

Budget 2007: Regulatory Impact Assessments

March 2007



HM TREASURY



HM Revenue
& Customs

Budget 2007: Regulatory Impact Assessments

March 2007

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VAT: FUEL SCALE CHARGE

Value Added Tax (Cars) (Determination of Consideration for Road Fuel Supplied for Private Use) Order 2007

PURPOSE AND INTENDED EFFECTS OF THE MEASURE

The Policy Objectives

1.1 The proposed measure will change the basis of the existing Value Added Tax (VAT) private use charge from engine size to CO₂ emissions and so will align the VAT private use charge with that for direct tax. The CO₂ based system is also designed to raise the environmental profile and encourage businesses to switch to cars with lower emissions.

Background

1.2 As a general rule VAT is deductible only in so far as it relates to the taxable business activities of a taxpayer. In the case of fuel, the business use of each car would need to be determined in order that the right amount of value added tax is deducted. This would involve taxpayers maintaining full mileage records for each car. By way of voluntary simplification the UK provides taxpayers with an average private fuel expenditure charge for each car, thereby removing the administrative burden of full mileage records. The existing legislation is in Value Added Tax Act 1994 section 57 and policy for this legislation is administered by HMRC.

Rationale for Government Intervention

1.3 The measure will introduce a new VAT fuel scale charge, which will follow a carbon emissions basis, as part of the Government's strategic approach to vehicle tax working alongside the reformed company car tax and fuel benefit charge. Legislation has been enacted in the Finance (NO. 2) Act 2005 which provides that the new system will be brought into force on a day or days as the Treasury may appoint by order.

CONSULTATION

Within Government

1.4 HMRC consulted with direct tax colleagues, Treasury and Department of Environment Food and Rural Affairs on the environmental aspects.

Public consultation

1.5 In advance of the legislation, HMRC sent a discussion paper to fourteen trade and professional bodies and advisers. In general terms, there was not much enthusiasm for the proposal. Several respondents expressed concerns about its effectiveness as an environmental measure; the incremental cost for a higher polluting vehicle was not significant as the charge must be linked to the cost of fuel and such a low differential would never affect the choice of vehicle. Similarly, several respondents thought the implementation costs could be significant where IT system changes were necessary although follow up consultation efforts have suggested that IT costs might not be as significant as first thought. However, there was an acceptance about the worthiness of a joined up environmental message and the consistency of having a VAT scale charge that, like direct tax and Vehicle Excise Duty, adopted a CO2 basis.

Option for Achieving Policy Objective

1.6 HMRC wished to raise the environmental profile and provide a consistent message on the issue of CO2 emissions. These benefits could not have been achieved if the VAT fuel scale charge had remained unchanged. Having undertaken to make the change, HMRC offered the respondents to our earlier discussion a range of options. The options were based on variants of the model adopted for company car fuel benefit charge purposes, which has 21 bands and CO2 increments of 5g/km ranging from 140-240 or above. The variants can be summarised as follows:

- Same range with increments of either 15g/km or 45g/km;
- Extended range with same increments; and
- Extended range with 15g/km, 30g/km or 55g/km increments.

1.7 Consultees accepted that the extended range would better target the lower and higher polluters. However, it would introduce a further system different to others already in place for company car fuel benefit, which has 21 bands and Vehicle Excise Duty, which has 6 bands. Therefore, the final preference was for a scheme based on the current company car fuel benefit tax scheme. This was on the basis that business is more familiar with this scheme and would find the changeover to a similar one for VAT purposes less of a burden.

COSTS AND BENEFITS

Sectors and groups affected

1.8 Any business that currently uses the existing VAT fuel scale charges system will be affected by the proposed measure. The measure does not impact on any one sector because the simplified system is available to all UK businesses and should be no more or less likely to be used by any particular sector or business owning cars. Furthermore, the fuel scale charge system is entirely voluntary. With regard to business groups, one of the respondents to the last round of consultation indicated that in their opinion not many large employers would use the VAT fuel scale charge system because of the cost inefficiencies of the benefit in kind rules. So it would appear that the proposed measure would impact more on small and medium enterprises.

Costs

1.9 This proposal should have a nil impact on businesses' administrative burdens, as measured by the Standard Cost Methodology. It will not lead to businesses having to submit any additional information to HMRC, nor should it add to the net level of complexity when completing existing information obligations. Instead, all costs of this proposal will be wider compliance costs that do not form part of the Standard Cost Methodology.

1.10 Business compliance costs are expected to be largely 'one-off' costs of introducing the new scheme. There was a general consensus amongst those consulted that ongoing compliance costs would be negligible. Once the new system becomes embedded, it should be no more complicated to operate than the existing system; businesses will still have to identify their vehicle on a table of vehicle characteristics, just as before.

1.11 Although the table will have more bands than at present, 21 possible charges compared to 6, it should be no harder to identify where vehicles fit on that table. Furthermore, the new system will have one less dimension to it in that the fuel scale charge will be determined by CO2 emissions alone rather than a combination of fuel type and engine capacity. The exception will be for vehicles too old to have an official CO2 rating; these businesses will be assigned a set band in the new system based on engine capacity alone, as with direct tax company car charges. However, the number of these older vehicles being used by businesses will decline over time, and so this issue will also continue to fade as time goes by.

1.12 Those who responded to the discussion paper indicated that the effect on a small business with few cars would be insignificant on an individual trader basis. Any one-off cost to smaller businesses should mostly be caused by having to familiarise themselves with the proposed CO2 based system. (Many businesses will already be aware of the underlying concept from using the company car fuel benefit.) For businesses unaware of their CO2 rating, a number of publicly available websites provide details on vehicles' official CO2 emission levels, and so the cost per business of searching for this information will be minimal.

1.13 Vehicle Certification Agency - CO2 Database¹ <http://www.vcacarfueldata.org.uk/search/search.asp>

1.14 Larger businesses operating large fleets of cars which still use the fuel scale charge system will incur some costs in adapting their IT systems to reflect the new system. However, meetings with those trade bodies involved in the discussion process concluded that these changes might be relatively easy to complete.

1.15 Having considered all of the above factors HMRC have estimated the total additional one-off compliance cost for the new measure to be around £4 million. HMRC also estimates that the total number of businesses affected is approximately 540,000. The estimated one-off cost per business is therefore low; around £7.50 per business on average, although there will be a distribution of businesses above and below this average figure depending on the circumstances of individual businesses.

¹ <http://www.vcacarfueldata.org.uk/search/search.asp>

Benefits

1.16 The measure will reinforce the Government's strategic approach to vehicle tax working alongside the reformed company car tax and fuel benefit charge. As such, it will contribute to the Government's goal of delivering a better environment and provide consistent tax incentives for less polluting cars.

1.17 There may be a small benefit to businesses through having Vehicle Excise Duty, direct tax company car charges and VAT fuel scale charges all using a common basis. However, some respondents to the discussion paper indicated that these efficiency savings might be negligible. In the interests of caution, we have therefore chosen to discount any such possible benefit from our analysis of this proposal.

1.18 This proposal is designed to be revenue neutral overall.

SMALL FIRMS IMPACT

1.19 As mentioned above, informal consultation indicated that there does not appear to be any significant impact on small business at the individual level. The Federation of Small Businesses has been involved at every stage of the consultation process and has not raised any concerns. Other respondents specifically made the point that the impact on small businesses would not be significant.

COMPETITION ASSESSMENT

1.20 This proposal has been run through the Cabinet Office's competition assessment filter test. As the proposal simply changes the basis of the existing VAT fuel scale charge, it is not expected to have any additional effects on competition.

ENFORCEMENT, SANCTIONS AND MONITORING

1.21 The private use charge is a well-established system by which taxpayers can account for privately used fuel. In addition, under the existing system, the charge is revalorised each year to reflect changes in fuel prices; taxpayers are therefore used to annual changes in the amount of the charge. Consequently, HMRC do not foresee any enforcement problems by simply changing the basis of the charge.

1.22 Clear guidance and information on the new arrangements will be published to minimise the potential for accidental errors when introducing the new system.

1.23 Since the level of the fuel scale charge will need to be kept in line with fuel prices, the effects of the new system will be monitored as part of that annual process.

IMPLEMENTATION AND DELIVERY PLAN

1.24 HMRC are publicising the changes to the fuel scale charge system in December 2006, which is well in advance of the 1 May 2007 implementation date. The advance publicity will give larger businesses sufficient time to make any necessary IT changes and will include a specimen of the new legislation as well as details of the link to the Vehicle Certification Agency website should businesses not have details of their vehicles CO2 rating. There is no need for additional guidance as those businesses which already use the existing VAT fuel scale charge will be familiar with the system and there are no new forms relating to the change.

POST IMPLEMENTATION REVIEW

1.25 HMRC will carry out a post implementation review after 2 years of the changes coming in to force.

SUMMARY & RECOMMENDATION

1.26 After extensive consultation with business we have recommended the 21 band CO2 system as detailed in the Option for Achieving Policy Objective section above. This option will achieve the policy objectives of raising the environmental profile of company cars and providing a consistent message on the issue of CO2 emissions.

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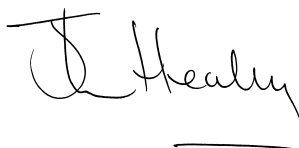
REGULATORY IMPACT ASSESSMENT

Value Added Tax (Cars) (Determination Of Consideration For Road Fuel Supplied For Private Use) Order 2007

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:



JOHN HEALEY, FINANCIAL SECRETARY TO THE TREASURY

Dated: 5 December 2006

VAT: IMPLEMENTATION OF ECJ DECISIONS CHARLES & CHARLES TIJMENS AND WOLLNY

PURPOSE AND INTENDED EFFECTS OF THE MEASURE

Objective

2.1 To introduce appropriate legislative controls to ‘Lennartz accounting’ in order to protect VAT revenues and help clarify the process for organisations using ‘Lennartz accounting’, by implementing certain decisions of the European Court of Justice (ECJ) in the ‘Lennartz’ strand of case law.

Background

2.2 So-called ‘Lennartz accounting’ derives from decisions of the ECJ. It allows taxpayers to treat a new asset as a wholly business asset, even if there will be some non-business use and even if business use is very small. This means they can recover all the VAT incurred on the asset immediately and then account for VAT on the non-business use over the economic life of the asset (“non-business use charges”). This spreads the cost of irrecoverable VAT over the economic life of an asset. If Lennartz accounting is not used, the VAT is apportioned between business and non-business use at the outset and there is no further adjustment. The choice of whether to use Lennartz accounting is implicit in EU and UK law.

2.3 To date, there have been no specific rules dealing with Lennartz accounting in the UK: the ECJ’s decisions have been allowed to apply directly. This is possible because the ECJ has consistently said that Lennartz accounting is implicit in EU (and therefore UK) law: the decision to allocate the asset wholly to business purposes is made at the outset and VAT law is then applied accordingly.

2.4 In 2003 legislation was introduced which was intended to prevent Lennartz accounting on land and buildings. This legislation was rendered ineffective by the ECJ’s decision in Charles & Charles-Tijmens (C-434/03). Subsequently, HMRC accepted that Lennartz accounting could apply to land and buildings, and adopted a policy that the economic life of the asset should be 20 years. Subsequently, the ECJ decided in Wollny (C-72/05) that an EU member State could introduce legislation to make the Lennartz accounting period the same as the scheme for adjusting input tax on capital items (the UK’s capital items scheme provides for a 10 year adjustment period).

2.5 In view of the above, the Government has decided to introduce three measures:

1. To implement the European Court of Justice (ECJ) decisions in Charles & Charles-Tijmens by repealing ineffective legislation;
2. To implement the European Court of Justice (ECJ) decisions in Wollny by limiting the period over which so-called ‘Lennartz accounting’ occurs; and
3. To clarify the legislation to resolve what is arguably a loophole.

Rationale for Government Intervention

- Certain legislation should be repealed because the decision of the ECJ in Charles & Charles-Tijmens has rendered it ineffective. If action is not taken, dead wood is left which might confuse tax payers or even be manipulated by those seeking to avoid VAT;
- The decision of the ECJ in Wollny allows the UK to legislate to set out the process of accounting for VAT on non-business use of 'Lennartz assets'. To date there has been no explicit process in the legislation. This change clarifies the process and helps protect VAT revenues and provide certainty for our customers. If action is not taken uncertainties will remain for affected organisations and HMRC, and VAT revenues will suffer; and
- There is a possible loophole which, if exploited successfully, could enable organisations to make an absolute VAT saving of up to 50 per cent of the VAT initially incurred. The position is being clarified to give customers certainty and protect the revenue. If action is not taken at the same time as the above measures, it may prevent an attractive exit route for those seeking to avoid VAT.

CONSULTATION

2.6 There has been an ongoing dialogue between HMRC and businesses for a number of years concerning the correct interpretation of a number of decisions of the ECJ in this area. The first two measures above implements two clear ECJ decisions in the context of that dialogue. Draft legislation for the main change, measure 2 above, should be published in time for consultation before the intended implementation date of 1 September.

OPTIONS

1. Implement all three measures

2.7 This option repeals ineffective legislation, protects the revenue and clarifies the process for accounting for VAT on non-business use charges.

2. Implement only measure 1

2.8 This option only repeals the ineffective legislation, with a view to making the minimum change necessary to keep UK legislation in line with the ECJ case law. This option carries the risk of deterioration in terms of increased revenue loss and ongoing confusion for HMRC customers in terms of the absence of any regulations governing the 'Lennartz accounting' process. This option might also encourage non-compliant organisations to try to exploit the absence of 'Lennartz accounting' regulations.

3. Do Nothing

2.9 This option carries the risk of deterioration in terms of increased revenue loss and ongoing confusion for HMRC customers in terms of the absence of any regulations governing the 'Lennartz accounting' process. This option might also encourage non-compliant organisations to try to exploit the absence of 'Lennartz accounting' regulations.

COSTS AND BENEFITS

Sectors and groups affected

2.10 These measures affect any organisation with both business and non-business activities, or any business which has regular non-business use of business assets. Primarily, organisations in the education, health and charity sectors are using 'Lennartz accounting', although in principle any business sector might be eligible, depending on the way their assets are used. In addition, some businesses are looking at ways to exploit 'Lennartz accounting' artificially.

Analysis of costs and benefits

2.11 Option 1. This option results in negligible additional compliance burden on businesses and other organisations in terms of familiarisation with the new rules. It also results in a negligible reduction in administrative burden in that (in simple terms) Measure 2 halves the period over which non-business use must be monitored and non-business use charges must be calculated and paid. Option 1 also produces the benefits of clearing 'dead wood' in the legislation, clarifying the process of accounting for non-business use charges and protecting VAT revenue.

2.12 Option 2. This option results in negligible additional compliance burden on businesses and other organisations in terms of familiarisation with the new rules. Option 2 has the benefit of clearing 'dead wood' in the legislation.

2.13 Option 3. This option has no immediate effect on costs and benefits.

SUMMARY OF COSTS AND BENEFITS

2.14 Option 1 involves negligible, and offsetting, compliance cost additions and reductions. It provides certainty for customers and helps to protect VAT revenues.

SMALL FIRMS IMPACT TEST

2.15 Small firms that use 'Lennartz accounting' will be affected by these changes. The effect will be to regulate the cash flow advantage that has been enjoyed by those that have used 'Lennartz accounting'.

COMPETITION ASSESSMENT

2.16 The competition filter test has been applied and the changes passed. The changes will not impact directly on any particular markets as 'Lennartz accounting' can in principle be used across all sectors by any size of business. Sectors where assets are commonly purchased for both 'business' and 'non-business' use include, Health, Education and Charities. The introduction of legislative controls to Lennartz accounting are not expected to have any significant effects on competition in any sector although they will make it easier for those businesses that purchase assets for both 'business' and 'non-business' use.

ENFORCEMENT, SANCTIONS AND MONITORING

2.17 This will be enforced through the normal operation of the VAT system, including HMRC's assurance programme. VAT repayment claims relying on 'Lennartz accounting' will continue to be separately monitored to detect trends to inform policy-making and identify artificial avoidance activity.

IMPLEMENTATION AND DELIVERY

2.18 These Measures involve very minor change to the VAT system, so will be implemented and delivered through the Finance Bill, secondary legislation and the normal VAT assurance programme. Measures 1 & 2 will be effective from 1 September 2007 and measure 3 will be effective from Budget Day. Guidance to customers will be provided as early as possible to ensure that the measures can be implemented as easily as possible.

COMPLIANCE COST REVIEW

2.19 A compliance cost review should be carried out two or three years after introduction of the legislation.

SUMMARY AND RECOMMENDATIONS

2.20 Option 1 is recommended because it delivers real benefits to both external organisations and HMRC with no overall additional administrative burden, as well as protecting VAT revenue in a significant area.

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REGULATORY IMPACT ASSESSMENT

Vat: Implementation Of European Court Of Justice Decisions Charles & Charles Tijmens And Wollny

Statement of Ministerial Approval

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister

A handwritten signature in black ink, appearing to read "Dawn Primarolo". The signature is fluid and cursive, with a prominent initial 'D' and a long, sweeping tail.

DAWN PRIMAROLO, PAYMASTER GENERAL

Dated: 1 March 2007

3

VAT: TRANSFER OF GOING CONCERNS - RETENTION OF RECORDS

PURPOSE AND INTENDED EFFECTS OF THE MEASURE

Objective

3.1 To simplify VAT record-keeping rules when a business is transferred as a going concern (TOGC) with effect from 1 September 2007.

Background

3.2 Special VAT rules apply where a person acquires a business and its assets as a going concern, and they intend to continue operating the business. In these circumstances, VAT law prescribes that the business records of the seller must be transferred to the buyer.

3.3 However, there are two common situations when this does not happen:

- Where on application from the seller HMRC directs that the records can be retained by the seller; and
- Where the seller or buyer and their advisers are unaware of the VAT rule.

3.4 HMRC estimates that there are around 50,000 TOGC's per year. Business advisors tell HMRC that in practice, many businesses are unaware of the rules and that the proposed changes will create greater certainty for them.

3.5 Requiring the records to be transferred to the buyer is at odds with direct tax, company law and insolvency law rules, which all require the seller to keep their records. In addition, there are a number of areas where the buyer needs to obtain certain information from the seller to enable them to comply with their VAT obligations. Thus the current rule does not tally with other regulatory regimes.

CONSULTATION

3.6 During an extended consultation (which was delayed pending a decision in the Zita Modes Sarl European Court of Justice case (C-497/01), which arrived at the end of 2003) businesses and advisers have consistently told HMRC that they wanted HMRC to change the law so that the seller was allowed to retain his records following a TOGC, and that this was their main aspiration for the review.

3.7 Following announcement at 2006 Pre-Budget Report of the intention to change the record keeping requirements, HMRC informally consulted interested parties on the draft legislation. No issues were raised that necessitate any significant changes in the legislation as drafted.

OPTIONS

1. Do Nothing

3.8 This option maintains the current rules, which prescribe that the business records of the seller must be transferred to the buyer.

2. Change the law so the records are retained by the seller

3.9 Amend VAT law so that:

- The seller will keep the business records in all but a few specified cases;
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act; and
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

COSTS AND BENEFITS

Sectors and groups affected

3.10 Some 100,000 businesses are expected to fall under these TOGC rules each year by buying or selling a business and over 99 per cent of these are expected to be small businesses. TOGC is used across all business sectors and although no individual sectors are likely to be affected to a significant extent, it is often seen among restaurants, cafés and small retailers.

Analysis of Costs and Benefits

Option 1. Do nothing

3.11 This option has no costs as it maintains the current rules, which prescribe that the business records of the seller must be transferred to the buyer. Requiring records to be transferred to the buyer under the TOGC rules, especially for small businesses, was top of the list of concerns that came out during the review. It causes uncertainty plus an unnecessary administrative burden on sellers who wish to retain their records and have to apply to HMRC to do so. As such, this option offers no direct benefits to businesses.

Option 2. Change the law so that records are retained by the seller

3.12 Amend VAT law so that:

- The seller will keep the business records in all but a few specified cases;
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act; and
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

Costs and Benefits

3.13 The proposed simplifications relate to three main areas:

Transfer of Records

3.14 This option removes the requirement for the seller to transfer business records to the buyer and provides the major benefit to businesses. A transfer of full records does not happen in all cases of TOGC (such as where on application from the seller HMRC directs that the records can be retained by the seller or where the seller or buyer and their advisers are unaware of the VAT rule). However, where records are transferred the time involved to produce the relevant records will vary. Sellers will normally have to examine records to make sure they are not needed for other purposes and this is likely to take many of them, or their agent or accountant, an hour or more. Assuming that across all 50,000 TOGCs each year it takes sellers on average at least one hour to transfer business records, the current administrative burden is estimated at around £760,000, of which around 99 per cent relates to small businesses.

3.15 Businesses will welcome the removal of this obligation, which will end the uncertainty for sellers that wish to retain their records and reduce the administrative burdens from costs incurred by some sellers in having to apply to HMRC for confirmation that they can keep the records.

3.16 This option will also set out in the law that information must be transferred to the buyer, so that they can comply with their taxpayer obligations. It had been intended originally that the information that must be passed to the buyer would be set down in the law. However, this has not been possible because of the variety of information that would need to be covered. Therefore, the seller will be required to make available to the buyer the information the buyer needs to comply with his duties under the VAT Act 1994. Also, HMRC will be able disclose such information to the buyer where the seller fails to provide it to the buyer. The information that must be passed to the buyer is expected to be readily accessible from the seller's records and sellers should not need to spend much time finding and sending information to the buyer. Assuming that extracting the specific information and sending it to their buyers will save 50,000 sellers over 50 minutes compared with the assumed time required for the current rules suggests that their administrative burden might be reduced by at least £650,000 a year.

Retention and VAT records

3.17 Under the current rules, at the request of the seller, HMRC may allow it to retain the VAT records of the business. HMRC estimate that requesting permission to retain their records each year costs businesses around £200,000, 99 per cent of which is borne by small businesses. By removing this obligation, businesses will no longer incur administrative burden costs of having to request permission from HMRC to retain their business records.

3.18 It is expected that businesses will welcome the removal of this requirement to seek permission and reduce the administrative burdens by around £200,000 from costs incurred in having to apply to HMRC for direction.

3.19 When the seller's VAT registration number is transferred to the buyer, the records will continue to be passed to the buyer. The seller will be able to seek permission from HMRC for the records to be retained. However, this is likely to affect very few businesses because transfer of VAT number usually occurs only where a business merely changes its legal status (and so it is essentially the same business).

Obligation of Transferee

3.20 To meet their VAT obligations following a TOGC, buyers will usually need to access and use information about the business before they take ownership. This is currently assumed to involve around 15 minutes of a buyer's time at an annual cost of over £190,000. Replacing the requirement for sellers to transfer all the business records with a requirement to make available to the buyer the information the buyer needs to comply with his duties under the VAT Act 1994, will make it much easier for buyers to fulfil their obligations. Although the exact information buyers will receive will vary according to the nature of business, the requirement is expected to ensure direct access to the information commonly needed by buyers and cut the amount of time they need to spend in obtaining information about the businesses before they take ownership. Assuming this will reduce the amount of time involved by 10 minutes indicates an administrative burden saving of around £125,000 a year.

3.21 The total savings in administrative burdens from this option in these three areas is estimated at around £1 million a year. The majority of businesses affected are small businesses, who are often confused by the perceived complexity of the rules or are totally unaware of them. By increasing certainty about the VAT treatment of TOGCs, this option provides a significant benefit to such businesses. As businesses tend to fall within TOGC rules on an occasional basis only, no initial set-up costs are anticipated.

3.22 Representatives of business and their advisors tell us that these proposed changes will reduce the administrative burden associated with a TOGC. Additional compliance costs for representatives and advisers are unlikely to be significant being restricted to a brief familiarisation with the new simpler rules.

3.23 Businesses will see other additional benefits from regularising the position with other regulatory regimes. The proposed changes will clarify the law and bring record keeping into line with other tax and regulatory regimes in that the seller will keep his business records in all but a few specific cases and legislation will require that the seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act.

Option 3. Seller retains records even where the VAT registration number is transferred

3.24 Amend VAT law so that;

- The seller will keep the business records in all cases;
- The seller must make available to the buyer information necessary for the buyer to comply with his duties under the VAT Act; and
- HMRC can obtain from the seller and disclose, if necessary, such information to the buyer.

Costs and Benefits

3.25 This option would similarly relate to three main areas:

Transfer of records

3.26 As for Option 2. However, under this option, the administrative burden will also be removed when a VAT registration number is transferred from the seller to the buyer. There would be a requirement that the seller make available to the buyer the information he needs to comply with his duties under the VAT Act. Although this is expected to apply to very few TOGCs, as the transfer of a VAT number usually occurs only where a business merely changes its legal status, it presents a revenue risk, since the buyer takes on the liabilities and obligations of the seller.

Retention of VAT records

3.27 As for Option 2, with the caveat in the above paragraph.

Obligations of Transferee

3.28 As for Option 2.

SMALL FIRMS IMPACT TEST

3.29 Small businesses were consulted as part of the review, which commenced in 2000. Some 100,000 businesses are expected to fall under these TOGC rules each year when they buy or sell a business and over 99 per cent of these are expected to be small businesses. TOGC is used across all business sectors and although no individual sectors are likely to be affected to a significant extent, it is often seen among restaurants, cafés and small retailers.

3.30 The proposed changes will be of benefit because the current rules cause difficulties by being at odds with other regulatory regimes. The clearer rules will reduce administrative burdens by saving time, particularly for the smallest businesses.

COMPETITION ASSESSMENT

3.31 The competition filter test has been applied and the changes passed. The changes will not impact directly on any particular markets as TOGC is used across all business sectors by mainly small local businesses. Sectors where TOGC is particularly common include restaurants, cafés and small retailers. These simplifications are not expected to have any significant effects on competition in any sector although they will make it easier for those businesses that change ownership and fall under these rules.

ENFORCEMENT, SANCTIONS AND MONITORING

3.32 We do not expect any enforcement, sanctions or monitoring issues because these changes release businesses from current requirements.

3.33 HMRC staff, as part of the assurance of the businesses affected, will monitor compliance with the law. Those businesses will be subject to the usual enforcement procedures for VAT registered businesses. No additional cost is envisaged as a result.

3.34 Options 2 and 3 should have an administrative saving for HMRC who will no longer need to grant permission for records to be retained by the seller.

IMPLEMENTATION AND DELIVERY PLAN

3.35 The intended changes will be effective for contracts entered into on or after 1 September 2007. Prior to the effective date, VAT Notice 700/9 and HMRC guidance will be revised to reflect the changes.

POST IMPLEMENTATION PLAN

3.36 HMRC will carry out a post-implementation review as soon as the change has bedded in and suitable data are available. This is expected to be within 3 years of implementation, but developments will be monitored to ensure that any review is neither premature, nor unnecessarily delayed. The findings will be used to enhance the policy-making process – both in this area and across HMRC in general.

SUMMARY AND RECOMMENDATION

3.37 The measure is intended to simplify the VAT record-keeping rules and reduce administrative burdens for businesses when a business is transferred as a going concern. The current rules are poorly understood, and out of step with other tax and regulatory regimes.

3.38 The options are:

- Do nothing (Option 1). This would maintain the current rules so that the business records of the seller must be transferred to the buyer. This would be unwelcome by business and at odds with direct tax, company law and insolvency law rules, which all require the seller to keep his records;
- Change the law so that the records are retained by the seller in most cases (Option 2.). It is HMRC's view that changing the law would provide an important contribution to reducing administrative burdens for business that are transferred as a going concern; and
- Change the law so that records are retained by seller even where the VAT registration number is transferred in most cases (Option 3.) Under this option, the administrative burden will also be removed when a VAT registration number is transferred from the seller to the buyer. However, the risk of tax loss if the records are not required to be transferred to the buyer by law, the limited number of TOGCs involved and the need protect buyers taking on the obligations of the seller, outweigh the minor saving in administrative burden associated with it.

3.39 It is therefore recommended that the changes outlined in Option 2 are taken forward.

3.40 At the same time, changes will be made to confirm that in UK VAT legislation the transfer of a going concern includes the transfer of part of a business which is capable of separate operation. This reflects HMRC current application of UK law, and ensures that UK law more accurately reflects EC law. Therefore, no additional burdens will occur.

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REGULATORY IMPACT ASSESSMENT

Vat: Transfer Of Going Concern - Retention Of Records

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:



DAWN PRIMAROLO M.P. PAYMASTER GENERAL

1 March 2007

4

ALTERNATIVE FINANCE PRODUCTS

INTRODUCTION

4.1 This final regulatory impact assessment considers the costs and benefits of options for addressing the tax treatment of sukuk. It is also concerned with a minor clarification to the alternative finance arrangement legislation in Finance Act 2006. It accompanies the announcement of legislation in Budget 2007 to amend certain rules for Income Tax, Corporation Tax, Capital Gains Tax, and Stamp Duty Land Tax (“SDLT”).

PURPOSE AND INTENDED EFFECTS OF THE MEASURE

4.2 Alternative methods of finance, structured in a way that does not involve interest, were not conceived of when most tax law was drafted. As a result the tax treatment of some alternative finance products is inconsistent or uncertain when compared with conventional finance products.

4.3 Since 2003 legislation has been introduced to ensure that the tax treatment of alternative methods of finance is made certain and is, as far as possible, neither more nor less advantageous than that of equivalent financial products. This gives those people and entities wishing to utilise alternative finance products the ability to do so without being disadvantaged because of tax.

4.4 There is currently legislation enabling the provision of alternative methods for an individual or business to finance a property purchase, bank deposits and borrow money from a financial institution. The focus has moved to the issue of sukuk.

Background

4.5 The demand for alternative finance products comes mainly from Muslims, although they may be used by any consumer. Islamic (or Shari’a) law prohibits transactions that involve interest, gambling, speculation or unethical investment.

4.6 The most pronounced difference between Islamic financing and existing equivalent products is the prohibition on interest. For customers wishing to adhere to Shari’a law, this rules out financial products that result in either payment or receipt of interest, such as conventional deposit accounts and loans. However, Shari’a law does not prohibit the making of a return on capital if the provider of the capital is willing to share in the risks of a productive enterprise. Thus profit and loss sharing arrangements are considered acceptable, provided there is shared risk.

4.7 Islamic financial transactions are structured using contracts, or combinations of contracts that satisfy the requirements of Shari’a law. Some of the most common are as follows:

- Mudaraba financing, a partnership structure, consisting of one or more partners that contribute capital and a managing partner who contributes knowledge and expertise. The managing partner receives a fee for services provided;

- Murabaha, sometimes referred to as mark-up or cost plus financing. The financial institution purchases the goods for the customer, and re-sells them to the customer on a deferred basis, adding an agreed profit margin;
- Musharaka financing, a partnership agreement. A common form is diminishing musharaka where the partners jointly acquire an asset. The financier's share of the asset decreases through periodic payment containing elements of capital repayment and rent from the other partner, who eventually becomes the sole owner;
- Ijara, the Islamic equivalent of a conventional lease. There are several variations on this structure, one important form being ijara wa'iqina. Ijara wa'iqina is similar to a hire purchase agreement; the financial institution buys goods, rents them to the customer and transfers the goods to the customer in exchange for a defined terminal payment;
- Wakala, a form of agency agreement. The financial institution promises a return to the investor. The financial institution keeps any return over and above that which has been promised to the investor as their agency fee; and
- Sukuk, which is at its simplest a certificate (sakh) that evidences a share in the beneficial ownership of particular assets. The holder of the certificate is paid a return that is their share of the income generated by the assets. The issue of the sukuk obtains funding and can 'securitise' assets.

4.8 Financial institutions in the UK are now offering Shari'a compliant alternative finance products that are economically equivalent to conventional banking products but do not involve interest or speculative returns.

4.9 In 2003, reforms to modernise SDLT included two reliefs for Alternative Property Finance.

4.10 The first concerned a series of chargeable land transactions that are not necessary under conventional mortgage structures, and the reform relieved those transactions from SDLT.

4.11 The second removed the possible double imposition of SDLT on a house purchased using two Shari'a compliant financial products.

4.12 Further reforms in 2005 and 2006 concerned:

- savings products (including mudaraba and wakala);
- asset finance (murabaha and musharaka products);
- SDLT (lease based mortgages); and
- Child Trust Funds.

4.13 A Regulatory Impact Assessment for the 2006 changes was published in March 2006 <http://www.hmrc.gov.uk/ria/ria-alt-finance.pdf>.

Rationale for Government Intervention

4.14 The tax treatment of the issue of a sukuk based upon Shari'a compliant financial products is in some areas uncertain and in others produces anomalous results. These anomalies can put providers of Shari'a compliant products at a commercial disadvantage. Whereas conventional mortgages can be securitised and the tax treatment certain. A securitisation of a conventional mortgage book enables the financial institution to expand its lending capacity whilst complying with the current Regulatory regime for lenders. Tax uncertainty is one factor that prevents providers of alternative finance products from issuing sukuk based on their portfolio of alternative finance products. This restricts the market for alternative finance products by preventing the financial institution from expanding its lending capacity.

4.15 A number of issues have emerged from further consultation with representatives from the community, professional advisors and financial institutions since the changes made in Finance Act 2006. Taking these forward it is proposed to make the following changes in Finance Bill 2007.

- Ensure that the current uncertainty on the tax treatment of sukuk is resolved; and
- Clarify the tax treatment of wakala based products to ensure that the income arising from such products is taxed on the correct person.

CONSULTATION

Within Government

4.16 The risks to be addressed are issues of taxation; consultation has therefore taken place within HM Treasury and HMRC as the two departments involved with tax policy.

Externally

4.17 HM Treasury and HMRC have continued the process of consulting informally with consumers and providers of alternative finance products. A technical working party involving banking, legal and accounting professionals has been formed to look at the direct tax treatment of alternative finance returns. This group has been informally consulted regularly throughout the last year, the last meeting of the working party being on 4 October 2006, although informal discussions have taken place since then.

OPTIONS

Do Nothing

4.18 This option will leave the risks and uncertainties set out above in place, disadvantaging those financial institutions who wish to offer alternative finance but are unable to securitise current financial assets. Islamic banking is a worldwide growth area – tax barriers will restrict the competitiveness of UK institutions (or UK branches of overseas banks) that wish to offer Shari'a compliant products.

Legal Opinion

4.19 Seeking a legal opinion of the tax treatment of each product seen and publishing it with guidance. This would remove any uncertainty over how much tax the parties were liable for and enable commercial decisions to be made about whether or not to proceed. However, this is only a temporary solution as products will need to be considered on an ad hoc basis and does not address the issues arising when an anomalous tax treatment is found.

4.20 As legal opinion can only be sought on existing products, this solution cannot address the need to provide a clear framework for developing new products for the UK market.

Legislation

4.21 After internal analysis and consultation, the preferred way forward is to recommend a legislative solution. However, the precise form of the legislation requires careful consideration to fit with existing tax law for financial products and the UK's responsibilities under its network of taxation treaties. In consultation it emerged that it would not be possible to address all tax issues affecting the development of Shari'a compliant products with a single piece of legislation. HMRC shall therefore be continuing the consultation process through to Budget 2008.

COSTS AND BENEFITS

Sectors and Groups affected

4.22 These issues affect two main groups:

- Financial institutions; and
- Muslim consumers and businesses wishing to invest in Shari'a compliant products.

4.23 Financial institutions offering Shari'a compliant products currently within the alternative finance regime will be disadvantaged because of the uncertainty over the tax treatment of any sukuk issued on the basis of such products, whereas the securitisation of conventional financial assets, such as a mortgage book will have certainty of tax treatment. If financial institutions are unable to securitise their Shari'a compliant financial assets this may restrict the ability of the financial institutions to offer such products.

4.24 Initially, Shari'a compliant products were geared primarily towards individuals, but this has now been extended to businesses. If tax uncertainty restricts the ability of financial institutions to issue sukuk based on Shari'a compliant financial assets within the alternative finance regime then this will similarly restrict the funding available to Muslim consumers and businesses for property purchases.

4.25 The issue of a sukuk provides an opportunity for Muslim individuals and businesses to invest in a Shari'a compliant product. Resolution of the tax uncertainty surrounding a sukuk issue will encourage Muslim investors to purchase sukuk certificates.

Benefits

Do nothing

4.26 There are no appreciable benefits of this option. This option will do nothing to address the underlying tax problems set out above and will therefore be of no benefit to the financial institutions who offer alternative financial products nor to customers and businesses that require them.

Legal Opinion

4.27 Providing legal opinions on individual products would offer limited benefits. It would offer some certainty over the tax treatment, but it is not a judgment so has no legal force. The issue of a sukuk also involves complex non-tax issues, such as trust law. In addition other sukuk issues with the same economic effect often have quite different legal structures and wordings. It is possible that products whose economic effect is the same could therefore have quite different tax treatments.

Legislation

4.28 The clarification of tax rules has the potential to further encourage development of Shari'a compliant financial products within the UK. The emergence of a thriving and competitive market in Islamic finance products could substantially benefit London as a global financial centre, generating further investment, jobs and tax revenues in the UK economy.

4.29 The primary policy objective is to remove existing inequalities that derive from the inapplicability of existing legislation to the taxation of alternative financial products, and to offer genuine choice to consumers wishing to take up these products. The Exchequer effect in the short term is expected to be minimal, but potentially positive in the long-term if more institutions offer such products, are able to securitise those products in a sukuk and so enabling the financial institution to provide further funding for their customer base.

4.30 Continued difficulties with the development of Shari'a compliant products has the potential to cause difficulty and frustration for the financial institutions offering such products and within the UK Muslim community. There are clear social and equality benefits in the wide availability of well-defined, well-regulated financial products in all sections of the community.

4.31 It is reasonable to expect that the development of a regulated Islamic financial sector in the UK would bring into the regulated environment financial transactions that may currently be taking place without any significant regulation or consumer protection.

Costs

Do nothing

4.32 Failure to act would not remove the uncertainties that inhibit the securitisation of Shari'a compliant products. It is likely that the market for sukuk will be constrained partly because of the tax issues involved with the result that any possible contribution towards financial inclusion and savings and asset objectives would be very limited.

4.33 There would be continued economic cost from this option. This could prevent financial institutions offering Shari'a compliant products or, for the major banks, locating their Islamic banking operations outside of the UK. In addition uncertainty over the tax treatment of sukuk issues would prevent the UK becoming a global player in the sukuk market.

Legal Opinion

4.34 Legal opinions might allow institutions offering sukuk issues to operate with certainty in the short-term with regard to specified issues but would not remove uncertainty in the longer term as products will need to be considered on an ad hoc basis. This option also cannot address the issues arising when an anomalous tax treatment is found.

4.35 This option would demonstrate the Government's serious consideration of the issues, but as legal opinion can only be sought on existing products, this solution cannot address the need to provide a clear framework for developing sukuk issues in the UK market.

Legislation

4.36 The social costs of legislating to remove inequality and uncertainty in the tax treatment of sukuk issues are minimal. This is however an evolving market. The Government is already aware that sukuk issues are being considered and developed, that may well need further legislation. The main risk is that, by raising customer expectations, HMT and HMRC will face continuing demands for further legislation as financial institutions develop more sophisticated Shari'a-compliant products that are not covered by existing provisions.

4.37 It is unlikely that legislation will have a significant Exchequer impact. For example, with regard to the changes to SDLT, the issues surrounding the tax treatment are discouraging sukuk issues based on Shari'a compliant property finance. Offering sukuk issues which do not give rise to a different level of SDLT will not result in any significant change in revenue.

4.38 Legislation will not be tied to the Qu'ran or the Islamic faith, but rather uses intrinsic features of the underlying contracts under UK law to define transactions to which the rules will apply. As always, the possibility of abuse has to be considered. The legislation will therefore contain safeguards to prevent it being used for avoidance.

4.39 It is not expected that there will be a compliance burden on business. There may be a cost during the transition period as advisors and financial institutions adjust to the new regime. However as the regime will only apply to financial institutions and investors issuing or holding sukuk any transitional costs will be limited.

4.40 There is some operational impact on HMRC. Amended guidance will be needed and advice may be requested by financial institutions on the tax treatment of a sukuk issue in a similar way as advice may be requested on a securitisation. However, it is not anticipated that the impact and cost will be substantial.

SMALL FIRMS IMPACT TEST

4.41 Initially most of the alternative finance products developed were geared towards individuals however over time a significant proportion of the customer base for providers of alternative finance products is likely to be Muslim proprietors of small businesses who wish to comply with the provisions of Shari'a law.

4.42 These measures, although not aimed directly at small businesses will enable financial institutions to continue to offer and potentially expand finance to customers requiring Shari'a compliant financing.

ENFORCEMENT, SANCTIONS AND MONITORING

4.43 These are positive measures for affected parties which allow consistent tax treatment. Avoidance disclosures will be monitored to identify, and where necessary act on, any attempt to use alternative finance arrangements for avoidance purposes.

4.44 The success, or otherwise, will be monitored on an ongoing basis through discussions with financial institutions and their advisors at the existing technical group meetings; any issues which arise will be addressed in a proportionate manner.

IMPLEMENTATION AND DELIVERY PLAN

4.45 The policy will be implemented by legislation to be included in the Finance Bill 2007 and by guidance to be published by HMRC.

ADMINISTRATIVE BURDEN

4.46 The cost is negligible. The aim of the policy is to provide an agreed tax structure and understanding within which sukuk can be taxed within the UK. There will be a small administrative burden placed on financial institutions and companies wishing to utilise the new legislation, as they will need to adjust to and understand the new regime, just as the securitisation regime. This will be more than balanced out by the benefits that the legislation brings through enabling financial institutions to securitise their Shari'a compliant products and providing certainty to investors wishing to purchase sukuk.

POST-IMPLEMENTATION REVIEW

4.47 There are plans to conduct a survey of financial institutions and alternative finance consumer groups (e.g. Muslim Council of Britain) at an appropriate juncture to check the awareness of alternative finance products in the market and whether there are any further taxation issues which hinder the adoption of alternative finance products.

4.48 Ongoing informal review, through the existing technical group meetings, of the legislation allowing early consideration of any problems will continue.

SUMMARY AND RECOMMENDATION

Table 4.1 Summary costs and benefits table

Option	Total benefit per annum: economic, environmental, social	Total cost per annum: - economic, environmental, social - policy and administrative
1	None	Unfairly restricts the business of Shari'a compliant financial services.
2	A Legal opinion will allow institutions to offer products with certainty over how HMRC will treat them for tax It will allow wider access to finance from the regulated sector.	This option will carry a small administrative burden to HMRC. There is a risk that a court may disagree with any legal opinion. There are likely to be future costs of finding a long term solution
3	Enables a level playing field for tax purposes. Indirectly promotes financial inclusion. Promotes competition in the financial sector. Provides a framework and precedent for future work in this area.	Small administrative burden to HMRC. Legislation will need to be updated to reflect further innovations.

4.49 The market for alternative finance products has the potential to be very large, but current providers of alternative finance products are rendered uncompetitive with other financial institutions due to the tax treatment of sukuk products.

4.50 The market has welcomed the legislation already enacted to remove unequal tax treatment from certain alternative finance products. Informal consultation has highlighted further areas containing unequal treatment. A long-term approach is required to enable the UK to maintain its position as a global financial centre.

4.51 Legislation is therefore recommended to provide a long-term, stable, solution to the unequal treatment presently received by alternative finance structures identified.

Contact point

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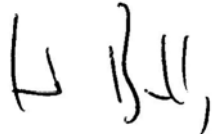
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REGULATORY IMPACT ASSESSMENT**Alternative Finance Products****Statement of Ministerial Approval**

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

Signed by the responsible Minister:

A handwritten signature in black ink, appearing to read 'Ed Balls,'.

Ed Balls, Economic Secretary to the Treasury

Dated: 13 March 2007

HMRC ONLINE SERVICES: INCREASING USE OF ONLINE FILING AND ELECTRONIC PAYMENT

PURPOSE AND INTENDED EFFECTS OF THE MEASURE

The policy objectives

5.1 To maximise customer take-up of the online services offered by HM Revenue and Customs in order to:

- provide a better and more cost effective service for customers;
- encourage wider use of new technology that can provide further benefits for customers; and
- capture clean, easily processed data to help drive down costs for customers and HMRC.

5.2 The aim is to encourage all customers, and in particular business customers, to file income tax self assessment (SA) returns, company tax returns, value added tax returns (VAT) and pay as you earn (PAYE) in-year forms online. Businesses will also be required to pay VAT and corporation tax (CT) electronically. The changes described below will be implemented in phases from 2007-08 to 2011-12. HMRC is aiming for universal online filing of the main businesses tax returns by 2012. It is also aiming to maximise the use of online filing by individuals.

Background

5.3 The Government has invested over £500 million in HM Revenue and Customs online services. The return on this investment takes the form of improved services for its customers, lower operating costs and greater service delivery flexibility. To maximise the benefits the services need to be more robust and customer orientated, so HMRC is planning to spend around a further £170 million in systems designed to deliver these proposals between now and 2012. The investment will be focussed on improving the existing services so that they are resilient and tailored to users' needs.

5.4 Over one third of Income Tax Self Assessment returns are now received online and this has grown year on year since the service was introduced in 2000-01. Almost 2.9 million people filed their 2006-07 return online by 31 January 2007, with the system coping with a peak demand of 14,500 returns per hour.

5.5 However, take up of the online services for the main business tax returns has been slower.

- A corporation tax (CT) online filing service was introduced in 2003, and HMRC received over 25,000 company tax returns through this service in 2005-06;
- An electronic VAT return was first introduced in 2001 and 10 per cent of VAT traders have signed up to make returns online since an improved online VAT service was launched in 2004; and

- This shows that slow but steady progress in increasing levels of take-up of online services can be achieved through voluntary adoption. However, the Government has concluded that more pro-active measures will be needed if the benefits are to be fully realised within a reasonable timescale.

5.6 Following Lord Carter's Review of Payroll Services² in 2001, the Government announced a three-stage move to universal online filing of employers' end of year returns. The first stage, for large employers³, was implemented in Spring 2005 and there has been a dramatic increase in the use of the PAYE service. These measures included financial incentives for smaller employers to move to online filing ahead of the planned requirement for them to do so - 65 per cent of small employers took advantage of this in 2005-06.

Rationale for Government Intervention

5.7 In July 2005, the Government asked Lord Carter to undertake a Review of HMRC Online Services⁴. The purpose of the review was to increase take up of online services for SA, VAT, CT and PAYE and maximise benefits for customers whilst ensuring that the department continues to deliver sustainable and efficient services that support compliance.

5.8 Lord Carter found that online services have the potential to offer benefits to businesses, taxpayers and the Government. He concluded that they can help customers to fulfil their tax obligations accurately, more quickly and provide them with greater certainty. For Government, customer use of online services will provide opportunities to free up resources from low value tasks, such as processing and error correction, to focus on more complex activities such as compliance and customer support. Lord Carter's recommendations are set out in Annex A.

5.9 Failure to further encourage customer adoption of online channels would mean that:

- take-up of online services would be likely to plateau;
- customers, and businesses in particular, would not gain from the benefits that adoption of online services can provide including reductions in their compliance costs; and
- HMRC would not realise the significant savings that can be achieved with greater take-up.

CONSULTATION

5.10 The aim of the consultation work has been to secure customers' input to the detailed development and implementation of the proposals from an early stage, and to ensure that there are no insurmountable obstacles to increasing the use of online services.

² Published with the Pre-Budget Report 2001 – http://www.hmrc.gov.uk/pbr2001/carter_review.pdf

³ Employers with 50 or more employees

⁴ Review of HMRC Online Services (2006) - <http://www.hmrc.gov.uk/budget2006/carter-review.htm>

Details of the Consultation

5.11 A full summary of the consultation with the public and other government departments can be found in Annex B.

5.12 In brief:

- A wide range of consultation began shortly after Lord Carter's report was published and has involved representatives from small, medium and large businesses; agents; software developers; trade associations and other groups;
- Most of those consulted broadly accept the proposed changes and the issues raised have been predominantly technical, for example, what specifically will or won't be done online? Problems with the current online services and concerns about previous bad experience with HMRC and other government departments were also raised; and
- The most frequently raised concern was that requirements to file online would be introduced before HMRC were able to provide a robust and resilient online service, resulting in reduced customer confidence and satisfaction.

Changes Following the Consultation

Income Tax Self Assessment

5.13 Following responses to the Partial Regulatory Impact Assessment, Lord Carter agreed to review further evidence about the potential impacts of his proposed changes to the filing date for Income Tax Self Assessment. After considering representations from tax practitioners, he recommended that, for 2007-08 and subsequent returns, the filing period for paper returns should be reduced to seven months - the new deadline should be 31 October - and the filing period for online returns should remain at ten months - with a deadline of 31 January. The Government accepted his revised recommendation.

Corporation Tax

5.14 Following the joint consultation on aligning filing dates with Companies House, launched at PBR 2005, the Government also concluded that it should not change the company tax return filing date at this time. Removing disincentives to early filing and offering an easy and convenient process for filing the accounts and the tax return together may in themselves lead to many companies filing their company tax returns online within nine months of the end of their accounting period (the deadline for sending accounts to Companies House). This approach avoids penalising companies and agents who might have genuine difficulty complying with an earlier statutory deadline for company tax returns. The Government will keep the issue of an earlier statutory filing date under consideration.

OPTIONS

Do nothing

5.15 Option 1 is to do nothing extra and hope that, through continuing investment, service enhancement and promotion, levels of voluntary use of online filing will continue to increase. However, though progress has been made it has been relatively slow. HMRC's projections indicate that voluntary adoption will plateau and that widespread adoption will not be achieved without further action. Under this scenario, the full benefits to both customers and HMRC of widespread online filing and electronic payment would not be delivered for many years, if at all.

5.16 Lord Carter's report identifies a relative reluctance to engage with government online, even among the majority of businesses and taxpayers that use IT for other tasks. Other research also indicates that UK businesses are much less likely to use public sector websites than their European counterparts⁵. In this context, the Government does not believe that reliance on organic growth will be a sustainable approach and so it has rejected it in favour of the more pro-active approach recommended by Lord Carter.

Lord Carter's Recommendations

5.17 Option 2 is the package of measures recommended by Lord Carter. These are set out in Annex A. The detail of HMRC's plans for income tax self assessment (SA), corporation tax self assessment (CTSA), value added tax (VAT) and pay as you earn (PAYE) online are set out below.

5.18 The ongoing investment in HMRC's online infrastructure makes it confident that its systems will be ready to meet the even higher demand projected under the Carter recommendations. HMRC's SA service successfully processed almost 2.9 million 2006-07 returns by the 31 January 2007 deadline, including 150,000 during the peak period in the final 24 hours. HMRC will be keeping the position under close review as HMRC moves towards implementation

Income Tax Self Assessment

5.19 Income Tax Self Assessment applies to individuals, partnerships and trusts. Included within these groups are the self-employed, employees with additional sources of income and pensioners. Within this population there is a very wide range of behaviours and abilities. There is no neat correlation between their taxable activities and their e-literacy.

5.20 The approach to increasing online filing by this group therefore stops short of setting a requirement to file online. Instead Lord Carter has proposed measures to encourage those who are e-literate, or who use intermediaries such as tax agents, to file their Self Assessment returns online. The option to submit a return on paper will remain but taxpayers who choose that route will need to file earlier, helping HMRC to spread the processing load.

⁵ Eurostat 2006 Dataset: E-government usage by enterprises – <http://epp.eurostat.ec.europa.eu>

5.21 Nearly 30 per cent of paper Self Assessment tax returns are currently submitted as ‘substitutes’ (paper outputs, approved for use in advance by HMRC, from computers using tax software products) submitted by post. The vast majority of the software products can be used to file online. More than 90 per cent of these substitute returns are produced by tax agents.

5.22 Printing and re-keying these returns is a wasteful process that can introduce error into the clean data produced by software. Even where optical data capture processes are available, manual intervention is frequently necessary.

5.23 The filing period for SA returns is currently 10 months, which is far longer than the OECD average for personal tax returns of 4 months. This can be unhelpful, as taxpayers are less likely to have the relevant information to hand if they complete their return towards the end of the filing period. It can also make enquiries into returns more difficult and stressful as the events during the return period may be less clear in the taxpayer’s mind.

5.24 The House of Commons Committee of Public Accounts’ report on Filing of Income Tax Self Assessment Returns⁶, published in February 2006, suggested that changing filing deadlines could smooth the workflow of processing in HMRC, with benefits for efficiency and accuracy. It also noted that overseas tax authorities typically allow far shorter filing periods than the UK and recommended that, subject to Lord Carter’s review, HMRC should explore differential filing dates for paper and electronically filed returns.

5.25 For Income Tax Self assessment returns Lord Carter initially proposed that for 2007-08 and subsequent returns, the income tax Self Assessment filing deadline should be brought forward from 31 January to 30 September for paper returns and to 30 November for returns filed online. Lord Carter has since reviewed the responses to the Partial Regulatory Impact Assessment published with his report and has received further representations from tax practitioners and he now recommends that:

- the deadline for filing 2007-08, and subsequent, paper returns should be 31 October, following the end of the tax year in April;
- the deadline for filing 2007-08, and subsequent, online returns should remain 31 January, following the end of the tax year in April;
- From 6 April 2008 paper substitute returns will not be accepted for 2007-08 and subsequent years; and
- For 2007-08 and subsequent years’ returns the enquiry window will be linked to the date the return is filed (this will encourage early filing and give taxpayers certainty sooner).

5.26 The SA payment dates (31 January and 31 July) will not change. The new filing dates will mean that all taxpayers that file on time will know how much they need to pay by 31 January as they will either receive a tax calculation from HMRC before that date⁷ or, if they file online, the software will produce an automatic calculation. These proposals take account of both the needs of tax professionals and the operational requirements of HMRC.

⁶ <http://www.parliament.the-stationery-office.co.uk/pa/cm200506/cmselect/cmpubacc/681/681.pdf>

⁷ Currently taxpayers that file after 30 September are required to include a “self assessment” of the tax due with their return. As part of the Carter legislation that will be changed to 31 October.

Corporation Tax and VAT

5.27 VAT and CT are taxes operated by business. Most businesses that pay these taxes already use information technology⁸ or will be able to make the move to using it without too much difficulty. Many small businesses will be employers and will have received financial incentives to help them make the transition to online filing for PAYE.

5.28 The proposals for VAT and CT are aligned so far as possible, but mandatory online filing of company tax returns (for corporation tax purposes) will not start until 2011 to allow for service improvements and the bedding down of XBRL⁹.

5.29 The proposals for CT are that:

- online filing of company tax returns, and use of XBRL for accounts and tax computations, required for all companies for accounting periods ending after 31 March 2010 where the return is submitted after 31 March 2011. Paper submissions will not be accepted. Companies will also be required to pay their CT electronically;
- working with software developers and others to implement a joint filing facility for companies with HMRC and Companies House. This will allow companies who wish to do so to make a single electronic transmission over the internet to file their company tax return and their accounts for the public record. This facility will be in place in plenty of time for the beginning of mandatory online filing of the company tax return in 2011; and
- the enquiry window, for most companies¹⁰, will to be linked to the date the return is filed for accounting periods ending after 31 March 2008.

5.30 The proposals for VAT are as follows:

- online filing of VAT returns, and electronic VAT payments required for traders with an annual turnover of more than £100,000 for accounting periods starting after 31 March 2010;
- online filing of VAT returns, and electronic payment of VAT, required for traders newly registering for VAT after 31 March 2010; and
- traders with an annual turnover below £100,000 will be encouraged, but not required to file online. The continuing need for this exemption will be reviewed in the run up to 2012, in line with Lord Carter's recommendation that HMRC should aim for universal electronic delivery of the main business tax returns by 2012.

Electronic Payment for CT and VAT

5.31 To encourage businesses to comply with the requirements to pay using HMRC's accepted electronic methods such as Direct Debit, BACS or CHAPS, changes will be made to the way HMRC handles payments made by cheque.

⁸ ONS report Information and Communication Technology (ICT) Activity of UK Businesses (2004) indicates that over 90 per cent of businesses were using ICT by 2004

⁹ eXtensible Business Reporting Language: ICT standard for business financial reporting

¹⁰ Existing rules will apply for large grouped companies.

5.32 This approach is consistent with other areas where electronic payment of taxes is required e.g. Large VAT traders on the Payments on Account Scheme.

5.33 In line with Lord Carter's recommendation, HMRC proposes to continue to allow most VAT traders¹¹ extra time for filing VAT returns online and making electronic payments.

PAYE

5.34 The three-phase move to compulsory online filing of employers' end of year returns is already underway. The final phase is planned for completion in May 2011. Employers using payroll software will see year-on-year benefits as the software generates clean data from the point that staff records are created, and helps to avoid problems at the end of the year. The announcement of compulsory online filing saw a huge demand-driven increase in the number of payroll products that could be used for online filing.

5.35 Lord Carter's Review of Payroll Services in 2001 also recommended that employers should, in time, be required to send in-year forms electronically. His Review of HMRC Online Services proposed a timetable for these changes. Employers will be required to file starter and leaver forms (P45 and P46) online:

- from April 2009 for large and medium sized¹² employers; and
- from April 2011 for all other employers.¹³

5.36 Online filing of these forms will generate electronic coding notices (the notices issued by HMRC to employers that tell them what code to operate to calculate an employee's tax). Electronic coding notices are generated and issued far quicker than paper notices meaning that employees tax positions can be updated faster. Electronic coding notices can be automatically uploaded by payroll software and reduce the work employers have to do to update employee records.

SECTORS AND GROUPS AFFECTED

5.37 Most businesses, large or small, incorporated or unincorporated, will, by 2011-12, be subject to the new online filing requirements. However, in practice, many businesses will already be filing online by the time the requirements apply.

5.38 This RIA assesses the impact of the new Carter proposals on just those businesses and taxpayers that will actually need to modify their behaviour as a result of the proposed changes. In other words, the baseline against which costs and benefits are measured is Option 1 (the status quo). This avoids any risk of double-counting businesses which have already gone online voluntarily.

¹¹ The incentive does not apply to large VAT traders on the Payments on Account scheme.

¹² Those with 50 or more employees

¹³ It is expected that special rules will apply for groups that have a religious conscience objection to the use of computers and the Internet

Table 5.1: Estimated proportions of taxpayers filing online by 2011-12

Area of Tax	Option 1 (natural growth)	Option 2 (Carter proposals)	Increase
Corporation Tax	22 per cent	100 per cent	+ 78 per cent
VAT	19 per cent	100 per cent	+ 81 per cent
PAYE in-year	47 per cent	100 per cent	+ 53 per cent
Self-assessment	50 per cent	77 per cent	+ 27 per cent

Table 5.2: Estimated number of businesses and taxpayers who will switch from paper to online filing.

Area of Tax (Businesses affected by more than one regime are included in every row that applies.)	Number of businesses / taxpayers
Corporation Tax – all company tax returns must be filed online from 01/04/11.	1.50 million
VAT – all returns must be filed online from:	
01/04/10 – for new registrations regardless of size..	0.25 million p.a.
01/04/10 – for existing registrations with turnover > £100k.	0.95 million
01/04/12 – The Government will consider existing registrations below £100k in 2011/12. No decision on mandating the 0.50 million businesses in this group has been made.	-
PAYE in-year forms (P45 / P46) – online filing from 6 April 2009 for employers with 50 or more employees.	0.05 million
PAYE in-year forms (P45 / P46) – online filing from 6 April 2011 for all employers.	1.25 million
Self-assessment tax returns – paper substitute returns no longer accepted from 06/04/2008.	1.40 million
Self-assessment tax returns – increase in online filing resulting from differential filing dates introduced for the 2007-08 and subsequent tax years.	1.00 million

5.39 Overall the proposals will affect all taxpayer groups that file CT, VAT, PAYE or SA returns and who are not yet filing online. In addition, the benefit of linking of the enquiry window to the filing date for Corporation Tax and Self-Assessment will affect all taxpayers in those regimes, including those already filing online.

5.40 The impact will be greater for businesses that pay CT or VAT, as all but the smallest VAT traders (who will be considered in the run up to 2012) will ultimately be required to file returns online and make payment electronically. The proposals may impact sooner on new, small businesses registering for VAT after 31 March 2010 than existing small businesses, as the former will need to file their VAT returns online, and pay electronically, from the outset. It is recognised that this will create differences in the treatment of smaller traders for the transitional period until the time is considered right for full mandation. However, our research shows that new businesses are more likely to be users of IT¹⁴. The requirement to file online from the outset will also mean that they avoid later transition costs.

5.41 The impact on the SA taxpayers (partnerships, individuals and trusts) is less as these groups will still have the option of sending SA paper returns, though they will need to do so by 31 October following the end of the tax year. There is a small percentage of people who will continue to be unable to use online filing. HMRC will continue to explore service enhancements to enable these groups to file online and in the meantime no taxpayer in these groups will be penalised for sending a paper return after 31 October

5.42 An initial diversity screening has indicated the only significant diversity issues surrounding this package of measures has been addressed by not making online filing of SA returns mandatory for any individuals. The earlier deadline for those unable to file online should not be a significant disadvantage. Special rules will be in place for businesses run entirely by individuals that have a religious conscience objection to using IT. A small number of very small employers may choose to use an agent to file where they have not before.

5.43 HMRC's web services will be as accessible as possible, so as to be more compatible with equipment for those with visual impairment or other disabilities affecting their use of internet technology. In addition, HMRC's literacy programme will address the needs of those who have difficulties with written English.

5.44 Self employed SA taxpayers, or their agents need to prepare accounts information in order to complete their returns and this work cannot be started until all information has been received from third parties. Many SA taxpayers have all the information they need to complete their returns by the end of July and those that do not may include provisional figures in their returns if necessary. A further recommendation is that further work be done to better understand the barriers, such as the late receipt of information from third parties, that stand in the way of introducing earlier filing dates at some time in the future.

¹⁴ The 2004 HMCE business needs survey found that 84 per cent of newly registering VAT traders had Internet access compared with 79 per cent of all VAT traders.

5.45 The most popular software products for producing SA substitutes already incorporate online filing functionality and HMRC anticipate that the announcement that substitutes will be withdrawn from 2008 will lead the remaining software producers to incorporate that functionality in their products. HMRC therefore does not anticipate that the withdrawal of substitutes should cause agents to incur significant additional hardware or software costs.

5.46 The change to the SA filing dates potentially impacts all SA taxpayers and their agents. Although the costs of completing a tax return should not change it will be essential that the new deadlines are well communicated to all SA taxpayers and HMRC is working with professional tax agents to achieve as smooth a transition as possible.

COSTS AND BENEFITS

Overview

5.47 Online filing offers a range of benefits to businesses, taxpayers and to Government. There is a transitional one-off cost associated with online registration, familiarisation and (for those firms without it) internet access itself. But thereafter, the time and cost of completing the returns should be lower than the paper equivalent, particularly when combined with electronic payment and other online services.

Benefits

5.48 Online filing offers a significant number of benefits. Complex returns may be completed more quickly as the software presents only those sections of the form that apply to the particular taxpayer. This reduces the time needed to work through the form and relevant guidance. Even for simpler returns and forms, the integral calculation and checking functionality will reduce the need for manual calculation and reduce the chance of error. There will be additional savings on printing or photocopying and postage. Accountants and other intermediaries can expect to see similar savings, which could be passed on to their customers.

5.49 To assess the total value of these benefits, the RIA discusses each of the main impacts in turn. Not all benefits are quantifiable, but figures are included wherever possible.

5.50 First, HMRC has considered the main business-related tax returns and forms affected by the Carter proposals (namely the CT600, VAT100, P45, P46, SA800, SA103, SA104 and SA105). For each, the cost of completing the form is compared between those that file online and those that do not. This comparison is based on research from KPMG into the main administrative burdens associated with completing and submitting tax returns¹⁵.

¹⁵ Following Budget 2005, HMRC commissioned KPMG to use the "Dutch" Standard Cost Model (essentially activity-based costing) to assess the burden of all information disclosure obligations on business for which HMRC is responsible. KPMG's findings were published at Budget 06 and provide detailed analysis of the tax obligations that businesses face, and the associated administrative burdens in monetary terms. This work had not been completed when the analysis leading to the partial RIA was being developed, but has been taken into account in this later analysis. The full KPMG report, and an explanation of the associated methodology, are available on HMRC's website at <http://www.hmrc.gov.uk/better-regulation/kpmg.htm>

5.51 The results vary considerably between different returns, different types of business and whether or not a business employs an agent. Typically, the saving is between 1 per cent and 2 per cent of the equivalent paper-based burden. The expected saving to business as a whole is around £10-£15 million per year, although this does not include consequential benefits, such as a reduced risk of error (discussed later).

5.52 In addition to filing the P45 and P46 forms themselves, online filing allows the resultant coding notices (P6 and P9) to be processed automatically by the employer's payroll system, instead of being keyed in manually. Many firms are already filing online and receiving this benefit, but for those affected by the new proposals, the saving should be between 2 and 5 minutes per form. We estimate the total benefit across all businesses to be between £5 million and £12 million.

5.53 A further benefit relates to the core SA100 individual tax return. Around 2.4 million returns are expected to switch to online filing as a result of the Carter proposals, and the impact is again expected to be a reduction in compliance costs. Quantifying the benefit is difficult because there is huge variation in the population affected, but it is likely to be highest for those who have online access, but who currently submit substitute paper returns. Software vendors estimate the total saving of online filing for that group to be between £18 and £25 per return, and we expect 1.4 million such returns to be affected, giving a total benefit of around £30 million. Around 55 per cent of these returns (and hence the benefits) are expected to come from businesses, and 45 per cent from private individuals.

5.54 For those not using substitute returns, but switching online to take advantage of the extended SA filing deadline, the benefits are likely to be similar to those seen with other forms. The full SA return (including supplementary pages) typically takes 2-3 hours to complete, although this varies considerably with individual circumstances and is considerably less for those issued with the Short Tax Return.

5.55 A survey of 2,000 online-filing taxpayers in 2005 found strong support for the online approach. 48 per cent said the time taken was a lot less than paper, 27 per cent a little less, 15 per cent no change and 9 per cent a bit more. The actual amount of time saved will vary according to individual circumstances. As a minimum, a taxpayer with simple tax affairs might save around 10-15 minutes. However, for the half who said they saved a lot of time, the savings could be a lot higher and may well exceed an hour in many cases. Our research shows that the time taken to use the online system decreases with familiarity, so the savings may be slightly less initially, but fully realised thereafter. Our estimate of the total benefit in financial terms is £5m-£30 million, this range reflects the potential for significant savings but also the likely variation amongst those affected. The enquiry window will be linked to the filing date rather than the filing deadline for many businesses, which in practice will shorten the period of uncertainty and be beneficial to business.

5.56 Online filing may provide a foundation for more significant e-reforms in future, including the wider use of XBRL and improvements in the way HMRC relates to customers.

5.57 HMRC's consultation has indicated that businesses and their agents will appreciate the certainty they gain by using the online services' automatic error-checking and handling routines. They also value the immediate delivery of a filing receipt and acceptance notice.

5.58 The use of software will also promote clean data and reduce the amount of time taxpayers have to spend on follow up queries after the form or return has been submitted.

5.59 The introduction of the joint filing service with Companies House will bring a reduction in the compliance costs associated with providing overlapping information to two government departments. The saving to a company will depend upon their current practice and the extent to which professional agents' fees are currently charged for the separate operations of filing with HMRC and with Companies House.

5.60 Coupled with online filing, using electronic methods of payment will give companies better control over their cash-flow. HMRC project that encouraging electronic payment, and removing the extra time incentive of using cheques, will encourage much greater use of methods such as BACS and Direct Debit to settle accounts.

5.61 There are no major environmental or social benefits, although the proposals will contribute to a reduction in paper usage, and also to the widening of Internet usage and skills amongst business generally.

5.62 The Government should benefit from savings in terms of processing and administration costs. These savings are estimated to climb to £64 million per year by 2012-13. Part of these savings will be used to fund improvements to the service offered by HMRC to taxpayers.

Costs

5.63 The most significant cost relates to the one-off costs of registering with the HMRC website. Assuming internet access is already available, this process is free and should take no more than 30 minutes. Businesses do not need to register for each regime separately, so there are considerable economies of scale for businesses affected by more than one tax area. The time taken would also be less where the person registering (or their agent) has previous experience of HMRC's online service.

5.64 The 30 minutes taken to register would typically cost around £10 in salary costs. From Table 2, the total number of existing taxpayers switching to online filing is 6.15 million (of whom around 5.1 million are businesses), but we estimate the actual number of business registrations would be around 60 per cent of the 5.1 million, because many businesses would handle more than one regime and only need to register once. The total one-off cost would therefore be around £31million for businesses and just over £10m for private individuals. Both numbers reflect the large number of taxpayers affected – the cost per taxpayer is small.

5.65 This figure applies to existing taxpayers not already filing online. In future, new businesses would need to register online too again at £10 each (although this might be cheaper than the status quo where online registration replaces paper-based alternatives). The number of new business registrations is typically around 10 per cent-15 per cent of the prevailing population per year, giving an indicative cost of under £4 million. The cost for individuals would be around £1 million.

5.66 Those who do not currently have internet access will be required to obtain it, but there are various ways of doing that and HMRC will be working with taxpayers and businesses to ensure that a range of options are available. The costs involved would vary, depending largely on levels of IT literacy, and whether a business chose to buy or borrow the necessary equipment. Our best assessment is that up to 250,000 taxpayers will need to obtain access to the internet as a result of these proposals (unless they were planning to go online anyway). HMRC will be offering help and support to ensure that the costs are kept to a minimum and the benefits of online filing achieved.

5.67 For Self-Assessment, if a taxpayer chooses not to file online, then they will need to adapt to the change to filing deadlines. There may be some transitional costs, particularly for agents' changing their working practices to adapt to the earlier filing date for paper returns, although these costs are expected to be modest and a one-off.

5.68 The Government will incur costs associated with the transition in providing support services and advice throughout the process. These costs include publicity and other communications relating to the new SA filing deadlines. These costs are estimated to be £36 million for initial set-up plus £3 million per year from 2012-13.

5.69 There are unlikely to be any significant social or environmental costs. The risk of online fraud is judged to be minimal but HMRC recognises that security is a concern for many people. HMRC will continue to ensure that its services use industry standard encryption and that clear information is provided to customers about the security measures built into the services and what they should do to protect themselves.

Summary

Table 5.3: Summary of Quantified Costs and Benefits

5.70 This table summarises the main costs and benefits for the recommended Option 2. It shows that Option 2 will reduce costs for businesses and HMRC by over £100 million per year in the medium term. However, the true benefit to taxpayers is expected to be higher, because a number of additional costs and benefits cannot be quantified accurately. These are summarised in Table 3b.

(£m per year)	One-off costs	Recurring costs (per year)	Recurring benefits (per year)
Businesses	31	4	35-42
Private individuals	10	1	18-43
HMRC	36	3	64
Total	77	8	117-149

Table 5.4: Summary of Unquantified Costs and Benefits

5.71 The following costs and benefits are difficult to quantify. Overall, though, we expect the benefits to significantly outweigh the costs and provide a net benefit to both business and taxpayers. This is in addition to the quantified figures above. The impact on HMRC beyond the quantified figures is likely to be negligible.

Additional Costs	Additional Benefits
acquiring (one-off cost) and maintaining internet access if not held already;	reduced chance of error and consequent queries / correction; immediate acknowledgement; faster transmission (24/7);
agent fees if choosing not to file online in person;	shorter enquiry windows for most businesses; enables easy electronic payment (which is also more secure and reliable than postal methods);
one-off costs associated with the change in filing date for SA taxpayers who choose to file on paper.	additional cashflow benefits (more time to pay); future-proofing / enabling access to other electronic services and support; enabling greater use of XBRL data transfer and associated benefits; greater synergies between accounting and tax-related software and data; instant updates to guidance (e.g. to reflect budget announcements after paper forms have been printed); and synergies with joint filing with Companies House.

N.B. All these costs and benefits are recurring unless stated otherwise.

Administrative Burdens Assessment

HMRC is committed to reducing one aspect of compliance costs in particular: the administrative burden on business of disclosing information to HMRC or third parties. This benefit is included within the figures above, but is itemised separately in this section for tracking purposes.

This “admin burden” is assessed through the Standard Cost Model ¹⁶. It considers the recurring activities that businesses need to do to comply with their legal obligations, and estimates the recurring cost of such activity. One-off impacts, and non-business taxpayers (including the SA100 form itself) are excluded.

In this case, HMRC estimates that by 2012, the administrative burden of completing forms and returns will be reduced by £9 million per year as a result of the Carter proposals ¹⁷.

¹⁶ See footnote 13 earlier in this document for further information on the SCM methodology.

¹⁷ This is a net figure based on the £10-£15 million recurring benefit identified in para 52 less the £4 million recurring cost in para 66. As explained in the main text, the SCM measures a subset only of the total costs and benefits to taxpayers.

SMALL FIRMS IMPACT TEST

5.72 Small businesses will be affected by these proposals but many small businesses have already made the move to submit returns online. Small businesses that have employees are benefiting from the financial incentives offered to encourage them to file online and over one million small businesses (65 per cent) sent their 2004-05 returns online although there was no requirement for them to do so.

5.73 Most incorporated businesses, both large and small, use intermediaries to file their company tax returns so the move to online filing is unlikely to present them with any major difficulty. Unincorporated small businesses will still have the option to file Self Assessment paper returns providing that they do so by 31 October.

5.74 Businesses that register for VAT after 31 March 2010 will be required to file their VAT returns online from the outset. This will include small businesses. However, our research indicates that internet use is highest among new businesses and we project that by 2010 it will be near universal.

5.75 The main impact will be upon small VAT registered businesses that have an annual turnover greater than £100,000 as they will be required to file online from 2010 and many do not currently use intermediaries. Research shows that the majority are already users of IT but it is recognised that there will be additional costs for those who are not. Those businesses will need help and support in identifying the options open to them and making the changeover. However, adopting IT may produce wider business benefits such as streamlined accounting and invoicing and improved access to information, customers and new markets

5.76 The responses to the consultation with small businesses that was launched by HMRC in March 2005¹⁸ indicate that small businesses are willing to conduct business with HMRC electronically provided that online services are reliable, easy to access and simple to use

5.77 There was a strong consensus that the combination of linking the enquiry window to the delivery of the return and a voluntary opt-in to earlier filing using a joint filing facility would be a positive benefit to small business. While the benefit is likely to be small for most individual companies, it will be significant cumulatively across the population of perhaps one and three quarter million small companies.

COMPETITION ASSESSMENT

5.78 These measures introduce a small set-up cost, followed by long-term savings. Because the costs per business are relatively low, HMRC does not anticipate any major effects on competition or competitiveness, however, there will be a differential effect on different types of business, particularly in the short term, as set out below.

5.79 The competition filter test has been applied. The proposals apply across the board to all businesses and do not affect any particular markets. However, the costs (and benefits) will fall on those businesses which do not currently file online, and that means that some categories will be affected more than others. Small businesses, new businesses and businesses not using agents are more likely to be affected than larger firms.

¹⁸ 'Working towards a new relationship: small business' at <http://www.hmrc.gov.uk>

5.80 HMRC will be looking to see how best to support those businesses and minimise the impact upon them. The possible cost of access should be weighed against the benefits of using online services from the outset. In certain sectors (the IT industry being an obvious one) firms are more likely to have access to online services, even when they are setting up, so would not be adversely affected.

ENFORCEMENT, SANCTIONS AND MONITORING

5.81 There are already provisions in place to secure compliance with the filing and payment requirements. There are

- financial penalties for failure to file returns by the filing date; and
- financial sanctions for failure to make payment on the due dates.

5.82 Under these new proposals there is no intention to make changes to those existing compliance provisions other than to link the existing sanctions to the new SA filing deadlines.

5.83 In the long term, HMRC envisages that paper returns and forms will not be accepted. However, while the requirements to file VAT returns and PAYE forms are being phased in, the rejection of paper would be resource intensive creating extra work for businesses and HMRC. It could also be detrimental to employees because it could lead to delays in updating their tax codes, and pensions and benefits entitlements.

5.84 HMRC have worked with a number of consultative bodies and are planning a package of measures to support the transition and enforce the requirements to file online. HMRC will identify businesses that should be filing online that have submitted paper and send them letters explaining their obligations and offering guidance and support. Ultimately, if businesses continue to fail to file online, without good reason, a penalty will be charged. In response to consultation feedback received, we plan to have a transitional period of nine months during which we will focus on alerting businesses to the requirement to file online where they fail to and so and no penalties will be charged before April 2010.

IMPLEMENTATION AND DELIVERY PLAN

5.85 As explained above, HMRC have an ongoing programme of meetings and discussions with representatives of all the groups affected by the changes including: businesses both large and small; individuals; trusts; agents and payroll providers; and IT and software providers. The collaborative work is enabling HMRC to prioritise and design enhancements to the services around the needs of users.

5.86 The main proposals will be introduced, subject to the right “building blocks” being in place, between April 2008 and April 2011. During that period the success of the proposals will be constantly monitored and evaluated so that any necessary improvements can be made to communications, processes and support.

POST-IMPLEMENTATION REVIEW

5.87 The compliance costs and savings analysis will be subject to HMRC’s post implementation procedures. Each area of tax will be considered separately.

5.88 The review will focus on take-up rates, compliance costs and benefits - confirming in each case whether the predicted effects were realised (both for taxpayers and for the Government). Any indirect effects (such as a reduction in errors on tax returns) will also be reviewed where practicable. HMRC will consider in due course how best to consult businesses and other taxpayers to inform this review.

5.89 The review will inform HMRC's decision on whether to expand the Carter package of measures to help meet the Government's aspiration of universal online filing by business and IT-literate individuals.

SUMMARY AND RECOMMENDATION

5.90 Technologically, the United Kingdom is now one of the most wired-up countries in the world and UK businesses are ranked amongst the most sophisticated users of information technology. Culturally, citizens and businesses have come to expect easy-to-use, high quality websites that provide quick access to information and services. In line with Lord Carter's recommendations HMRC will be working towards universal electronic delivery of business tax returns by. HMRC will also be looking at further measures to encourage IT literate individuals to file online.

5.91 HMRC will continue to invest in the right infrastructure. That also means building in more rigorous testing to confirm it has capacity to cope with anticipated demand at peak times.

5.92 To maximise the benefits that the recommendations seek to achieve, the services, must be designed collaboratively and around the needs of customers.

5.93 To realise the benefits to both the customer and HMRC of online filing, legislation will be introduced to following changes, together with a package of measures to ensure they are adopted:

- SA – for 2007-08 and subsequent returns, the filing date for paper returns will move to 31 October while the date for filing online will remain at 31 January. The enquiry window will be linked to date the return is filed;
- PAYE – from 2009 employers with more than 50 employees must do in-year business online with smaller employers following in 2011;
- VAT - in phases until 2012. Only in the run-up to this year will the Government consider universal mandation for the smallest businesses;
- CT - from 2011 returns from all companies will only be accepted online and in XBRL format, with the enquiry window linked to the filing date for all except large grouped companies; and
- Cheque payments for CT and VAT will be discouraged and any cheques will be treated as made only when the funds have cleared into HMRC's accounts.

ANNEX A – LORD CARTER'S FINAL RECOMMENDATIONS

5.94 These recommendations follow an amended timetable to give businesses and HMRC more time to prepare for the changes.

5.95 Government should set an aspirational goal for HMRC that it should aim for universal electronic delivery of Business tax returns by 2012. It should also aim for universal electronic delivery of individuals' tax returns from IT literate groups by the same date.

5.96 HMRC should benchmark customer satisfaction with its online services against commercial online services and seek to learn from best practice.

5.97 HMRC should work with other public and voluntary organisations to ensure that access to the internet, and appropriate assistance with using IT, are available locally, for example at libraries and UK Online centres, for taxpayers who wish to file their returns online but do not own a computer.

5.98 HMRC should introduce mandatory online filing and payment for most businesses as follows:

5.99 VAT:

- All traders with an annual turnover in excess of £100,000 should be required to file their VAT returns online, and make payments electronically, for accounting periods starting 31 March 2010; and
- Paper filing will remain an option for traders with turnover below £100,000 but the Government should review the need for this exception in the run-up to 2012.

5.100 CT

- All companies should be required to file their company tax returns online, using XBRL², and make payments electronically, for returns due after 31 March 2011.

5.101 PAYE

- Large and medium-sized employers (those with 50 or more employees) should be required to file in-year forms (P45 and P46) online from 6 April 2009; and
- Small employers (those with fewer than 50 employees) should be required to file in-year forms (P45 and P46) online from 6 April 2011.

5.102 HMRC should establish a Taxpayer Data Standards Forum, with membership drawn from a cross-section of Employers and chaired by an independent external person. The forum should be tasked, over a 1-2 year period, with identifying and disseminating best practice for cleaning data and maintaining quality.

5.103 Consideration should be given to reducing the filing periods for income tax self assessment (SA) and company tax returns, to bring them closer to the international norms, and that HMRC should offer extra time for online filing of SA returns.

5.104 From 2007-08, the filing period for SA taxpayers for paper returns should end at 31 October; anyone filing between 1 November and 31 January must do so electronically.

5.105 NB: This is the revised recommendation Carter agreed, following extensive feedback from agents.

- 5.106** HMRC already offers VAT traders an extra 7 calendar days to submit their VAT Returns online. This incentive for online filing should be continued, at least until April 2010.
- 5.107** Period in which HMRC can query SA tax returns and most company tax returns (the 'enquiry window') should be linked to the date that the return is submitted. This will promote earlier filing and give taxpayers certainty sooner.
- 5.108** HMRC should stop accepting computer generated SA 'substitute' Returns on paper, from April 2008 for 2007-08 and subsequent returns.
- 5.109** HMRC should review the payment rules for the different methods of payment and different types of taxes and consider what changes should be made to harmonise the rules.
- 5.110** HMRC should provide an electronic payment facility on its website which would allow taxpayers to set up a future electronic payment. This would enable taxpayers to complete the filing and payment tasks in a single session.
- 5.111** HMRC should offer agents workshops on online services, possibly in partnership with software developers, in the run up to the implementation of recommendations
- 5.112** HMRC should offer an agent registration scheme. This could enable potential clients to identify agents that are registered for and using HMRC online services. Agents that apply for the scheme could be required to abide by a Code of Practice.
- 5.113** HMRC should consider offering agents a regular email newsletter, which could update them on developments relating to online services and respond to common queries.
- 5.114** HMRC should provide a list of consultation fora on their website, details of the matters which are considered by each group and how to contact members of those groups.
- 5.115** Test services for software developers should be provided for all services at least 6 months before major changes to tax returns or the online services.
- 5.116** HMRC should share more of the risk rules used to select cases for enquiry with software developers.
- 5.117** HMRC should explore the idea of an online forum for software developer bodies to see if it could offer an opportunity for enhanced collaboration between HMRC and developers.
- 5.118** HMRC should look closely at how it both produces standard letters and provides online forms to see if it can do so at lower cost using new technology, while still giving customers a good experience.
- 5.119** HMRC work with DWP to speed up the issue of work-related NINOs for adults both through links with other departments and through exploring the idea of a 'work-related NINO'.
- 5.120** HMRC should continue to work with Companies House to provide a joint filing facility by 2011.

5.121 HMRC should build in more rigorous testing. Each of the services should be capacity tested at least a year before our recommendations are implemented, and if any tests are not successful the measures relating to that service should be deferred.

5.122 HMRC should streamline the processes by which taxpayers authorise HMRC to disclose confidential information to their agents.

5.123 Agents should be able to file returns for clients who have not yet given HMRC authorisation to disclose.

5.124 HMRC should streamline and align the requirements for client approval of a return so that it may be done electronically in all cases.

5.125 HMRC, working with the Government Gateway, should improve the facilities for managing the secure credentials required to access and use online services.

5.126 HMRC should continue to support digital certificates, but not compel customers to use one.

5.127 HMRC and the Government Gateway should, working with agents, consider how the processes for delegating authority to file and access client data within large agent organisations could be improved, for example, by enabling bulk uploading and downloading of data.

Additional Suggestions/Proposals (Embedded In The Text)

5.128 HMRC should consider letting software industry provide all necessary software, and focus instead on providing infrastructure for exchanging electronic data with customers, agents and other intermediaries.

5.129 HMRC to explore opportunities for intermediaries to develop and offer innovative methods to enable their customers to meet their tax obligations, conveniently for customers and effectively for everyone.

5.130 HMRC to work in partnership with agents, software developers and other potential intermediaries, to consider how best to reduce the strain on existing service provision.

5.131 Website improvements to include the dating of pages and highlighting changes to guidance.

ANNEX B – CONSULTATION SUMMARY

Consultation with the public

5.132 A wide range of consultation began shortly after Lord Carter's report was published and has involved representatives from small, medium and large businesses, agents, software developers, trade associations and other groups. This has included:

- Meetings arranged specifically to canvass comments on the recommendations and how they should be implemented. These focused on groups highlighted by Lord Carter, such as agents and software vendors, as well as organisations such as UK Online who help customers who will find it less easy to access and use online services;

- Putting Carter implementation on the agenda for existing regular business meetings, for instance, internally, the PAYE Employers and the IMS Software Developers Support Team forums and, externally, the 100 Group Fiscal Committee. These meetings have been used both to publicise the planned changes and to raise and respond to issues;
- Attending 55 external events and exhibitions held by software developers, such as “Softworld” at the NEC, in order to publicise Carter changes, respond to questions and feed back issues raised by both vendors and their customers;
- Engaging, through HMRC’s regionally based Business Development Consultants, with around 12,000 agents since April 2006 to raise awareness of Carter messages and to promote use of current online services as well as feeding back comments and issues raised; and
- Reviewing new and existing research and feedback from sources including internal and external surveys; customer research; and ongoing user feedback on the current online services.

Who was involved

5.133 Where HMRC have hosted meetings, usually professional and representative bodies and trade associations have been invited, who in turn choose a representative or cross section of their membership to attend – for instance, for one meeting ICAS (Institute of Chartered Accountants of Scotland) invited a range of their members which included a sole practitioner and representatives from small, medium and very large practices. Many groups engaged are already actively talking with HMRC.

Other initiatives

5.134 HMRC are continuing to expand the consultation approach going forward, including:

- Usability testing – this is focusing on small businesses and builds on work already done in HMRC Online Services. It is a process where volunteers are recorded using our services (in a test environment) and details such as particular pages on the website where they encounter difficulty can be noted. The outputs are due in March. Volunteers for this are being recruited from the locality of the testing as well as from businesses represented at other meetings who expressed an interest in taking part;
- Marketing plans to inform people of the changes to their obligations as these are implemented and to make them aware of the benefits of transacting with HMRC online; and
- Work to increase our customer insight, including research, training in the issues faced by customers (delivered by external representative bodies to HMRC staff), and a ‘case study’ approach to understand the issues faced by larger and more complex accountancy firms in bringing their business with HMRC online, which will support improved guidance and processes for the future.

Main Issues raised

5.135 Most of those consulted broadly accept the proposed changes and the issues raised have been predominantly technical for example what specifically will or won't be available to be done online? Problems with the current online services and concerns about previous bad experience with HMRC and other government Departments were also raised.

5.136 The most frequently raised concern was that requirements to file online would be introduced before HMRC were able to provide a robust and resilient online service, resulting in reduced customer confidence and satisfaction.

Issues included

- Whether HMRC could provide robust systems in the time available, previous bad experience was widely quoted;
- Need for support, particularly well trained Contact Centre staff to help with the transition;
- A considerable amount of feedback on issues surrounding the decision to withdraw the facility to submit substitute entries;
- Technical issues with current systems in general which hinder current use. In particular there are problems with agent authorisation and rejection messages/reason for validation failures which don't always make it easy to see what's wrong with what's being filed;
- Need to cater for the very small proportion of people who cannot yet file online for infrastructure or operational reasons;
- On the other hand, representative bodies argued strongly that it is not necessary to legislate for an earlier filing date which aligns HMRC's deadline with that of Companies House; and
- How HMRC should respond to the filing of paper returns and forms by those businesses that will have been mandated to file online. The feedback HMRC received suggested that any sanctions against this behaviour should be implemented with a light touch and after a 'soft landing' transitional period.

Consultation within the Government

5.137 HMRC has worked closely with colleagues in HM Treasury to help ensure that this package of measures is business-friendly. HMRC are also in consultation with Companies House on providing a joint filing service capable of delivering a secure and efficient service for customers.

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REGULATORY IMPACT ASSESSMENT

HMRC Online Services: Increasing Use Of Online Filing And Electronic Payment

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:



Dawn Primarolo, Paymaster General

Dated: 13th March 2007

6

SINKING FUNDS IN THE PRIVATE SECTOR

Relief from the 40 per cent trust rate of tax service charges and sinking funds in the private sector

PURPOSE AND INTENDED EFFECT OF THE MEASURE

Policy Objective

6.1 The proposal will provide relief from the 40 per cent rate of taxation applicable to income from the investment of service charges and sinking funds held on trust, in the private sector. Because such funds are commonly held on bank deposit, they will instead be subject to income tax at the lower rate of 20 per cent. Because most forms of investment income are taxed at source, no further tax will be payable.

6.2 Finance Act 2006 provided relief from the 40 per cent trust rate of tax to income arising from the investment of service charges and sinking funds held on trust in the social housing sector. Extending this relief to the private sector will place it on the same footing as the social housing sector. This measure will be deregulatory on private landlords. Landlords of properties with service charges and sinking funds held on trust will no longer be required to complete and submit an annual tax return for this income, and HMRC will not have to process them.

6.3 Collecting service charges from tenants to cover the day-to-day repairs and maintenance costs of the property and holding them on trusts is only a statutory requirement for landlords in England and Wales. However, the proposal to extend the tax relief would also apply to the income from service charges and sinking funds held by landlords in Scotland and Northern Ireland who are voluntarily operating trusts in the same way.

Background

6.4 Service charges are collected from tenants of leasehold property. They cover the day-to-day repairs and maintenance costs of the property. In order to provide funds for long-term dilapidations and repairs, a portion of the charges are saved up – this portion is called a “sinking fund”. Service charges and sinking funds in the private sector are required to be held in trust funds for the tenants (Section 42 of the Landlord and Tenant Act 1987) which ring fences them from the landlord and ensures that the tenants are entitled to any surplus in the funds over the cost of repairs etc. The purpose of this requirement is to ring fence these funds from the landlord’s own monies, so that residents’ contributions are protected in the event of landlord insolvency. Sinking funds are normally invested in interest bearing bank accounts or other similar investments. They are chargeable to tax at the special trust rates.

6.5 In Finance Act 2006, an exemption from the full rate of 40 per cent was provided for the first £1,000 of trust income. The exemption was intended to benefit small trusts including those holding service charge and sinking funds. The first £1,000 is taxed at the basic (20 per cent) or lower (10 per cent) rate of tax instead of 40 per cent. More significantly in relation to the present proposal, Finance Act 2006 legislated for an exemption from the 40 per cent rate, for service charges and sinking funds held in the social housing sector.

Rationale For Government Intervention

6.6 In short, this measure is deregulatory and supportive of the Government's wider housing agenda for increasing the supply of affordable and sustainable housing.

6.7 It is considered good management practice for the management companies of leasehold blocks to maintain sinking funds. Sinking funds are a provision against future liabilities. The Government supports sinking funds as they help to ensure that sufficient funds are available for the upkeep and repair of properties containing residential units and help even out annual service costs. The use of sinking funds prevents properties falling into disrepair, potentially leading to a decline in local communities and neighbourhoods.

6.8 Many private sector leaseholders have similar affordability issues to social sector leaseholders. Finance Act 2006 provided relief from 40 per cent trust rate of tax to income arising from the investment of service charges in the social housing sector. Extending this relief to the private sector will place it on the same footing as the social housing sector; especially given that sinking funds are a statutory requirement on the private but not on the social housing sector.

6.9 All residential properties will, over time, require repairs and maintenance. Many homeowners will budget to fund such work and will put savings on deposit. (The income from these savings could be tax-efficient if they were to be held in an ISA). However, leaseholders, through their leases are generally required to "save" and are required to hold the savings for maintenance purposes in trust which is taxed at the higher 40 per cent rate. Therefore, even though the majority of these homeowners would only be liable at the 20 per cent savings rate of tax on any other savings they might have, they are taxed at the higher rate for their 'maintenance savings'. Leaseholders with a private sector landlord will therefore enjoy the same benefit as ordinary homebuyers from this measure.

6.10 A variety of rights for leaseholders and obligations for landlords have been introduced by Government. In doing so, it has been policy to ensure that, unless there was a practical reason why it was not possible, the rights and obligations prescribed applied equally to leaseholders and landlords irrespective of whether the landlord was from the social or private sector. Extending tax relief to the private sector landlords would be consistent with this approach.

6.11 The intention in specifying that service charges and sinking funds were to be held on trust was to protect residents' investment in their homes, providing an incentive to save in order to meet future costs. However, a disproportionate tax burden has been created that is detrimental to housing affordability. Sinking funds can only be spent on a given purpose, yet are more heavily taxed than savings which are freely available to their investors.

6.12 Government supports sinking funds as they provide increased returns on the savings within them, and by doing so help to reduce the long-term need for grants to cover renovations and increases in service charges to cover any shortfall. There is also an indirect connection with housing benefit costs. Some of those who rent in the private sector are in receipt of housing benefit. The cost of housing benefit (which will cover costs such as service charges) would be lower in the long term as service charges need to be lower to reflect less tax being paid.

6.13 HMRC is also committed to reducing tax related administrative burdens on business. This measure is consistent with that objective. It is also consistent with the Treasury objective of promoting a fair, efficient and integrated tax and benefit system with incentives to work, save and invest.

CONSULTATION

6.14 We have carried out an informal consultation on the draft legislation within Government (Department for Communities and Local Government (DCLG); Scotland Office; Scottish Executive; Northern Ireland Office; and Northern Ireland Executive). Overall, there was contentment with the legislation as drafted especially in its applicability to Scotland and Northern Ireland where service charges are not a statutory requirement.

6.15 Housing sector bodies (Association of Residential Managing Agents (ARMA) and the Association of Retirement Housing Managers (ARHM)) have provided valuable information and data to enable the Treasury and HMRC to assess the costs and benefits of this measure.

OPTIONS

6.16 The following options have been considered.

Option 1: Do nothing

6.17 Doing nothing would save the Exchequer the tax cost and would keep the tax rules simple. But would mean that private sector landlords would continue to face a regulatory burden through tax compliance (as would HMRC) as well as continue to incur a higher tax cost than their counterparts in the social housing sector. Overall, this option provides no benefits to business (i.e. private sector landlords).

Option 2: Exemption from higher trust rates of tax

6.18 All income from service charges and sinking funds held by private sector landlords is taxed at basic (20 per cent) or lower (10 per cent) rates of income tax. Private sector landlords will face lower tax and administrative costs under this option.

COSTS AND BENEFITS

Benefits

Option 1: Do nothing

- No Exchequer costs (loss in tax revenue) - an estimated £1 million to £1.5 million per year;
- Keeps tax rules simple by avoiding a special rule; and
- HMRC will not be required to publicise any changes as part of their Budget change publicity, and guidance for Trusts and Settlements pages of the self-assessment tax return will not be required to be updated in time for the 2008 return issue.

Option 2: Exemption from higher trust rates of tax

- Financial benefits to private sector landlords from paying less tax – an estimated £1 million to £1.5 million per year;
- As long as the fund receives only taxed income such as UK bank interest, it would have no further tax obligations. Landlords will no longer be required to submit an annual tax return and HMRC will not have to process them. Estimated annual administrative savings to private sector landlords of between £580,000 and £725,000 per year;
- More sinking funds will be available to prevent properties falling into disrepair, and avoid leading to a decline in local communities and neighbourhoods;
- Some of those who rent in the private sector are in receipt of housing benefit. The cost of housing benefit (which will cover costs such as service charges) would be lower to reflect no tax being paid;
- All residential properties will over time require repairs and maintenance. Many homeowners will budget to fund such work and will put savings on deposit attracting at most the basic rate of tax (The income from these savings could be tax-efficient if they were to be held in an ISA). Leaseholders with a private sector landlord would enjoy the same benefit as ordinary homebuyers; and
- Extending the relief will place private sector leaseholders on the same footing as those in the social housing sector especially taking into context that sinking funds is a statutory requirement on the private but not on the social housing sector.

Costs

Option 1: Do nothing

- Private sector landlords will continue to pay tax at 40 per cent on income from services charges and sinking funds in excess of £1,000 - an estimated £1 million to £1.5 million per year;
- Private sector landlords will continue to incur administrative and regulatory cost of completing and submitting an annual tax return to HMRC – estimated annual administrative cost to private sector landlords of between £580,000 and £725,000 per year;
- HMRC will also continue to incur costs in processing these tax returns;
- Tenants and landlords may be deterred from making adequate provision for future major repairs through sinking funds by the 40 per cent tax rate;
- Fewer sinking funds will be available to prevent properties falling into disrepair, potentially leading to a decline in local communities and neighbourhoods;

- Sinking funds can only be spent on a given purpose, yet are more heavily taxed than other forms of savings which are freely available to their investors for a host of purposes which could include refurbishment and acquiring capital assets;
- Private sector leaseholders will be at a disadvantage compared to those in the social housing sector who enjoy relief from the 40 per cent rate of tax; especially when viewed within the context of the statutory requirement placed on private sector landlords to hold service charges and sinking funds on trust;
- All residential properties will over time require repairs and maintenance. Many homeowners will budget to fund such work and will put savings on deposit which would attract at most the basic rate of tax. (The income from these savings could be tax-efficient if they were to be held in an ISA). Leaseholders with a private sector landlord will continue to be at a disadvantage compared to the benefit ordinary homebuyers currently enjoy; and
- Some of those who rent in the private sector are in receipt of housing benefit. The cost of housing benefit (which will cover costs such as service charges) would continue to be higher than otherwise as service charges need to be higher to reflect tax being paid at 40 per cent.

Option 2: Exemption from higher trust rates of tax

6.19 Exchequer costs (loss in tax revenue) - estimated £1 million to £1.5 million per year.

6.20 HMRC will be required to inform landlords and their own staff about the change, but implementation will not have significant impact on HMRC.

Sectors Affected

6.21 The sector affected by the measure would be those who are managing private sector housing on behalf of tenants. This could be an individual member of the public, or a company managing leasehold flats. In terms of the market as a whole it is estimated that there are some 1.5 million leasehold flats, of which some 900,000 are professionally managed. There is no information on the ownership of the freeholds, however, there is information on who has control of the management. Figures from ARMA¹⁹ members indicate over 65 per cent of blocks they manage are lessee controlled. Given members manage over 80 per cent of the 900,000 it would be reasonably safe to say the figure is greater than 65 per cent once self-managed properties are taken into account.

6.22 It is estimated that 4,000 to 5,000 trusts and 225,000 leaseholders might benefit from this measure. Private sector landlords will no longer be required to complete and submit an annual tax return to HMRC.

¹⁹ Association of Residential Managing Agents

SMALL FIRMS IMPACTS TEST

6.23 The majority of private sector landlords of leasehold properties affected by this measure would be considered small businesses (although there are some landlords with larger portfolios of leasehold property). This measure will have a positive financial impact on all private sector landlords with leasehold properties irrespective of size. They will pay less tax, and incur less administrative costs from not having to complete and submit an annual tax return to HMRC.

COMPETITION ASSESSMENT

6.24 Finance Act 2006 provided relief from the 40 per cent trust rate of tax to income arising from the investment of service charges in the social housing sector. Extending this relief to the private sector would place it on the same footing as the social housing sector. There is no competition impact within the private housing sector.

ENFORCEMENT, SANCTIONS AND MONITORING

6.25 The tax relief is within the self-assessment system and is expected to be self-policing. It is a tax relief and levels of compliance are likely to be high. No new sanctions are required.

IMPLEMENTATION AND DELIVERY PLAN

6.26 The new tax rules will take force for income arising in the relevant service charges and sinking funds from 6 April 2007. They will need to be taken into account in making tax returns after the end of the 2007-08 tax year by the deadline of 31 January 2009.

POST IMPLEMENTATION REVIEW

6.27 DCLG will monitor the development of sinking funds and evaluate the success of the policy in 2009.

SUMMARY AND RECOMMENDATION

6.28 We recommend option 2 – providing a relief from the 40 per cent trust rate of tax to income arising from the investment of service charges in the private sector.

6.29 Sinking funds support sustainable communities, create an equitable system, and address disparity in tax treatment between social and private sector leaseholders. It is estimated that 4,000 to 5,000 trusts and 225,000 leaseholders might benefit. Private sector landlords will no longer be required to complete and submit an annual tax return and therefore, HMRC will not be required to process them. In short, the measure is deregulatory and supportive of the Government's wider housing agenda of increasing the supply of affordable and sustainable housing.

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REGULATORY IMPACT ASSESSMENT

Relief From The 40 per cent Trust Rate For Service Charges And Sinking Funds In The Private Sector

Statement of Ministerial Approval

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:



Dawn Primarolo MP, Paymaster General

Dated: 22 February 2007

7

THE TAX TREATMENT OF GENERAL INSURERS' RESERVES

TITLE OF PROPOSAL

7.1 The proposals affect the tax treatment of general insurers' reserves. Current legislation is at section 107 Finance Act ("FA") 2000 with Regulations at SI 2001/1757.

PURPOSE AND INTENDED EFFECT OF THE MEASURE

The policy objective

7.2 To ensure that the tax rules dealing with general insurers' reserves are proportionate to the tax risk that they seek to address. In particular, the government aims to reduce the cost to industry of complying with the current tax rules and to eliminate the tax lost to the Exchequer through the use of an election within the rules.

Background

7.3 All general insurers²⁰ make what in technical accounting terms are provisions (or what are often still referred to as "reserves") for claims against insurance policies that they will have to pay out in future years. Provisions for future claims are by their nature estimated. The amount of the provision is determined in accordance with accounting standards²¹, which focus on making sure that the provision is large enough to pay all claims that can reasonably be foreseen.

7.4 A provision that is larger than the amount needed to pay claims defers recognition of profit, and therefore payment of tax. Section 107 FA 2000 was introduced to limit any tax advantage if a general insurer's provisions are over-estimated. Extensive Regulations require general insurers to compare the original provision with the later cost of settling claims and make a tax adjustment if there is a difference. The tax adjustment is in the Exchequer's favour if the original provision was too large and in the general insurer's favour if the original provision was too small.

7.5 The primary legislation includes an election ("the disclaimer election") the intention of which was to provide general insurers with the flexibility to disclaim a small proportion of their reserves to mitigate the effect of the tax adjustments that would otherwise arise. The disclaimer election has also been used to accelerate the use of tax losses in groups of companies, which causes a significant loss of tax.

²⁰ general insurers for this RIA include: general insurance companies, firms carrying on general insurance business which operate in the UK through a branch and controlled foreign companies that carry on general insurance business. Members of Lloyd's are also affected by the current rules, but a new revenue protection measure, as described in this RIA is more likely to operate at syndicate level at Lloyd's. Reference to general insurers and the current rules therefore should be read as including Lloyd's members, but references to general insurers and a revenue protection measure should be read as including Lloyd's syndicates, but not Lloyd's members.

²¹ paragraph 43 Schedule 9A Companies Act 1985

Rationale for Government Intervention

7.6 The current tax rules dealing with general insurers' provisions are complex, lengthy and require continual maintenance. The operation of them therefore is at considerable cost to general insurers and especially at Lloyd's where the calculations are particularly difficult. Unless there is a change to the current rules, the way that they operate is likely to mean an increase in this cost until at least 2010 after which it would remain level. The frequent need for maintenance represents an additional burden for both general insurers and government in consultation over the technical detail and in implementation.

7.7 Industry representatives have assured HMRC that provisions for claims are set solely in accordance with a reasonable standard of prudence and not with a view to the tax advantage that might result. Analysis of trends across the general insurance sector supports this assurance. That is not to say that no provision is excessive, but it does suggest that the current rules may be disproportionately complex for the tax risk that they seek to address, and that they merit a thorough review.

7.8 In addition, the use of the disclaimer election other than for its intended purpose causes a significant loss of tax. The tax lost to date is estimated to be £740 million. Of this around £640 million has been lost through the accelerated use of tax losses, and from the use of losses that would otherwise never have been tax effective. £100 million has been lost as a result of artificially created taxpayer-favour adjustments, but will not recur because of changes made to the Regulations in 2003. If there is no government action, tax will continue to be lost.

CONSULTATION

Within Government

7.9 There has been extensive consultation with operational tax specialists in HM Revenue & Customs with HM Treasury and with the Government Actuary's Department. The options discussed with industry were developed through this process and frequent discussions have been held to update progress and to obtain feedback. The measure has no impact though on other government departments.

Public Consultation

7.10 There has also been extensive informal consultation with representatives of the insurance sector including representative bodies – the Association of British Insurers ("ABI") and the International Underwriting Association ("IUA") – Lloyd's, insurance companies and their accountants, and other interested parties including the Financial Services Authority ("FSA") and actuaries.

7.11 This process began in January 2006 at which time the government's focus was on the extent to which the disclaimer election was undermining the effectiveness of the rules. The industry response was clear and consistent: the disclaimer election was essential to maintaining the fairness of the rules, but there was anyway a case for a more wide-ranging review.

7.12 At Budget 2006 the government announced further consultation to identify an appropriate way forward. A working group of HMRC and insurance sector representatives (the “Working Group”) met several times throughout 2006 and in 2007 to consider and discuss options.

7.13 There have been two HMRC / industry joint presentations to publicise the consultation, to outline progress and to encourage input. The first of these was organised by industry on 16 June 2006 and the second by HMRC, the Association of British Insurers, Lloyd’s and the International Underwriting Association on 13 October 2006.

7.14 As part of the review work HMRC also had meetings and exchanges with tax specialists from several other countries, including France, Spain, Germany, Ireland, Australia, USA and Canada.

OPTIONS

No Change

7.15 The consultation was on the presumption that any proposals would involve the repeal of the disclaimer election because of the tax lost through its use. No change would not achieve this aim and would not reduce the compliance cost to the insurance sector.

Repeal of the disclaimer election within the context of an overhaul of the current rules

7.16 This would stem the tax lost through use of the disclaimer election. The Working Group identified several improvements and simplifications that could be made to the current rules and which would be welcomed by the insurance sector. These though, and the repeal of the disclaimer election, would represent only a minor reduction in the cost of complying with the rules, and industry believe that those rules would then be overly harsh and operate unfairly.

7.17 During the Working Group meetings, general insurers explained that regulatory rules influence their group structure and that the disclaimer election affords them access to group relief rules²² in the same way as other companies, albeit as an unintended impact of the legislation. They asked that, as an alternative to repealing the disclaimer election, the government consider restricting the effect or extent of it.

7.18 HMRC were unable to identify a restriction that would achieve the government’s key aims to stem the tax loss through use of the disclaimer election and reduce the cost of complying with the tax rules in this area. An arbitrary restriction, perhaps related to the amount of the provision, was rejected because it would still leave the disclaimer election functioning, albeit in a reduced way, to address the group relief issue rather than for the purpose for which it was intended. More sophisticated restrictions – including consideration of a change to the group relief rules – were rejected as likely to add to the already complex legislation in the affected areas. And restricting the disclaimer election would not eliminate the tax loss, unless the restriction was so tight that making a disclaimer election would have no practical effect.

²² “Group relief” is the scheme under which a tax loss made by one company in a group can be surrendered by it and claimed by another: but the loss must be the loss of the same year, and must not include any losses that have been carried forward to the year.

7.19 General insurers remain of the view that the disclaimer election is essential to maintaining the fairness of the current rules on reserves for future claims. Their view is that that the suggested improvements and simplifications would not adequately balance the impact of repeal of the disclaimer election and that, if the disclaimer election is repealed, the rest of the rules should also be repealed.

7.20 This option – repealing the disclaimer election and overhauling the rest of the rules – would therefore be unpopular with, and strongly resisted by, general insurers.

Repeal of the current rules and replacement with a new regime

7.21 This option would result in repeal of the disclaimer election and would therefore stem the loss of tax from the use of it.

7.22 The Working Group was however unable to identify (elements of) regimes elsewhere in the world, or to design a new set of rules that were attractive to either government or to the insurance sector.

7.23 In particular, nothing was identified as improving on the current rules, at materially lower cost to the general insurers. For example, almost all required an annual test to be applied by general insurers to their provisions, which the Working Group was not convinced would represent a material reduction in the cost of complying with the tax rules in this area. This was lent additional weight at meetings and in exchanges between HMRC and tax specialists from several other countries who identified similar levels of dissatisfaction with the complexity and effectiveness of their own rules as had been expressed with the UK rules.

7.24 The Working Group was also concerned that any new regime might be overtaken in fairly short time by the changes expected from Phase II of the review of International Financial Reporting Standard 4. Any benefit afforded by a new system might therefore be short-lived and outweighed by the cost of implementing it.

7.25 There was no enthusiasm for this option.

Repeal of the current rules without replacement

7.26 This too would stem the tax lost through use of the disclaimer election. It would also represent for the insurance sector a significant reduction in the overall cost of complying with the tax rules.

7.27 There are however risks with this approach. The government would be vulnerable to a loss of tax if provisions were over-stated and its only redress would be to challenge the amount of the provision by formal tax enquiry in particular cases, as was the case before the introduction of section 107 FA 2000. Those tax enquiries proved costly for both sides and were generally unproductive. They relied for resolution on interpretation of compliance with the accounting standard, which provides an effective lower limit for provisions, but is not designed and is not sufficiently detailed to determine in most cases whether a provision was excessive.

7.28 Phase II of International Financial Reporting Standard 4 is expected to be implemented around 2010. This might produce an accounting standard of sufficient robustness to limit the tax risk from excessive provisions without the necessity for further tax rules, but this is some way off and the detail is by no means certain.

7.29 This option – repeal of the current rules without replacement – was industry’s preferred approach, although the Working Group acknowledged that it was not without risks. Discussions produced a further option which could provide both the benefits of repeal of the current rules and a measure of protection for the Exchequer against overstatement of provisions.

Repeal of the current rules and replacement with a “revenue protection measure”

7.30 A “revenue protection measure” would take the form of a legislative standard setting out the maximum acceptable provision for tax purposes thereby providing the clear ceiling that it is not the accounting standard’s function to perform. It could be designed so as to impose no annual obligation on general insurers, yet enable HMRC to counter effectively exceptional cases of over-statement of provisions.

7.31 The provision calculated in accordance with accounting standards would normally be accepted for tax purposes and the vast majority of general insurers would not have to apply any other test. In exceptional cases, where the standard was breached there would be a tax adjustment.

7.32 Possibilities for operation of a revenue protection measure include:

- the general insurer would make an adjustment in its tax return if it breached the standard;
- the general insurer would submit with its tax return an explanation for breaching the standard, if it believed that it had done so. There would be no automatic adjustment to the tax return. HMRC would enquire into the tax return if not satisfied with the explanation or if there was no explanation but it appeared that the standard had been breached; and
- no action by the general insurer. HMRC would identify exceptional cases where a general insurer had, or may have, breached the standard. In cases where significant amounts of tax were at risk an enquiry into the tax return would follow to seek an explanation.

7.33 All of these possibilities involve the repeal of the current rules and the significant reduction in the cost of complying with the tax rules that is inherent in repeal.

7.34 In the first possibility, the current annual obligation would be replaced with a new annual obligation requiring general insurers to test their provisions against an objective standard. This would affect the whole sector, but probably at less cost than that imposed by the current rules. Such a system might not be dissimilar to the current tax rules dealing with general insurers’ reserves and is not favoured by HMRC or industry because it could prove just as inflexible as the current rules.

7.35 The second and third possibilities connote an element of judgment and discussion – most likely, if discussion was required, through a tax enquiry. The reduction in the cost of complying with the tax rules across the sector from repeal of the current rules would be replaced by a cost only on those general insurers that breached, or may have breached the standard and into whose tax return HMRC enquired. Such enquiries would be expected to be the exception, not the norm.

7.36 Central to the success of a revenue protection measure is the mechanism to resolve disputes about whether or not it has been breached, and, if so, to what extent. The absence in tax enquiries before 2000 of actuarial assistance in a highly specialised and technical area made disputes difficult to resolve and the whole process unsatisfactory for both parties. Actuaries are the experts in the field of estimating liabilities and one option therefore would be to seek the advice of an independent actuary in cases of continuing dispute. If an independent actuarial report were required to resolve a dispute, the cost of obtaining it would fall on the general insurer. This would represent a further potentially significant cost to the particular insurer and is not a step that HMRC would take lightly. It is hoped though that the facility to require the production of such a report, allied with a right of appeal against the requirement, would operate to encourage resolution before this point was reached.

7.37 Referral to an independent actuary would not be an alternative to the appeals Commissioners who would still determine appeals in cases where HMRC and the taxpayer could not reach agreement. Any independent actuarial report obtained during the tax enquiry would be available to assist the Commissioners' deliberations.

7.38 This approach – a standard setting out the maximum acceptable provision for tax purposes, supported by a power to require production of an independent actuarial report with an established appeals process – would, to some degree, mirror the FSA's approach²³ to the investigative process that supports their regulation of general insurance business.

7.39 This option – repeal of the current rules and replacement with a “revenue protection measure” – emerged as the most likely way forward, with the third possibility for how such a standard might operate as the industry's preference.

Transitional arrangements

7.40 The disclaimer election has given groups of companies that include a general insurer a large degree of flexibility to position tax losses where they might most quickly be tax effective for the group. As part of the consultation process, the Working Group considered whether it was appropriate to have a period of transition to ease the impact of repeal. Options considered were

- no transitional rule;
- allowing, at the general insurer's discretion, the unwinding²⁴ of the last disclaimer election made under the rules before they are repealed to be spread over 2 (or more) subsequent periods; and
- allowing a limited disclaimer election to be made by general insurers for the first period to end after repeal of the rules.

²³ Parts IX and XI Financial Services and Markets Act 2000

²⁴ an amount disclaimed for tax purposes in one period normally “unwinds” – that is it is allowed for tax purposes – in the next following period. It is this shifting of an allowable tax debit from one period to the next that gives the flexibility with tax losses, and is at the root of the loss of tax for the Exchequer.

7.41 The first of these options reflects the fact that general insurers can make a disclaimer election until at least two years after the end of the period for which the provision was set. There is therefore arguably a measure of transition built into the rules. Industry argued strongly that a further period should be allowed to enable them to effectively manage the transition from having the ability to make a disclaimer election to not having it.

7.42 The second option was proposed by industry representatives on the Working Group. A period of six years was suggested initially. HMRC resisted this suggestion for lack of evidence that any groups of companies would be significantly disadvantaged by a short transition, and on the basis that the time limits within the current rules would, in effect, add a further two years to add to any formal transitional period. In addition, HMRC resisted such a lengthy transition on grounds of Exchequer cost as it would have wiped out the entire Exchequer yield from the measure. After discussion industry accepted that there was no strong case for longer than a 2 year formal transition.

7.43 The third option discussed was similar in effect to the two-year period proposed under the second option. Industry's preferred limit, should this option be selected, was the greater of the last disclaimer election made under the rules before they are repealed and 10 per cent of the provisions made for the first period to end after the rules were repealed. The figure of 10 per cent was suggested by HMRC as representing a reasonable amount which would encourage a stepped approach to transition rather than a cliff edge.

7.44 HMRC's preference was simply for a limited election of no more than 10 per cent of the provisions made for the first period to end after the rules were repealed which would still give some flexibility to general insurers, but would have a more modest effect on Exchequer yield than any of the other options discussed.

COSTS AND BENEFITS

Sectors and Groups affected

7.45 Any change would only affect the general insurance sector. Those affected will normally be large businesses, or sophisticated small / medium businesses. There will be no race, Northern Ireland or other equality issues.

Benefits

7.46 Repeal of the disclaimer election – inherent in all of the options except 'no change' – for periods of account ending after 31 December 2006 would increase Exchequer yield by £640 million over 7 years as follows:

2007-08	2008-9	2009-10	2010-11	2011-12	2012-13	2013-14
£0	£130M	£150M	£130M	£100M	£80M	£50M

7.47 There would be no yield in 2007-08 because of the way the disclaimer operates to reduce profits of the general insurer in the year following the year in which the disclaimer is made.

7.48 Allowing a disclaimer election of up to 10 per cent of the provision set for the first period to end after repeal of the rules would eliminate £90 million of the yield for 2008-09 but leave 2009-10 and subsequent years unchanged, as follows:

2007-08	2008-9	2009-10	2010-11	2011-12	2012-13	2013-14
£0	£40M	£150M	£130M	£100M	£80M	£50M

7.49 Repeal of the rest of the rules would also increase Exchequer yield in the short term, but much more modestly, and the effect over time should be Exchequer neutral.

7.50 The requirements of the current tax rules impose a considerable cost to general insurers and especially at Lloyd's. The compliance cost has been calculated as £2 million to £3 million per year across the sector.

7.51 The 'no change' option would have no effect on this, and repealing the disclaimer election and overhauling the current rules would have only an insignificant impact.

7.52 The other options consulted on involve repealing all of the current tax rules. Repeal would represent a significant cost reduction for the insurance sector. It would also represent a saving for HMRC in not having to check calculations made under the rules.

Costs

7.53 To support and enforce a revenue protection measure HMRC intend to develop a centralised approach to risk-assessment of provisions to identify outliers from industry trends.

7.54 It is only after this process that a tax enquiry into the quantum of a general insurer's provision would be carried out, and it is only such an enquiry that would bring with it costs of any significance for general insurers.

7.55 Tax enquiries into the quantum of provisions are expected to be the exception rather than the norm and reference to an independent actuary very much a last resort if agreement cannot be reached. The cost of commissioning an independent actuary will depend of the size and complexity of the general insurer's business and the scope of the work needed. It is recognised though that a complete review, from scratch, of a large general insurer's provision could cost many tens of thousands of pounds.

7.56 The cost of meeting the new information requirement (see 'implementation and delivery' below) – essential to the delivery of a centralised approach to risk assessment of general insurers' provisions, which underpins the revenue protection measure – is believed to be small as the information is already maintained for other purposes.

7.57 The cost across the insurance sector of the new measure is therefore expected to be insignificant, and especially so when compared to the cost of complying with the rules that are being repealed.

SMALL FIRMS IMPACT TEST

7.58 The only small firms potentially affected by this measure are Lloyd's members.

7.59 The current rules are framed in such a way as to exclude all, or practically all of the small businesses operating at Lloyd's. Preliminary discussions with Lloyd's on the impact of a revenue protection measure are positive and Lloyd's have agreed that it would be appropriate for such a measure to operate at syndicate level (rather than at member level) where the adequacy of the provision is already subject to testing. Lloyd's are represented on the Working Group and will continue to be consulted about the impact on all of its members and on its syndicates. Any Lloyd's members affected already operate in a sophisticated business sector and have access at Lloyd's or through HMRC to any support they require.

7.60 As with larger firms, for all affected small firms, repeal of the current rules would bring a significant compliance cost reduction and, as long as their provisions are set with a reasonable standard of prudence, and not with a view to the tax advantage that might result, there is unlikely to be any new cost if a revenue protection measure were introduced.

COMPETITION ASSESSMENT

7.61 On latest available figures, general insurance business is carried on in the UK by 434 UK incorporated general insurance companies and 129 branches of insurance companies incorporated elsewhere (68 within the European Economic Area, 61 outside)²⁵.

7.62 In addition there are 62 syndicates at Lloyd's containing 2199 Lloyd's members (1483 individuals, 471 small companies ('Namecos' and 'Group Conversions' run by former individual members), 132 Scottish Limited Partnerships (SLPs, also run by former individual members) and 113 large companies (often members of large groups)). Of these, the current tax rules affect UK incorporated companies, branches of foreign insurers and Lloyd's members with less than 4 per cent of the business written by a syndicate. In practice this excludes all, or practically all Lloyd's members from the current rules, with the exception of the 113 large company members.

7.63 It is not expected that any change would have a substantially different effect from firm to firm. As with all other firms in this sector however, any compliance costs from the revenue protection measure will fall only on those general insurers that breached, or may have breached the standard, and into whose tax return HMRC enquired. Breaches of the standard, and therefore tax enquiries, are expected to be the exception, not the norm, and tax enquiries will only be made where there are significant amounts of tax at risk. It is unlikely therefore that the emerging preferred option would have any effect for the smaller businesses in the sector.

²⁵ according to the FSA's Annual Report 2006

7.64 Such a change, if it were to happen, would not be expected to have any effect on the competitiveness of Lloyd's members within the general insurance sector – since business at Lloyd's is conducted at syndicate, not member level – nor would it be expected to have an effect on competition within the sector more generally. No particular businesses would be penalised by the changes and the effect of change is likely to be in proportion to the size of the individual business' reserves, which will be in proportion to their market share. All businesses affected by the current tax rules or potentially affected by a replacement measure operate in a sophisticated business sector. The sector is highly driven to find new products and new ways of marketing products and this measure will have no effect on this.

7.65 The complexity and effect of the current tax rules dealing with general insurance reserves are sometimes cited as counting against the UK as a territory for new insurance start-ups. As all options except the 'no change' option involve repealing all of those rules, this may increase competition in the UK general insurance market.

ENFORCEMENT, SANCTIONS AND MONITORING

7.66 The 'no change' option would not require a change in the present arrangements for enforcement, sanctions and monitoring.

7.67 The extensive rules set out how calculations must be done and how the tax computation is affected by the result of them. Cases of non-compliance with the rules would be dealt with using the normal enquiry powers available to HMRC compliance inspectors. Calculations done under the current rules are reviewed for accuracy and if necessary a tax enquiry is made. Sanctions in the case of errors, or non-compliance, follow the normal rules for tax enquiries.

7.68 Repealing the election within the context of an overhaul of the current rules is unlikely to result in any change to the present arrangements for enforcement, sanctions and monitoring. The tenor of the rules would be unaffected by the improvements and simplifications considered by the Working Group.

7.69 The enforcement, sanctions and monitoring necessary following repeal of the current rules and replacement with a new regime would depend on the detail of the replacement regime. There is no enthusiasm within industry or HMRC for a replacement regime and no consideration has therefore been given to these issues for this option.

7.70 The enforcement, sanctions and monitoring necessary following repeal of the current rules and replacement with a "revenue protection measure" would depend on the detail of the revenue protection measure and how it operates. There are three possibilities outlined above for how it might operate, which are under discussion with industry.

7.71 If general insurers were required to make an adjustment in the tax return where the standard is breached, the enforcement, sanctions and monitoring provisions would be similar to those already in existence. HMRC compliance inspectors would review calculations for accuracy and if necessary make a tax enquiry. Sanctions in the case of errors, or non-compliance, would follow the normal rules for tax enquiries.

7.72 If general insurers submitted with the tax return an explanation for breaching the standard, where it believed that it had done so, HMRC would assess this explanation and might undertake a tax enquiry if not satisfied or, in the case where there was no explanation, it appeared that the standard had been breached. Sanctions in the case of errors, or non-compliance, would follow the normal rules for tax enquiries. The same applies if assessment of whether the standard has been breached were left entirely to HMRC with no action by the general insurer.

7.73 In both cases, monitoring would be through HMRC risk-assessment of tax returns and the information submitted with them. Given that our analysis of industry trends and assurances from industry suggest that provisions are not excessive when viewed across the general insurance sector, we would expect tax enquiries only in exceptional cases where there is thought to be significant tax at risk.

7.74 The process to resolve tax enquiries is central to the enforcement of any revenue protection measure. The preferred option identified includes following the normal rules for tax enquiries, which lead in the end to referral to the appeals Commissioners, and interposing a new power allowing HMRC to require the insurer to produce an independent actuarial report in such form as they may reasonably require for the purposes of the tax enquiry.

7.75 Such a power would be subject to the normal appeals procedure that applies to notice to produce documents etc²⁶. It would be used to assist only in high-risk cases where disputes in this highly technical area could not be resolved between HMRC and the general insurer. It is recognised that such reports are expensive to produce and they would not be called for routinely.

7.76 The absence of actuarial assistance was the cause of difficulties with resolving tax enquiries into general insurers' provision before the current rules were introduced in 2000. A return to this situation would be unwelcome for HMRC and general insurers, hence consideration of the introduction of a power enabling HMRC to require the insurer to produce an independent actuarial report.

7.77 Referral to an independent actuary would not be an alternative to the appeals Commissioners who would still determine appeals in cases where HMRC and the taxpayer could not reach agreement. Any independent actuarial report obtained during the tax enquiry would be available to assist the Commissioners' deliberations.

7.78 As discussed above, this approach would mirror the FSA's approach to the investigative process that supports their regulation of general insurance business.

IMPLEMENTATION AND DELIVERY

7.79 To enable HMRC to develop a centralised approach to risk-assessment of general insurers' tax returns, a new information requirement would also form part of the revenue protection measure.

²⁶ paragraph 27 Schedule 18 Finance Act 1998 / section 19A Taxes Management Act 1970.

7.80 This would require to be submitted with the tax return a breakdown of the provision, which, for UK regulated general insurers, would be satisfied by production of a copy of three or four pages from the regulatory return. Lloyd's syndicates would be able to satisfy the requirement by production of a copy of three or four pages from the Lloyd's syndicate annual accounts and report. For non-UK regulated general insurers, it would require details to be extracted from accounting records. Such general insurers would anyway maintain a detailed breakdown for internal risk-management purposes.

7.81 Estimating liabilities is fundamental to the business of insurance. In reaching the figure included in the accounts, almost all, if not all, general insurers will have statistical and / or actuarial advice on the appropriate size for their provision as a matter of course. Consideration of whether the provision is in line with regulatory and accounting requirements – whether it is sufficient – is embedded as part of the process.

7.82 The standard set by the revenue protection measure will not interfere with provisions that are set with a reasonable standard of prudence – that is a modern commercial assessment of the likely liabilities – in accordance with the regulatory and accounting standards. Where this is the case, general insurers can be confident that their provision would not exceed the standard.

SUMMARY AND RECOMMENDATION

7.83 The recommended option is

- repeal of the current rules dealing with general insurers' provisions;
- a transitional rule allowing a disclaimer election, under the current rules, for the first period to end after the rest of the rules are repealed, but limited to 10 per cent of the provisions set for that period;
- the introduction of a revenue protection measure, incorporating;
- a standard setting out the maximum acceptable provision for tax purposes;
- an information power to require the delivery of a breakdown of the provision set for a period; and
- a power to require the production of a report from an appropriately qualified person.

7.84 Some of the detail will be set out in secondary legislation. This will allow for the maximum time to consult on the fine detail, particularly for example clarification of the precise detail of the standard to make sure that the standard is pitched at the right level.

7.85 This is the only option which delivers tax rules dealing with general insurers' provisions that

- are proportionate to the risk and targeted on the highest risk cases;
- reduce the compliance cost for the insurance sector;
- are consistent with regulatory and accounting rules; and
- are straightforward to operate, for general insurers and for HMRC.

Date of change

7.86 The current rules will cease to apply, subject to the transitional rule, and the new revenue protection measure will have effect, from Royal Assent, as follows:

- the existing rules will not apply to periods of account ending on / after the date that Royal Assent is given to Finance Act 2007, subject to the transitional rule; and
- the revenue protection measure will apply to periods of account ending on / after the date that Royal Assent is given to Finance Act 2007.

7.87 The transitional rule extends the period for which a disclaimer election may be made to include the first period of account to end after the date that Royal Assent is given to Finance Act 2007. This disclaimer is limited to 10 per cent of the provisions set for that period;

7.88 As almost all, if not all, general insurers have periods of account that end on 31 December, where this is so, the practical effect of the changes will be that

- the existing tax rules will not apply to periods of account beginning on / after 1 January 2007;
- a limited disclaimer election can be made for periods of account ending 31 December 2007; and
- the revenue protection measure will apply to periods of account ending 31 December 2007.

Contact point

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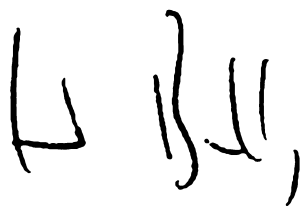
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REGULATORY IMPACT ASSESSMENT**The Tax Treatment Of General Insurers' Reserves****Statement of Ministerial Approval**

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

A handwritten signature in black ink, appearing to read 'Ed Balls', is positioned below the text 'Signed by the responsible Minister:'. The signature is written in a cursive style with a comma at the end.

Ed Balls, Economic Secretary to the Treasury

Dated: 14 March 2007

8

EXTENSION OF THE LANDLORDS ENERGY SAVING ALLOWANCE

PURPOSE AND INTENDED EFFECT OF MEASURE

The Policy Objectives

8.1 This Regulatory Impact Assessment considers the extension of the existing Landlords Energy Saving Allowance (LESA). This extension comprises four elements:

- extending LESA to corporate landlords to bring more private rented properties within the scope of the allowance;
- extending the existing sunset clause from 2009 to 2015;
- applying the cap to the allowance (£1500) per property rather than per building, ensuring that smaller properties have access to the full value of the allowance; and
- including the cost of acquiring and installing floor insulation as qualifying expenditure, expanding the range of energy efficiency measures available to landlords within the allowance.

8.2 Installing insulation is one of the most cost-effective means of improving household energy efficiency; LESA provides an allowance for the insulation of properties within the private rented sector. Extending LESA expands the scope of the scheme and therefore increases the incentives for energy efficiency savings to be made in line with the Government's environmental objectives.

Background

8.3 Households produce over a quarter of total UK carbon emissions and, while existing measures have helped to reduce emissions in this area, properties within the private rented sector are not on track to meet the emissions reduction targets that have been set for it. Such properties have low energy efficiency levels compared to the rest of the housing sector and typically produce around 500kg of carbon dioxide per year more than other houses. One reason may be the particular market failure, whereby landlords are disincentivised to invest in energy efficiency because the benefits of doing so, in the form of lower energy bills and increased comfort, flows not to them but to the tenants.

8.4 Budget 2004 took the first steps to address this market failure with the introduction of the Landlords Energy Saving Allowance (LESA), offering a deduction against taxable profits for private landlords' expenditure on loft and cavity wall insulation. In the intervening two years LESA has been extended to include solid wall and hot water system insulation as well as draught proofing. Budget 2006 announced work on extending the allowance to corporate landlords as well as raising its profile within the sector.

Rationale for Government Intervention

8.5 A particular market failure exists in the private rented sector where cost savings from investing in energy efficiency are difficult for landlords to recover in increased rent and unlike private house owners those investing are not those who benefit. In Budget 2004, the Government took action to address this market failure by introducing LESA. The Government believes that further energy efficiency gains could be realised in the private rented sector by extending the allowance in four ways:

- extending the scheme to corporate landlords – thus making the allowance available to an extra 25 per cent of properties within the sector;
- extending the sunset clause from 2009 to 2015 – thus allowing corporate landlords a longer investment window and providing an incentive to landlords purchasing properties post-2009 to invest in energy-saving measures;
- applying the allowance per property rather than per building – ensuring that even smaller properties such as flats within a block have access to the full allowance; and
- including the acquisition and installation of floor insulation – thus giving landlords a wider choice of insulating all parts of a property when carrying out energy efficiency improvements.

CONSULTATION

8.6 No formal public consultation has taken place to date. However, informal discussions have taken place with representatives from the energy efficiency and rental industries. The proposals were well received both in terms of the incentive to landlords to improve the standards of properties as well as the increased benefit to the environment.

OPTIONS

1. Do Nothing

8.7 Doing nothing would mean that the existing allowance would continue to apply to individual landlords until 2009. The cap of the allowance (£1500) would continue to apply on a per building basis. The group of insulation products that qualify for expenditure under the scheme would remain unchanged.

2. Extending the Landlords Energy Saving Allowance

8.8 Expand the scope of the existing allowance through:

- the extension of LESA to corporate landlords (subject to State aid approval);
- the extension of the existing sunset clause from 2009 to 2015;
- the application of the allowance per property rather than per building; and
- the addition of the acquisition and installation of floor insulation as a qualifying expenditure.

COSTS AND BENEFITS

Economic impacts

- Exchequer costs (loss of tax revenue of all extensions planned) up to £10 million;
- The extension to corporate landlords will mean that all landlords within the private rented sector will now have access to allowances for expenditure on insulation; and
- There will also be a negligible impact on HMRC in terms of increased compliance activity.

Social impacts

8.9 It is not anticipated that there would be any additional impacts on devolved regions, human rights, rural areas or crime.

Race and Equality Impacts

8.10 There will be no race or equality impact arising from this measure.

Environmental impacts

8.11 It is not anticipated that there will be any adverse impacts on the environment.

8.12 The extensions to the allowance are likely to result in a carbon dioxide saving of 0.15-0.67 MtC in 2010/11 – this is dependent on the take-up by corporate landlords.

Sectors and groups affected

8.13 The extension to the LESA will mean that corporate landlords benefit from the allowance for the first time. The overall additional administrative burden that will result for these companies is estimated to be less than £100,000. The other three aspects of the extension will also apply to private landlords, who are already eligible for LESA. There will be an indirect benefit to companies providing insulation materials. There will also be a benefit to tenants in the form of reduced utility bills and increased comfort.

Benefits

Option 1 – Do nothing

- No exchequer costs; and
- No additional administrative burden on corporate landlords.

Option 2 – Extend the Landlords Energy Saving Allowance

- The extension of LESA to corporate landlords will provide incentives for them to install energy saving materials in their properties, benefiting their tenants in terms of their reduced energy bills and improved accommodation. This will also lead to a small reduction in carbon emissions as a result of decreasing energy demand;
- The extension of the sunset clause will: provide a longer window for all landlords to invest in residential properties; incentivising all new and existing landlords purchasing properties after 2009 to also invest in the energy efficiency of their property;
- The application of the allowance per property rather than per building will simplify the allowance and increase uptake. It will also encourage more energy efficiency measures in smaller properties; and
- Extension of LESA to floor insulation will increase the range of qualifying insulation types available to landlords when carrying out improvements to their property.

Costs

Option 1 - Do nothing

- A significant proportion of the private rental market (i.e. corporate landlords) would continue to have no economic incentive to invest in energy efficiency measures in their properties, as they do not directly benefit from the improvements;
- LESA would not be available to landlords making improvements to properties after 2009;
- Blocks of flats etc. would continue to receive a smaller allowance per property and therefore would have less incentive to invest; and
- Choice of insulation would be restricted.

Option 2 - Extend LESA

- Exchequer costs (in terms of revenue foregone) up to £10 million per year;
- Increased overall administrative burden for corporate landlords of less than £100,000 per year; and
- For HMRC, the extension to corporate landlords would require updated guidance including changes to the notes on the Corporate Tax Return.

SMALL FIRMS IMPACT TEST

8.14 There will be no disproportionate burden on small firms. There is no compulsion to deduct the expenditure and the benefit received from the allowance would outweigh the associated administrative cost. Corporate landlords will only be required to deduct the appropriate amount as part of their profit or loss computation and do not have to provide details on the Corporation Tax return, reducing the administrative burden.

COMPETITION ASSESSMENT

8.15 Extensions to LESA level the playing field across the private rented sector. Other incentives are in place to improve energy efficiency in commercially rented properties.

8.16 The impact of the proposed extension to LESA was assessed by applying the competition filter to the private rental market. It was found that an in-depth competition assessment is not warranted.

8.17 The proposed extension to corporate landlords has been formally notified to the European Commission to request approval of a State aid on environmental grounds.

ENFORCEMENT, SANCTIONS AND MONITORING

8.18 The proposed extension to LESA will be monitored and enforced through HMRC's existing processes for administering the tax system, including the authority to enquire into tax returns where appropriate.

IMPLEMENTATION AND DELIVERY PLAN

8.19 Individual landlords claim LESA as a relief from income tax. The implementation of the extensions to these landlords runs to the following timetable:

4. Finance Bill 2007 will contain clauses extending the sunset clause from 2009 to 2015;
5. On 13 March 2007 existing legislation was amended by the Energy-Saving Item Regulations 2007. These Regulations, which were laid before the House of Commons on 14 March, ensure that the £1500 cap for the allowance applies per property rather than per building; and
6. On 14 March 2007 a Statutory Instrument was laid extending LESA to cover the acquisition and installation of floor insulation.

8.20 Corporate landlords will claim LESA as a relief from corporation tax. The extension to corporate landlords is subject to State aid approval – the European Commission has been notified of the proposed extension to the scheme.

8.21 Provision will be made in Finance Bill 2007 for the extension to come into force by Treasury Order once approval has been received from the Commission. Companies will then be able to deduct expenditure incurred after the date on which the extension comes into force. If State aid approval is not received it will not be possible to extend the availability of LESA to corporate landlords in this way. The additional three elements of the extension (extension of the sunset clause, extension to smaller properties and extension to include floor insulation) will also apply to corporate landlords from that date.

8.22 The LESA will allow corporate landlords to deduct the appropriate expenditure as part of their profit or loss computation (submitted with their Corporation Tax return). Individual landlords will continue to claim in the same way as previously (by means of their income tax return).

POST-IMPLEMENTATION REVIEW

8.23 The LESA is time limited and is due to expire in 2015. The scheme will be continually reviewed to ensure that it is effective in incentivising landlords to improve the energy efficiency of properties within the private rented sector.

SUMMARY AND RECOMMENDATION

8.24 We recommend option 2 – extending the Landlords Energy Saving Allowance.

8.25 The extension of LESA will incentivise corporate landlords to install energy efficiency measures in their rental properties; allow more time for the allowance to operate, thus incentivising landlords to improve their properties after 2009; give a more generous allowance to properties in shared buildings and give landlords a greater choice of insulating materials by also making floor insulation a qualifying installation.

8.26 The additional administrative and regulatory burden associated with this measure would be minimal. There will be no additional burden to those landlords who are already eligible for LESA. Corporate landlords will incur increased administrative costs of less than £100,000. There is little additional administrative burden to HMRC.

8.27 The extension of LESA is consistent with the Government's objective to protect and improve the environment by using instruments that will deliver efficient and sustainable outcomes through evidence-based policies.

Contact Point

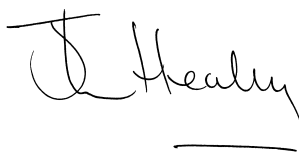
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REGULATORY IMPACT ASSESSMENT**Extension of the Landlords Energy Saving Allowance****Statement of Ministerial Approval**

I have read the Regulatory Impact Assessment entitled and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

A handwritten signature in black ink, appearing to read 'J Healey', with a horizontal line underneath.

JOHN HEALEY MP , FINANCIAL SECRETARY TO THE TREASURY

Dated: 19 March 2007

STAMP DUTY LAND TAX RELIEF FOR NEW ZERO-CARBON HOMES

PURPOSE AND INTENDED EFFECT OF THE MEASURE

Policy Objective

9.1 The objective of introducing a stamp duty land tax relief is to help kick start the market for zero-carbon homes, encourage microgeneration technologies, and raise public awareness of the benefits of living in zero-carbon homes. It will also help to incentivise major changes in house building and will complement the ambition announced by the Department for Communities and Local Government (DCLG) in December 2006 that all new homes be built to a zero-carbon standard by 2016. It is, in short, a signal that the Government would like to see more of these types of houses built in the future, and is a fiscal incentive to get the market to move in this direction.

9.2 It is expected that by 2050 about one third of the housing stock will have been built since 2006. So new homes have a vital role to play in helping to meet the United Kingdom's target of 60 per cent reduction in carbon emissions by 2050. According to the partial Regulatory Impact Assessment (RIA) published by DCLG alongside their consultation on "Building A Greener Future: Towards Zero Carbon Development" (December 2006)²⁷, it is estimated that having all new development built according to a zero-carbon standard is expected to save between 6.5 MtC (million tonnes of carbon) and 7 MtC per annum in England and Wales by 2050 compared to the do nothing option. This measure will have an additional effect on carbon savings in years to come.

9.3 The relief will apply to the whole of the United Kingdom and will be time-limited to five years. Before that point, the Treasury will conduct a review of the scheme to determine to what extent it has achieved its objectives. The relief will apply only to residential transactions (individuals) and not to commercial transactions (business).

9.4 The relief will provide exemption from tax liability when house costs less than £500,000, and will provide a £15,000 reduction in tax liability to all homes worth more than £500,000. . The risk of not setting an upper limit would be that the relief would exceed the additional construction costs associated with building a home to a zero-carbon standard. The relief will only be available at the first point of sale. Allowing the relief to apply to second and subsequent sales would result in no new environmental benefits to either homebuyers or to society, and would, therefore, not provide good use of public money.

9.5 Introduction of the relief will not significantly affect the administrative burden on solicitors who usually complete and submit the stamp duty land tax return to HMRC on behalf of homebuyers. The tax relief is within the self-assessment system and we expect it to be largely self-policing. The stamp duty land tax return will remain unchanged. There will be very small administrative burden on developers in obtaining the certificate acknowledging the property they have developed is built to a zero-carbon standard. As it is the aim to use the existing Energy Performance Certificate (EPC) system, this has helped to keep the additional administrative burden on both solicitors and developers to a minimum.

²⁷ http://www.communities.gov.uk/pub/173/BuildingaGreenerFutureTowardsZeroCarbonDevelopment_id1505173.pdf

9.6 The stamp duty land tax relief is consistent with the Treasury's objective to protect and improve the environment by using instruments that will deliver efficient and sustainable outcomes through evidence-based policies. It is also consistent with the United Kingdom's objective of reducing carbon emissions by 60 per cent by 2050.

Background

9.7 Stamp duty land tax is a transaction tax payable on the purchase of land and property, or any consideration for the acquisition of an interest in land or property. It is payable by the buyer at a rate which depends on the purchase price of the property, and is administered and collected by HMRC. As part of a major modernisation in Finance Act 2003, stamp duty (on documents) was replaced by stamp duty land tax (on the transaction itself) with effect from 1 December 2003. Stamp duty is also charged on grants of new leases of land and buildings both on the premium (capital sum paid by the purchaser) and on the rental element.

9.8 The current (with effect from 22 March 2006) residential rates and thresholds for stamp duty land tax is set out in the table below:

Rate (per cent)	Threshold (£)
0	0 - 125,000 *
1	125,001 - 250,000
3	250,001 - 500,000
4	500,001+

* Starting residential threshold in 2000 disadvantaged areas²⁸ is £150,000.

9.9 The Pre-Budget Report (PBR) 2006 announced that a stamp duty land tax exemption for the vast majority of new zero-carbon homes would be introduced in 2007. Further details of the exemption, as promised, were set out in Budget 2007; this included a five-year time limit, a cap on the relief of £15,000, and a definition of a new zero-carbon home.

9.10 A zero-carbon home is one that does not consume fossil fuels for heat and power. It is highly insulated and uses renewable energy to power its needs over a year through microgeneration. Heat and power technologies include ground source heat pumps, photovoltaic cells, solar water heaters and wind turbines. It will draw from the grid when the microgeneration is insufficient but could sell excess generation back to the grid. The Government wants to stimulate a significant shift in technology in this area. The definition proposed would not include carbon emitted during construction nor that "embodied" in the manufacture of these materials. Similarly, it would not include recycled material quotas nor will it allow the home to offset carbon by such as planting trees. But these issues could be addressed in the future.

²⁸ Disadvantaged areas are designated as 'enterprise areas' in the 2002 PBR. They are the 2000 areas which are most deprived on the basis of the indices of deprivation published by the administrations of England, Wales, Scotland and Northern Ireland.

9.11 DCLG is the Government department responsible for building regulations. They published a consultation (Building A Greener Future: Towards Zero-carbon Development” (December 2006)²⁹) setting out the Government’s plans to set a timetable for moving towards zero-carbon development as a contribution to meeting the United Kingdom target to reduce carbon emissions by 60 per cent by 2050. In short, it is an ambition that by 2016 all new homes should be built according to a zero-carbon standard.

Rationale For Government Intervention

9.12 The Stern Review³⁰ reported that the scientific evidence was overwhelming in suggesting that climate change is a serious global threat and demands urgent action. The overall costs and risks of climate change resulting from failure to act now will be equivalent to losing at least 5 per cent of global Gross Domestic Product (GDP) each year. If a wide range of risks and impacts are taken into consideration, this could rise to as much as 20 per cent of GDP or more. According to Stern, taking action now to avoid the worst impacts of climate change could limit the cost of mitigation to 1 per cent of GDP. In short, the conclusion of the Stern Review is that the benefits of strong and early action far outweigh the economic costs of inaction.

9.13 More than a quarter of the carbon dioxide emissions in the United Kingdom arise from energy used to heat and light homes. It is also clear that providing enough new homes to meet demand is an important issue. Increases in longevity and the tendency for people to form more, but smaller, households means that we need additional housing provision. Recent projections show that number of households will grow by 200,000 each year until 2026. In 2005-06, over 180,000 new homes were built, the highest level for over 15 years but still short of the 200,000 needed. It is expected that by 2050 about one third of the housing stock will have been built since 2006. So new homes have a vital role to play in helping to meet the United Kingdom’s target of 60 per cent reduction in carbon emissions by 2050.

9.14 It is therefore important we take immediate steps. The main driver on standards in new homes has been building regulations and the planning system which prescribes the way we design, build and locate development. These will continue to be very important as evident by DCLG’s consultation to drive higher environmental performance in new homes. The move to zero-carbon development through these measures will take time, as it will require a revolution in construction techniques, training and employment of technology to deliver this. We, therefore, believe that there is a role for fiscal policy, in the form of a stamp duty land tax relief, to help kick start the market in the short term. It should be highlighted that there are limits to what a stamp duty land tax relief can achieve. This is because energy consumption is ultimately a function of lifestyle, and stamp duty land tax has limited influence on the lifestyles of individuals. Stamp duty land tax, however, is well suited to incentivising the construction of homes which incorporate specific energy efficiency standards in the fabric of the building and incorporation of microgeneration technology at the design stage. Reducing energy consumption in the home is also a Government objective, and there are other measures and instruments Government is introducing that are better designed and able to address this.

²⁹ http://www.communities.gov.uk/pub/173/BuildingaGreenerFutureTowardsZeroCarbonDevelopment_id1505173.pdf

³⁰ Stern Review on the Economics of Climate Change (30 October 2006) - http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/sternreview_index.cfm

9.15 According to the partial Regulatory Impact Assessment (RIA) published by DCLG, if all new homes reached zero-carbon standard it would have a significant effect on carbon emissions; it is estimated that this could save between 6.5 MtC (million tonnes of carbon) and 7 MtC per annum in England and Wales by 2050. This measure aims to increase the speed at which zero-carbon homes come onto the market in the years up to 2016. By doing that, the measure will have an additional effect on carbon savings in years to come.

9.16 Zero-carbon homes will offer homebuyers significant reductions in energy bills, potentially to nil. The average combined annual household gas and electricity bill is estimated at about £78031. However, the financial benefits of this would need to be offset by the annual maintenance costs of some of the equipment associated with running a zero-carbon home, and there are not yet estimates of this cost available.

9.17 The stamp duty land tax relief will only be available for a newly built zero-carbon home at the first point of sale. The relief will not apply to the second or subsequent points of sale. This is because a key objective of this measure is to provide an incentive to developers to build these homes through stimulating consumer demand. Once homes are built to highly insulated standards with other energy saving technology, we expect the benefit in terms of energy savings (and reductions in CO2 emissions) to remain in the home for many years. Allowing the relief to apply to second and subsequent sales would result in no new environmental benefits to either the homebuyer or society, and would, therefore, not provide good use of public money.

9.18 The relief will provide exemption from tax liability when a house costs less than £500,000, and will provide a £15,000 reduction in tax liability to all homes worth more than £500,000. The risk of not setting an upper limit on the tax reduction available would be that the relief could exceed the additional construction costs associated with building a home to a zero-carbon standard and would not deliver good use of public money.

CONSULTATION

9.19 No formal public consultation has taken place to date. However, informal discussions have taken place across Government principally with HM Revenue and Customs (HMRC); Department for Communities and Local Government (DCLG); and, the Department for Environment, Food and Rural Affairs (DEFRA). Other Government stakeholders involved in discussions are: Department for Trade and Industry (DTI); Welsh Assembly; Scotland Office; Scottish Executive; Scottish Building Standards Agency (SBSA); Northern Ireland Office; Northern Ireland Executive; and, the Greater London Authority (GLA). Overall response received was generally positive and welcomed the introduction of such a tax relief.

9.20 Informal discussions took place with a number of interested parties in the field of zero-carbon development since the initial announcement at PBR 2006. Informal consultations will take place after Budget 2007 on the (technical) definition of a new zero-carbon home and on administration matters. The definition of a zero-carbon home will be set out in a draft Treasury Order (Statutory Instrument) which will be made and come into force only after Royal Assent is granted to Finance Bill 2007.

³¹ Based on *Quarterly Energy Prices*, DTI, December 2006

OPTIONS

9.21 There are essentially two options under consideration in which stamp duty land tax can be used as an effective fiscal instrument to contribute to reducing carbon emission emanating from homes and at the same time helping to kick start the market for zero-carbon homes with a view to having all new homes developed to a zero-carbon standard by 2016.

9.22 The two options are as follows:

Option 1: Do nothing

9.23 Developers who decide to build zero-carbon homes will incur additional construction costs compared to building a conventional home. These additional costs are likely to fall as more zero-carbon homes are built and the benefits of economies of scale are realised as the number of zero-carbon developers increase. The stamp duty land tax relief will help reduce potential cost barriers to building such homes. Developers may also experience marketing difficulty in selling them to the public. As a result, the market for zero-carbon homes will not grow as fast as the Government would like it to between now and 2016 – at which point it becomes mandatory for all new homes to be built to a zero-carbon standard. This would result in less energy efficient homes being built and utilised, and more carbon emissions being let out into the atmosphere than otherwise would. This could jeopardise the United Kingdom's ambition to reduce carbon emissions by 60 per cent by 2050.

Option 2: Stamp duty land tax relief for new zero-carbon homes

9.24 The relief will help kick start the market for zero-carbon homes, encourage microgeneration technologies and raise public awareness of the benefits of living in a zero-carbon home. It will complement the ambition announced by the DCLG in December 2006 that all new homes be built to a zero-carbon standard by 2016.

9.25 25 per cent of UK carbon emissions derive from consumption of energy in the home and by 2050 approximately one third of the housing stock will have been built since 2006. So new homes have a vital role to play in helping to meet the United Kingdom's target of 60 per cent reduction in carbon emissions by 2050.

9.26 The relief is designed to incentivise demand for zero-carbon homes among homebuyers, recognising that in order to raise energy efficiency standards significantly beyond where they are now the industry will have to modernise production methods and innovate through employment of new materials and technologies. The relief will also provide developers with a powerful marketing tool – they will be able to advertise these homes as free of stamp duty land tax which many potential buyers would find very attractive.

9.27 The table below shows the financial benefits of the two options in terms of stamp duty land tax liability.

Cost of House (£)	Stamp Duty Land Tax liability under		Value of savings resulting to homebuyer under option 2 compared to option 1 (£)
	Option 1 (£)	Option 2 (£)	
100,000	0	0	0
150,000*	1,500	0	1,500
200,000	2,000	0	2,000
250,000	2,500	0	2,500
300,000	9,000	0	9,000
400,000	12,000	0	12,000
500,000	15,000	0	15,000
600,000	24,000	9,000	15,000
700,000	28,000	13,000	15,000
800,000	32,000	17,000	15,000
900,000	36,000	21,000	15,000
1,000,000	40,000	25,000	15,000

* Assuming this property does not fall within a disadvantage area; otherwise it would attract the disadvantage areas relief and would be exempted from tax as it is below the starting threshold of £150,000 for disadvantage areas.

COSTS AND BENEFITS

Benefits

Option 1: Do nothing

- No administrative impact on developers from obtaining a certificate verifying that a home is built to a zero-carbon standard, and on solicitors who usually complete and submit the stamp duty land tax return to HMRC on behalf of home buyers; and
- No administrative impact on public sector bodies responsible for administering the certification process, and, on HMRC who is responsible for administering and collecting stamp duty land tax.

Option 2: Stamp duty land tax relief to new zero-carbon homes

- Reduction in carbon emissions;
- Helps kick-start the market for zero-carbon homes and raises public awareness of the benefits of living in these homes;

- Provides developers with a powerful marketing tool to sell zero-carbon homes; and
- Reduces potential cost barriers for developers given such homes cost more to build than conventional homes.

Costs

Option 1: Do nothing

- Market for zero-carbon homes does not develop as fast as the Government would like in the run up to 2016;
- Developers experience marketing difficulty in selling these homes to potential homebuyers; and
- Developers continue to face potential cost barriers to building these homes given they cost more than building a conventional home.

Option 2: Stamp duty land tax relief to new zero-carbon homes

- A small administrative impact on developers from obtaining a certificate verifying that a home is built to a zero-carbon standard, and on solicitors who usually complete and submit the stamp duty land tax return to HMRC on behalf of home buyers; and
- A small administrative impact on public sector bodies responsible for administering the certification process, and, on HMRC who is responsible for administering and collecting stamp duty land tax.

Sectors Affected

9.28 The following groups and sectors are likely to be affected by this measure: house builders; homebuyers; society; energy sector; manufacturers of sustainable technologies; solicitors engaged in property work; and, the public sector.

House Builders

9.29 The house building industry will be affected as they would have to make commercial decisions, albeit voluntarily, about whether to build homes to a zero-carbon standard. The building industry has to do this in any case to meet new demands from customers and to match changes in industry standards. We expect many developers to use the stamp duty land tax relief as a powerful marketing tool to sell these homes to the public.

9.30 It is likely that a significant proportion of the tax incidence will fall upon developers - this means developers will be able to sell these homes at a higher price than they would have otherwise were it not for the tax relief. It would, therefore, reduce potential cost barriers in building these homes.

Homebuyers

9.31 Homebuyers will benefit from the improvements, both in financial and non-financial terms, from living in homes built to a zero-carbon standard. They will benefit from savings on a stamp duty land tax liability ranging from £1,250 to £15,000 - depending on the value of the property. But this financial benefit is likely to be partially offset as developers of zero-carbon homes are likely to sell these homes at higher price to cover the additional costs associated with building a home to a zero-carbon standard. Even allowing for this, we still expect zero-carbon homebuyers to remain overall financially better off compared to the do nothing option.

9.32 Homebuyers will benefit from lower energy bills throughout the time spent in the home compared to living in a conventional house. The average annual gas and electricity bills combined together is estimated at about £780. But this will be offset by the annual maintenance costs of some of the equipment associated with running a zero-carbon home – there are currently no estimates of this cost.

Society

9.33 More generally, the environmental benefits of reduced carbon emissions from improving the energy performance of new build will affect wider society.

Energy Sector

9.34 The energy sector will be indirectly affected, as improvements in energy performance of zero-carbon homes will reduce the demand for energy from the domestic sector. The generation and exportation of power from homes to the grid will result in the energy sector having to produce less power compared to households living conventional houses. This will have further environmental benefits, as less carbon emissions will be let out into the atmosphere from power stations. It will also have a negative economic impact on power companies as less power overall will be imported i.e. demanded by households living in zero-carbon homes. The policy could also increase the rate of development of renewable energy power.

Manufacturers of Sustainable Technologies

9.35 Another sector that will be indirectly affected would be manufacturers of sustainable technologies as a result of the impact on demand for these technologies. The market for their products will be stimulated further, contributing to economies of scale in production as the technologies become more commonplace.

Solicitors and Conveyancers

9.36 Solicitors who are employed in property work will be affected, as it is they who usually complete and submit the stamp duty land tax return to HMRC on behalf of homebuyers. Solicitors will be provided from the buyer with a certificate qualifying the home as meeting the Treasury's zero-carbon standard. No additional administrative work will have to be carried out by solicitors other than to retain a copy of the certificate on their files for HMRC compliance purposes. The stamp duty land tax return will remain unchanged as a result of this measure but will updated in due course.

9.37 In England and Wales there are almost 9,000 solicitors firms who deal with conveyancing. In Scotland and Northern Ireland there are about 800 and 200 solicitors, respectively. Therefore, a total of about 11,000 solicitors in the United Kingdom potentially affected by this measure.

Public Sector

9.38 There will be two types of impact on the public sector. The first will be on HM Revenue and Customs who administer and collect stamp duty land tax. The tax relief is within the self-assessment system and we expect it to be largely self-policing. It is a tax relief and levels of compliance are likely to be high. There will be no change to the stamp duty land tax return. The additional administrative impact on HMRC will be extremely small.

9.39 The second impact will be on DCLG who will be responsible for administering the Energy Performance Certificate (EPC) system in England and Wales. In Scotland the certification process will be controlled by the Scottish Executive and in Northern Ireland by the Northern Ireland Executive (Department for Social Development). The certification process will provide developers (and homebuyers) with the certificate that a house falls within the definition of zero-carbon set by the Treasury. The homebuyer will need to be given this certificate in order to claim the stamp duty land tax relief. Given the aim to use the existing Energy Performance Certificate (EPC) system, this has ensured this additional administrative burden on developers and solicitors is kept to the bare minimum.

Regional Impact

9.40 A significant proportion of the stamp duty land tax yield is derived from sale of homes in London and the South East of England. Around 50 per cent stamp duty land tax yield on residential property in 2005-06 arose from London and the South East of England. This is largely because of a significant proportion of homes transacted fall within the threshold bands where the 3 per cent and 4 per cent rates apply compared to other regions. However, having a cap on the relief at £15,000 will help to minimise any regional distortions arising from this relief.

Race and Equality Impact

9.41 There will be no race or equality impact arising from this measure.

SMALL FIRMS IMPACTS TEST

9.42 The tax relief is targeted at individuals and not business (although there may also be an effect on businesses involved in the building and selling of zero-carbon homes).

9.43 Solicitors employed in property work usually complete and submit a stamp duty land tax return to HMRC on behalf of homebuyers. The administrative impact, on solicitors (irrespective of the size of their business) would be small.

9.44 There currently exists very few developers of zero-carbon homes, and the ones that do currently exist are predominantly small and medium size enterprises. Developers will financially benefit from this measure given the incidence of tax relief will fall upon developers (see paragraph 5.7 for further explanation of tax incidence).

COMPETITION ASSESSMENT

9.45 Tax relief will benefit only those transacting in the residential property market (individuals) and not those transacting in the commercial property market (business).

9.46 The aim of the relief is to generate consumer demand for new homes to be built to zero-carbon standard in advance of the change in building regulations which will make it mandatory for all new homes to be built to a zero-carbon standard. The tax relief does not compel developers to build homes to a zero-carbon standard but provides a financial and marketable incentive for them to do so.

9.47 This measure incentivises microgeneration above other forms of low carbon electricity generation, for example onshore wind farms. However the proposals leave it to the market to determine which are the most appropriate technologies.

ENFORCEMENT, SANCTIONS AND MONITORING

9.48 Sanctions will be in place if an individual attempts to claim the tax relief that they are not entitled to. HMRC will have the power to impose penalties on such individuals as well as being able to recover the tax relief. If a false certificate has been issued by the developer without the knowledge of the homebuyer then not only will HMRC have the power to recover the tax relief but have the power to impose a penalty on the developer.

9.49 The stamp duty land tax relief for new zero-carbon homes will be time limited to five years. A review, including of the standards for zero-carbon home, will take place by 2012. By that point we will also review the costs and benefits of the scheme including the regulatory, compliance and administrative costs. In the interim, monitoring of stamp duty land tax relief scheme including take up of the relief and compliance related issues will be carried out using HMRC's existing procedures.

IMPLEMENTATION AND DELIVERY PLAN

9.50 Finance Bill 2007 will legislate for the provision of a stamp duty land tax relief for new homes built to a zero-carbon standard. The legislation will provide for the relief to expire after five years; cap the relief at £15,000; and, provide the Treasury with the power to define a new zero-carbon home through secondary legislation.

9.51 In order to claim the stamp duty land tax relief, the homebuyer will need to claim it as a relief on the stamp duty land tax (transaction) return which is submitted, via the solicitor, to HMRC. Any certificate provided verifying that the home qualifies will need to be retained by the homebuyer (and solicitor) as evidence in use of enquiry.

9.52 The certification process will be part of the Energy Performance Certificate (EPC) process. EPC was initiated by the European Union (EU) in January 2003 and will be compulsory. The EPC will be introduced in Scotland from May of this year and in England and Wales from October also of this year. As for Northern Ireland, it will be introduced from January 2009. The EPC will be part of the Home Information Packs, and will detail average costs for heating, hot water and lighting in the home. It will also quantify how energy efficient the home is and how to cut costs with energy efficiency measures. It is mandatory that an EPC be issued when a new building (including a new home) is constructed.

POST IMPLEMENTATION REVIEW

9.53 The stamp duty land tax relief will be time limited to five years. – will expire in 2012. The scheme, including the standards for zero-carbon home, will be evaluated by 2012.

SUMMARY AND RECOMMENDATION

9.54 We recommend option 2 – providing a stamp duty land tax relief for a new zero-carbon home.

9.55 Relief will incentivise demand for zero-carbon homes among homebuyers and will complement the ambition announced by the Department for Communities and Local Government that all new homes be zero-carbon by 2016. In short, it will help kick start the market for zero-carbon homes, encourage microgeneration technologies and raise public awareness.

9.56 The additional administrative and regulatory burden associated with this measure would be small. Solicitors, who usually complete and submit the stamp duty land tax return on behalf of their clients (homebuyers) to HMRC will not experience or notice any substantive change to their administrative burden or costs. The EPC process has enabled to keep the additional administrative burden on developers and solicitors to the very bare minimum.

9.57 The stamp duty land tax relief is consistent with the Treasury's objective to protect and improve the environment by using instruments that will deliver efficient and sustainable outcomes through evidence-based policies. It would also help contribute towards the United Kingdom's objective to reduce carbon emissions by 60 per cent by 2050, given a quarter of all emissions arise from consumption of energy in the homes and that by 2050 about one third of homes would have been built since 2006.

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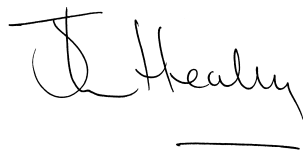
REGULATORY IMPACT ASSESSMENT

Stamp duty land tax relief for new zero-carbon homes

Statement of Ministerial Approval

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

A handwritten signature in black ink, appearing to read 'J Healey', with a horizontal line underneath.

JOHN HEALEY MP, FINANCIAL SECRETARY TO THE TREASURY

Dated: 19 March 2007

INTRODUCTION

10.1 This is a full RIA on the implementation of the measures on tax relief for pensions for Finance Bill 2007. It updates and expands on the relevant sections of the partial RIA ‘Tax Relief for Pensions – 2006 PBR reforms’ published in December 2006 and in addition includes a section on Pension Tax Relief on Term Assurance, which did not feature in the partial RIA at PBR.

10.2 All the measures in this RIA follow on from the Pensions Tax Simplification (A-day) legislation that came into effect on 6th April 2006.

PURPOSE AND INTENDED EFFECT OF THE PACKAGE OF MEASURES

Objective

10.3 The measures to be implemented and legislated in Finance Bill 2007 are designed to ensure that:

- the pensions tax rules continue to meet the original intentions of the simplified regime and that the generous tax reliefs for pensions are used to support pension saving to provide for an income in retirement; and
- industry costs in administering the pensions tax rules are reduced wherever possible.

Background

10.4 Pensions tax relief is a longstanding feature of the pensions tax landscape. The generous tax relief provided by the Exchequer raises incentives to save in a pension relative to other products, encourages employer engagement and sits alongside Government’s wider objectives to tackle pensioner poverty and to enable low and moderate earners to have access to low cost saving for their retirement. Part of the longstanding deal is that pensions tax relief is given in return for pensions saving being used to produce an income in retirement.

10.5 The Government introduced a radical simplification of the pensions tax rules on 6th April 2006. In making these changes, the Government’s ambition has been to maintain stability, fairness and encourage long-term saving, providing a transparent and flexible regime, enabling individuals to make informed choices about pensions saving. The following key principles, have guided, and continue to underpin the Government’s approach to pensions tax relief:

- Generous tax relief is provided to support pensions saving to produce an income in retirement. Pensions saving is not however provided to support pre-retirement income, asset accumulation or inheritance;
- Pensions are provided with more favourable tax treatment compared to other forms of saving in recognition that these are less flexible than other savings and are locked away until retirement;

- Incentives for employer contributions are provided as it is more efficient for pensions to be provided on a collective basis through the employer; and
- A commitment to affordability by ensuring that the cost of pensions tax incentives fall within current fiscal projections.

10.6 The Government recognises the importance of a stable environment that allows the pensions industry to plan ahead and minimise disruption to the regimes already in place that are working well. At the same time, the Government will need to respond to circumstances that move away from the above principles, or where the market seeks to identify loopholes in legislation that permit behaviours clearly outside the original intention of the legislation. Alongside that Government is also keen to act to assist the industry in further reducing administrative burdens in operating the new system.

Rationale for Government intervention

10.7 The purpose of the reforms to the tax regime for pensions are to bring practice in the simplified tax regime into line with policy intention that tax-relieved pension saving is used to provide an income in retirement. Within this, there are four sets of reforms:

- reforms to Alternatively Secured Pensions (ASPs);
- reforms to Pension Tax Relief on Term Assurance;
- reforms to ensure the new regime technically works as originally intended and provide administrative easements; and
- reforms to ensure policy on diversified ownership of investment-regulated pension scheme investments is maintained as a consequence of the change in the way the UK-REIT regulations are to operate.

ALTERNATIVELY SECURED PENSIONS

Rationale for government intervention

10.8 Successive Governments have offered tax relief on contributions to and investment growth in approved pension schemes in order that the savings produce an income in retirement. By saving in a tax-privileged pension, individuals are committing to use the funds to secure an income in retirement. The Government has been clear that the reason for introducing ASPs was for those who have principled religious objections to the pooling of mortality risk in annuities. Despite the introduction of the IHT changes in Finance Act 2006 it is clear that there remains a minority interested in continuing to explore the scope for using ASP to accumulate capital, rather than to provide for an income. This is not the purpose of the generous reliefs and both undermines the principle of producing a secure income from tax-privileged pension saving, and by deferring tax charges, has costs to the Exchequer.

CONSULTATION

Within government

10.9 There have been discussions with tax specialists in HM Revenue & Customs and with HM Treasury and the FSA. There is no impact on other government departments.

Public consultation

10.10 The PBR announcement set out four specific areas of the ASP proposals on which HMRC would consult. These were:

- the start date of the ASP measures
- alternative treatment for members that schemes are unable to trace by their 75th birthday and who are currently defaulted into ASP
- the interaction of the ASP and IHT charges; and
- measures to prevent avoidance of the ASP requirements through the other pension options.

10.11 HMRC held a number of consultation meetings to discuss the proposed changes with interested parties, including members of a range of bodies representing the pensions industry. We've also received representations on the above specific areas, as well as the ASP proposals more generally.

10.12 Representations covered a wide range of issues, but generally there was an acceptance that there needed to be some tax charge on funds passing on the death of an ASP member. Respondents were concerned both with the combined level of the unauthorised payment and inheritance tax charges and also with the administration of the two tax charges. Representations were also received on the level of the minimum income requirement.

10.13 As a result of these discussions, the Government has today announced a number of changes and refinements to the ASP proposals set out at PBR on 6th December 2006. Further details of these changes are included in a Budget Note.

10.14 The Government has considered the representations received on the unauthorised payment charge and the IHT charges, but maintains that both should apply as appropriate. Without both charges, ASPs may be seen as an attractive route to pass on tax reliefs obtained for the purpose of providing a pension for the member, and also to pass on funds avoiding the inheritance tax charges that apply where assets are passed on death. Changes to the IHT rules to help the administration of the charges for pension schemes and to ensure a fair outcome where the deceased has some nil-rate band remaining before including the ASP funds in the value of the estate have been announced in a Budget Note.

10.15 A range of representations were received in respect of the measures to prevent anti-avoidance of the ASP changes. The Government has considered these representations, but does not accept that arrangements that are designed to allow part of a member's tax-relieved funds to be inherited by their survivors (other than in the form of authorised benefits) are a proper use of tax-relieved pension savings (even where such arrangements provide for the payment of a level of pension commensurate with the size of the fund from which it is provided). The Government intends, therefore, to bring forward measures, which will impose pension tax charges and IHT where funds are not used as intended. HMRC is continuing the PBR consultation, but will be seeking representations only on the detail of the measures and not on the principles. These are set out in the consultation paper 'Tax Relief for Pensions: Inheriting Tax-Relieved Pension Savings' which is available on the HMRC website. Should this further consultation result in further legislation an appendix to this full RIA will be published.

OPTIONS

1. Do nothing

10.16 This option would mean that ASP would be a widely available mechanism for avoiding annuitisation and enabling individuals to produce from their tax-privileged pension saving not a secure income in retirement but a capital sum that they could pass on to their heirs after age 75.

2. Introduce tax changes for ASPs to ensure that pension saving is used to provide an income in retirement. This is the measure that the Government will be taking forward in the Finance Bill.

10.17 This option would introduce tax changes for ASPs to ensure that pension saving is used to provide an income in retirement. The change to the rules that currently apply to ASPs include:

- the introduction of a requirement to withdraw a minimum level of income each year from an ASP fund. Following the consultation the Government has decided that the minimum income withdrawal will be 55% of the annual amount of a comparable annuity for a 75 year old that could be purchased with the sums and assets of the ASP fund. A new maximum withdrawal of 90% of a comparable annuity will also be introduced. If in any year the minimum income is not withdrawn then a scheme sanction charge will apply to the difference between the actual income drawn and the minimum amount. The facility to pass on funds on death as a transfer lump sum death benefit will be removed from the authorised payment rules. Such payments in the future will be unauthorised and attract unauthorised payment charges of up to 70 per cent. This means that on the death of a member any remaining ASP funds can be authorised payments only where they are used to pay dependants' pension benefits, paid to a charity or in limited circumstances be repaid to the employer. The Inheritance Tax charges introduced in Finance Act 2006 on ASP funds will remain in place with modifications mainly to reflect the interaction of unauthorised payment charges in estates where there is some unused nil-rate-band before the ASP funds are taken into account. The changes will apply both to members and dependants ASP funds.

3. Restricting ASPs to certain religious groups

10.18 The Government considered whether it would be feasible to limit the availability of ASP to those with principled objections on religious grounds to the pooling of mortality risk that is inherent in annuities and concluded it would not be feasible to do so.

4. Remove ASPs entirely from the authorised payment rules

10.19 The Government also considered the possibility of removing ASPs entirely from the authorised payment rules, which would leave lifetime annuities and scheme pensions as the only form of authorised pension benefit once a member reaches age 75.

COSTS AND BENEFITS

Sectors and groups affected

10.20 The changes to ASPs will affect certain pension scheme providers, insurance companies, pension scheme administrators and members of registered pension schemes and their dependants, and financial advisers.

Benefits

10.21 The changes will bring practice and policy intention into line, and provide a fair balance between meeting the needs of those with principled religious objections to annuitisation and the needs of the wider public who are provided tax relief to secure an income in retirement.

Costs

10.22 The measures are designed to ensure that there is no additional cost to the Exchequer of pension simplification. Estimates of the overall Exchequer costs of pension simplification remain at £25 million for 2006-07, rising to £250 million in 2010-11 (for estimates relating to the intermediate years, see the full RIA on Pensions Simplification published at Budget 2006).

10.23 The measure should only have a negligible effect on industry burdens in the long-term (the on-going costs to industry should be relatively unaffected by the measure). A small ongoing burden to industry may arise from those still wishing to take out ASPs on principled religious grounds in operating the minimum income requirement and complying with the rules that will apply on the death of an ASP member (no representations were received on this issue in response to the questions raised in the December partial RIA).

10.24 However, although it was never the intention of the Government that ASPs should be marketed and sold so widely, it is possible that some providers may have incurred one off costs in setting up and making ASP available to customers (or costs in anticipation of new ASP business in the future) that they cannot recover following these changes.

10.25 ASP changes will also result in HMRC having to make adjustments to IT systems as well as to guidance and literature. At this stage it is not possible to quantify these costs although these are likely to be quite small.

Pension tax relief on term assurance

PURPOSE AND INTENDED EFFECT

Rationale for government intervention

10.26 The generous pension tax reliefs are provided to support pension saving to produce an income in retirement for individuals and their dependants. Personal term assurance policies that are not linked to saving for a retirement income do not fit within these principles and it is not therefore in isolation an activity for which the Government wishes to give tax relief.

10.27 ABI quarterly sales data shows that sales of tax-relieved term assurance were taking a far larger share of the life insurance protection market than intended. The result was that the general body of taxpayers faced a potentially significant cost for tax relief on activities that were not linked with saving for an income in retirement.

CONSULTATION

Within government

10.28 There has been extensive consultation with tax specialists in HM Revenue & Customs and with HM Treasury. The FSA have been kept informed and consulted on the practical aspects for firms. There is no impact on other government departments.

Public consultation

10.29 Following the announcement in the 2006 Pre-Budget Report HMT and HMRC officials met jointly with representatives from the Association of British Insurers, the Investment and Life Assurance Group, the Society of Pension Consultants and the Association of Independent Financial Advisers to discuss in practical terms the options for maintaining pension tax relief for term assurance while keeping in line with the Government's objective of giving pension tax relief to encourage individuals to save for income in retirement.

Summary of public consultation

10.30 Term assurance is taken out to insure against the risk of one of the household earners dying. It is often linked to the need to be able to repay a mortgage. Industry calculates that as a nation we are substantially under-insured. Apart from the effect of tax relief, it is more expensive to buy when sold as part of a registered pension scheme. This is because of the corporation tax treatment of the insurer and the administrative costs of claiming the tax relief from HMRC. The pricing in the market is very competitive and sensitive to price but the monetary value of tax relief on individual policies is small. Term assurance with tax relief took around a quarter of the total life insurance market by December 2006. But it would not take much additional regulation to make tax-relieved term assurance more expensive than term assurance sold without tax relief.

Impact on decision taken

10.31 On the basis of pensions industry representations the Government has concluded that any sort of meaningful link between term assurance and saving for an income in retirement would not be commercially viable. The Government therefore had the choice either to allow term assurance policies to keep tax relief with no means of ensuring this relief would encourage saving for a retirement income or to remove pension tax relief from the contributions individuals pay towards personal term assurance altogether.

OPTIONS

10.32 The Government's purpose in giving tax relief for pension contributions is to support pensions saving to produce an income in retirement and the options below were all evaluated against this underlying principle.

1. Do nothing

10.33 The cost of tax relief for life insurance may be largely dead weight, because many individuals would have taken out life insurance outside of a pension anyway. Tax relief would also distort the life insurance market. The potential costs to the Exchequer are significant via additional tax reliefs on pension contributions unrelated to individuals increasing the provision they make for themselves to secure an income in retirement so the Government has to act. There is uncertainty about the possible cost, but based on assumptions that the product would maintain the market share it had reached by December 2006 failing to act could have led to additional costs of £160m pa by 2010/11, well above the costs estimated prior to A-day.

2. Place a cap on the sum assured

10.34 This was the favoured option of the Association of British Insurers. A cap would not provide a link to ensure tax relief on life insurance would support pensions saving. A cap on the size of policies attracting relief might limit this cost to the general body of taxpayers a little but none of the levels of cap proposed as workable by pension industry representatives would have significantly affected the large majority of policies sold. The impact of a cap on the costs of relief to the general body of taxpayers would be difficult to predict, so it would leave a risk that the Government would need to intervene again. This would not therefore provide the certainty of tax treatment that the market requires.

3. Ensure that term assurance with tax relief has a meaningful link to pension saving

10.35 In consultations with the industry the Government has explored a number of options for linking personal term assurance policies firmly to pension saving. On the basis of those consultations and further written representations the Government has concluded that there are no viable options that both work commercially for the industry and also offer a meaningful link to a pension that it would be feasible for HMRC to subject to compliance activities.

4. Remove the right to pension tax relief for individuals on the cost of new personal life insurance policies in both personal and occupational pension schemes. This is the measure the Government is taking forward in the Finance Bill

10.36 It is not the role of pensions tax relief to incentivise individuals to take out personal term assurance policies and therefore the Government has decided to abolish the relief. Allowing employees to continue to buy term assurance with tax relief through occupational schemes would provide a loophole that could be easily exploited. The loophole would favour the occupational sector over other sectors and would not encourage more saving by employees for retirement. The cost of giving tax relief on personal term assurance policies would be significant, and much of the cost would relate to activities that customers would engage in anyway without getting tax relief. It would be neither a prudent nor sensible use of public funds. However, the Government recognises that many people will already have taken out or applied for term assurance policies on the understanding that tax relief would be available. It has therefore taken steps to allow tax relief to continue for these people at an estimated cost of around

£20m a year, compared to the cost of doing nothing that would increase to around £160m a year within a few years (see Costs below).

COSTS AND BENEFITS

Sectors and groups affected

10.37 The changes to tax-relieved term assurance will affect the insurance companies that began to sell tax-relieved term assurance policies, financial advisers and individuals when buying protection life insurance.

Benefits

10.38 The measure gives rise to benefits for consumers, as well improving market efficiency and protecting the taxpayer from unwarranted new costs of tax relief.

10.39 The measure will benefit consumers in that it mitigates the risk of people taking out life insurance policies that may not be suitable for their needs and which, apart from the relief, are generally more expensive. This will ensure that consumers take decisions about life insurance on the basis of their personal needs and not on the basis of tax relief.

10.40 The measure also removes a significant tax distortion from the life insurance market and so promotes market efficiency. It is expected that most consumers that were drawn to term assurance policies offering pensions tax relief following the A-day changes will revert to life insurance policies outside of a pension, and that providers will return to selling life policies solely on the basis of commercial considerations, not tax relief.

Costs

10.41 The measure is designed to ensure that there is no additional impact on the exchequer cost of pension simplification for activities not linked to saving for a pension. Estimates of the overall Exchequer costs of pension simplification remain at £25 million for 2006-07, rising to £250 million in 2010-11 (for estimates relating to the intermediate years, see the full RIA on Pensions Simplification published at Budget 2006). In the absence of government action the overall cost of Pension Simplification would be much higher, although there are a number of uncertainties.

10.42 Based on the market share tax-relieved term assurance had reached by December 2006 and taking into account the estimated £20m a year cost of transitional relief for existing scheme members, we estimate that the additional cost to the Exchequer of failing to act through this measure could be around £140m a year by 2010/11.

10.43 In terms of the costs to industry, the Government recognises that some providers will have incurred costs in anticipation of business volumes that are no longer likely to arise as a result of this measure. Some providers may not be able to recover these costs over the lifetime of the term assurance policies they have sold. The 15 insurance companies involved in the consultation estimate they have spent around £15m to £30m on product design, administrative systems and marketing in anticipation of ongoing tax-relieved term assurance business. There are no independent means of validating these estimated costs. However, the removal of the tax relief effectively means that these costs are 'one off' costs to industry. Going forward, there will also be

some further one off costs to providers arising from the need to amend marketing literature to reflect the removal of tax relief.

10.44 Longer term, the removal of tax relief for pension life insurance means that the market should revert broadly to the position before A-day, where life insurance sales growth was focussed predominantly on business outside of pensions. Industry costs should therefore reflect the normal costs of life insurance business and so the impact on long term ('steady-state') industry costs from this measure should be negligible.

10.45 There are no additional costs to HMRC as a result of this measure.

TECHNICAL IMPROVEMENTS

PURPOSE AND INTENDED EFFECT

Rationale for government intervention

10.46 All the proposed technical changes have the potential to offer some deregulatory gains and general technical improvement. They are in response to representations made by the industry.

i) Transfers and Transitional Protection

10.47 Representations have been made that the rules governing the transfer of rights, or other shift of benefit provision, from one registered pension scheme to another are unnecessarily complicated, restrictive and difficult for administrators to comply with, and that it is too easy for members to inadvertently lose the transitional protection that they might have.

ii) Ill Health Retirement

10.48 Generally the tax rules provide that members cannot draw their pensions until they reach minimum pension age of 50 (55 from 2010). An exception to this is where a member takes their pension early on ill-health grounds. The tax rules permit an ill-health pension to be stopped (but not reduced) if a member recovers. Representations have been received requesting that schemes are permitted the flexibility to reduce an ill-health pension where the member makes a partial recovery.

iii) Pension Commencement Lump Sum Rules

10.49 Where a member first becomes entitled to a pension, they may also draw a tax-free pension commencement lump sum of up to 25% of the value of the pension fund. This lump sum must be paid within three months of the member becoming entitled to the pension, and it cannot in any case be paid after the member reaches age 75. However, representations have been received that both of these requirements are too restrictive and do not always provide sufficient time to enable all the necessary administration to be completed.

iv) Unsecured Pension Fund Rules – Reference Periods

10.50 The rules for unsecured pension funds provide that the maximum annual amount of income that can be withdrawn from the fund is 120% of the annual amount of the income that could be obtained from a comparable annuity. The maximum is reviewed and set for a 5 year period. The rules also provide for the annual maximum to

be reviewed every 5 years but they do not permit reviews to take place more frequently. Industry has raised concerns that sometimes 5 years is too long a period between reviews, particularly if there has been a big change in the value of the investments, in which case it may be appropriate to review the level of income that may be drawn.

v) Two year time limit on lump sum death benefits

10.51 The tax rules require that certain lump sum death benefits are paid within two years of the member's death. However, representations have been received that the two-year window is sometimes inadequate, where the scheme is not notified of the death until more than two years after the member has died.

vi) Winding up lump sums – conditions to be satisfied

10.52 The winding-up lump sum facility is used where scheme trustees are winding-up a scheme and otherwise would have to buy small annuities which would be disproportionately expensive for the scheme and of limited real value to the scheme member. The conditions attached to paying a winding-up lump sum can require the pension scheme to make enquiries of all former employers of the scheme member. Representations have been made asking that the conditions be changed to only cover employers who have recently contributed to the scheme.

vii) Non-cash benefits

10.53 As from 6 April 2006 all non-cash benefits (subject to some minor exceptions) are taxable, regardless of how they are paid. The purpose of the change which came into effect on 6 April 2006 was to ensure a level playing field for pensioners who receive non-cash benefits, whether they are paid to them with cash benefits or separately. Concerns have been raised over the tax charge and the administrative burden involved in the non-cash benefits that former employers provide to pensioners.

viii) Unauthorised member payments and unauthorised employer payments

10.54 There was evidence that the legislation was not being applied as originally intended by Parliament. The overall tax rate on unauthorised payments made from a registered pension scheme can be up to 70% of the unauthorised payment made. There were ways to manipulate the way in which the payment and scheme's liability are made to reduce the effective rate.

CONSULTATION

Within government

10.55 There has been extensive consultation with tax specialists in HM Revenue & Customs as well as colleagues in HM Treasury and the Department for Work & Pensions. There is no impact on other government departments.

Public consultation

10.56 All these measures are in response to informal representations made by the industry following the introduction of pensions simplification legislation on 6th April 2006.

OPTIONS

10.57 The options the Government has considered in each of these areas are set out below.

i) Transfers and Transitional Protection

1. Do nothing

10.58 This option would mean that no deregulatory gains or technical improvements would be achieved.

2. Legislative changes

10.59 The rules are relaxed under which individuals with transitional rights to an enhanced lifetime allowance may transfer between schemes, or have scheme rules varied, without losing those rights. In particular, safeguarding transitional rights when:

- individuals make partial transfers;
- there are bulk transfers of employees due to the sale of a business;
- members transfer to new occupational death-in-service arrangements; and
- the terms of a life policy in an occupational scheme are varied to comply with the Age Directive.

ii) Ill Health Retirement

1. Do nothing

10.60 This option would mean that no deregulatory gains or technical improvements would be achieved.

2. Legislative changes

10.61 To allow scheme pensions paid early on ill-health grounds to be reduced at the discretion of the scheme administrator. This would be entirely relieving and will be deemed to have always had effect. This relaxation in the ill-health rules will help schemes to contain the quite significant costs of paying ill-health pensions in circumstances when it would not be appropriate under the contract to stop the pension altogether. However as a consequence of these changes the anti-avoidance rule that applies in certain circumstances where a scheme pension has been reduced or stopped outside specified circumstances needs to change to accommodate this flexibility.

iii) Pension Commencement Lump Sum Rules

1. Do nothing

10.62 The pension commencement lump sum must be paid within 3 months of becoming entitled to the pension.

2. Legislative changes

10.63 The rules are relaxed, so that a pension commencement lump sum may be paid within 12 months of the member becoming entitled to the related pension and if this 12 month period falls to some extent after the member's 75th birthday, the lump sum may still be paid. These changes, which are entirely relieving, will be deemed to have always had effect.

iv) Unsecured Pension Fund Rules – Reference Periods

1. Do nothing

10.64 Cannot review the level of income that may be drawn more frequently than 5 years.

2. Legislative changes

10.65 A review of the annual maximum withdrawal from an unsecured pension fund may be permitted more frequently than every 5 years. Reviews should only be conducted more frequently than every 5 years at the member's direction and for the scheme administrator to ultimately determine whether to carry out a member's direction. The requirement that the maximum withdrawal needs to be reviewed at least every 5 years will remain.

v) Two year time limit on lump sum death benefits

1. Do nothing

10.66 Lump sum death benefits cannot be paid after two years.

2 – Legislative changes

10.67 Amendment is introduced to allow lump sum death benefits to be paid within 2 years of the scheme being notified of the member's death but if the scheme should have been reasonably aware of the member's death at an earlier date then the time limit will be 2 years from that earlier date. The change will have effect in relation to deaths occurring on or after 6th April 2006.

vi) Winding up lump sums – conditions to be satisfied

1. Do nothing

10.68 Scheme administrators would have to continue to incur administration costs researching old employment information, which many will not have.

2. Legislative changes

10.69 A change to restrict the term "employer" for the purposes of the winding-up lump sum condition to the member's current employer when the winding-up lump sum is paid. By restricting the condition to the current employer the administrative burden on schemes winding up will be reduced and allow winding up to be speeded up. The change will have effect on or after 6 April 2006.

vii) Non-cash benefits

1. Do nothing

10.70 This would mean all non-cash benefits (subject to some minor exceptions) remain taxable, regardless of how they are paid.

2. Legislative changes

10.71 Extend the category of benefits to be excluded from taxation and more closely align the tax treatment for non-cash benefits provided to pensioners with that of employee benefits.

viii) Unauthorised member payments and unauthorised employer payments

1. Do nothing

10.72 This would mean that some registered pension schemes could arrange payments to give an overall reduction on tax charge where as others who could, not would pay tax at the rate intended in legislation.

2. Legislative changes

10.73 Ensures that if the administrator of a registered pension scheme withholds any amount to cover the scheme's liability to the scheme sanction charge then this amount is included in the amount of the unauthorised payment to a member or employer and they are taxed accordingly.

COSTS AND BENEFITS

Sectors and groups affected

10.74 These technical improvements will affect pension scheme providers, insurance companies, pension scheme administrators and members of registered pension schemes and their dependants, and financial advisers.

Benefits

10.75 The pensions industry has told HMRC that, in certain areas, the rules are needlessly complex or restrictive. These changes would bring additional flexibility, saving costs by making administration simpler – although at this stage it is not possible to quantify the effect. HMRC will monitor the response to the proposed change as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures.

Costs

10.76 There are no additional cost impacts on industry as these technical improvements have the potential to offer some deregulatory gains and general technical improvement. They are in response to representations made by the industry.

10.77 There are no additional costs to HMRC as a result of these measures.

INVESTMENT-REGULATED PENSION SCHEMES AND UK-REAL ESTATE INVESTMENT TRUSTS (UK-REITS)

PURPOSE AND INTENDED EFFECT

Rationale for government intervention

10.78 Regulations laid on 1 November 2006 provide for an additional tax charge on a UK-REIT where a company holds an interest of 10% or more in the UK-REIT. This modifies the position proposed in the draft regulations published for consultation on 2 June 2006, where the tax charge would have applied where any legal person, including an individual or a pension scheme, held an interest of 10% or more in the UK-REIT. As a result of this modification the Government will make a small consequential change to the rules on residential property held by investment-regulated pension schemes.

OPTIONS

1. Do nothing

10.79 This would mean that the Government would not be maintaining its position on investment-regulated pension scheme investments in UK-REITs.

2. Legislative changes

10.80 The Government will make a small consequential change to the pension tax rules on property held by investment-regulated pension schemes where a pension scheme holds property indirectly via a UK REIT. This will maintain the position that an investment-regulated pension scheme should not hold more than a 10 per cent investment in any UK-REIT which is consistent with the application of the rules on diversity of ownership apply to other vehicles.

COSTS AND BENEFITS

Sectors and groups affected

10.81 This technical improvement will affect pension scheme providers and administrators, members of registered pension schemes and financial advisers.

Benefits

10.82 The change will ensure that investment-regulated pension scheme investments in UK-REITs maintain the necessary diversity of ownership. The rules on ownership of UK-REIT shares will be aligned with the 10% ownership rules for other non trading investments. This will ensure that the Government's policy on diversified ownership of investment-regulated pension scheme investments is maintained as a consequence of the change in the way the UK-REIT regulations are to operate.

Costs

10.83 The Government does not anticipate any material effects on costs as the measure would ensure that the pensions tax rules continue to meet the original intentions of the simplified regime.

10.84 There are no additional costs to HMRC as a result of this measure.

SMALL FIRMS IMPACT TEST

10.85 The Pensions Simplification RIA, published at Budget 2006, stated that simplification would be particularly helpful to small businesses and the self-employed. Employers should find it easier and cheaper to sponsor or contribute to a pension scheme for their employees, and the increased flexibility provided through more generous personal contribution limits should make it easier for the self-employed to contribute to a pension. The Government does not anticipate any further material effects on small firms from the measures contained in this RIA.

COMPETITION ASSESSMENT

10.86 The Pension Simplification RIA published at Budget 2006 noted that the changes were intended to improve competition among financial services firms providing pensions. In addition to these effects, the Government does not anticipate any material effects on competition from the measures contained in this RIA.

ENFORCEMENT, SANCTIONS AND MONITORING

10.87 The new pensions tax rules incorporate proportionate arrangements for awarding tax relief and preventing abuse. These arrangements help ensure that tax relief on pension contributions is used in the intended manner and only for individuals to secure an income in retirement.

10.88 HMRC plans to monitor the response to the changes contained in this RIA as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures. The latter includes plans for external research, analysis of administrative data and secondary analysis of survey data. Baseline research covering 2005/6 is already underway and will continue with employers, individuals, and the financial services industry. Given the longer-term nature and likely impact of pensions reforms, it is expected that further external research will be conducted over a number of years to measure the impact of Pension Tax Simplification measures over time.

IMPLEMENTATION & DELIVERY

10.89 These measures will not have any significant additional impacts on business activities other than those that were announced in the RIA on 'Simplifying the taxation of pensions' at Budget 2006 as all the measures will ensure that the pensions tax regime operates as intended when introduced on 6th April 2006.

Alternatively Secured Pensions (ASPs)	<p>Schemes will have to update literature and advice to ensure that members are aware of the change to the rules on ASPs.</p> <p>For providers offering ASPs, they will need to ensure systems are in place to meet the minimum income requirement, and, if necessary, the additional tax charges that may apply on the death of the ASP member.</p> <p>There are no additional reporting or information gathering obligations on businesses as a result of this measure.</p>
Pension Tax Relief on Term Assurance	<p>Businesses will have to update literature to reflect that this measure will mean that new contracts can no longer be entered into.</p> <p>- There are no additional reporting or information gathering obligations on businesses as a result of this measure.</p>
Technical Improvements	
i) Transfers and Transitional Protection	<p>These changes ensure that the transitional protection is not lost due to events beyond the member's control and mean that businesses and schemes do not have to undertake extra administration or incur additional costs in certain circumstances. The changes are therefore de-regulatory.</p>
ii) Ill Health Retirement	<p>This relaxation in the ill-health rules will help schemes to contain the quite significant costs of paying ill-health pensions in circumstances when it would not be appropriate under the contract to stop the pension altogether.</p>
iii) Pension Commencement Lump Sum Rules	<p>The extension from 3 months to 12 months for payment of the PCLS allows administrators more time and flexibility to ensure that a payment can be made without attracting tax charges.</p>
iv) Unsecured Pension Fund Rules - Reference Periods	<p>Where the scheme agrees to the request of a member a review can be carried within 5 years particularly if there has been a big change in the value of the investments.</p>
v) Two year time limit on lump sum death benefits	<p>This change increases the time period during which a lump sum death benefit must be paid and therefore saves on administration.</p>
vi) Winding up lump sums – conditions to be satisfied	<p>By restricting the conditions to employers that have recently contributed to the scheme the administrative burden on schemes winding up will be reduced and this should allow winding up to progress faster.</p>

vii) Non-cash benefits	In some cases the changes to non-cash benefits will mean that the employer return due on 7 July 2007 is no longer required.
viii) Unauthorised member payments and unauthorised employer payments	- This change restores what was intended in the legislation introduced in Finance Act 2004.
Investment-Regulated Pension Schemes and UK-Real Estate Investment Trusts	- This will ensure that the taxable property provisions apply as intended to pension schemes holding an interest in a UK REIT.

POST-IMPLEMENTATION REVIEW

10.90 HMRC plans to monitor the response to the changes contained in this RIA as part of its on-going commitment to monitoring and evaluating the Pension Tax Simplification measures. The latter includes plans for external research, analysis of administrative data and secondary analysis of survey data. Baseline research covering 2005/6 is already underway and will continue with employers, individuals, and the financial services industry. Given the longer-term nature and likely impact of pensions reforms, it is expected that further external research will be conducted over a number of years to measure the impact of Pension Tax Simplification measures over time.

SUMMARY AND RECOMMENDATION

MEASURE	RECOMMENDATION
Alternatively Secured Pensions (ASPs)	<p>The provisions on members' and dependants' ASPs will be tightened up. There will be a requirement to draw a minimum income from a member's or dependant's ASP fund. A higher maximum annual withdrawal from an ASP fund will also be introduced. A tax charge will be introduced where ASP funds remaining on the death of a member or a dependant of the member are transferred to the pension funds of other members in the scheme.</p> <p>Preventing other devices designed to pass on tax-favoured pension savings</p> <p>A tax charge will be imposed on those seeking to use other benefit options (for example, scheme pensions) as a means of passing on tax-favoured funds on or before the death of a member.</p>

Pension Tax Relief on Term Assurance Remove individual's entitlement to tax relief on any pension contributions they pay that are used to fund personal term assurance policies, whether in a personal or occupational pension scheme.

For contributions under occupational registered pension schemes, it applies to all contributions made on or after 1 August 2007 in respect of personal term assurance policies, unless the insurer received the application for the policy before 29 March 2007 and the policy was taken out as part of the pension scheme before 1 August 2007.

For contributions under other registered pension schemes, it applies to all contributions made on or after 6 April 2007 in respect of personal term assurance policies, unless the insurer received the application for the policy before 14 December 2006 and the policy was taken out as part of the pension scheme before 6 April 2007.

Technical Improvements

i) Transfers and Transitional Protection The rules are relaxed under which individuals with transitional rights to an enhanced lifetime allowance may transfer between schemes, or have scheme rules varied, without losing those rights. In particular, safeguarding transitional rights when:

- individuals make partial transfers;
- there are bulk transfers of employees due to the sale of a business;
- members transfer to new occupational death-in-service arrangements; and
- the terms of a life policy in an occupational scheme are varied to comply with the Age Directive.

These changes would be de-regulatory and ensure that the transitional protection is not lost due to events beyond the member's control.

ii) Ill Health Retirement Allow scheme pensions paid early on ill-health grounds to be reduced at the discretion of the scheme administrator. This relaxation in the ill-health rules will help schemes to contain the quite significant costs of paying ill-health pensions in circumstances when it would not be appropriate under the contract to stop the pension altogether.

iii) Pension Commencement Lump Sum Rules The rules are relaxed, so that a pension commencement lump sum may be paid within 12 months of the member becoming entitled to the related pension and if this 12 month period falls to some extent after the member's 75th birthday, the lump sum may still be paid.

iv) Unsecured Pension Fund Rules - Reference Periods A review of the annual maximum withdrawal from an unsecured pension fund may be permitted more frequently than every 5 years. Reviews should only be conducted more frequently than every 5 years at the member's direction and for the scheme administrator to ultimately determine whether to carry out a member's direction. The requirement that the maximum withdrawal needs to be reviewed at least every 5 years will remain.

v) Two year time limit on lump sum death benefits	Amendment is introduced to allow lump sum death benefits to be paid within 2 years of the scheme being notified of the member's death but if the scheme should have been reasonably aware of the member's death at an earlier date then the time limit will be 2 years from that earlier date. This will ensure that the same treatment that is applied to pre A-day payments also applies to post A-day payments. A corresponding change is being made to the IHT rules (effective for lump sum death benefits paid on or after 6 April 2006) so that lump sum death benefits paid out on death within the revised time allowed by the pension scheme rules will be protected from the IHT trust charges which could in strictness otherwise apply from the date of the member's death.
vi) Winding up lump sums – conditions to be satisfied	A change to restrict the term “employer” for the purposes of the winding-up lump sum condition to the member's current employer when the winding-up lump sum is paid. By restricting the condition to the current employer the administrative burden on schemes winding up will be reduced and allow winding up to be speeded up.
vii) Non-cash benefits	Amendment to extend the category of non-cash benefits to be excluded from taxation and closer alignment with taxation of non-cash benefits provided for employees.
viii) Unauthorised member payments and unauthorised employer payments	Amendment to ensure all unauthorised member and employer payments are taxed at the same rate.
Investment-Regulated Pension Schemes and UK- Real Investment Trusts	A small consequential change to the pension tax rules on property held by investment-regulated pension schemes where a pension scheme holds property indirectly via a UK REIT. This will maintain the position that an investment-regulated pension scheme should not hold more than a 10 per cent investment in any UK-REIT.

Contact Point

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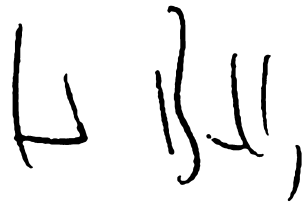
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REGULATORY IMPACT ASSESSMENT**Tax Relief For Pensions****Statement of Ministerial Approval**

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

A handwritten signature in black ink, appearing to read 'Ed Balls', is written over the line.

Ed Balls MP, Economic Secretary to the Treasury

Dated: 20 March 2007

PARTIAL REGULATORY IMPACT ASSESSMENT FOR LAND REMEDIATION RELIEF

PURPOSE AND INTENDED EFFECT OF MEASURES

Policy Objective

11.1 This partial regulatory impact assessment examines proposals to reform land remediation relief and the exemption from landfill tax for waste from the clearing of contaminated land. Reform of these tax reliefs aims to improve targeting of help to developers of hard to remediate sites whilst at the same time providing better environmental outcomes.

11.2 The reform package is intended to support other measures, particularly the commitment to increase housing supply and to respond to proposed changes to business rates aimed at improving the fiscal incentives for efficient use of urban land. The Government would not implement changes arising from this consultation earlier than 2008.

Background and rationale for Government intervention

11.3 Contaminated land is subject to obligations under the Environmental Protection Act 1990. Lord Rogers Urban Task reported in 1999 and the Government responded with the Urban White Paper in 2000, recommending that additional tax relief should be given to help developers decontaminate contaminated land. Land remediation relief, providing a 150 per cent corporation tax relief was introduced in 2001. Kate Barker's 2004 Review of Housing Supply recommended that the relief should be extended to long-term derelict land, as long as the extra public money levered into the market would encourage genuine new investment in brownfield remediation, and not simply subsidise development that would take place anyway.

11.4 Proposals for reforming business rates on empty property and vacant land will introduce fiscal incentives for bringing unused land back into use. Land remediation relief reform can provide a channel for increased Government support through the tax system to return to productive use properties and vacant land that suffer from contamination or features of long-term dereliction.

11.5 Current legislation for land remediation relief is contained in Schedule 22 of the Finance Act 2001 and for the landfill tax exemption for waste from contaminated land in Sections 43A and 43B Finance Act 1996.

11.6 Other Government departments with an interest are the Department for Communities and Local Government through their policy responsibility for planning law and development and the Department for Environment Food and Rural Affairs in relation to waste and the environment.

Consultation

11.7 The partial regulatory impact assessment forms part of the formal consultation on tax reliefs for brownfield land. Comments are welcomed on the likely regulatory impact of the proposals.

OPTIONS

Option 1: Do nothing

11.8 Leaving the current system unchanged would mean there was no additional regulatory burden.

11.9 It would however mean that the land remediation relief would continue to lack targeting and would not be available for cleaning up Japanese Knotweed or long-term derelict land.

11.10 It would also mean that the landfill tax exemption for contaminated land would continue, and as landfill tax rates rise there would continue to be an increasing incentive to send to landfill waste from contaminated land whereas other waste, much of it less polluting, would continue to be taxed at the standard rate. The tax system would also continue to encourage landfill solutions for contaminated land instead of on site clean up, which can have better environmental outcomes.

Option 2: Extension of land remediation relief to long-term derelict land

11.11 The extension of land remediation relief to long-term derelict land would apply to specific expenditure incurred on long-term derelict sites. The consultation proposes that dereliction could be generally defined and could qualify if it has been vacant and unused since a fixed date in the past. Evidence from the National Land Use Database for England and similar databases would be accepted as evidence of the status of the land, but any land could meet the tests whether or not it was on the database. Setting a fixed date in the past avoids the problem of development being postponed until it can qualify.

11.12 There is a risk that it might not be possible to identify whether particular land counts as derelict. However the tax relief will be self-assessed and ascertaining the availability of the relief is unlikely to be a significant burden.

11.13 There is also a risk that insufficient clarity will be available about the types of qualifying expenditure qualifying for relief. This can be resolved through the consultation process.

11.14 A possible unintended consequence is that development on qualifying long-term derelict sites will be encouraged instead of those which have not been derelict for so long. The proposal makes an assumption that the social good in remediating a site is correlated to the length of time it has been derelict.

11.15 Compliance and monitoring of this option (and the other corporation tax options below) would be through the corporation tax self assessment process.

Option 3: Focusing on development

11.16 This option would remove land remediation relief from some taxpayers who can at present qualify, but would allow resources to be more accurately targeted at development. It would bring the relief more in line with the Government's statement in 2001 that the relief was intended to help developers.

11.17 The type of expenditure which would not qualify under this option is the clean up of land for regulatory (for example health and safety reasons) which could currently qualify for relief, (as long as the land was not polluted by the current owner in the first place) where no redevelopment requiring an application for planning permission is needed.

11.18 As expenditure would have to be pursuant to a planning requirement this change could encourage taxpayers to ensure that planning authorities stipulate clear conditions in relation to contamination and dereliction. This may mean that planning authorities incur some additional burden in granting planning permission.

Option 4: Timing of land remediation relief

11.19 This option would accelerate the availability of land remediation relief to companies by allowing claims to relief to depart from standard accountancy rules.

11.20 There is a risk that accelerating the relief could lead to a loss of tax revenue if developers claiming the repayable tax credit cease trading before recognising the profits at the end of the development.

11.21 This risk would be difficult to mitigate within the self-assessment system for corporation tax.

Option 5: Extension to Japanese Knotweed

11.22 This option would allow expenditure on removal of Japanese Knotweed as part of the development process to qualify for enhanced tax relief.

11.23 There is a risk that the costs of removing Japanese Knotweed are far greater than expected which could limit the Government's scope to help in the long-term. The consultation therefore seeks to explore the costs with consultees in more detail

Option 6: Ending the exemption from landfill tax for waste from clearing contaminated land

11.24 This option would remove an existing distortion in the tax system whereby "dig and dump" is subsidised through the landfill tax exemption and on site clean up is not. Currently both landfill costs and on site clean up costs can qualify for land remediation relief at the enhanced 150 per cent rate, but dig and dump qualifies for the additional help of the landfill tax exemption. Removing this exemption would remove the distortion and the additional funds could be recycled into improvements in land remediation relief such as those covered in this consultation. However, the exemption is currently available for all who remove waste from contaminated land but under the options covered by the consultation some taxpayers who are entitled to claim the exemption will not be able to claim land remediation relief. There may, for example, be some sites where on site remediation is not a viable option.

11.25 Removing the exemption risks affecting some large sites where considerable amounts of contaminated land waste needs to be removed quickly. The impact of this can be mitigated through transitional rules, which are the subject of the consultation.

11.26 Ending the exemption would not have any compliance or monitoring impacts.

COSTS AND BENEFITS

Sectors and groups affected

11.27 The proposals have the potential to affect those carrying out development on contaminated and derelict land. This includes:

Private Sector

- property developers, including landowners, developing their own property investments with planning applications;
- construction industry and services;
- landfill site operators; and
- landowners who remove contamination from land and are not developing it.

Public Sector

- Central Government; and
- planning authorities (indirectly).

Benefits

11.28 Government help through the tax system will be targeted more closely on developers allowing funds to be recycled into hard to remediate sites. It should encourage development on brownfield land, supporting Government targets, the National Brownfield Strategy and similar programmes in Scotland, Wales and Northern Ireland.

11.29 There are also environmental benefits in discouraging dig and dump and encouraging on site remediation as well as encouraging developers to clean up Japanese Knotweed and dereliction.

11.30 On site decontamination may offer better environmental results overall than using landfill as it can reduce environmental externalities such as transportation.

11.31 Economic benefits accrue from bringing vacant and derelict land back into use. It can create jobs and homes and regenerate towns and cities.

11.32 Discouraging dig and dump will encourage technologies and techniques for on site remediation. Providers of these services will benefit and many are small and medium sized enterprises.

11.33 Ending the landfill tax exemption for clearing contaminated land would have a deregulatory benefit for developers, who currently have to send extensive documentation to HM Revenue and Customs to obtain the exemption certificate. It would also reduce HM Revenue and Customs' administrative costs and deregulate landfill site operators to a minor extent by removing their need to be satisfied that the waste is certified as exempt.

11.34 Direct benefits will accrue to those incurring expenditure on developing land where Japanese Knotweed or dereliction is present.

Costs

11.35 The measures proposed, if all implemented, would increase overall help for many developers but would reduce tax help for those not undertaking development, or returning damaged land to beneficial use. It will therefore lead to additional costs on those taxpayers.

11.36 Removing the landfill tax exemption could potentially encourage alternatives such as use of exempt sites and illegal activity such as hiding waste by mixing it with clean soil.

11.37 Limiting the land remediation relief to planning permission could possibly increase costs associated with planning permission if additional negotiations were needed to ensure that the conditions would allow land remediation relief to be claimed.

SMALL FIRMS IMPACT TEST

11.38 The proposals will have some impact on small businesses. The Government welcomes the opportunity given by consultation to gather evidence on this aspect.

COMPETITION ASSESSMENT

11.39 The proposals do not appear to have any direct competition impacts but the Government welcomes the views of stakeholders on this issue.

ENFORCEMENT, SANCTIONS AND MONITORING

11.40 Land remediation relief is a corporation tax relief which is monitored by HM Revenue and Customs as part of its ordinary self-assessment compliance processes. HM Revenue and Customs also administer landfill tax and the exemption for waste from contaminated land.

Contact Point

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MODERNISING TAX RELIEF FOR BUSINESS

EXPENDITURE ON CARS: REVISED

PARTIAL RIA

12.1 This revised partial Regulatory Impact Assessment (RIA) summarises many of the arguments contained in the consultation update document, Modernising tax relief for business expenditure on cars. It is intended to build on the partial RIA of March 2006, adding commentary with respect to the refinement of the Government's preferred option. It should be read alongside the 2006 partial RIA, included in the 2006 consultation document.

12.2 In addition, it highlights areas where the Government intends to carry out further analysis through discussions with business, in order to inform policy decisions and the full RIA.

PURPOSE AND INTENDED EFFECT

A.1 The purpose and intended effect of the reform is set out in the partial RIA of March 2006.

CONSULTATION

12.3 There were a number of responses to the 2006 consultation document. In general, business recommended that, further detail on the design of the Government's preferred option would be valuable in taking consultation forward (Options 1 and 2 were better understood given their simpler structure).

12.4 In light of the consultation, the Government has refined its preferred option and has therefore also revised its partial RIA.

12.5 Over the Summer, the Government will publish a summary of the responses made to the 2006 consultation document and to the consultation update document, together with its formal response to the consultation as a whole and a revised Regulatory Impact Assessment. It will also publish draft legislation with a view to further discussion with stakeholders.

OPTION 3: REFINEMENT OF THE GOVERNMENT'S PREFERRED OPTION

12.6 This revision to the RIA is based on the refinement of the Government's preferred option (Option 3). For Options 1 & 2, the March 2006 partial RIA stands as a current assessment.

Current rules

12.7 From the consultation with stakeholders, it is clear that businesses see the current rules as imposing a disproportionate compliance burden, requiring them to keep separate capital allowance computations for each "expensive car" they own, identifying when the car has been purchased and disposed of. This process requires businesses to:

- identify the acquisition cost of a car;

- decide on whether to include or exclude it from the general plant and machinery pool, with vehicles costing more than £12,000 having to be allocated into a tracking process;
- restrict the writing-down allowance to £3,000 per annum on a reducing basis, which has to be calculated individually;
- apply this figure to offset the amount against taxable profits;
- retain and check supporting documentary evidence; and
- record and identify on disposal the sale price in order to calculate whether a balancing charge or allowance is generated to be adjusted against taxable profit for the tax year.

12.8 The Government estimates that the administrative burden of conducting those activities for capital allowances is approximately £10 million per annum, affecting 750,000 businesses. This figure acts as a broad baseline estimate.

12.9 With respect to the lease rental restriction, a similar set of compliance activities as outlined above is required for businesses leasing “expensive cars”. The level of restriction is computed for each car by applying a formula based on the car’s acquisition cost (identified, for example, by requesting a copy invoice from the leasing company) and the £12,000 threshold to the car’s particular lease payment.

All sectors and group affected

12.10 The proposed reforms would impact on all sectors that purchase cars, and would therefore impact on a vast number of businesses. The impacts would be greatest for businesses that operate large vehicle fleets. They would also potentially impact on all sectors that construct, develop and sell cars as the environmental incentives could change businesses’ purchasing behaviour.

12.11 As discussed in the 2006 partial RIA, the impact of the options on unincorporated business owners, who also use business cars for private purposes, will be more limited. The preferred option for the lease rental restriction would: benefit significantly all firms that lease cars with CO₂ emissions up to 165g/km by abolishing all the administrative requirements associated with the current system. It would also benefit, to a lesser extent, those business purchasers of cars with CO₂ emissions above 165g/km by reducing computational requirements.

Benefits

12.12 The Government’s preferred option seeks to reduce the costs of the activities listed above whilst introducing environmental incentives. **The Government intends to use the consultation period up to 16 May 2006 to gather supplementary evidence on the potential benefits the preferred option would bring to businesses.**

Economic

12.13 The Government's preferred option seeks to reduce compliance costs for businesses purchasing cars with CO₂ emissions up to 165g/km by allowing those cars to be treated in the same way as most other plant and machinery in the general pool. For those cars, this option shares the significant compliance costs savings attached to Option 1 of the 2006 consultation document, apart from the need to identify the CO₂ emission of the car (see section on "costs" below).

12.14 For cars with CO₂ emissions above 165g/km, the Government's preferred option removes the requirement to track individual cars once their CO₂ emission has been identified, although cars would still need to be identified when they are disposed of in order to allocate the disposal proceeds to the correct pool. The rate of writing-down allowance for these cars would be set to ensure the overall package achieves the Government's public finance and deregulatory objectives.

12.15 With respect to the lease rental restriction, abolition of the restriction for cars with CO₂ emissions up to 165g/km achieves significant compliance cost savings by abolishing all the requirements to compute and apply a restriction, and check and retain the supporting documentary evidence. For cars with CO₂ emissions above 165g/km, the preferred option aims to reduce the computational requirements associated with the lease rental restriction formula by replacing the current formula with a uniform fixed percentage rate of disallowance.

Environmental

12.16 The Government's preferred option has the potential to deliver environmental benefits by linking the rate of writing-down allowance treatment for expenditure on cars to their CO₂ emission. This should act as an appropriate incentive towards the purchase of cars with lower CO₂ emissions around 165g/km range, where the key boundary sits. It is difficult to predict the impact on CO₂ emissions accurately, given the wide range of factors that influence car purchasing and leasing decisions. However, the Government's preferred option chimes with the other forms of vehicle taxation.

12.17 Furthermore, since it is proposing to reform the capital allowances rules to a CO₂ emissions basis, the Government believes that it is appropriate to adopt a similar framework for the lease rental restriction. This would act to maintain and support the environmental signals within the leasing market. The rate of disallowance for cars with CO₂ emissions above 165g/km is still being considered within the overall reform.

Costs

Economic

12.18 For the Government's preferred option, there would be one-off, though in some cases sizeable, costs to businesses from changing their systems to cope with the new rules, e.g. learning the rules, upgrading software, staff training etc. For cars with CO₂ emissions above 165g/km, the benefits of pooling would be partly offset by the need for businesses to set up a new capital allowance pool, and the resulting required changes to tax computation software. The Government intends to use the consultation period to gather supplementary evidence on the potential compliance time and/or costs, based on the design of the preferred option.

12.19 Under the preferred option, businesses will be required to identify the CO2 emission of the car they purchase. The company car taxation scheme already requires businesses to keep records of vehicle CO2 data and the information is readily available from the V5C vehicle registration certificate. Therefore, moving to a CO2 based regime should not impose any more than minimal information retrieval and record keeping obligations.

12.20 Since the consultation process commenced, the Government's preferred option has been refined to maximise the possible compliance cost savings available under a CO2 based regime by:

- keeping the number of bands and rates to a minimum; and
- aligning the thresholds with the Vehicle Excise Duty bandings, which represent a recognisable precedent in the tax system.

12.21 Moving away from the current system would also help to future-proof the regime, which could be modified over time to keep it aligned with the CO2 fiscal incentives being utilised under the company car tax and Vehicle Excise Duty regimes.

Environmental

12.22 As this option would seek to create incentives towards the purchase of cars with lower CO2 emissions it would not create any environmental costs.

SMALL FIRMS IMPACT TEST

12.23 Please see the partial RIA of March 2006.

COMPETITION ASSESSMENT

12.24 Please see the partial RIA of March 2006.

ENFORCEMENT, SANCTIONS AND MONITORING

12.25 None of the proposed options are likely to require any further resources to secure compliance.

SUMMARY

12.26 A number of responses have been received to the March 2006 consultation document.

12.27 Noting responses received to the consultation so far, the Government welcomes supplementary views regarding the refined option and would **appreciate any evidence business can provide that would help to quantify compliance time and cost savings identified in this revised partial RIA.**

12.28 Over the Summer, the Government will publish a summary of the responses made to the 2006 consultation document and to the consultation update document, together with its formal response to the consultation as a whole and a revised Regulatory Impact Assessment. It will also publish draft legislation with a view to further discussion with stakeholders.

CONTACT POINT

12.29 Enquiries relating to this RIA should also be addressed to:

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12.30 Comments should be received by 16 May 2007.

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