Finance Bill Sub-Committee inquiry into Draft Finance Bill 2018

1 October 2018

Introduction

1. The British Property Federation (BPF) represents the commercial real estate sector. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax. We welcome the opportunity to respond to the Select Committee's inquiry.

2. Domestically the commercial real estate sector contributes almost 50% of its GVA in taxes, compared to 27% for the rest of the economy[1]. Our members pay a fair share of tax and support a tax system which makes it easier for well-intentioned taxpayers to comply through simplification and appropriate support from HMRC; and while it is accepted that penalties are needed to drive compliance, HMRC should focus resources on pursuing and penalising those looking to deliberately evade the system.

3. This is supported by the latest HMRC data on the tax gap, which stood at £33 billion in 2016-17[2]. Of this a quarter (26%) resulted from non-malicious reasons such as errors or legal interpretation, while almost half (47%) was due to factors such as criminal activity or evasion. This suggests that in setting the balance between HMRC and taxpayers the focus of resources and penalties should be on those looking to break the rules; however, our members have identified a number for examples where penalties are unfairly levied or HMRC are potentially seeking to collect tax from compliant taxpayers in timeframes which are impractical.

4. In the paragraphs below, we set out principles by which we believe the tax system should operate to support compliance, with more detailed responses to the inquiry's questions (including detailed examples on the balance of power) in Appendix 1. If you would like further information on the BPF response, please contact:

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Supporting well-intentioned taxpayers to comply

5. In setting the balance between HMRC and taxpayers, efforts should be focused on ensuring a less complicated and more efficient tax system which supports well-intentioned tax payers to comply. This would ensure HMRC can focus resources and any penal measures on those whose goal is to deliberately break the rules. To make compliance simpler, the tax system should be based on the following principles:

   - **Stability:** Recent fiscal events have seen a stream of changes to real estate taxation, with the current draft Finance Bill implementing substantial new measures for non-residents on the taxation of property gains and income, and alterations to payment periods for CGT and SDLT. Each new tax change adds a layer of complexity in terms of implementation - the Corporate Interest Restrictions rules for example

[1] Commercial real estate taxation, Cebr, 2018
[2] Measuring tax gaps 2018 edition, HMRC, 2018

(which took effect in April 2017) were accompanied by over 500 pages of guidance – and understanding how different tax measures inter-relate is becoming increasingly difficult.

- **Effectiveness:** To support businesses apply the current property taxation rules, and the new measures coming forth in the draft Finance Bill, it is essential that HMRC operates effectively and provides the right support to businesses so that projects and transactions can be completed smoothly, and the tax system operates effectively. Decisions will be taken on tax every day (e.g. on VAT) – at all levels within companies – and this can be hampered if the right support is not in place. However, HMRC's resources can be stretched and officials do not always have sufficient time to engage with property businesses and build their understanding of how the sector operates day to day. This can result in tax guidance not keeping pace with policy or business changes, and misunderstandings between HMRC and businesses.

  Ensuring the reliability of tax guidance must be a priority as it is the main source of information for businesses dealing with tax rules. It is surely preferable that HMRC focus on accuracy of guidance and not on penalising taxpayers for relying upon or interpreting guidance that may be out of date. However, members' experience is that guidance can be slow to be updated following developments in case law, particularly where cases go against HMRC and therefore require a change in policy.

- **Fairness:** Another issue is HMRC's perceived attitude to challenging taxpayers at tribunals – with the feeling that HMRC will often pursue cases even if the position is well established and the ruling is expected to go against them; or that HMRC will not put sufficient resource into the First Tier Tribunal in the knowledge that they can appeal. However, the process can be uncomfortable for taxpayers and cost them time and money.

Appendix 1 – response to inquiry questions

What principles should underlie the design of HMRC powers, and where should the balance be struck between taxpayer and tax authority?

6. HMRC should support well-intentioned businesses to comply with their tax obligations through a simpler tax code and appropriate support/guidance to help taxpayers interpret the rules. Penal measures need to be in place as a deterrent to drive compliance, but HMRC's resources should be focused on pursuing those who seek to deliberately break the rules as opposed to well-intentioned taxpayers who may simply be guilty of misunderstandings, genuine ignorance or a genuine inability to comply with the timeframe for paying tax.

7. An HMRC discussion document on penalties in 2015[3] set out principles for the penalty regime with which our members would agree (although it is not clear what has since happened to this piece of work). In particular:

   - The penalty regime should be designed from the customer perspective, primarily to encourage compliance and prevent noncompliance. Penalties are not to be applied with the objective of raising revenues.
   - Penalties should be proportionate to the offence and may take into account past behaviour.
   - Penalties must be applied fairly, ensuring that compliant customers are (and are seen to be) in a better position than the non-compliant.

[3] HMRC Penalties: a discussion document, Summary of responses, HMRC, September 2015

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To what extent, or in what areas, is the existing balance of powers between HMRC and the taxpayer inappropriate or unfair?

How should HMRC powers be differentiated to reflect the different problems being tackled e.g. careless error, sophisticated tax avoidance, and deliberate tax evasion?

How are HMRC's powers operating in practice? Are they being used in line with their original policy intent?

8. BPF members have identified a number of areas where the tax rules or how they are applied by HMRC is unfair from the perspective of well-intentioned taxpayers. These are set out below.

9. **Setting unrealistic timeframes for payment, with potential penalties for non-compliance:** The draft Finance Bill (Clause 6) includes new measures requiring non-residents to pay Capital Gains Tax on any direct or indirect disposals of an interest in UK land (residential or otherwise) within 30 days (with an enacting power to extend this requirement to non-resident companies who pay Corporation Tax on gains). The draft legislation is more stringent in its treatment of non-residents than of residents; and as a policy-making principle it should be noted that the draft legislation proposes much broader measures than contained in the original April 2018 consultation. This had only proposed non-residents paying on account for direct disposals of residential property (extending the current regime under NRCGT for non-residents outside self-assessment).

10. As a principle, thirty days is a short period for taxpayers to make relatively complex calculations that could include an assessment of allowances, gains/losses accrued on different assets and the sale of mixed use properties. This is even more the case in relation to the new non-resident CGT charges, particularly in relation to indirect disposals where, save in the most clear-cut cases, the non-resident will need to determine if they have a "substantial indirect interest" (both by reference to their ownership history and interests of connected persons) and in some cases whether an entity is property-rich or not.

11. The danger is that taxpayers face penalties for filing late in circumstances where it was not possible to make calculations in time, or because non-residents were unaware of the new rules (which take effect in April 2019) – and it remains to be seen how Government will raise awareness of the new measures to a scattered global audience. If the Government do not amend the proposals, then this is a case where a pragmatic approach needs to be taken to penalties given the stringency of the rules and the scope for innocent non-compliance. The introduction of the current payment on account regime under NRCGT in 2015 has already seen a number of tribunal cases with taxpayers arguing they had been unaware of the payment requirements.

12. The difficulties with compliance will be compounded for non-residents investing through funds (collective investment vehicles), particularly as the legislation on the tax treatment of funds under the non-resident gains measures is yet to be published. Funds will need to provide their investors with all the required information for relevant disposals and apportion gains between investors who may have different timeframes for payment depending on whether they are UK resident or non-resident, or liable for CGT or corporation tax. This will be extremely difficult in the timeframe.

13. The BPF's response to the draft Finance Bill recommended a quarterly payment period for all taxpayers affected by the new payment on account measures. This will be especially relevant for funds who tend to work on quarterly distributions to investors - a 30-day payment window could lead to investors having 'dry' tax charges (i.e. where a taxpayer faces an immediate liability on an amount/gain not yet received). As a

minimum, with the final legislation only being known so close to the April 2019 start date, the payment window should be extended for the first year of its operation to give taxpayers time to adjust.

14. **Issuing tax-geared penalties where there is no tax loss to HMRC:** While there will be a number of examples of where this occurs, our submission focuses on the Construction Industry Scheme (CIS) as it demonstrates both administrative burdens and the issue of penalties.

15. The purpose of CIS is to tackle potential tax evasion in the construction industry due to a highly mobile and often self-employed labour force. It is a withholding regime applicable to individuals and large businesses in an identical manner, whereby ‘contractors’ deduct tax from payments made to ‘subcontractors’ for construction work and pay this directly to HMRC (unless the subcontractor has applied for gross payment status). It applies to the non-materials element i.e. labour cost of any payment. Compliant taxpayers can recover any amounts withheld from HMRC.

16. The Income Tax (Construction Industry Scheme) Regulations 2005 sets out circumstances whereby a contractor who fails to withhold the right amount of tax, is not required to pay over the missed withholding to HMRC where the subcontractor has filed a tax return that includes this income i.e. there is no loss of tax to HMRC as the underlying amount is being correctly taxed through inclusion in the subcontractor’s tax return. The CIS penalty regime has fixed administrative penalties but also tax geared penalties in some cases. The rules allow the imposition of full tax geared penalties on the missed withholding even where HMRC has issued a Direction under paragraph 9(5) of the 2005 regulations i.e. they effectively agree that there is no loss of tax. It is inconsistent for HMRC to agree not to collect a withholding tax because the recipient has met compliance obligations in respect of the amount but then apply a tax geared penalty for ‘loss of tax’.

17. The issue is further compounded by the administrative requirements of applying CIS which, unlike other taxes, has no grouping mechanism. Property groups are usually made up of several separate companies and intra-group payments between these that relate to subcontractor payments (covered by CIS) are themselves subject to the full requirements of the CIS scheme. Treating internal companies on this ‘arm’s length’ basis means firms have to apply CIS twice to the same invoice – both to any internal payments and the payment to the subcontractor. This is administrative duplication and does not add to efforts to prevent tax evasion.

18. In addition, this means penalties could be issued under the 2005 regulations (as set out in paragraph 16) even when no loss of tax occurs, and the withholding tax applies to payments within the same property group.

19. **Tax regimes which have seen a steady increase in penalties:** The Senior Accounting Officer (SAO) measures were enacted in the Finance Act 2009 (Schedule 46). They seek to ensure that large companies (broadly, those with a relevant balance sheet total exceeding £2bn and/or a turnover exceeding £200m) take reasonable steps to ensure that “appropriate tax accounting arrangements” are in place.

20. A penalty regime is in place with fines of £5,000 for companies who fail to notify the name of their SAO in the required timescale; or for SAOs themselves who fail to to take reasonable steps to ensure that the company establishes and maintains appropriate tax accounting arrangements.

21. Fines issued under the SAO regime have increased by 150% in the last five years from 46 in 2012 to 115 in 2017. While members agree with the purpose of the SAO measures and the need to ensure compliance, fines will often be for administrative errors that can occur within large businesses. For example, one BPF

member cited being fined for missing a group company off their list of entities on their certificate (out of c150 group companies), even though it was listed elsewhere on the notification.

How prepared are HMRC, businesses (small and large) and software providers for the implementation of Making Tax Digital for VAT in April 2019, and what are the challenges of concurrent preparations for Brexit?

22. The April 2019 start date is fast approaching, yet many firms will not be advanced in the planning processes with further information on the MTD process and potential software providers only having been recently published. Anecdotal evidence at this stage is that some companies will use bridging software as opposed to a full MTD solution.

October 2018