PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCE BILL

(Except clauses 7 to 18, 41 to 44, 65 to 81, 129, 132 to 136 and 144 to 154 and schedules 2, 3, 11 to 14 and 18 to 22)

Second Sitting

Thursday 30 June 2016

(Afternoon)

CONTENTS

PBC (Bill 001) 2016 - 2017

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Monday 4 July 2016

The Committee consisted of the following Members:

Chairs: Sir Roger Gale, † Mr George Howarth

† Argar, Edward *(Charnwood)* (Con)
† Atkins, Victoria *(Louth and Horncastle)* (Con)
† Blackman, Kirsty *(Aberdeen North)* (SNP)
† Boswell, Philip *(Coatbridge, Chryston and Bellshill)* (SNP)
† Burns, Conor *(Bournemouth West)* (Con)
† Cadbury, Ruth *(Brentford and Isleworth)* (Lab)
Cooper, Julie *(Burnley)* (Lab)
† Donelan, Michelle *(Chippenham)* (Con)
Dowd, Peter *(Bootle)* (Lab)
† Frazer, Lucy *(South East Cambridgeshire)* (Con)
† Gauke, Mr David *(Financial Secretary to the Treasury)*
† Hall, Luke *(Thornbury and Yate)* (Con)
† Hinds, Damian *(Exchequer Secretary to the Treasury)*
† Long Bailey, Rebecca *(Salford and Eccles)* (Lab)
† McGinn, Conor *(St Helens North)* (Lab)
† Mak, Mr Alan *(Havant)* (Con)
† Marris, Rob *(Wolverhampton South West)* (Lab)
Matheson, Christian *(City of Chester)* (Lab)
† Merriman, Huw *(Bexhill and Battle)* (Con)
† Mullin, Roger *(Kirkcaldy and Cowdenbeath)* (SNP)
† Quin, Jeremy *(Horsham)* (Con)
Streeting, Wes *(Ilford North)* (Lab)
† Stride, Mel *(Lord Commissioner of Her Majesty's Treasury)*
† Tolhurst, Kelly *(Rochester and Strood)* (Con)

Simon Patrick, Marek Kubala, *Committee Clerks*

† attended the Committee

Public Bill Committee

Thursday 30 June 2016

(Afternoon)

[Mr George Howarth *in the Chair*]

Finance Bill

(Except clauses 7 to 18, 41 to 44, 65 to 81, 129, 132 to 136 and 144 to 154 and schedules 2, 3, 11 to 14 and 18 to 22)

Clause 21

Dependants' scheme pensions

Question proposed, That the clause stand part of the Bill.

2 pm

The Financial Secretary to the Treasury (Mr David Gauke): Welcome to the Chair, Mr Howarth; it is a great pleasure to see you again. I am pleased to see the Gale-Howarth team reunited.

The clause makes changes to simplify the administration of dependants' scheme pensions. At present, when an individual who is entitled to a scheme pension dies, their dependants may be entitled to receive a scheme pension from the deceased's registered pension scheme. The value of that dependant scheme pension must be tested annually to ensure that an individual has not avoided paying a lifetime allowance charge by setting aside excessive amounts to fund a pension for their dependants.

That test applies to all members who died on or after 6 April 2006, having reached age 75 and either started to take a scheme pension on a date from 6 April 2006 onwards or died without starting to take their scheme pension. That is the case even if their pension savings are small or with modest benefits for dependants where there is little chance of manipulating the lifetime allowance. As a result, the industry faces a substantial administrative burden, carrying out unnecessary tests on modest pension savings where the risk from abuse is low.

The changes made by the clause will remove the vast majority of dependants' scheme pensions from the current test, thereby reducing the administrative burden for industry. New and simpler tests will be applied to determine whether the total of all the deceased's pensions savings used to fund dependants' scheme pensions are below a certain threshold. The threshold for this tax year will be either the total amount of the individual scheme pension at their death or, if higher, £25,000.

The clause also makes provision for an annual increase in both thresholds by 5%, or the rate of inflation if that is higher, so that more dependants' scheme pensions are not drawn back into the current tests over time. The clause will exempt those cases where the deceased had already had all their pension savings tested against the lifetime allowance at age 75, before their death, or where the deceased had had enhanced protection since 2006, so that they are not subject to the lifetime allowance charge on their pensions during their lifetime. As a result of those changes, more than 90% of dependants' scheme pensions will fall within the exclusions provided by the clause, which will mean that the current tests will focus on the larger dependants' scheme pensions that remain, reducing administrative costs and making the scheme easier to operate.

The current tests serve a useful purpose as they prevent individuals from avoiding the lifetime allowance charge, but we want to reduce the administrative burdens where we can. The clause has been introduced to make the alteration of dependants' scheme pensions simpler and to support the Government's policy to reduce the administrative burden on UK industry. I hope the Committee will agree that the clause should stand part of the Bill.

Question put and agreed to.

Clause 21 accordingly ordered to stand part of the Bill.

Clause 22

Pension flexibility

Question proposed, That the clause stand part of the Bill.

The Chair: With this it will be convenient to discuss the following:

Government amendment 134.

That schedule 5 be the Fifth schedule to the Bill.

Mr Gauke: The clause makes changes to ensure that the historic pension flexibility measures that we introduced last April are working as intended for everyone. As the Committee will be aware, from April 2015 individuals with defined contribution pension savings have been able to access their entire pension flexibly, subject to their marginal rate of tax. The Government introduced that historic reform because they believe that individuals who have worked hard and saved responsibly throughout their lives should be trusted to make their own decisions with their pension savings. In general, the flexibilities have been working well, and so far more than 230,000 people have benefited from pension flexibility in the first year of operation. However, there are a few minor points in the legislation that have not been working as intended. The Government therefore propose a series of small changes to ensure the new pension flexibility works for everyone.

The first change being introduced by the clause relates to serious ill health lump sums. Serious ill health lump sums are paid when an individual can produce medical evidence that they are expected to have fewer than 12 months to live. Before the introduction of pension flexibility, those lump sums were paid tax-free if the individual was under 75 and taxed at 45% if they were aged 75 or over. That was in line with the taxation of certain lump sum death benefits and was intended to ensure that tax considerations did not drive whether pension lump sums were taken before or after an individual dies.

From 6 April this year, the rules around death benefits have changed. Now, when someone dies having reached age 75, the lump sum death benefit is taxable at the marginal rate of the individual who receives it, not 45%. Under the clause, where someone takes a serious ill health lump sum having reached age 75, it will be taxed at the recipient's marginal rate instead of 45%. The clause will therefore realign the tax treatment of serious ill health lump sums with that of the lump sum death benefits.

In addition, the clause makes changes to help people with a pension who have become seriously ill. Under the current rules, serious ill health lump sums can only be paid from the pension savings that have not been accessed at all. The current legislation was appropriate for a world in which people could either access the whole of their pension or not access it at all, but it now means that people could be disqualified from taking a serious ill health lump sum if they take a small lump sum from their pension and then become seriously ill later in life. The clause will remove the rule that prevents serious ill health lump sums being paid from the unaccessed portion of partially accessed funds. The changes bring the taxation of such lump sums into line with the treatment of comparable lump sum death benefits, while ensuring that there is flexibility in the system.

The second change relates to charity lump sum death benefits. Under current rules, when a pension scheme member dies leaving certain unused pension savings and uncrystallised funds, a lump sum death benefit can be paid to any beneficiaries, including a charity. That is tax-free if the member is under 75 at death, but the payment needs to be made within a two-year period, or it is taxed at a separate rate of 45% if paid to a charity. The changes being made by the clause will ensure that unused funds at the member's death can be used to pay a charity lump sum death benefit completely tax-free, whatever the age of the member or length of time taken to pay.

The third change relates to dependants' flexi-access drawdown funds. Before pension flexibility was introduced, children of a deceased member who wanted to claim funds from a drawdown account had to use all of this fund by the age of 23. Any remaining funds paid to them after reaching that age would be taxed at rates of up to 70%. The reforms last year enabled any nominated beneficiary, including a member's child aged 23 or over at their parent's death, or a member's step-child of any age, to inherit their parent's pension and receive drawdown pension payments at any age. However, the current legislation still means that children aged under 23 at their parent's death have to draw all of their funds before they turn 23 in order to avoid paying 70% tax on those funds. Schedule 5 will amend legislation to allow dependants with drawdown accounts to access their funds as they wish without incurring a 70% tax charge from their 23rd birthday.

The fourth change relates to trivial commutation lump sums. Before pension flexibility, the option of trivial commutation existed for both defined-contribution and defined-benefit pensions. That allows individuals aged 60 or over with total pension savings of £30,000 or less to withdraw all of their savings as a lump sum, with the first 25% of any previously untouched savings paid tax-free. Since April 2015, pension flexibility changes allow anyone aged 55 or over to withdraw some or all of their funds that they have yet to access as a lump sum, 25% of which is tax-free. Trivial commutation was therefore removed for defined-contribution pensions and limited to defined-benefit arrangements, which were not affected by the introduction of pension flexibility.

Under the defined-benefit arrangement, the only kind of pension possible is a scheme pension, although some people have scheme pensions that come from a defined-contribution fund. As such, under current rules, if a defined-contribution scheme pension is already in payment, it cannot be taken as a trivially commuted lump sum. Schedule 5 will allow defined-contribution scheme pensions that are already in payment to be paid as a lump sum, if they satisfy all the other requirements of trivial commutation.

The fifth change brought about by this legislation relates to the top-up of dependants' death benefits. Some pension schemes specify a minimum amount that dependants are entitled to receive when the member dies. If there is not enough money in the member's pension pot when they die, their employer will top it up to ensure that it reaches the minimum amount. Under current rules, certain lump sum death benefits funded by an employer top-up will count as an unauthorised payment and be taxed at rates of up to 70%. Schedule 5 will address that issue by allowing employer top-ups to fund certain dependants' death benefits to be paid out as authorised payments and therefore not be taxed at those rates.

The sixth and final change introduced by the clause relates to inheritance tax in respect of alternatives to annuities for dependants. At present, some schemes can pay an annuity to a deceased member's surviving spouse, civil partner or dependant if the deceased had the option for a lump sum to be paid to personal representatives instead. The lump sum is not included in the estate of the deceased member for inheritance tax purposes. Pension flexibility changes mean that, after an individual's death, an annuity may be paid to someone other than a spouse or partner or dependant, such as a nominee. However, nominees are currently not included in the inheritance tax exclusion, so if an annuity is payable to a nominee, any alternative lump sum payment could be subject to inheritance tax. The changes made by the clause will provide for the same treatment as in April 2015 and keep annuities for nominees out of inheritance tax.

Government amendment 134 to schedule 5 clarifies that the sums or assets available to fund a lump sum death benefit are valued immediately after the member's death. The change is a minor, technical one to provide clarity and to ensure that the legislation works.

To conclude, the Government introduced pension flexibility because we believe that individuals who have worked and saved responsibly throughout their life should be trusted to make their own decisions about their pension savings. The changes made in the clause will help to ensure that the flexibilities work for everyone. I hope that it may stand part of the Bill.

Rob Marris (Wolverhampton South West) (Lab): It is a pleasure to appear before you again, Mr Howarth.

The Labour party supports clause 22, schedule 5 and the amendment, which will come as no surprise. Pension flexibility was in the manifesto on which you and I got elected, Mr Howarth, and we support it. I have a few technical questions that the Minister may wish to write to me about, or not. As ever, I was helped by the Chartered Institute of Taxation briefing, which, in reference to paragraph 6(3) of schedule 5, on page 297 of the latest print edition of the Bill, states: "This is complicated,

[Rob Marris]

although we agree that it achieves the stated aim. However, it is not clear to us what exactly paragraph 6(3) is trying to do, and it is unclear whether the 'person' is the dependant or the original member." Perhaps the Minister will clarify that.

More importantly, the CIOT goes on to state: "It will be very complicated in future to determine who might be a dependant for various legislative purposes." Thirdly, it said that it contacted Her Majesty's Revenue and Customs about various typographical errors. Perhaps the Minister will reassure the Committee about that, or look into it to ensure that any of the errors CIOT discovered have been tidied up, or will be on Report, if necessary. Notwithstanding all that, we welcome the five small changes to which the Minister referred.

Mr Gauke: I thank the hon. Gentleman for his support for pension flexibility, which I debated with some of his colleagues and predecessors over many months in the previous Parliament. Inevitably, when a fundamental change is undertaken in how we address these matters, there will be areas that require refinement and correction, and that is what we are doing.

2.15 pm

The hon. Gentleman asked about the definition of "dependant". Hopefully I can reassure him by saying that that will be clarified in the guidance that will be produced. I can also assure him that any typographical errors are being dealt with, with regard to the guidance and so on. We welcome engagement from the CIOT in these matters, as with other matters.

As for paragraph 6(3), I will be—

Rob Marris: Sometimes it is helpful to sort this out in Committee, because it goes on the record in *Hansard*. However, if the Minister is unable immediately to bring the answer to mind, I appreciate that he might clarify later the contents of paragraph 6(3).

Mr Gauke: For paragraph 6(3), guidance will be produced dealing specifically with that point. I hope that is helpful and that the clause will be accepted by the Committee.

Question put and agreed to.

Clause 22 accordingly ordered to stand part of the Bill.

Schedule 5

Pension flexibility

Amendment made: 134, in schedule 5, page 299, line 9, after "immediately", insert "after".—*(Mr Gauke.)*

Schedule 5, as amended, agreed to.

Clause 23 ordered to stand part of the Bill.

Clause 24

Fixed-rate deductions for use of home for business purposes

Question proposed, That the clause stand part of the Bill.

Mr Gauke: Clause 24 makes changes to ensure that businesses that operate through a partnership have clarity on how they should apply the simplified expenses regime. The Finance Act 2013 introduced a new simplified expenses regime for small unincorporated businesses. Two of the simplifications relate to the expenses of premises used for both personal and business use. As originally enacted, it could be difficult to interpret how a partnership business should apply the provisions. The changes made by clause 24 will enable unincorporated partnerships to apply these rules with clarity and in line with the original policy objective.

The changes will achieve two things. First, where partners occasionally work from home, they can also apply the fixed-rate deductions, subject to the partnership applying the provision consistently and ensuring that any hour worked at the home is counted only once, no matter how many people work at the home at the same time. Secondly, if only some members of the partnership live on the business premises—for example, a pub, restaurant or B and B—the partnership can apply the fixed-rate adjustments for the non-business costs based on the number of occupants in the same way as for individual traders.

The clause will clarify the rules and ensure that partnerships can apply the simplification as intended. Overall, the clause will put partnerships on the same footing as businesses operated by individuals and I hope it stands part of the Bill.

Rob Marris: I have one or two minor technical issues to raise, the first of which has been brought to my attention by the ever helpful Association of Taxation Technicians. It tells me, and I quote, "The current wording of section 94H(4)"—this is set out on page 32 of the Bill—"is silent on how any overlap of hours worked should be treated," so there may be a technical issue when more than one person is working in the premises under consideration.

The Chartered Institute of Taxation says: "It would appear that clause 24 is actually restricting the claim that can be made for use of a home by an individual, compared to what is in existing 94H." Proposed new section 94H(4B) of the Income Tax (Trading and Other Income) Act 2005 states:

> "Where more than one person does qualifying work in the same home at the same time, any hour spent wholly and exclusively on that work is to be taken into account only once".

The CIOT continues: "There was no similar restriction in existing section 94H, which defined number of hours worked." Will the Minister look at those two technical points, if he does not have the answer immediately to hand? Will he also give us an indication of what take-up there has been of these deductions and so on, since they were introduced in 2013?

Mr Gauke: Let me turn first to section 94H(4). The simplified expenses option is designed to cover all the expenses of the home. Many of those are not affected by the number of people working in the home at any one time. Some other expenses, such as telephone and broadband costs, can be claimed separately. In line with the desire to provide simplicity, any hour is counted only once, no matter how many people are working in the home at the time. It is also worth bearing in mind, in the context of these provisions, that this regime is optional. Nobody needs to make use of it if they do not want to or if they find themselves disadvantaged by it.

It was also asked whether the need to record the actual hours worked in the home would make things more complicated, especially where individuals work in the home at different times. Ensuring that any overlap hours are counted only once does require some element of calculation, but we still believe that simplified expenses is an easier calculation for businesses to make than measuring the actual expenses incurred and then correctly apportioning these between business and private use. In any case, where a home is used extensively for business, it is likely that simplified expenses will not be appropriate. It is also worth drawing the Committee's attention to the fact that the gov.uk website has a straightforward, simplified expense checker, which allows a business to quickly see whether using the fixed-rate amounts would be to their benefit.

As for whether we should backdate this change to the start date of the simplified expenses regime in 2013-14, it is three years since the option to use simplified expenses became available. This measure is a clarification, and Her Majesty's Revenue and Customs will accept partnerships applying the pre-existing legislation in the same way when making tax returns covering a period before the legislation has effect. I hope that is helpful.

On wider issue of take-up, I am not sure how much information I can provide at this point—*[Interruption]*—although if I think long and hard about it, my recollection is that we have no analytical data available to answer that question. The self-assessment returns used by unincorporated businesses do not require businesses to separately identify if they have used the simplified expenses or not. Information from HMRC's customer call handlers is that some callers found the simplified expense approach useful, in particular the fixed-rate deductions for working from home. I am not sure I can provide any more information than that. I hope that provides useful clarification for the Committee and that the clause will stand part of the Bill.

Question put and agreed to.

Clause 24 accordingly ordered to stand part of the Bill.

Clause 25

AVERAGING PROFITS OF FARMERS ETC

Question proposed, That the clause stand part of the Bill.

Rob Marris: I have a couple of technical points and an opening comment. Clause 25 is about averaging profits of farmers. I am a great believer in averaging income. I first filled in an income tax form many years ago—I think it was called a T4 then; it might still be called that in Canada—in the days of automatic income tax averaging. As a fairly impecunious student, I benefited from that as my income rose over the years. I do not know whether it was done by computers in those days, but income tax averaging makes a lot of sense and the clause will extend it from two to five years. I gather there was a consultation on it, which closed on 27 September last year, but that there were only 26 respondents, 17 of whom thought the two-year option should be retained.

The Chartered Institute of Taxation has raised a technical issue. It likes the idea of retaining both the two-year system and the five-year system. That was its suggestion, and fair enough: the CIOT is not always right, but it is very helpful to all parts of the House. The CIOT cross-references clause 25 with HMRC's "Making tax digital" approach, with its quarterly reporting or quarterly records being lodged, or whatever term we used to use—I realise they are technically not quarterly returns. The CIOT says: "We wonder how something like farmers' averaging is going to work, given that taxable profits will depend on averaging calculations over a number of years, so rendering quarterly figures pretty much meaningless." Perhaps they are meaningless; perhaps they are not. Will the Minister say a little about that?

Mr Gauke: Clause 25 will give self-employed farmers the option to average their profits over five years as well as the existing option to average over two years. Farmers typically have volatile profits, often due to uncontrollable factors such as the weather, disease or fluctuating product prices. Farming is a highly capital-intensive sector, the volatility of which makes it difficult for farmers to plan and invest for the future. It is a long-standing feature of our income tax system to allow farmers to average their profits over two consecutive years for income tax purposes, smoothing their tax bills over consecutive good and bad years, which prevents them from having to pay significantly higher amounts of tax in the good years. The clause will give farmers additional flexibility and protection from volatile profits by allowing them to choose to average their profits over a two-year or five-year period. More than 29,000 self-employed farmers could benefit from the additional option, with an average saving of around £950 on their income tax bill each year.

As for online digital accounts, it is expected that annual claims such as the averaging of profits will be incorporated into the design of the "Making tax digital" programme as it develops. However, I stress that quarterly reporting is not a quarterly calculation or a quarterly return. It is not about being taxed on the basis of what is earned in the quarter; it is about the provision of information. HMRC is well aware that issues such as seasonal work mean that one quarter may be very different from the next—it is certainly alive to that. As more information on HMRC's thinking is put into the public domain, people will be reassured that the "Making tax digital" programme should not in any way undermine the policy objectives set out in clause 25.

Question put and agreed to.

Clause 25 accordingly ordered to stand part of the Bill.

Clause 26 ordered to stand part of the Bill.

Clause 27

INDIVIDUAL INVESTMENT PLANS OF DECEASED INVESTORS

Question proposed, That the clause stand part of the Bill.

Rob Marris: I would like to make a general comment, which is partly related to clause 26, which we have just covered. With all the changes to inheritance tax—this is tangentially related to that, of course, and I referred to

[Rob Marris]

it this morning when I spoke about inheritable individual savings accounts—it is time to look at the whole issue of taxes related to death, if I can put it that way. Because of the huge changes to inheritance tax there is now effectively a £1 million threshold for those who own an expensive house. It is time to look again at the whole panoply of death-related taxes, to which the clause relates.

2.30 pm

Mr Gauke: I shall not run through all the aspects of the clause. The change it contains builds on earlier individual savings account changes we have made. It will allow us to remove unfair tax charges and simplify the tax-advantaged transfer of ISA savings after death. I note the hon. Gentleman's remarks about the tax treatment of death and look forward to Opposition Front Benchers putting forward their policy proposals, which we will no doubt scrutinise closely.

Question put and agreed to.

Clause 27 accordingly ordered to stand part of the Bill.

Clause 28

EIS, SEIS AND VCTs: EXCLUSION OF ENERGY GENERATION

Rob Marris: I beg to move amendment 135, in clause 28, page 2, line 42, at end add—

'(7) The Chancellor of the Exchequer shall, within one year of the passing of this Act, publish a report giving the Treasury's assessment of the effect of excluding energy generation from EIS/SEIS/VCT schemes on—

(a) the renewable energy sector,

(b) community energy projects, and

(c) the energy sector".

The Chair: With this it will be convenient to consider clause stand part.

Rob Marris: I hope the amendment is fairly clear. It is a standard amendment of the sort we are all used to, requiring the Chancellor of the Exchequer to publish a report. There is concern that the leverage afforded by the three types of tax advantage scheme referred to in the clause will be completely removed if all energy-generation schemes are removed from those fiscal schemes. I appreciate that the risk factor of several types of energy-generation schemes has dropped so much that the use of such tax measures is no longer efficacious, because they are giving people a tax break for doing something that used to be very risky but no longer is—namely, the development of technology—but it seems a little strange to remove tax breaks for energy generation completely. Will the Minister say something about that?

Mr Gauke: The clause makes changes to exclude all remaining energy-generation activities from the tax advantage venture capital schemes, thereby ensuring that the schemes continue to be well targeted towards high-risk companies and that the tax reliefs are in keeping with the original policy intent.

The venture capital schemes offer generous tax reliefs to encourage investment in small and growing higher-risk companies that cannot otherwise access finance. In recent years, there has been a significant increase in tax-advantaged investment in energy-generation companies. Such activities are generally lower risk, with predictable, reliable and regular income streams. The Government have previously made changes to exclude from the schemes those companies that have benefited from guaranteed income streams for the generation of energy. However, those exclusions have resulted in investment shifting to other forms of energy generation, rather than to the higher-risk investment that the schemes are intended to support. The changes made by this clause will ensure that the Government remain consistent in their approach by keeping the venture capital schemes targeted at higher-risk companies.

The clause will exclude all forms of energy generation from qualifying for the venture capital schemes, including the seed enterprise scheme, the enterprise investment scheme and venture capital trusts. The Government also intend to apply the exclusions to the social investment tax relief once it is enlarged. The measure is expected to yield £95 million annually from 2016-17 onwards, helping the Government to deliver on their commitment to tackle the budget deficit.

Amendment 135 would require a report to be published on the impact of the exclusion of energy generation from the venture capital schemes on the renewable energy sector, community energy projects and the energy sector. Such a report would need to be published within one year of the Bill becoming an Act. The Government provide a range of support for renewable energy, and that support will double over this Parliament, reaching more than £10 billion in 2020-21. That represents a sixfold increase in spend since 2011-12. The relief schemes I have mentioned serve a different purpose: to help smaller, higher-risk companies across a range of sectors to access the investment they need to grow and create jobs.

Energy generation is typically a lower-risk activity for which investment can be secured without tax relief. Allowing it to qualify for tax relief diverts investment away from the companies that need it most. In addition, from a practical perspective, companies that raised investment for the purpose of energy generation before its exclusion have up to two years to spend the money. A report in just one year's time would therefore serve little purpose.

A report as suggested by the amendment would have little value from a practical point of view. The exclusion of energy from the venture capital schemes is a principled decision based on the lower risk profile of the activity. The Government therefore believe the amendment is unnecessary, and I hope it will be withdrawn.

Kirsty Blackman (Aberdeen North) (SNP): With all the changes the Government are making to the support of energy policy and with the lack of a pot 1—established technologies—contracts for difference round in the near future, does the Minister not feel that projects such as onshore wind are much less likely? This measure has to be taken in the round. It may cause problems because the Government are doing many other things that go against, in particular, onshore wind generation.

Mr Gauke: Where I agree with the hon. Lady is that these things should be looked at in the round. The Government are committed to supporting the investment and innovation needed to achieve a cost-effective transition to a low-carbon economy while ensuring security of energy supply and avoiding unnecessary burdens on businesses and households. We are making great strides towards our commitments, with emissions down 30% since 1990. Support for renewables from taxpayers and bill payers will double over this Parliament, reaching more than £10 billion in 2020-21, as I mentioned. That is a sixfold increase in spend since 2011-12. We have more than trebled our renewable electricity capacity since 2010. In the round, the Government's record is strong.

We are committed to supporting small and growing businesses. The presence of low-risk, asset-backed investments such as those described today crowds out investment in higher-risk propositions. It is right that the Government act to exclude such investors.

Rob Marris: I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Clause 28 ordered to stand part of the Bill.

Clauses 29 to 32 ordered to stand part of the Bill.

Clause 33

TRANSACTIONS IN SECURITIES: COMPANY DISTRIBUTIONS

Question proposed, That the clause stand part of the Bill.

The Chair: With this it will be convenient to discuss the following:

Clause 34 stand part.

Amendment 7, in clause 35, page 57, line 2, at end add—

'(4) The Chancellor of the Exchequer shall, within one year of the passing of this Act, publish a report on the impact of this section on deterring tax avoidance during the procedure of distributions during a winding up."

Clause 35 stand part.

Rob Marris: I will refer first to amendments 7 and 8, which I think we are dealing with in this group.

The Chair: Order. Amendment 8 is not in this group.

Rob Marris: I beg your pardon, Sir—I am shuffling a lot of papers—and I am grateful to you for your guidance.

Amendment 7 is the usual amendment—no doubt the Minister will say the timeframe is too premature—to have a report from the Chancellor of the Exchequer within one year, on how efficient or otherwise the provisions in clause 35 are at deterring tax avoidance during wind-ups.

Clause 33 relates to transactions and securities. We welcome the tax avoidance measures introduced by the Government. I understand from a response from HMRC that guidance is due to be published on these sorts of issues. Can the Minister say when that is likely to be?

Mr Gauke: Clauses 33 and 34 will amend the transactions in securities legislation, which focuses on transactions where one of the main purposes is to obtain a tax advantage. Clause 35 will introduce a new targeted anti-avoidance rule aimed at preventing an unjustified tax advantage being obtained from distributions in the winding up of a company. Together, these changes will raise £80 million by the end of this Parliament. As well as helping to reduce the deficit, they will protect revenue raised from the reform of dividend taxation by ensuring that those who should pay income tax on dividends cannot convert their income into capital, which is chargeable at lower capital gains tax rates.

Companies usually distribute profits to shareholders by way of dividends, which are subject to income tax when received by individuals. There is an incentive for some people, particularly those running owner-managed companies, to convert this income into a capital receipt, which would attract lower capital gains tax rates. This incentive will be increased by the proposed reform to dividend taxation.

Clauses 33 and 34 deal with the changes to the transactions in securities legislation, strengthening and modernising those rules. They will apply where there is a transaction in securities, such as a disposal of shares, and where one of the main purposes of the transaction is to obtain a tax advantage by manipulating the border between income and capital. They will ensure that people who should pay income tax on distributions do so.

Clause 35 addresses the phenomenon of "phoenixism", whereby a person carries on the same trade or activity through a succession of companies, extracting the profits as capital by winding the companies up rather than paying dividends. The new rule is carefully targeted and will not affect the vast majority of companies that are being wound up—for example, where a shareholder sells the trade or is retiring—but it will spell the end of companies being wound up by people seeking to obtain an unfair tax advantage.

The changes will introduce additional safeguards, including a connected parties rule, and modernise the way in which the rules are applied. They remove some of the archaic mechanisms that applied to the compliance process. Like the new "phoenixism" rule, the changes will not affect transactions that are undertaken for normal commercial reasons and they will only apply to transactions that have as one of their main purposes the aim of obtaining a tax advantage. Without these changes, the owners of some companies would be able unfairly to reduce their income tax liability simply by changing the form in which they take money out of a company, which would put at risk revenue from the dividend tax reform.

The Opposition's amendment to clause 35 seeks to explore how the Government will determine the effectiveness of the measures to deter tax avoidance that it contains. I quite understand the hon. Gentleman's interest in this issue; it is an interest that I share. The Government expect that the clause will be effective in closing off the great majority of tax avoidance in this area, as it involves very specific arrangements that the legislation has been carefully designed to address.

In practice, determining the clause's deterrent effect will require information from the self-assessment process that would not be available until 2018 at the earliest. *[Laughter.]* Again, the hon. Gentleman anticipates the point that I was going to make. For that reason, we will be unable to report within a year on its effectiveness as the amendment proposes we should, so I hope that he will understand if we are not minded to accept the

[Mr Gauke]

amendment. HMRC will publish guidance on the new rules as soon as possible and before the end of the year, when any tax that is due under the new rules will first become due.

In summary, this reform strengthens and modernises the rules that prevent tax advantages from being unfairly obtained by a minority of shareholders who artificially convert income into capital. It also protects revenue accruing from the dividends tax reform and makes the UK a fairer place to do business. Therefore, I hope the clause will stand part of the Bill.

Question put and agreed to.

Clause 33 accordingly ordered to stand part of the Bill.

Clauses 34 and 35 ordered to stand part of the Bill.

Clause 36

Disguised investment management fees

2.45 pm

Question proposed, That the clause stand part of the Bill.

The Chair: With this it will be convenient to discuss the following:

Amendment 8, in clause 37, page 58, line 26, leave out from "is" to end of subsection and insert "100%".

Government amendments 43 to 49.

Clauses 37 and 38 stand part of the Bill.

Mr Gauke: With your permission, Mr Howarth, my remarks will cover clauses 36, 37 and 38, and amendments 43 to 49. I will also touch on amendment 8.

These clauses introduce a test to limit the circumstances in which performance-based rewards paid to asset managers will be taxed as chargeable gains. The main test will be introduced by clause 37. Clause 36 will change some related definitions in the disguised investment management fees rules. Clause 38 sets out how the rules will work with regard to individuals coming to the UK. Taken together, these clauses will ensure that only fund managers engaging in long-term investment activity pay capital gains tax on their performance-related reward or carried interest; otherwise, that form of remuneration will be fully charged to income tax.

In 2015, we legislated to ensure management fees are always subject to income tax. Where carried interest is taxable as a chargeable gain, the full amount will be taxable without reduction through arrangements such as base cost shift. These clauses build on the previous legislation. They will ensure that capital gains treatment for carried interest is reserved only for those managing funds that are genuinely long-term investments. Treating carried interest as a capital gain rather than an income is the right approach and keeps the UK in step with other countries. It is also the approach that has been adopted consistently by previous Governments in this country over a long period. However, to ensure the regime is fair and not open to abuse, these changes limit capital gains tax treatment to those managers who can demonstrate long-term investment activity by the fund they manage.

Clauses 37 and 38 will insert a test that applies to all payments of carried interest. On receipt of carried interest, asset managers will be required to calculate the average holding period of the investments in the fund. If the average holding period is less than 36 months, the payment will be subject to income tax. If the period is more than 40 months, the payment will be subject to capital gains tax. There is a taper in between those two time limits, and targeted anti-avoidance rules to ensure that the rules cannot be exploited. The rule is slightly different for managers of debt funds, turnaround funds or venture capital funds, reflecting the specific investment strategies of those kinds of funds.

Clause 38 specifically sets out how individuals who move to the UK will be taxed in certain situations. It will apply in the first five years after an individual moves to the UK when he or she receives a reward that is taxable to income under the time held test, which I referred to earlier. Where the reward relates to services performed outside the UK, before they were resident in the UK, it will be charged to UK tax only when it is remitted to the UK. That reflects the fact that the reward relates to work done before the individual lived in this country, and it will help to ensure these rules do not make it harder for UK asset managers to attract the best talent in the global labour market.

Clause 36 will amend definitions in the disguised investment management fees rules to ensure the rules introduced by clauses 37 and 38 work as intended, especially in relation to more complicated investment fund structures.

The Government tabled seven amendments to clause 37. They are technical changes to ensure the provisions operate as intended. Amendments 43, 46 and 48 make the same technical change in three of the specialised rules we have included in clause 37. Each rule will apply a targeted calculation rule to a particular type of fund investment strategy—for example, a fund that invests in real estate or provides venture capital—thus ensuring that the average investment holding test accurately captures a fund's underlying activity.

A fundamental concept in all these rules is that of a relevant disposal. A relevant disposal is, in effect, a disposal that is taken into account when calculating a fund's average holding period. These changes will ensure that the legislation uses a consistent definition throughout the various specialised regimes that is clear and understood by industry and its advisers.

Amendments 44, 45 and 47 will correct a technical error that would have prevented the relevant provisions from working in practice.

Amendment 49 will expand the definition of a secondary fund to include the acquisition of investment portfolios from unconnected investment schemes. Stakeholders have informed us that many secondary funds undertake that type of activity, and that amendment is necessary to ensure that the relevant rules still apply to those funds.

The Opposition's amendment 8 would remove the taper rule that I have described. The decision to introduce a taper rule followed extensive engagement with interested parties to examine the impact of such a measure on the market. Removing that rule would create a cliff edge—a concern that the Opposition raised in another context—so that marginal differences in the average time for which a fund held its assets could lead to radically different tax treatment for its managers. That cliff edge would lead to a market-distorting incentive for fund managers to dispose of assets earlier than was optimal, to the detriment of investors and with no policy benefits. For those reasons, I urge that that amendment is not pursued.

Clauses 36 to 38 will ensure that only those managers engaged in genuinely long-term investment activity pay capital gains tax on their performance-related rewards, and I therefore hope that those clauses stand part of the Bill and amendments 43 to 49 are made.

Rob Marris: This series of clauses is an interesting mixture of the technical, the conceptual and the political. Technically, the clauses are complex and lengthy, and the Government have been forced to table several amendments because of the complexity of these issues and the way that they have gone about dealing with them.

The conceptual point is about whether we go for a simpler and more rough and ready approach or a lengthy one. Professor Sol Picciotto at Lancaster University said about these clauses that instead of going for a broad provision to allow carried interest to be treated as income, the Treasury and HMRC had, typically for them, preferred long and complex statutory provisions that would keep tax lawyers happy and spawn more avoidance. These provisions are very lengthy.

The political point is highlighted by amendment 8. Our wording of that amendment may well be deficient, but it is not designed to create a cliff edge; it is designed to remove the table on page 58 completely, so that there is no taper and all carried interest is treated at 100%—that is, taxed as if it were income. As I understand it, that is in line with the OECD recommendations. Ministers properly say that when we engage in double taxation agreements, which the Minister and I have discussed on several occasions in different Committees, Her Majesty's Government's starting point is the OECD model, and I quite understand that, but suddenly we are not going along with an OECD suggestion when it comes to carried interest. That is obviously guidance and has no direct statutory relevance, but it is issued by the OECD, which is made up of our sister advanced countries. Instead of going for a simpler approach in which carried interest is straight income—that is what amendment 8 is designed to introduce—we have ended up with 21 pages of complex provisions in the Bill, which necessitate 10 pages of explanatory notes.

I hope that the Minister will say a little more about that conceptual point and why we do not just follow the OECD guideline. To those of us who are politicians and not tax experts, it appears quite just for carried interest, which has on occasions been used for legitimate tax avoidance, to be knocked on the head simply by being treated and taxed as income, as the OECD suggests.

As far as my excellent researcher Imogen Watson could find, there is no tax information and impact note. If that is the case, I hope that the Minister will outline—or perhaps write to members of the Committee to outline—what the Government think the impact on the Exchequer will be, and the number of taxpayers the Government expect to be affected by the provisions.

Roger Mullin (Kirkcaldy and Cowdenbeath) (SNP): It is a pleasure to serve under your chairmanship again, Mr Howarth. I will be brief. We on the Scottish National party Benches support the amendment. The issue of carried interest has also been of interest to us, as the Minister knows only too well. I commend the amendment, and if the Labour party wishes to press it to a vote, we will certainly support it.

Mr Gauke: Let me address the issue of complexity; I hope I can be helpful to the Committee on that. The new rules replace the badges of trade that previously outlined the tax treatment of carried interest. The badges of trade are based on complex case law, which means that the law was determined by a wide range of varied and outdated judicial decisions. Bringing these new rules into legislation removes ambiguity and makes the tax code easier to follow. Furthermore, much of the detail of the legislation comprises bespoke rules that apply to specific types of funds. Those specialised rules will help reduce the compliance burden for funds in practice. Asset managers are sophisticated taxpayers who often have personal advisers; we therefore anticipate it being easy for those individuals to follow these rules.

Very often, the measure of tax complexity is taken to be the length of the tax code. I confess that I have sat where the hon. Member for Wolverhampton South West is sitting and made that point myself; he has heard me make it. In this example, there are additional pages of legislation; however, they are replacing legislation that took up fewer pages but was based on case law, which can be very complicated. It is worth pointing out the limitations of pages as a measurement of complexity.

On the OECD recommendations, treating carried interest as a capital gain rather than income is the right approach. It keeps the UK in step with other countries and, as I said, it is the approach adopted consistently by previous Governments in this country over a long time. There is nothing particularly unusual about the way in which we treat carried interest in this country. I am conscious that this is a matter that we debate on a fairly regular basis; it is the second time we have debated it in a week. We are being consistent with what we have done in this country for some time and with what other countries do. I hope those points are helpful, but if the hon. Gentleman presses amendment 8, I will urge my colleagues to oppose it.

Question put and agreed to.

Clause 36 accordingly ordered to stand part of the Bill.

Clause 37

INCOME-BASED CARRIED INTEREST

Amendments made: 43, in clause 37, page 67, line 45, leave out "value" and insert "amount".

Amendment 44, in clause 37, page 68, line 41, leave out "company" and insert "underlying scheme".

Amendment 45, in clause 37, page 68, line 43, leave out "a company" and insert "an underlying scheme".

Amendment 46, in clause 37, page 68, line 47, leave out "value" and insert "amount".

Amendment 47, in clause 37, page 70, line 15, leave out "company" and insert "underlying scheme".

Amendment 48, in clause 37, page 70, line 21, leave out "value" and insert "amount".

Amendment 49, in clause 37, page 70, line 34, at end insert

", or the acquisition of portfolios of investments from,".—*(Mr Gauke.)*

3 pm

Clause 37, as amended, ordered to stand part of the Bill.

Clauses 38 and 39 ordered to stand part of the Bill.

Clause 40

Deduction of income tax at source: tax avoidance

Mr Gauke: I beg to move amendment 20, in clause 40, page 80, leave out lines 33 to 39 and insert—

""intellectual property royalty payment" means a payment referred to in section 906(2)(a) or (3)(a);".

The Chair: With this it will be convenient to discuss the following:

Government amendment 21.

Clause stand part.

Government new clause 7—*Receipts from intellectual property: diverted profits tax.*

Government new clause 8—*Deduction of income tax at source: intellectual property.*

Government new clause 9—*Receipts from intellectual property: territorial scope.*

Mr Gauke: For the benefit of the Committee, I will discuss clause 40 together with new clauses 7 to 9, as they collectively implement the royalty withholding tax policy that the Government announced at Budget 2016.

Together with the new clauses, clause 40 strengthens our regime for the deduction of income tax at source from payments of royalties overseas. It introduces a rule to prevent the abuse of the UK's tax treaties. It will prevent multinational enterprises using conduit arrangements and other schemes to exploit the provisions of tax treaties to avoid UK taxes on royalties.

New clause 8 broadens the categories of royalties from which tax must be deducted at source in the UK when they are paid abroad. Going forward, all payments considered to be royalties under internationally recognised criteria will be subject to withholding tax in the UK unless a specific exemption applies.

Mr Speaker—sorry, Mr Howarth.

The Chair: I am sure that there will be lots of changes of personnel over the next few days, but I can assure the Minister that that will not be one of them.

Mr Gauke: Thank you, Mr Howarth, although such is the fast-moving nature of British politics at the moment that who knows?

New clause 9 introduces rules to ensure that royalties paid by non-residents have a UK tax charge if they are paid in connection with a trade carried on in the UK through a permanent establishment. New clause 7 introduces consequential changes to the diverted profits tax to ensure that no advantages accrue to entities within its charge as a result of the changes I have described.

Taken together, the clauses mean that all payments of royalties from the UK will now be subject to withholding tax, unless we have explicitly given up our taxing rights under an international agreement or domestic law. The new regime will provide a robust defence against those wishing to use royalty payments to shift profits to jurisdictions where there is little, if any, taxation.

Most countries tax non-residents on royalties that arise in that country. They generally require the payer of the royalty to withhold tax from the payment and account for it to the tax authorities. The UK is no exception to this practice. The withholding requirement is subject to tax treaties, of which the UK has more than 120, and the EU interest and royalties directive. Many of those treaties provide that royalties are taxable only in the country where the royalty payment is received. The Government think that that is an appropriate treatment, as it removes tax obstacles from cross-border investment and provision of services.

However, the UK gives up its taxing rights under tax treaties only in the expectation that the royalties will be paid for the benefit of a resident of a treaty partner country. It is a frustration, and not the intention of a tax treaty, that a person resident in a third country can use a bilateral tax treaty with the UK to extract tax-free royalties from the UK, especially if no tax is paid on the receipt and no substantive activity is taking place in that third country.

It has become increasingly prevalent for multinational groups to derive large sums from the exploitation of intellectual property and cross-border royalty payments. The need to ensure that they are taxed appropriately is more important than ever. Some multinational groups have put in place arrangements under which intellectual property is held in jurisdictions where no tax is paid and no substantive activity takes place. They structure the payments of royalties to such companies in a way that takes advantage of the UK's tax treaties with other countries, depriving the UK—the country in which the royalty arises from sales or other activity—of the right to tax. Had the royalty been paid direct to that ultimate jurisdiction, the UK would have retained its taxing rights on the basis that there was no treaty in place between the UK and that jurisdiction.

For that reason, many tax treaties in the EU interest and royalties directive contain anti-abuse provisions to prevent so-called treaty shopping and other abuses by third country residents. The OECD has recognised such abuses as a problem and, as part of its recent work to counter base erosion and profit shifting, has recommended that countries adopt regimes, either in their tax treaties or in domestic law, to counter such treaty shopping.

Not all of the UK's tax treaties contain anti-abuse provisions that frustrate treaty shopping arrangements and other abuses. The Government have therefore introduced a targeted domestic anti-abuse rule based on the rule recommended by the OECD and aimed at royalty payments between related parties that seek to take advantage of the UK's tax treaties. The rule took effect for royalties paid on or after 17 March 2016. As part of this approach to tackling tax avoidance, new clause 8 will bring the definition of royalties on which non-residents are required to withhold tax into line with the OECD definition of royalties used in tax treaties. At present, payments for the right to use trade names and trademarks are subject to UK withholding tax only if they are annual payments. New clause 8 will ensure that all such payments will be subject to withholding tax.

The third part of the Government's reform, which goes hand in hand with the anti-abuse element introduced by clause 40, is to change what is meant by royalties arising in the UK—that is, to define whether they come from a source in the UK. At present, there is no statutory definition of what constitutes a UK source for royalties. As a result, it is not clear that all royalty payments connected to a permanent establishment that a non-resident has in the UK have a UK source. New clause 9 will introduce a new rule to ensure that all royalties have a UK source where the payment is connected with activities taking place through a permanent establishment that the payer has in the UK. Royalties paid by a non-resident to another non-resident that are connected to a UK permanent establishment of the payer will now be taxable in the UK, and the non-resident payer will be expected to withhold tax and account for it to Her Majesty's Revenue and Customs.

However, where there is a tax treaty between the UK and the country of residence of the beneficial owner, that treaty will govern the taxation of the payment. Where that treaty follows the OECD model and the anti-abuse rule does not apply, the taxation rights will continue to belong exclusively to that other country. New clause 7 is being introduced to ensure equal treatment between cases where a non-resident company maintains an actual permanent establishment in the UK, and cases where a person has contrived to avoid a taxable presence in the UK in circumstances that bring them within the diverted profits tax.

The changes made by the clauses are fairly simple. Clause 40 inserts a rule that denies the benefit of a tax treaty in the face of abuse. New clauses 8 and 9 extend the definition and territorial scope of royalty payments within the charge to tax in the UK. Finally, new clause 7 amends the diverted profits tax to ensure that entities within the scope of that tax are subject to the changes being made. The changes bring the UK into line with accepted international practice in respect of the taxation of royalty income arising in a state. The benefits of tax treaties and the interest and royalties directive will remain available, except where taxpayers have entered into transactions internationally recognised as abusive.

Before I conclude, I will speak briefly to amendments 20 and 21, also tabled by the Government. The amendments are being introduced to ensure that royalty payments subject to the anti-abuse rule include those payments brought within the scope of withholding tax by new clause 8. Together, the proposed new clauses will protect the UK from arrangements that seek to avoid UK tax through the use of royalty payments.

I hope that my explanation helps the Committee to understand the issues set out both on the odd-numbered pages and on the even-numbered pages.

Amendment 20 agreed to.

Amendment made: 21, in clause 40, page 81, line 12, at end insert—

'(3) In relation to payments made (under any such arrangements) on or after 17 March 2016 and on or before the day on which this Act is passed, section 917A of ITA 2007 as inserted by subsection (1) has effect as if the definition of "intellectual property royalty payment" in that section were as follows—

""intellectual property royalty payment" means—

(a) a payment of a royalty or other sum in respect of the use of a patent,

(b) a payment specified in section 906(1)(a) (as originally enacted), or

(c) a payment which is a "qualifying annual payment" for the purposes of Chapter 6 by virtue of section 899(3)(a)(ii) (royalties etc from intellectual property);".

(4) In relation to payments made (under any such arrangements) on or after 28 June 2016 and on or before the day on which this Act is passed, section 917A of ITA 2007 as inserted by subsection (1) has effect as if "intellectual property royalty payment" also included (so far as it would not otherwise do so) any payments referred to in section 906(2)(a) or (3)(a) of ITA 2007 as substituted by section (deduction of income tax at source: intellectual property).'—*(Mr Gauke.)*

Clause 40, as amended, ordered to stand part of the Bill.

Clause 45

LOAN RELATIONSHIPS AND DERIVATIVE CONTRACTS

Question proposed, That the clause stand part of the Bill.

The Chair: With this it will be convenient to discuss the following:

Amendment 9, in schedule 7, page 305, line 3, leave out

"the preceding provisions of this section"

and insert

"Part 4 of TIOPA 2010".

Amendment 10, in schedule 7, page 305, line 9, leave out

"the preceding provisions of this section"

and insert

"Part 4 of TIOPA 2010".

That schedule 7 be the Seventh schedule to the Bill.

Rob Marris: I rise to address amendments 9 and 10, which are technical amendments. Schedule 7 is a technical area about which I know little.

The Chair: I have never known that to stop the hon. Gentleman.

Rob Marris: That is indeed the case. I will now proceed to address the Committee at some length—well, appropriate length.

The amendments have been suggested by our old friends at the Chartered Institute of Taxation. The schedule is designed to address three particular scenarios in which I understand previous legislation has had unintended consequences in relation to notional finance costs, credits arising on reversal of debits—of course, you are intimately familiar with that part of the financial world, Mr Howarth—and, finally, amounts excluded from taxation under our old friends, the transfer pricing rules. On the first two issues—non-market loans and transfer pricing—the world has changed since the legislation

[Rob Marris]

was introduced. The UK accounting standards have changed and the Bill, in a sense, is matching up the standards with what will be in statute.

On the third area—exchange gains and losses—the explanatory notes helpfully state:

> "A particular concern has been identified with those provisions, as a result of which they can introduce a foreign currency exposure for corporation tax purposes even though none exists commercially or in the accounts."

It seems a strange state of affairs that a company can suddenly have notional foreign currency transactions that do not really exist. Such things can happen in the wonderful and weird world of finance, but it is not a good idea and the Bill will helpfully sort that out.

The amendments were suggested by the CIOT, and the Minister, with his excellent knowledge and information, will no doubt say whether they will work as intended—they might not. That is not to doubt the CIOT, as I may have mixed things up in translation when tabling the amendments. I have a whole page of technical information, Mr Howarth, but you will be pleased to know that I do not propose to read it out unless members of the Committee wish me to do so.

The excellent research by Imogen Watson shows that the amendments would make it clear that, in each case, the references in paragraphs 3 and 4 of schedule 7 are to debits that have been left out of accounts for the purposes of sections 446, on loan relationships, and 693—as all hon. Members will recall, section 693 is on derivative contracts—of the Corporation Tax Act 2009 as a result of the application of part 4 of the Taxation (International and Other Provisions) Act 2010. I am told that the amendments are not controversial, although the Minister may tell me otherwise, and they are intended merely to refer to the provisions that have resulted in debits not being brought into account as debits.

It is unusual for the Government to accept Opposition amendments. It may be that I get a result today because of the technicalities, but after looking at the Minister's face I am not optimistic. No doubt he will explain, with his usual patience and helpfulness, either why he thinks they should not be made, or that what I am seeking to do does not need doing or would not, in fact, be done by the amendments.

3.15 pm

Mr Gauke: Clause 45 introduces schedule 7, which deals with three different issues that can arise from interactions between accounting rules and tax rules. These changes will prevent some unintended and unfair outcomes. I welcome the opportunity to debate amendments 9 and 10, tabled by the hon. Member for Wolverhampton South West, which are linked to the clause and which I will turn to later.

All three of the issues being addressed arise when loans made by companies are interest-free or otherwise involve financial instruments on non-market terms. Typically, those will happen in the context of commercially driven funding arrangements where loans are between companies that have some connection. Some of the issues have come about because of recent changes to accounting standards. The changes will support the Government's policy of simplifying taxation, ensuring businesses pay the right tax at the right time.

Accounting standards can now require an interest-free loan, or other loan taken out on non-market terms, to be recognised in accounts at a lower value than the actual amount of the loan. That can lead to an interest cost being shown in the accounts of the borrower, even when no interest has actually been paid. This cost can lead to a tax deduction for the borrower, but no matching tax liability for the lender. That is an unfair outcome. The changes made by schedule 7 address this unfair situation by putting the borrower back in the position that applied before the changes to accountancy rules, to make sure that they do not benefit unfairly from the new rules.

The second issue also involves adjustments that apply when a loan or financial derivative is not made at arm's length. Tax law means that an adjustment is made to the amount brought into account for tax on the loan. The adjustments can have the effect of restricting the deductions that can be claimed by the company for tax purposes. However, under the current rules a corresponding amount can be taxed in full later. The changes made by schedule 7 ensure that in these circumstances the company will not be taxed on amounts if it has not been given a tax deduction for corresponding amounts previously. Again, this restores the position before the accounting changes were made.

The final issue addressed by schedule 7 concerns the application of the transfer pricing divisions to exchange gains and losses. In some circumstances these provisions can give companies a tax charge or benefit from foreign exchange movements, even when there is no commercial exposure to foreign exchange. Schedule 7 will make minor technical changes so that the transfer pricing will not create an overall foreign exchange exposure for tax purposes in cases where the company is commercially hedged.

The changes made by schedule 7 ensure that the rules operate as intended. The impact on the Exchequer will be negligible. Only companies or other corporate bodies will be affected by the changes, and the impacts will be negligible as companies learn the new rules. Moving forward, we expect companies' costs to be reduced as the legislation will be simpler to use in practice.

Let me take the opportunity to discuss amendments 9 and 10, which concern paragraphs 3 and 4 of schedule 7 respectively. They propose that the new legislation dictating the tax treatment of loan relationships and derivative contracts be linked directly to the transfer pricing rules. The Government have looked closely at that suggestion but concluded that the amendments are unnecessary.

Transfer pricing adjustments in respect of loans and derivatives are already given effect by sections 446 and 693 of the Corporation Tax Act 2009 respectively. That includes a situation in which deductions are decreased. This point was considered and confirmed by the tax tribunal last year, in the case of Abbey National Treasury Services plc *v.* Her Majesty's Revenue and Customs. It is therefore right that the changes introduced by clause 45 do not refer directly to the transfer pricing rules but instead refer to sections 446 and 693, which apply them to loans and derivatives. To be clear, the exclusion of credits as a result of paragraphs 3 and 4 of schedule 7 applies to cases where deductions have been reduced as a result of the transfer pricing rules operating through sections 446 and 693 respectively. The rules therefore work as currently drafted.

The amendments could give rise to problems. In particular, they could have the effect of the exclusions applying more widely than intended. In addition, the amendments would go against the decision in the Abbey National case. For those reasons, it is important that the limitations link through sections 446 and 693.

Schedule 7 addresses three situations in which the interaction of accounting and tax rules may lead to unintended and unfair outcomes. It supports the Government's policy of simplifying taxation by giving certainty to the rules and making them easier to comply with, and I therefore invite the hon. Gentleman to withdraw the amendment. I am grateful for the opportunity to provide some clarity to the Committee on the technical concerns that have been expressed. I hope that clause 45 and schedule 7 will stand part of the Bill.

Rob Marris: I had forgotten about the legal case to which the Minister referred. I will not press either of my amendments.

Question put and agreed to.

Clause 45 accordingly ordered to stand part of the Bill.

Schedule 7 agreed to.

Clauses 46 to 49 ordered to stand part of the Bill.

Rob Marris: On a point of order, Mr Howarth. I want to put on record my thanks to the Chartered Institute of Taxation, the Association of Tax Technicians, members of the Committee and my researcher, Imogen Watson. I thank the Minister for the patience he has shown and the excellent support and help he has given me. I thank you, Mr Howarth, and Sir Roger Gale, because I am resigning as the shadow Financial Secretary to the Treasury forthwith, and I will not be before this Committee unless there is a change of leadership in the Labour party.

The Chair: I am grateful to the hon. Gentleman. He has effectively taken himself out of the Committee. Strictly speaking, it is not a point of order, but the Committee is grateful for the information he has given, because obviously it will affect the future conduct of the Committee.

Mr Gauke *rose—*

The Chair: Strictly speaking, that was not a point of order and there should not even be a "Further to that point of order", but in these exceptional circumstances I will stretch the point.

Mr Gauke: Further to that non-point of order, Mr Howarth. I want to put on the record my thanks to the hon. Member for Wolverhampton South West. He has performed his role with great diligence, good humour and common sense. He has performed the role extremely well in sometimes difficult circumstances. Whatever the future holds for his party, I wish him well. I am sure he will continue to be an excellent and dedicated Member of Parliament.

The Chair: On behalf of Sir Roger Gale and myself and the Officers of the House, I thank the hon. Member for Wolverhampton South West for his kind words.

The Lord Commissioner of Her Majesty's Treasury (Mel Stride): May I also associate myself with the generous comments that have been made?

Ordered, That further consideration be now adjourned. —*(Mel Stride.)*

3.24 pm

Adjourned till Tuesday 5 July at twenty-five minutes past Nine o'clock.