Low Incomes Tax Reform Group
A voice for the unrepresented

Treasury Committee Inquiry into the 2017 Spring Budget and Finance Bill
Response by the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 Given the focus of LITRG's work, we comment solely on measures affecting those on low incomes, judged against the principles of tax policy set by the Treasury Committee.

1.2 As with previous submissions, we do not intend to score the tax measures in the 2017 Spring Budget and Finance Bill numerically – rather, we have simply commented on those which concern us and outlined how we think they stand against the principles, including comments on how the measures could be adjusted such that they score more highly.

1.3 In summary:

- The income tax charge and rates are in themselves uncontroversial, but the plethora of different rates at which different types and bands of income are charged to or exempted from tax make it very difficult for an ordinary unrepresented taxpayer to understand what tax they should be paying and how to secure the exemptions and allowances to which they may be entitled.

- The new optional remuneration rules allow most employees to benefit from salary sacrifice arrangements in respect of certain benefits such as pensions, but the lowest paid are unable to benefit from such arrangements because of the rules surrounding the National Minimum Wage (NMW). The interaction between the two produces an unfairness which ought to be remedied by adjusting the NMW regulations.

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- The pensions advice annual allowance is a good way of encouraging employees to take proper pensions advice, even though the amount allowed – while greater than originally proposed – barely pays for a few hours of an independent financial adviser's (IFA) time.

- Regarding the money purchase annual allowance (MPAA), we fully understand that the Government wishes to limit the extent to which pensions tax relief can be claimed more than once; but think that two important safeguards are absent from these proposals: first, there should be a mechanism to keep the MPAA under review at least annually; and secondly, the taxpayer should be able to recover from the pension fund any tax charged as a result of inadvertently exceeding the MPAA.

- While ostensibly there may be some fairness in all pensioners paying the same amount of tax on their pension income, the lower taxation of overseas pensions has in the past done something to compensate recipients of those pensions for the added costs they incur.

- The new trading and property income allowances are to be welcomed in that they will support growth, and they are easily understood, clear and practicable. There is however a lack of coherence in that the trading and property income that is covered by these tax allowances is still taken into account for means tested benefits.

- The discretionary remedy provided for policyholders who find themselves with a wholly disproportionate tax charge on certain surrenders or assignments of part policies will produce much fairer outcomes than hitherto, but is uncertain in its application and lacks the essential safeguard of a right of appeal.

- The new requirements a disabled motorist must fulfil in order to be able to claim VAT zero-rating on an adapted vehicle is primarily an anti-avoidance measure, but in attempting to stamp out the abuse the proposals will also deter, and in some cases even prevent, genuine claimants from taking advantage of the relief that was intended for their benefit.

- It is impossible to comment on how well the proposals on digital record-keeping and reporting measure up against the Committee's principles of tax policy, because they are merely enabling clauses with the substance to be contained in regulations which are yet to be published. But we fear that they may distort competition because the smaller businesses will spend a disproportionate amount of time in training and equipping themselves to meet HM Revenue & Customs' (HMRC) demands rather than running their business activities. We suspect that the mandatory nature of the new regime is an over-reaction to a particular problem with record-keeping that could be fixed by less intrusive methods.

2 About Us

2.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

3.1 The principles set by tax policy should:

1) be fair;

2) support growth and encourage competition;

3) provide certainty without regular recourse to the courts – which in turn requires legal clarity, simplicity and targeting (so that taxpayers are clear whether or not they are liable for particular types of charges to tax);

4) provide stability, with minimal change unless there is a justifiable economic or social basis;

5) be practicable, meaning that a person's tax liability should be easy to calculate and straightforward and cheap to collect; and

6) be coherent, with new provisions complementing the existing system rather than conflicting with it.

3.2 We comment on a number of tax measures in the 2017 Budget and Finance Bill as compared to the above principles.

4 Specific measures

4.1 *Income tax charge and rates (clauses 1 – 5)*

4.1.1 These clauses usher in the rates of tax on income, including savings income, for 2017/18 and fix the savings nil rate band for the year. The amount of dividend income charged at the nil rate is also reduced from £5,000 to £2,000 for 2018/19 and later years.

4.1.2 These measures are seemingly uncontroversial, but they mask some of the most complex interactions between different rates in the entire tax system. Above the personal allowance, non-savings and non-dividend income is subject to the basic rate while savings income benefits from (a) a further 'personal savings allowance' which is £1,000 for basic rate taxpayers, £500 for higher rate taxpayers and nil for additional rate taxpayers, and (b) a starting rate on savings of nil per cent if total income is no more than £5,000 above the personal allowance in which is included some savings income; while the first £5,000 of dividend income is charged at nil and the remainder at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. The problem is compounded by the introduction, this year, of further allowances in respect of the first £1,000 of trading income and the first £1,000 of property income.

4.1.3 We are not unappreciative of the opportunities now enjoyed by taxpayers on low and modest incomes to save so much tax, but to take full advantage of them requires such mathematical agility that we think many unrepresented taxpayers will fail to do so. The complexity of these arrangements is such that not even HMRC's software can cope with the resulting calculations – see http://www.accountingweb.co.uk/tax/hmrc-policy/errors-in-tax-return-software-force-paper-filing. While generous, and born of a desire for fairness to taxpayers on low and modest incomes, this group of provisions nevertheless scores low in terms of certainty, simplicity and legal clarity.

4.1.4 About the level of the personal allowance (£11,500) as compared with the NIC primary threshold (lagging behind at £8,164) and the universal credit work allowance (see http://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/calculating-universal-credit/, first table), the views we set out in our submission on the Autumn Statement remain unaltered (see http://www.litrg.org.uk/sites/default/files/files/161208-LITRG-response-Assessment-of-tax-measures-Autumn-Statement-FINAL.pdf).

4.2 *Optional remuneration arrangements (clause 8)*

4.2.1 There is a fairness issue here. Employees will continue to be able to enjoy favourable tax and National Insurance treatment in respect of pensions, childcare, Cycle-to-Work and ultra-low emission cars; but those on incomes at or near the NMW will be barred from taking advantage of such arrangements, since their cash earnings cannot be reduced below NMW rates. This leaves the lowest earners at a disadvantage compared with those doing broadly similar work but on slightly higher wages.

4.3 ***Pensions advice (clause 12)***

4.3.1 Broadly this clause (which allows employees to claim a tax-free benefit where their employer provides up to £500 worth of pensions advice in a tax year) exhibits good policy making. It recognises and attempts to deal with the increased complexity of the pensions field since the liberating reforms of 2015, and encourages contributors to pension schemes to take proper advice about their options.

4.3.2 While the £500 limit is a substantial increase from the provisions it replaces under which the benefit is capped at £150, we would have preferred at least £1,000 given that £500 will barely pay for two or three hours of an IFA's time, and a good IFA should spend at least two hours carrying out a proper fact-find before beginning to give advice on options. The well-advised might react to this by spreading their engagement with the IFA over two tax years – the fact-finding meeting on 5 April, say, and the advice meeting on the 6th or 7th – in order to claim two annual limits of £500.

4.4 ***Money purchase annual allowance (MPAA) (clause 16)***

4.4.1 The MPAA is intended to put a limit on the amount that individuals who have already accessed pension savings can recycle back into pensions, thereby benefiting from tax relief a second time. This clause reduces the MPAA from £10,000 to £4,000.

4.4.2 We think that two important safeguards are absent from these proposals: first, there should be a mechanism to keep the MPAA under review at least annually; and secondly, the taxpayer should be able to recover from the pension fund any tax charged as a result of inadvertently exceeding the MPAA.

4.4.3 We fully understand that the Government wishes to limit the extent to which pensions tax relief can be claimed more than once. But there is a risk too of double taxation. For example, if an individual withdrew an amount from their pensions savings in order to repay a mortgage, then reinvested their new-found disposable income back into their pension scheme, they would be limited to reinvesting £4,000 a year, or £333 a month. Without fully understanding the complexities of the tax rules governing pensions saving, they could soon end up with an unexpected and unbudgeted-for tax bill which they might be unable to pay.

4.4.4 For reasons of certainty and practicability, an individual in such a position should be able to recover the tax charge from the pension fund; otherwise they might have to withdraw a further sum from the pension scheme in order to pay the tax, thus incurring a further tax charge on 75% of the amount of the withdrawal – a complex and unfair case of double taxation.

4.5 ***Overseas pensions (clause 17)***

4.5.1 We commented in our submission on the Autumn Statement on the Government's proposals to bring the tax treatment of overseas pensions into line with those based in the UK. While ostensibly there may be some fairness in all pensioners paying the same amount

of tax on their pension income, the lower taxation of overseas pensions has in the past done something to compensate recipients of those pensions for the added costs they incur.

4.6 ***Trading and property allowances (clause 20 and Sch 6)***

4.6.1 The proposed trading and property allowances are to be welcomed in that they allow individuals a bit of flexibility between setting up a small part-time business and seeing if it will work or moving from a hobby to trading without being put off by the formalities of registering with HMRC, etc. To that extent they will support growth, and they are easily understood, clear and practicable.

4.6.2 There is however a lack of coherence in that the trading and property income that is covered by these tax allowances is still taken into account for means tested benefits. Thus, a universal credit claimant must declare that income in their monthly returns to the Department for Work and Pensions (DWP) even though they are not required to report it to HMRC. More confusingly, there are similar allowances in pension credit, but of different amounts which could be £5, £10 or £20 a week depending on the claimant's circumstances.

4.6.3 Another concern is that there has so far been a complete absence of publicity, and if the people who would benefit from these allowances do not know about them then take-up will be seriously compromised (cf the marriage allowance). That is not so much a function of the policy itself but of its implementation, but it does diminish the value of the allowances in terms of their practicability.

4.7 ***Life insurance policies: recalculating gains on past surrenders (clause 22)***

4.7.1 We broadly welcome this change as it lays to rest a perennial unfairness in the taxation of part surrenders and part assignments of life policies, thereby making the charge potentially much fairer for policyholders. But we echo the comments of our CIOT colleagues in their submission about the absence of a right of appeal. Giving the right to have a tax charge recalculated if the strict wording of the legislation leads to a wholly disproportionate result is to be welcomed, but it is a discretionary remedy and if there is no appeal against HMRC's refusal to apply it in an individual case, or against the method of calculation used, recourse must be had to judicial review which because of the high fees involved is wholly inappropriate for the kind of individual taxpayer hitherto affected by the problem this legislation is intended to address.

4.7.2 Having consulted on a range of solutions to the legislative problem, HMRC are adopting none of the solutions they themselves proposed, but are instead implementing a discretionary remedy to be set out in greater detail in guidance. But that guidance may not be available by the time Parliament debates the clause, so it is as yet uncertain what HMRC will regard as wholly disproportionate, what precisely is the just and reasonable method of recalculation, and how unrepresented taxpayers will know that they have a right to ask for a recalculation.

4.7.3 In short, while removing a manifest unfairness which arises from the strict words of legislation, the Government have introduced a remedy which is uncertain in its application

and lacks the essential safeguard of a right of appeal. We do nevertheless acknowledge that it will produce much fairer outcomes for policyholders in the future.

4.8 ***VAT – zero-rating of adapted motor vehicles (clause 57 and Sch 19)***

4.8.1 This is primarily an anti-avoidance measure designed to stop exploitation of a relief for disabled motorists, but in attempting to stamp out the abuse the measure will also deter, and in some cases will actually prevent, genuine claimants from taking advantage of the relief that was intended for their benefit. We would argue that such treatment is unfair to those with a genuine need which will be compromised, and incoherent in that it conflicts with the original aim of the legislation which was to ensure that the tax system did not place unnecessary barriers in the way of disabled motorists adapting motor vehicles for their use.

4.8.2 For instance, once a disabled motorist has acquired an adapted vehicle and claimed relief, they cannot claim relief on another vehicle in the next three years unless there is a change in their condition, in respect of which they have to satisfy HMRC (or unless, quite rightly, the original vehicle is written off or stolen). We would argue that three years is longer than necessary to necessary to guard against abuse of the relief; that a change in the motorist's circumstances within the three years (for example an addition to their family) should be capable of justifying acquiring a new vehicle, not just their condition; the relief should be available to users of prosthetics, not just wheelchairs or stretchers; and the limitation to 'domestic or personal use' should be extended to enable the disabled motorist to use their vehicle at work.

4.9 ***Digital reporting and record-keeping for income tax (clause 120ff)***

4.9.1 Here again we concur with our CIOT colleagues. This is the most important change to the taxation of unincorporated business since self-assessment, and while self-assessment was exhaustively set out in primary legislation over three finance acts, with lengthy and detailed consultation meanwhile, these clauses do little but provide a framework for secondary legislation which may not even be available in draft for the MPs debating the enabling clauses. With the secondary legislation subject to the negative resolution procedure, the significant administrative burdens which will doubtless be introduced by it will pass into law with the barest minimum of parliamentary scrutiny.

4.9.2 It is impossible to comment on how well these proposals measure up against the Committee's principles of tax policy, because we do not yet know for certain what the substantive measures will be. But we fear that they may distort competition because the smaller businesses, for whom the burden of digital record-keeping and reporting is likely to be more costly than for larger enterprises, will spend a disproportionate amount of time in training and equipping themselves to meet HMRC's demands rather than running their business activities.

4.9.3 Another of the Committee's principles is that there should be minimal change unless there is a justifiable economic or social basis. We are given to understand that Making Tax Digital will make considerable inroads into the sizeable portion of the tax gap that is said to be

attributable to errors by small and medium-sized businesses, but we have not seen the evidence for this assertion, only the doubts cast on it by numerous commentators. Under the Business Records Checks initiative carried out by HMRC between 2011 and 2016, some 67% of the inadequacies in record-keeping identified that contributed to the tax gap were related to private use adjustments, which leads one to question whether compulsory digital record-keeping and frequent reporting to HMRC for all unincorporated businesses may not be an over-reaction to what appears to be a quite specific problem.

4.9.4 Finally, a person's tax liability may well be cheaper for HMRC to collect under the new regime, but unless the business is already using software that will be compatible with HMRC's systems it will almost certainly be more expensive for the taxpayer to calculate it.

4.10 ***Errors in taxpayer documents (clause 124)***

4.10.1 We acknowledge that this measure is intended to act as a disincentive to using tax avoidance arrangements. Its effect is to reverse the burden of proof, so that where certain avoidance arrangements are being used, HMRC does not have to prove that the taxpayer has failed to take reasonable care – rather, the taxpayer has to show that they have not failed to do so.

4.10.2 We are concerned that the provision is drawn too widely and that as a result it may unintentionally catch unrepresented taxpayers, who have not engaged in the type of tax avoidance that HMRC intend to target. This is a particular concern, because they may catch arrangements of the type that might be forced on low-income, unrepresented taxpayers in order for them to be able to obtain work, for example through umbrella companies or personal service companies. Such individuals may enter into arrangements without fully understanding that they are caught; may not appreciate the need to obtain specific advice, or indeed be able to afford advice; and may not be able to judge whether or not an adviser has the appropriate legal or tax expertise to advise on the arrangements. If they did not obtain appropriate advice as provided for in clause 124, they would be unwittingly removing a whole line of defence.

4.10.3 The rules as to the burden of proof are there for good reasons of fairness, and while to subvert them in this way may be an appropriate way to deal with deliberate avoiders, it can result in manifest unfairness to innocent individuals who are unwittingly caught in the line of fire. The only way to mitigate the unfairness, in our view, is for HMRC to produce clear guidance to assist taxpayers in assessing whether or not advice is "disqualified" under any of the conditions in paragraph 3A (4). This guidance should set out clearly what "appropriate expertise" is and what "reasonable steps" in accordance with paragraph 3A (5) are.

LITRG

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