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NOTE: References in the text of the report are as follows:

(Q) refers to a question in oral evidence

(p) refers to a page of written evidence

The Report of the Committee is published in Volume I, HL Paper No 113-I

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ABSTRACT

This is the seventh report in a series which began in 2003 when the House of Lords Select Committee on Economic Affairs first appointed a Sub-Committee to inquire into selected aspects of that year's Finance Bill.

This year our report focuses on the Finance Bill's measures on the taxation of foreign profits, real estate investment trusts (REITs) and pensions. In addition, as last year, we consider two issues which cut across these and other topics: first the effectiveness of the process of consultation, a matter on which we were very critical last year; and second the likely impact of the proposed measures on the international competitiveness of the United Kingdom, where again we had had serious concerns last year.

Consultation

Our private sector witnesses were generally agreed that the consultation on foreign profits has been well conducted: we are however concerned that insufficient time was allowed to enable the complete provisions to be included in the Finance Bill as published. We conclude that it would have been very difficult for the Government to have consulted, even on an informal basis, on pensions. However we accept the views of our private sector witnesses that HM Treasury (HMT) and HM Revenue & Customs (HMRC) were at fault in failing to consult over the novel and contentious measures on the duties of accounting officers of large companies and on the naming and shaming of serious tax defaulters: we did not find persuasive the reasons for this put forward by officials.

Competitiveness

As for competitiveness, on foreign profits there was general agreement that the exemption for foreign profits and the changes to the Treasury consent rules were positive changes. But there was less agreement among our private sector witnesses as on how far these were outweighed by the negative impact of the debt cap rules. In our view the outstanding issues on the latter need to be resolved before the overall impact can be determined. We thought that the opinion of officials that the pension changes would have little effect on competitiveness was likely to be over-optimistic and we recommend that the effect of the changes be monitored and kept under review. The likely impact on the UK's competitiveness of the Finance Bill provisions overall is not clear. We agreed with some of our private sector witnesses that it might be narrowly positive if the concerns about the debt cap rules are resolved.

Pensions

We fully accept that the Government has to be free to make the changes it sees fit. But on the taxation of pensions, we regret that significant changes were introduced so soon after the redesign of the whole system. There seems little official recognition that this precedent has undermined simplicity, consistency and certainty or that it risks a reduction in pensions savings. We accept the views of our private sector witnesses that the highly paid may look elsewhere to invest their savings. Whilst the numbers directly affected may be relatively small, among them will be individuals who are influential in determining the pensions policy in many companies.

We accept that the Government intends that there should be a level playing field between defined benefit (DB) and defined contribution (DC) schemes, but close attention needs to be paid to the practical difficulties; we recommend that the Government should complete the consultation well before implementation in 2011. Careful consideration is also needed to avoid exceptionally high marginal rates exceeding 100% from the combination of the marginal rate of income tax and the reduction in pension tax relief on significant increases in incomes which cross the £150,000 threshold. We do not recommend alternative approaches to restricting relief.

We question whether the anti-forestalling provisions are necessary. Solutions will need to be found for all the individuals who have good reason for not making their pensions savings regularly or frequently: these include the self-employed and those retiring or made redundant. If answers cannot be found for all these groups, as a fall-back the special annual allowance should be increased significantly. Otherwise the introduction of these provisions will require the most careful consideration of all the concerns of legitimate expectation, complexity, even handedness and the practical and administrative issues raised by witnesses.

Foreign Profits

On foreign profits, we agree with witnesses from the private sector that it is difficult to assess the package while holes in the Finance Bill proposals remain; that HMT and HMRC should keep under review the possibility of moving towards a “pure” territorial system so that, were the Government to consider that the conditions had become favourable for such a move to fund a cut in the corporation tax rate, the ground work would have been done; and that it is a pity that dividend exemption, which was universally welcomed, has been marred by complicated drafting. We recommend that where appropriate there should also be consultation on the approach to drafting.

We accept the need for some restriction of interest relief. But the debt cap was the part of the proposals least welcomed by our private sector witnesses and we were not greatly reassured by the response of officials as to the case for moving away from the arm’s length principle. We were also concerned about the complexity of the provisions and we recommend that the problems need to be resolved either by making changes or by persuading representative bodies that changes are not needed. We also recommend that, since there is already a gap between the coming into effect of the dividend exemption rules and the debt cap rules, the application of the latter should be delayed by a few months unless the outstanding issues can be resolved during the passage of the Finance Bill. We welcome the change in rules for Treasury consents.

Real Estate Investment Trusts

REITs were introduced after careful planning and amidst high hopes. But they have not lived up to expectations, since there are no residential REITs, nor any new ones not converted from property companies. It is difficult to conclude that this is wholly due to economic circumstances and not also to structural defects. In our view the measures in the Bill, though useful, do not go far enough and officials should take a more flexible and responsive approach. HMT and HMRC should look again at proposals by representative bodies, especially for the residential sector. The official approach seems complacent and unduly cautious and there could be reconsideration of, for example, the total entry charge, now that there is more than two years’ experience of REITs’ operation. The consultations when REITs were introduced originally were excellent and we recommend that advantage of this machinery should be taken to look, in the light of international experience, at what might be done.

Finance Bill 2009

CHAPTER 1: INTRODUCTION

1. This is the seventh report in a series which began in 2003 when the House of Lords Select Committee on Economic Affairs first appointed a Sub-Committee to inquire into selected aspects of that year's Finance Bill. The Finance Bill Sub-Committee's inquiries address technical issues of tax administration, clarification and simplification rather than rates or incidence of tax.
2. Each year the Economic Affairs Committee aims to publish the report drawn up by its Sub-Committee in time to enable members of the House of Commons, if they so wish, to draw on its recommendations in moving amendments to the Bill at the Report Stage. The report should also inform the Second Reading debate of the Bill in the House of Lords.
3. As in previous years the Sub-Committee selected a few topics for close examination. If it chose to examine the whole Bill, its treatment of each topic could only be cursory.
4. This year the Sub-Committee chose three topics which it considered of particular importance. It also considered two issues which cut across these matters and indeed across many other policy initiatives in the Bill which the Sub-Committee did not otherwise examine. First, how the consultative process has been carried out on these topics and whether improvements to the process could be made. Second how, for better or worse, these tax changes affect the international tax competitiveness of the United Kingdom.
5. The first topic involved the changes to the taxation of pensions. The Sub-Committee inquired into the process leading to the restriction of relief for pension contributions, effective from April 2011, and the anti-forestalling provisions in the Finance Bill, in the light of experience of the new pensions regime since its introduction in 2006. The Sub-Committee did not question the Government's right to restrict the relief in principle, nor to set the level at which the restriction is to be introduced.
6. The second topic concerned the reforms to the taxation of foreign profits, representing a move towards a more territorial system of taxing foreign subsidiaries: an exemption from tax for foreign dividends received by all companies; a restriction to the interest deduction rules by the introduction of a debt cap; consequential changes to the rules for controlled foreign companies; and the replacement of the Treasury Consent rules with a post-transaction reporting requirement.
7. The third topic related to Real Estate Investment Trusts (REITs). The Sub-Committee looked not only at the provisions in the Finance Bill, but also at the experience of the REITs regime since its introduction in 2007 and how it compares with expectations then.
8. As in previous years, the Sub-Committee conducted its inquiry by taking written and oral evidence from leading professional and business organisations and from HM Treasury (HMT) and HM Revenue & Customs (HMRC). A list of those who have contributed to the inquiry in this way is

given in Appendix 2: their evidence is in Volume II of this report. The Sub-Committee would like to thank all those who have contributed, at very short notice this year following the late Budget, to its work. Without their help this report could not have been written.

9. The Sub-Committee's findings on the two cross-cutting issues are in Chapter 2 of this report; the three chosen topics are in Chapters 3 to 5. Its conclusions and recommendations are in Chapter 6.

CHAPTER 2: GENERAL ISSUES

10. Last year our report discussed two cross-cutting issues that were common to the topics we examined and indeed went wider. We adopt the same approach this year, looking again at consultation and international competitiveness.

Consultation

11. In last year's inquiry, we confirmed that we were firmly in favour of consultation which should take place as early as possible in the development of an initiative if clarity and certainty are to be achieved. We commented unfavourably on the consultation that had taken place in the development of two of last year's initiatives: the changes to capital gains tax and to the residence and domicile rules. Given the strength of feeling amongst the private sector witnesses, our view was that something had gone wrong in the development of those initiatives. We were particularly disappointed that the progress on consultation, which we welcomed in the 2007 report, had not been maintained in the 2008 changes. So we were keen to examine how good the consultation had been this year.

Consultation on Foreign Profits

12. On the first of the topics that we examined this year, it was a general view amongst our private sector witnesses that there had been extensive consultation on the taxation of foreign profits. There were many positive comments: Mr Peter Cussons, Institute of Chartered Accountants in England & Wales (ICAEW), thought that "If we take the timeline from June 2007 when there was a discussion document put out I think by the Treasury, through to publication of the Finance Bill, as a whole I would say that the conduct of the process has been pretty well handled" (Q 2).
13. The Confederation of British Industry (CBI) expressed the view that: "This year the consultation process on Foreign Profits has been much improved compared with the situation on Residence and Domicile in 2008" (p 37). The 100 Group wrote that they "would like to formally acknowledge the extensive consultation undertaken by HMT and HMRC on these proposals and the many changes that have been made as a result, prior to the publication of the Finance Bill" (p 34).
14. The Chartered Institute of Taxation (CIOT) "commends the Government for ensuring that the foreign profits consultation process has been thorough, and in many ways, an example of how consultation should be done. The CIOT feels that significant improvements to the original proposals have been made as a result of this consultation" (p 56).
15. However, there was not unqualified praise. The ICAEW wrote: "Further consideration needs to be given to these rules, in particular the debt-cap rules" (p 2). The Institute of Directors (IoD) acknowledged that "There has also been extensive consultation on draft legislation" but added that "We do feel that the work could have gone a little faster. In particular, there was a long delay between the closing date for the first consultation, in September 2007, and publication of the next technical note, in July 2008" (p 41). The IoD continues with an acknowledgement that "officials have put a great deal of effort into consultation on the debt cap, and that work to improve the legislation has not slackened off. Proposed changes were announced on

7 April 2009, and further changes in the open letter from the Financial Secretary dated 30 April. But the fact that the Government sees the need to propose changes even at this late stage indicates that further time for consultation would be worthwhile” (p 42).

16. Mr Ashley Greenbank, Law Society of England & Wales (LSEW), expressed the view that “Overall, we found the process a little unsatisfactory ... HMRC and the Treasury were very willing to meet with us when we initiated the process but we did not get invited into the process by them an awful lot. As a result we sort of dipped in and out of the process, we felt, and it did not really get moving ... For the first time we had some detailed legislation after the PBR in 2008, which is what we have been consulting on ever since. The process after that has been again a bit frustrating. We have been making comments on that detailed legislation but it seems to me that the Treasury and HMRC have been stuck in terms of what the policy is ... they have been very prepared to try to ameliorate what we have demonstrated are disadvantages of the debt cap, but have never been prepared really to look again at what the policy is, which is what a lot of our comments were about. Also in the process, because we have always been talking about bits of the legislation that were not there ... so there has never been any real in depth consultation on the drafting itself. That is how I feel it has been unsatisfactory” (Q 27).
17. Some were concerned that some of the consultation was happening very late. The British Bankers’ Association’s (BBA) focus was on an exclusion from the debt cap rules for financial services. Ms Angela Knight commented “Just as we were leaving for this meeting, an email came through to the BBA with some more information for first time on the financial services exemption. The meeting with the Revenue on this is tomorrow. The Finance Bill starts its process tomorrow. For something which is complicated ... this does seem extraordinarily late” (Q 50). She put the point more generally “Our concern is that whilst the consultation was good we still sit with so much uncertainty in some very key areas. Amendments that are going to be laid during the Finance Bill by government seem a little late for the proper discussion and reasoned debate on some of these issues” (Q 47).
18. The IoD discussed a particular change and were “very pleased that it was in the end possible to find a solution that allowed the exemption. It was however unfortunate that the solution was not thought of early enough to allow public consultation on its details. We wonder whether there is a lesson to be learnt for the future, about putting in the necessary effort to come up with solutions well before the deadline for finalising legislation” (p 42).
19. The CBI told us that: “An optimal consultative process would not leave extensive important material to be seen for the first time after the relevant Finance Bill has been laid before Parliament. Such sub-optimal process leaves dialogue on important matters constrained by the already unsatisfactory Finance Bill timetable” (p 38). And later in their evidence “the dialogue needs to continue at a level of intensity such that there is minimal residual uncertainty at the times the provisions come into effect” (p 39).
20. When we raised these issues with officials, Mr Mark Neale, HMT, thought that the consultation had been “successful because it led us to an outcome which balances competitiveness gains for business with protection for the Revenue ... [and] because it consolidated the good relationship which the

Treasury and HM Revenue and Customs have with business generally in addressing issues of common concern” (Q 150).

21. Asked about whether the consultation could have gone faster in the early stages Ms Judith Knott, HMRC, said that the “early part of the consultation ... was not in practice quite as leisurely as it may have seemed from the actual documents that were published, because what was happening during some of those periods where there was no formal publication was quite an intense process of dialogue directly with business, with a lot of meetings and discussions with groups and individual businesses as the process evolved, so that when we did go into publication we very much were not coming out with things that were fresh but things that had been discussed in evolution with business. I think it was better as a result” (Q 151).
22. In responding to the criticism that consultation on some issues, such as the exclusion for financial services from the debt cap rules, had been too late, Ms Knott said “During the consultation on the draft legislation that was published in December we did get a large number of comments in response to that legislation. We did listen to those comments and made a significant number of changes as a result. That process of listening and making the changes does take time, and in some cases, for example the financial services exclusion ..., that process of dialogue extended beyond the publication of the Finance Bill” (Q 160). Asked why it had not been possible to start consultation on the draft clauses earlier, Ms Knott defended what they had done “we did start a lot earlier. In fact, I have been involved in this dialogue on foreign profits since I was in the Treasury in 2006, so it has been a long process with a number of consultation documents” (Q 161).
23. **Overall, we were left with a favourable impression of how the consultation on foreign profits has been handled and we welcome that. It was clearly not perfect in the eyes of our private sector witnesses, but it was much better than that on the two topics we looked at last year.**
24. **We accept HMRC’s view that although the consultation looked a little leisurely in the early stages, there was much work going on in the background, as well as less formal consultation, so that the next document to be published would meet with more general approval.**
25. **The one area that does concern us is that there was an underestimate of how many comments would be received on the draft legislation exposed in December 2008 and how long it would take to work through these and discuss the points with consultees. This resulted in the Finance Bill being published with changes still in the pipeline.**
26. **We recommend that HMT and HMRC should review the best aspects of this consultation on foreign profits and apply it more generally. In particular, we recommend that they should consider carefully why they did not allow themselves sufficient time to incorporate a complete version of the legislation in the Finance Bill as published and should make every effort to prevent this happening again.**

Consultation on Taxation of Pensions

27. The Government has committed itself to consulting business, pension fund trustees, the insurance and pensions industries and other stakeholders on the substantive changes to the taxation of pensions to be introduced from 2011.

“The Government will use this consultation to engage with stakeholders to introduce the new system in a way that minimises administrative burdens”¹.

28. In anticipation of people forestalling these changes (i.e. entering into additional transactions between now and April 2011 in anticipation of the changes coming into effect), anti-forestalling provisions were included in the Finance Bill. We turn later to consider whether this anti-forestalling schedule is necessary. We asked our private sector witnesses about the possibility of being able to consult on the schedule, given the Government’s decision to introduce it.
29. Some acknowledged the difficulty of consulting on an anti-forestalling schedule. Mr Andrew Hubbard, CIOT, put it this way “although we are very much in favour of consultation, there is an acceptance that consultation in relation to anti-forestalling measures is difficult and therefore I do not feel aggrieved in any way that there was no prior consultation on this point” (Q 86).
30. Others were less persuaded that there could not have been informal, confidential discussions. As Mr Neil Carberry, CBI, said “It may have been desirable to take views over coffee perhaps but I do not think that took place. The result, if you look at the anti-forestalling legislation, is that there are a number of areas where unlooked for consequences occur” (Q 65). In answer to the same question Ms Knight said “there is a view developing strongly that if there had been some quiet discussions or consultations, even at a high level with a few experts, some of the cliff edge adverse impact could have been resolved” (Q 65).
31. Ms Maggie Craig, Association of British Insurers, (ABI) echoed this “we do think that a few key organisations could have been consulted informally because it was obvious that this was going to be a huge issue and also, having worked through the proposals, it was obvious that they were going to be complex proposals, so I think that there could have been better consultation” (Q 135). Ms Joanne Segars, National Association of Pension Funds, (NAPF) agreed and added “The changes around the 2004 Finance Act actually seemed to be a model of the consultative process at the time, if I cast my mind back ... We very much agree that it would have been helpful had the Treasury been able to pre-consult or, at least, flag in the Pre-Budget Report that these were issues that were under consideration. Now, clearly, there is an issue about people, as you have identified, ‘piling’ into pensions, as the Treasury call it, to meet the deadline, but we are sure that very clever people at the Treasury could have found ways round that, for example, saying that anybody who did put in extremely out-of-usual patterns of contributions between the PBR period and the Budget could have been treated as avoidance in some way; there are clearly precedents available for that” (Q 135).
32. Mr Frank Haskew, ICAEW, went further in his evidence “On the face of it you might say that there should not have been consultation on an anti-forestalling measure, but I think we are in a different league here. This is a fundamental change to a pension regime and it is such a fundamental policy shift that I think we feel that there should have been consultation on the proposal with a view to it coming in at some future date and that really there

¹ HM Treasury: *Budget 2009, Economic and Fiscal Strategy Report and Financial Statement and Budget Report*, April 2009, HC 407, para 5.93, The Stationery Office, London.

should not have been anti-forestalling rules of this nature introduced at this time” (Q 16).

33. When these points were put to officials, Mr Neale made the point that “immediately after the Budget—indeed the day after—I convened a meeting with all the interested stakeholders to discuss the implementation of the budget measures and to get a process of consultation underway” (Q 154). On the principle of whether consultation might have been possible on the anti-forestalling schedule before the announcement and its becoming effective, his view was “as you will know, we do not consult about everything in advance of a budget. We tend not to consult about changes to tax rates or to consult about measures which could be subject to forestalling” (Q 154). He said that he found himself very much in agreement with the view expressed by Mr Hubbard. Mr David Richardson, HMRC, added later that “Consulting on the anti-forestalling provisions would be extremely difficult and largely self-defeating” (Q 221).
34. **Given the Government’s decision to introduce an anti-forestalling schedule, it would have been very difficult to consult, even on an informal, confidential basis before announcement. Informal consultation is partial, not acceptable to those not involved and can put those involved in a difficult position. In last year’s report we recommended “that consultation should be even-handed and open, involving as many as possible of the professional bodies and other parties which have a valid interest”². We hold to that view.**

Consultation on Wider Issues

35. In oral and written evidence, our private sector witnesses commented on other provisions in the Bill where there should have been consultation. In particular, they focused on clauses 92 and 93. Clause 92 is the provision that imposes obligations upon senior accounting officers of large companies. Clause 93 is the ‘naming and shaming’ provision, authorising HMRC to publish information about serious tax defaulters.
36. The BBA wrote in relation to clause 92 “The BBA is dismayed that HM Government has again chosen to make a policy announcement of this nature in the Budget without attempting to consult industry in advance on the ramifications of its initiative” (p 34). And in relation to clause 93, they opined “It is not clear to the BBA that, as presently drafted, the new proposal on naming and shaming tax evaders is solely limited to evaders, as we consider it should be” (p 45).
37. The IoD commented “We are also concerned that the Government’s commendable commitment to consultation is not always reflected in what happens. Two examples stand out. First, the proposals on senior accounting officers (clause 92) would certainly have benefited from advance consultation on the principle, rather than just post announcement consultation on the practicalities. Second, we note with concern the casual mention in a technical note that was published by HMRC on Budget Day, *Furnished Holiday Lettings in the European Economic Area*, that the furnished holiday letting rules are to be abolished from 2010–11 onwards ... It should have been given a proper announcement in its own right and been subject to advance public

² House of Lords Select Committee on Economic Affairs, 2nd Report, (2007–08), *The Finance Bill 2008*, HL 117-I, paragraph 33

consultation on the principle” (p 41). Mr Richard Baron for the IoD went further “[Clauses 92 and 93] are both measures on which we cannot see why there was not advance consultation on the principle” (Q 46).

38. Mr Mervyn Woods for the CBI said: “Mr Baron has already referred to at least two of the major provisions in the Bill on which there has been no consultation at all. It is firmly the CBI policy that where possible the normative process should be to consult first and legislate after and not produce material to go to the House that is incomplete and ill considered in some way, in as much as on examination of proposals in subsequent dialogue with officials it appears that answers to pretty basic questions have not been thought through and are not even immediately available” (Q 49).
39. Mr John Whiting for the CIOT put it pithily “The consultation shortcoming has been on other measures such as clause 92 and 93” (Q 86).
40. When these points were put to officials, Mr James Harra, HMRC, justified the lack of consultation in different ways for the two clauses “in the case of clause 92, ... the Government had to take very difficult and urgent decisions on fiscal consolidation, and ... this is why this decision was taken at the same time as [those] measures ... Going to clause 93, that clause ... is based on definitions that are already in legislation for the past two years, in the penalties regime, which were subject to prolonged consultation over a period of three years ... Once again, consultation is underway on the practical implementation of this; and given that the first names are unlikely to be published until early 2011, there is time to sort that out and address those concerns” (Q 156).
41. **We remain of the view that consultation should be the norm and only subject to limited exceptions, such as rates, reliefs and anti-forestalling measures. In fact, in their oral evidence, HMRC specifically agreed with this. We are therefore at a loss to know why there was no consultation on the clauses setting out the duties of accounting officers of large companies and the naming and shaming clause.**
42. **We do not find persuasive the reasons put forward by officials why it was not possible to consult on these clauses. Our view is that with measures as novel and contentious as these, there should have been consultation on the principles as well as the practicalities of implementation. Even by their own criteria, we see this as a failing on the part of HMT and HMRC and we recommend that in the future there should be consultation on changes such as these. We hope that it will not be necessary to revert to this issue again in a future report.**

International Competitiveness

43. In this section we turn to the second cross-cutting issue and consider the effect on the UK’s international competitiveness of the topics that we have under inquiry, but also more widely where our private sector witnesses commented. Last year we were concerned at the negative effect on the UK’s competitiveness of the proposals at which we looked.

Foreign Profits

44. The Impact Assessment on the taxation of the foreign profits of companies stated that “The primary policy objective is to enhance the competitiveness

and attractiveness of the UK as a location for multinational business, while ensuring that the new regime cannot be used to undermine the UK tax base”³.

45. We asked our private sector witnesses about the overall effect of the foreign profits package on international competitiveness. The ICAEW expressed concern “about the overall balance of the Foreign Company profit proposals and their impact on the UK’s tax competitiveness. Headquartering a multinational business in the UK, or inward investment into the UK, is likely to be less attractive in the future on account of these changes” (p 1). In particular they remained “concerned that the introduction of the worldwide debt cap, as currently proposed, will add considerable complexity to the UK tax system and affect its competitiveness” (p 1).
46. The Association of Chartered Certified Accountants (ACCA) were also “concerned that this may deter inward investment into the UK, as companies may need to gear up to maintain sufficient working capital particularly in a difficult economic climate. The major disincentive to inward investment is uncertainty and, while relieved that the proposed CFC rules have not been introduced, we remain concerned at the administrative burdens and uncertainty engendered” (p 119). The Law Society of Scotland (LSS) thought that “Coupled with the proposed increases in personal taxation these changes [the debt cap provisions] may well mean that the UK is perceived as less competitive in tax terms” (p 21).
47. The overall view of the package was summarised by Mr Cussons “Obviously dividend exemption in Schedule 14 and the repeal of Treasury consents and criminal sanctions and breach of those, both of which come in from 1 July, are extremely welcome ... So what we have are two very welcome things; the start of CFC reform, on which it is too early to take a view; but in tandem, a bit like Shelley, a sort of Frankenstein monster has been created, the debt cap” which is going “to create an enormous compliance burden” (Q 3). Mr Mike Hardwick, LSEW, thought that “the main gainers are the UK multinationals, for inbound investors and for wholly domestic groups, I think [the overall effect] is negative” (Q 35).
48. The IoD, whilst warmly welcoming the dividend exemption, thought that “the UK’s competitiveness will be damaged [by the debt cap] deterring businesses from using the UK as a base and reducing opportunities for providers of professional support services. The overall effect on the tax take may therefore be negative” (p 42).
49. The BBA saw the overall position as “A competitive system for the taxation of foreign profits must be an essential cornerstone of the UK fiscal system. Overall, we think that the Finance Bill measures [on foreign profits] should give a more sensible regime and we support the direction of the proposals, provided that a satisfactory solution to the issue of the Worldwide Debt Cap can be found” (p 43).
50. Mr Whiting saw the changes on foreign profits as “generally a good move and is good progress towards increasing competitiveness” (Q 85). However he went on to qualify that by the effect of other measures and we return to that below. Ms Isobel d’Inverno, Law Society of Scotland, (LSS) said “Can I return to the competitiveness question? Our concern is that this whole

³ HM Treasury and HM Revenue & Customs: Budget 2009, *Impact Assessments*, April 2009

process of consultation about foreign profits having gone on for three years and still not having come to a landing, with lots of concerns about the worldwide debt cap and whether it is going to work, whether it is flawed and so on, has not done the UK any good at all in terms of being perceived as a competitive place to be located, not just on the detail of the tax legislation that we may end up with, but the whole process, the uncertainty and where it is going to be” (Q 36).

51. Mr Julian Heslop, 100 Group, was positive “In terms of the foreign profits, the 100 Group welcomes the overall package. It helps UK competitiveness” (Q 49).
52. Responding to the suggestion that the problems on the debt cap schedule have to be resolved before the Government’s objectives for the foreign profits package will be achieved, Mr Neale said “we are very confident that we have a good package. As Judith [Knott] and I have said, it is important to see it as a package in the round. The government is seeking on the one hand to enhance business competitiveness, and on the other to protect revenue. The dividend exemption will give business a competitive gain. The debt cap helps to protect the Exchequer ... I think [the package] provides a sensible outcome which gets that balance between competitiveness and the protection of revenue in the right place” (Q 157).
53. **Everyone agreed that exemption for foreign dividends was a very positive change; and that the changes to the Treasury consent rules were positive. Officials were confident that the foreign profits package was a good one in the round, with the debt cap provisions being necessary to protect the Exchequer.**
54. **However, our private sector witnesses, in some varied comments, were less sure that that the negative impact of the debt cap rules did not outweigh the positive effect of the dividend exemption and the Treasury consent rules. Whilst, in general, they accepted that some rules on the restriction of interest were a price worth paying for the dividend exemption, they thought that the way this restriction had been imposed would add very considerable complexity to the UK tax system and damage the UK’s competitiveness.**
55. **As a minimum we recommend that the issues with the debt cap schedule need to be resolved in order that the overall package has a positive effect on competitiveness.**

Taxation of Pensions

56. We received evidence on how the changes to the taxation of pensions, both the substantive changes proposed for 2011 and the anti-forestalling provisions, would affect UK competitiveness.
57. The ACCA remained “concerned about the administrative burdens and complexity. These will be felt particularly by small businesses, but will be a concern at all levels. Major group companies have been leaving the UK as a result of the lack of certainty in fiscal legislation. Whilst the provisions impact directly upon taxpayers with incomes in excess of £150,000, the implications will be felt more widely ... The smaller companies often use their pension schemes as a source of investment (up to the permitted limits) ... Larger pension funds invest heavily in the stock market and this investment will inevitably be suppressed ... The extra compliance would be unlikely to

benefit either the economy or our members, as the business owners may decide not to bother” (p 119).

58. Mr Trevor Johnson, Association of Taxation Technicians, (ATT) put it this way “Our view on the Schedule 35 proposals and the proposals on tax relief on pensions is that it cannot aid competitiveness within British industry. It is bound to be a disincentive to some extent” (Q 85). Mr Hubbard thought that “It may well be that those transitional provisions have quite a significant impact on people coming in to the UK but there is a lot to be done on that” (Q 85).
59. Asked about the effect on UK competitiveness of the pensions provisions Ms Craig found this very difficult to quantify. She went on “The problem with that is that in the current economic context any kind of disincentive or anything that makes high earners feel unhappy or discouraged is a problem. It is very difficult actually quantifying” (Q 128). Ms Segars agreed “the main impact would be to discourage those high earners from saving in pensions and they will look to switch out of pensions into other forms of remuneration and savings, and certainly that is the message that we are getting very clearly from NAPF members who advise this group of individuals and from large corporates” (Q 128).
60. Asked about the effect of the anti-forestalling provisions on competitiveness, Mr Richardson thought that the schedule would not “have a material impact on competitiveness. If you look at its impact, it affects a maximum group of about 230,000 people earning over £150,000; and for those people what Schedule 35 does is to say that if they continue with their regular ongoing savings that they will not be caught by Schedule 35. It is only a very small subset of the 230,000 that are affected for the two-year forestalling period; so I do not think that Schedule 35 itself will have a huge impact on competitiveness” (Q 159).
61. **We think that the opinion of officials that the changes for pensions will not materially affect competitiveness is likely to prove to be an over-optimistic assessment. As was put to us by our private sector witnesses, the people affected are likely to be the opinion formers in the business world and an adverse impact on them, particularly when coupled with the change in the highest rate of income tax, may well produce upward pressure on the cost of employing highly paid talent. This could have knock-on consequences over a much wider range of people. We recommend that the effect of these changes should be carefully monitored and kept under review to establish what impact they do have, particularly on UK competitiveness.**

The Effect of Other Issues

62. Some of our private sector witnesses gave us their views on the effect on UK competitiveness of other measures in the Finance Bill and of the Finance Bill as a whole.
63. Mr Woods commented, in the context of clause 92, that the Government was “not able or willing to have consultations ahead of the introduction of legislation creates an impression of uncertainty and instability. That is not conducive to making the UK competitively attractive from an investment point of view” (Q 49). Mr Baron said he: “would also be concerned about some other elements in the Finance Bill package ... There are other elements like

the 50 per cent tax rate and the withdrawal of the benefit of personal allowances once income goes over £100,000, where we are concerned that that sort of measure can send the wrong signal ... It is not just business that we are losing; it is also the business of all the ancillary services ... If you can say that ... the UK is a good place to be and you can rely on us remaining a reasonably low tax country, that sends out the right signals. I do not think the government with this Finance Bill is sending out the right signals” (Q 49).

64. Ms Knight said “I think the perception is also quite important and the external perception of the UK with this Finance Bill and the other measures in it is not terribly positive. That does concern me, especially in this current climate” (Q 49). Mr Heslop as part of the same discussion and having welcomed the overall package on foreign profits as helping UK competitiveness, did “not think the senior accounting officer certification eliminates that.” Nevertheless, he saw the provision as “a pity. It is a sentiment thing. I do not think it is material in the scheme of the foreign profits package. I think it is an unfortunate step to introduce. If it had been consulted on in advance, it could have been brought in in quite a different way which probably would have achieved the same effect” (Q 49).
65. Mr Haskew picked up on the wider aspects of the Bill “there are certainly other parts of the Bill where similar issues are coming out in terms of complexity; for instance, the VAT changes in relation to place of supply, which are considered to be potentially quite onerous on UK companies. Going back to your point and your question on clause 92 with the duties of senior accounting officers ... I think there is a question mark slowly arising as to just how uncompetitive are provisions like clause 92” (Q 3).
66. Summing up, Mr Whiting saw the overall position as “It is a case of swings and roundabouts because foreign profits ... has been generally a good move and this is good progress towards increasing competitiveness. On the other hand, the measure we have just talked about [clause 92] sends a signal that we want more documentation, more procedures. Something like, inevitably, the 50% tax rate has implications, particularly when you look at its implications for trusts business ... So there is a strong element of swings and roundabouts, a strong element of two steps forward and one and a half back” (Q 85).
67. Asked how they assessed the effect on UK competitiveness of the Finance Bill as a whole, and asked “Why can we not remove this impression that Britain is becoming uncompetitive”, Mr Neale said “I very much hope that that impression is not out there. I do not think it is a true impression. It is very important in considering competitiveness to look not just at any particular measure or budget but at the impact of the tax system as a whole. As things stand the UK has a Corporation Tax rate of 28%, which is the lowest among the major G7 economies, and our taxes on labour also are among the lowest among the major economies ... I think my answer would be that we need to look at this in the round; and looked at in the round the UK has a very competitive tax system” (Q 158).
68. **As our private sector witnesses concluded, the effect of the Finance Bill provisions is a netting of pluses and minuses. It is difficult to be sure what the end result might be. The likelihood of the overall result being positive would be considerably enhanced by a satisfactory resolution of the concerns surrounding the debt cap schedule, either by changes being made, or HMRC persuading others that changes are not necessary. If that can be achieved, then we should not be inclined to differ from the assessment of one of our witnesses of a net half step forward.**

