance has reduced from £3.7bn in 2005-2006 (of which £1.5bn related to marketed avoidance) to an estimated £1.4bn in 2021-2022, of which about £0.5 bn relates to marketed avoidance schemes sold primarily to individuals [Measuring tax gaps 2023 edition: tax gap estimates for 2021 to 2022 - GOV.UK (www.gov.uk)].

7. Action by the main professional bodies which subscribe to Professional Conduct in Relation to Taxation (PCRT) has also played a part. The standards on tax planning were introduced into PCRT in 2017 and include: "Members must not create, encourage or promote tax planning arrangements or structures that: i) set out to achieve results that are contrary to the clear intention of Parliament in enacting relevant legislation; and/or ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation."

8. Other requirements include that tax planning must be client-specific, lawful (based on a credible view of the law – with any uncertainties highlighted to clients) and based on full disclosure to HMRC [Professional Conduct in relation to Taxation | ICAS]. As the 2023 consultation [Tougher consequences for promoters of tax avoidance] notes, promoters are rarely members of professional bodies.

9. As also mentioned in the consultation, many promoters and enablers have left the avoidance market, as a result of wide-ranging actions taken in earlier years. Of those remaining, we understand that many are based outside the UK. For the new offence to act as an effective deterrent it is essential that promoters of marketed schemes believe that they could be successfully prosecuted and subject to the criminal sanctions.

10. Whilst UK-based promoters might believe that prosecution is a realistic prospect, it is unclear how HMRC would be able to act against promoters based outside the UK. The government response to the 2023 consultation noted that concerns had been raised about how the offence would apply

to offshore promoters and stated: “The UK has one of the world’s largest networks of tax treaties and exchange agreements and HMRC regularly uses this to exchange information with other countries’ tax authorities. This includes asking for information to help with investigations into tax avoidance schemes and the companies and agents who promote them.”

11. If the new offence is to deter non-UK based promoters, it will need to be much clearer how action will be taken against them – and this would need to be publicised to the promoters.

12. We support efforts to tackle the remaining promoters of marketed schemes, including the measures in Finance Act 2022 which allowed HMRC to publish details of specific avoidance schemes and their promoters at a much earlier stage. Our members report problems where promoters approach their clients with avoidance schemes; early publication of details by HMRC is useful in allowing them to explain the possible consequences of entering into these schemes.

13. However, we are concerned that individuals who do not take any independent advice may be unaware of the published list (and other HMRC guidance on avoidance schemes) and are still being drawn into schemes which will leave them facing unexpected tax bills. Information published by HMRC in its list of schemes and promoters indicates that most of the remaining marketed avoidance schemes relate to disguised remuneration.

14. In addition to measures like the proposed criminal offence, it is important that HMRC continues to develop improved and more targeted communication to individuals. We also continue to believe that both the Scottish and UK Governments could take action to prevent employees (particularly lower paid ones) being pushed into disguised remuneration schemes. Government departments and public sector bodies taking on workers should be required to ensure that their procurement policies and contractual arrangements preclude the use of agency or umbrella companies using any type of disguised remuneration scheme.

Q2: What approach to prosecution is needed to support these measures? And is HMRC adequately resourced for the work involved?

15. We regularly call for HMRC to be given adequate resources to enable it to provide acceptable service levels for taxpayers and agents. HMRC’s role is no longer confined to running the tax system but has expanded into other areas, such as student loans. Resources have not kept up and the result has been an adverse impact on its core role of administering the tax system.

16. HMRC service levels have steadily deteriorated since 2019 which is having a significant impact on agents and taxpayers who need to engage with HMRC. 2023 has seen the closure of the main self assessment helpline for taxpayers for three months and two periods of restrictions on the main agent helpline (and a permanent reduction in service levels from October).

17. A survey conducted by members of the Charter Stakeholder Group earlier this year indicated widespread problems with HMRC’s performance against its Charter standards. Respondents gave very low scores to HMRC for its performance on ‘Being responsive’ (average 2.3 out of 10), ‘Making things easy’ (average 2.7 out of 10) and ‘Getting things right’ (average 3.4 out of 10).

18. Against this backdrop, we are concerned that giving HMRC any additional responsibilities, without providing extra resources to deal specifically with the new work involved, will lead to the diversion of existing resources and even further deterioration of core services to agents and taxpayers who wish to comply with their tax obligations.

Q3: Are there sufficient safeguards and appropriate governance around the criminal offence/disqualification measures? How necessary are these additions to HMRC powers?

19. We have had little feedback from our members about the proposals; as indicated in paragraphs 7 and 8 above, PCRT requirements on tax planning mean that promotion of tax avoidance schemes would breach PCRT, and promoters are not generally members of professional bodies.

20. However, we are aware that concerns have been raised about the lack of proper safeguards. The ‘stop notice’ regime was not designed or introduced on the basis that promotion in breach of a

stop notice could lead to criminal prosecution. In principle, we therefore agree with the suggestion made by the CIOT, that there should be some independent oversight of HMRC's initial decision to issue a stop notice. Reliance solely on HMRC's internal procedures at that initial stage could be inappropriate, particularly if adequately trained resources are not available.

Q4: What evidence have you seen of people being recruited as directors to "front" companies involved in promoting tax avoidance in return for payment?

21. We have no evidence on which to base a response to this question.

Q5: 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?

22. We have no comments on this question.

Q6: How should "the public interest" be interpreted in the context of the decision whether to prosecute these offences?

23. We note the government's comments that the new criminal offence will be reserved for the most serious cases where HMRC needs to send a strong deterrent message or where civil investigations are ineffective. If HMRC decides to proceed with a criminal investigation, it would still be for the relevant independent prosecuting authority to decide whether to bring a charge based on the evidence and whether prosecution would be in the public interest.

24. Key factors that could usefully be considered in determining whether it is in the public interest to prosecute would be firstly, persistent involvement in the promotion of schemes and secondly, the adoption of the behaviours outlined in the 2023 consultation and the previous consultation [Clamping down on promoters of tax avoidance] to try to delay or sidestep action from HMRC.

25. Another factor to be considered could be the targeting of lower paid and unrepresented taxpayers by promoters. Sir Amyas Morse, in his report on the loan charge, noted that those affected by the charge were not the 'usual suspects', ie large corporates with advisers or very rich individuals.

26. He went on to say that those who were affected "are frequently on mid-range or lower incomes, coming from industries like construction, IT and oil and gas, as well as financial or business services. It is clear to me that many of those affected may not have been fully aware what they were doing when using loan schemes or failed to distinguish between genuine professional advisers and those acting more as salespeople. Certain of them felt that they had little option but to use the schemes."

27. As we outlined above, we would like to see more action taken to prevent lower paid, unrepresented workers from being drawn into these schemes in the first place. Where promoters do target these individuals, it would be in the public interest for this to be taken into account by the prosecuting authorities, when considering whether to bring a charge.

R&D reforms: a potential merged R&D scheme and additional relief for R&D-intensive SMEs

28. Since 2021 and the launch of the review of R&D reliefs, there have been a series of consultations and changes to the R&D tax relief regime, alongside reforms to HMRC's compliance approach for dealing with error and fraud.

29. We strongly support efforts to tackle abuse, and some of the individual compliance changes (such as the requirement to file an Additional Information Form (AIF)) should be helpful. However, the overall effect of reforms and consultations over a short period has been to produce considerable uncertainty and instability. This has not been helped by the reduction of the SME rates of relief from April 2023 (quickly followed by the announcement of increased rates for R&D intensive SMEs, also from April 2023). From 1 April 2024, the previously announced restrictions on overseas costs will also come into effect.

30. Further uncertainty has been generated by HMRC's approach to the rules on contracting and subsidised expenditure. The challenges in this area are highlighted by the recent First-Tier Tribunal cases of Hadee Engineering and Quinn, with significantly different interpretations of the rules by agents (and professional bodies) and HMRC.

31. We regularly receive feedback from members on the importance of certainty and stability in the tax system, in encouraging business investment. This is particularly important for R&D where long term projects are being planned and contracts may extend over several years. Changes at short notice cause difficulties with contracts potentially needing to be renegotiated, and may deter some companies from investing at all.

32. We would like to see more time taken to consult on the details of a merged, simplified scheme for R&D reliefs, and a longer implementation period that allows companies to plan and prepare.

33. As set out in our evidence to the Sub-committee last year, we have extensive feedback from our members about the problems caused by some 'rogue' agents (generally not members of professional bodies) offering R&D claims services. Often the claims do not appear to have any sound basis or ignore the detailed rules.

34. We support efforts by HMRC to tackle fraud and error. However, we are now receiving feedback that one aspect of HMRC's R&D compliance work, the 'volume compliance' approach to R&D claims conducted by HMRC's ISBC team, is causing problems (and significant costs) for some legitimate SME claimants. This will deter future investment unless changes are made to ensure that claims are properly considered, on a timely basis, by appropriately trained and qualified HMRC staff. We would like to see immediate action from HMRC to ensure that there is a clear escalation route for legitimate claimants involved in ISBC enquiries.

35. The introduction of the AIF, which must be submitted with all R&D tax relief claims from 8 August 2023, should give HMRC more information (particularly about agents involved in R&D claims) to allow it to target its SME compliance activities more effectively on abusive claims. It would be helpful to take some time to assess the impact of the AIFs (and the pre-notification requirements) before finalising the details of any merged scheme for relief. It might be possible for a new scheme to be more generous (or simpler) if the prevalence of abuse is significantly reduced.

Specific questions on R&D:

Q1: How much of a tax simplification would a merger of the two existing R&D schemes be?

36. In our response to the 2023 consultation on a possible merged R&D tax relief scheme, we supported the government's aim to introduce a simplified, single relief based on the current Research and Development Expenditure Credit (RDEC) scheme.

37. We would still support such a scheme, but the current draft legislation falls short of delivering one. It includes legislation for a merged scheme to be introduced from April 2024 (if the government decides to proceed), but this significantly diverges from the existing RDEC scheme in the important area of contracting, and leaves uncertainty on the treatment of subsidised expenditure (this part of the draft legislation is in square brackets because it is still under consideration).

38. The draft legislation also introduces a separate scheme providing additional relief (through a higher rate of payable credit) for R&D intensive SMEs from April 2023. According to the explanatory note "those entitled to this higher rate would, from April 2024, continue to claim under rules similar to the current SME scheme rather than under the merged scheme, should it be introduced."

39. The continuation of two separate schemes undermines any simplification benefits. The additional relief for R&D intensive SMEs was announced in the March 2023 Budget (with an effective date of April 2023, although final claims cannot be made until the legislation is enacted) so it seems

inevitable that this will proceed. However, in the longer term, if a merged scheme is implemented, consideration should be given to integrating the additional reliefs for R&D intensive SMEs into the single scheme, with a suitable transition period to minimise further uncertainty and disruption.

Q2. How easy will it be for SMEs to adjust to a single RDEC-based scheme for R&D?

40. See our response to Question 3 below.

Q3. 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?

41. This is not a realistic timetable. It is likely to have an adverse impact on the financing of projects already in progress, where the planning was based on the current rules (and in the case of SMEs, on higher rates of relief than those generally available to SMEs from April 2023).

42. Until the legislation is enacted, it is impossible for businesses to prepare. The current draft legislation leaves considerable uncertainty around many fundamental areas, particularly whether relief will continue to be available in respect of subsidised expenditure and contracted R&D. Even after the legislation is finalised HMRC will need time to prepare detailed guidance, which will be essential for SMEs.

43. Our strong preference would be for a longer period of consultation on the details of any merged scheme and a longer implementation period, to allow businesses (and HMRC) to prepare. This would also permit an assessment of the impact of compliance changes (particularly pre-notification and AIFs) which might influence some aspects of a new unified scheme.

Q4: 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?

44. The impact assessment in the policy paper relating to the merged scheme states that "the impact on businesses and civil society organisations will be estimated following the final scope and design of the policy. One off costs could include familiarisation with the changes and updating systems to reflect them. There is not expected to be any continuing costs."

45. Given the uncertainty about whether a merged scheme will go ahead and the likely final rules if it does, we cannot usefully comment on the potential costs for businesses.

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

46. In our response to the 2023 consultation, we stressed the importance of taking into account the wide variety of different commercial arrangements between the parties engaged in R&D activities, which determine where the economic risk lies. The current schemes are also designed to ensure that relief cannot be claimed more than once on the same expenditure.

47. We are concerned that the government may not be aware of the full spectrum of commercial arrangements under which R&D can be undertaken. Whilst the application of the rules at either end may appear clear, there will be areas in between where it is less obvious.

48. At one end of the spectrum, an arrangement could involve a company (A) engaging another company (B) to undertake R&D on its behalf, with company A bearing all economic risk, directing the R&D activity and owning any IP generated. At the other end, company A could contract with company B to manufacture a bespoke product, with payment due on delivery, without knowing that company B will need to undertake R&D to fulfil the contract. In between these extremes, there are multiple possibilities, with parties negotiating staged payments (for example, on completion of technical milestones) and negotiating about the ownership of any IP. Factors such as who bears economic risk, who directs the R&D and who owns the IP will vary.

49. Our 2023 consultation response set out our preferred option for a merged scheme: the default position would be that the subcontractor could claim R&D relief (with the requirement that the activities of the subcontractor represent an R&D project in their own right). However, given the range of contractual arrangements that can be negotiated - and the different consequences for economic risk, ownership of IP and direction of the R&D activities - this default position would not always be appropriate. We therefore proposed that the parties should be able to make a joint election to permit the contractor to claim, where appropriate. This would provide certainty over who would claim, and the risk of both parties claiming would be mitigated.

50. The draft legislation adopts a different approach that allows the contractor to claim relief in most cases. This is similar to the approach in the current SME rules on contracted out R&D. To avoid relief being claimed twice on the same expenditure, subcontractor companies will no longer be able to claim relief (except in limited circumstances where the contracting company is not within the scope of UK corporation tax). We do not consider that this approach takes sufficient account of the range of commercial arrangements and allocation of economic risk, as set out above.

51. Further consultation on the details of a merged scheme would allow the treatment of contracting (and subsidised expenditure) to be considered in more depth. A longer implementation period would also permit long term commercial contracts to be renegotiated where necessary.

Q6: 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?

52. The proposed scheme for R&D intensive SMEs appears to have been a rushed response to concerns raised about the general reduction in the rates of SME relief from April 2023. It took effect without any legislation, or details of the qualifying conditions, being available.

53. It is not well-designed; we have concerns that the cliff-edge nature of the 40% threshold, to qualify as R&D intensive, could drive boundary pushing and abuse. As set out in our response to Question 1, it also undermines any simplification benefits that would arise from a merged scheme.

54. If the government wanted to introduce higher rates of relief for certain companies, it would have been preferable to take the time to design one overarching framework, which incorporated two different rates of relief. Proper consideration could also have been given to determining the appropriate defining characteristics of those companies or projects which would qualify for enhanced support, to achieve the government's policy objectives.

Q7: Is the additional support for R&D intensive SMEs appropriately targeted to incentivise the types of innovation the Government wants to encourage?

55. It is unclear what types of innovation the government does want to encourage. Granting additional relief to companies with expenditure on any type of qualifying R&D that crosses a certain threshold, is a blunt instrument. If the policy objective is to stimulate economic growth, it is not clear how the additional relief for R&D intensive SMEs will meet that objective, as relief could be claimed for R&D that does not have any significant positive impact on growth.

56. If the government wants to encourage R&D relief that drives economic growth, or facilitates the expansion of specified sectors with future potential (for example, life sciences or robotics), a far more targeted approach would be beneficial.

Additional HMRC data requirements

Q1: How straightforward will it be for businesses to provide this data to HMRC?

57. The 2022 consultation [Improving the data HMRC collects from its customers] included wide-ranging proposals, some of which would have imposed onerous administrative burdens on businesses. Some of the information did not relate to tax and would have been collected by

HMRC for other government departments; we commented that this would be inappropriate, in view of HMRC resource constraints and the risk of undermining trust in HMRC.

58. We welcomed the government's response to the 2022 consultation which confirmed that the most onerous proposals for businesses, relating to sectoral, occupation and location data will not be implemented for the time being, but will be kept under review, whilst the government continues to look for ways to improve data it already holds.

59. The draft legislation therefore relates to the collection of information in three areas, which we can see will be relevant to HMRC's work in administering the tax system. However, it is unclear whether HMRC intends to share information with other government departments. If it does, there should be further consultation and a clear explanation of what will be shared, with whom and why. HMRC's ability to share information is restricted by the Commissioners for Revenue and Customs Act 2005, so unless a 'legal gateway' already exists, legislative change would be required.

60. The legislation in the Finance Bill will enable the Commissioners to make regulations to specify the information to be collected. In the absence of the regulations, it is difficult to comment in detail on how straightforward it will be for taxpayers to comply. HMRC should publish draft regulations for consultation as soon as possible.

Employee hours worked

61. The government response to the 2022 consultation recognises that HMRC needs to work closely with businesses and software providers to ensure clear definitions and requirements and adequate time for implementation of changes. HMRC should commence this vital work as soon as possible.

62. Draft regulations should also be published as soon as possible for consultation. Providing the additional information will require software and process changes which can be time consuming to implement. The scope of the required changes needs to be established quickly.

63. Many employers outsource their payroll function, so will also require time to agree any new procedures with their payroll providers.

Dividends paid to shareholders in owner-managed businesses

64. Feedback we received from our members on the proposals indicated that there would be no significant practical problems, provided that the percentage shareholding information is only required for directors (as the 2022 consultation indicated would be the case). Close company ownership structures can be complex, and many will involve split ownership between connected parties.

65. The government response to the 2022 consultation explicitly confirms that the intention is to "request specific information on the SA 102 form [employment tax pages] pertaining to the value of dividends and percentage shareholding in a close company of which the individual is a director." It is important that the scope is not extended to cover all shareholders.

66. The government response also recognised that ownership structures can be complex and stated that HMRC will work closely with businesses to ensure clear definitions and requirements and adequate time for implementation. As with the information on employee hours, we would like to see HMRC beginning the consultation work as soon as possible; provided this happens, we believe that the requirements should be workable.

Self-employed start and end dates

67. Again, we do not see any significant problems with this proposal. Subject to confirmation of the details, it should be reasonably straightforward for taxpayers to provide this information.

68. However, we commented in our response to the 2022 consultation that unrepresented taxpayers may not always find it easy to identify their start date, particularly where, for example, a hobby has

developed into a business. HMRC will need to provide guidance, linked to the completion of the SA return. This could incorporate, or link to, some of the content already on GOV.UK which deals with: 'Working for yourself'; 'Check if you need to tell HMRC about additional income' and 'Tax-free allowances on property and trading income'.

69. Historically, HMRC also published guidance (now archived), including some useful examples that covered moving from a hobby to trading, situations where capital gains tax would be likely to be relevant rather than trading – and the difference between clearing out unwanted items and trading. Something similar (with updated examples) might be useful to unrepresented taxpayers trying to identify whether, and when, they started trading.

Q2: How accurate are the one-off and continuing costs of implementing the measure? and to what extent are these proportionate to the expected benefits?

70. It is impossible to comment on the likely accuracy of HMRC's estimates of the one-off and continuing costs, when the exact details of what will be required are currently unknown.

Q3: If this measure is implemented, what should be the timetable?

71. As noted above, it is important that taxpayers and software providers have adequate time for preparation. This is particularly important for the requirement to report employee hours. Whether the proposed implementation date of the 2025-26 tax year is achievable will depend on how quickly HMRC publishes regulations and undertakes the detailed consultation required for the first two categories of information and on its ability to produce guidance for all three categories.

72. Progress should be kept under review; if it becomes clear that the proposed timetable is unrealistic, implementation should be postponed.

Q4: How confident are you that the measure will deliver the benefits claimed for it?

73. The government claims that the measure will provide better outcomes for taxpayers and businesses, improving compliance, and resulting in a more resilient tax system. Whilst we do not agree with the sweeping claim that the result will be a more resilient tax system, we can see that there are potential benefits arising from the collection of some of the information.

74. We agree with the suggestion in the 2022 consultation that the information about dividends will give HMRC a better view of the total remuneration package for owner managers, which will help HMRC to target its compliance activities. Better targeting of compliance activities helps compliant taxpayers, as they are less likely to be subject to a compliance intervention. Having this information would also have been useful during the pandemic, as it would potentially have enabled the government to provide more support to owner managers.

75. The consultation suggested several reasons why information on start and end dates would be helpful. Many of these seem unlikely, given the delay between business commencement or cessation and the filing of the return. However, reporting the date of cessation, could be helpful to taxpayers as their self employment might have been the only reason for them to be in self assessment. Where that is the case, HMRC should be able to update its systems and stop issuing notices to file, reducing the risk of penalties being incurred for failing to file returns.

76. It is more difficult to see significant benefits arising from the collection of the additional employee data. Potentially, reporting actual hours could assist HMRC with minimum/living wage compliance, particularly for employees working irregular hours. However, we cannot see any benefits for employers, who will incur additional costs and administrative burdens to enable them to provide the extra information.

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