PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCE (NO. 2) BILL

(Except clause 8; clause 33 and schedule 9; clauses 40 and 41 and schedule 11; new clauses or new schedules relating to the income tax treatment of armed forces' accomodation allowances, the bank levy, stamp duty land tax, the effect of the Bill on equality, or the effect of the Bill on tax avoidance or evasion)

Second Sitting

Tuesday 9 January 2018

(Afternoon)

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PBC (Bill 134) 2017 - 2019

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not later than

Saturday 13 January 2018

The Committee consisted of the following Members:

Chairs: † Sir Roger Gale, Albert Owen

† Blackman, Kirsty *(Aberdeen North)* (SNP)
† Burghart, Alex *(Brentwood and Ongar)* (Con)
† Carden, Dan *(Liverpool, Walton)* (Lab)
† Chalk, Alex *(Cheltenham)* (Con)
† Clarke, Mr Simon *(Middlesbrough South and East Cleveland)* (Con)
† Dodds, Anneliese *(Oxford East)* (Lab/Co-op)
† Dowd, Peter *(Bootle)* (Lab)
† George, Ruth *(High Peak)* (Lab)
† Graham, Luke *(Ochil and South Perthshire)* (Con)
† Kerr, Stephen *(Stirling)* (Con)
† Lee, Ms Karen *(Lincoln)* (Lab)
† Maclean, Rachel *(Redditch)* (Con)
† Philp, Chris *(Croydon South)* (Con)
† Pidcock, Laura *(North West Durham)* (Lab)
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Stride, Mel *(Financial Secretary to the Treasury)*
† Stuart, Graham *(Beverley and Holderness)* (Con)
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Whately, Helen *(Faversham and Mid Kent)* (Con)

Colin Lee, Jyoti Chandola, Gail Bartlett, *Committee Clerks*

† attended the Committee

Public Bill Committee

Tuesday 9 January 2018

(Afternoon)

[SIR ROGER GALE *in the Chair*]

Finance (No. 2) Bill

(Except clause 8; clause 33 and schedule 9; clauses 40 and 41 and schedule 11; new clauses or new schedules relating to the income tax treatment of armed forces' accommodation allowances, the bank levy, stamp duty land tax, the effect of the Bill on equality, or the effect of the Bill on tax avoidance or evasion)

Clause 13

PENSION SCHEMES

2 pm

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

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

Amendment 39, in schedule 3, page 65, line 28, at end insert

"or

(j) the pension scheme is a Master Trust scheme which has not complied with the relevant requirements of section 159E(2)."

This amendment paves the way for Amendment 41.

Amendment 40, in schedule 3, page 65, line 37, at end insert

"or

(i) the pension scheme is a Master Trust scheme which has not complied with the relevant requirements of section 159E(3)."

This amendment paves the way for Amendment 41.

Amendment 41, in schedule 3, page 65, line 37, at end insert—

'(4A) After section 159D, insert—

Additional registration requirements for Master Trust schemes

159E Additional registration requirements for Master Trust schemes

(1) This section establishes additional registration requirements for Master Trust schemes.

(2) In respect of any such scheme, an investment strategy must be presented to the Commissioners prior to registration.

(3) In respect of any such scheme, and in respect of each year of registration, an annual report must be published on administration, fund management costs and transaction costs for each asset class and for active and passive asset management strategies.'

This amendment requires additional information to be provided on investment strategies and costs for Master Trust schemes prior to and in each year of registration with HMRC.

Amendment 42, in schedule 3, page 67, line 14, after "153(5)(i)", insert "and (j)".

This amendment is consequential on Amendment 41.

Amendment 43, in schedule 3, page 67, line 16, after "158(1)(h)", insert "and (i)"

This amendment is consequential on Amendment 41.

Amendment 44, in schedule 3, page 67, line 17, at end insert—

'(ba) sub-paragraph (4A);'.

This amendment is consequential on Amendment 41.

That schedule 3 be the Third schedule to the Bill.

The Financial Secretary to the Treasury (Mel Stride): May I start by saying what a pleasure it is once again to serve under your chairmanship, Sir Roger? Clause 13 makes changes to extend Her Majesty's Revenue and Customs' powers to refuse to register and deregister pension schemes. The changes will enable HMRC to restrict tax registration to those pension schemes providing legitimate pension benefits and support the Pensions Regulator in its new authorisation and supervision regime for master trust schemes. The measure supports the Government's objective of fairness in the tax system by maintaining the integrity of pensions tax relief.

Over the past few years, there have been growing threats to individuals' pension savings, and they come in many forms. Many start with the setting up of a scheme, into which individuals are persuaded to pay their hard-earned savings, with a promise of various benefits. Sometimes these apparent pension schemes are no more than a scam, designed to extract money from unsuspecting individuals who end up with little or no retirement savings as a consequence. The Government are committed to tackling that threat, to ensure that individuals who save in a pension scheme have those funds available to them when they retire.

A master trust scheme is an occupational pension scheme for multiple employers, and clause 13 will extend HMRC's powers to refuse to register and to deregister master trust pension schemes that are not authorised under the Pensions Regulator's new authorisation and supervision regime. Aligning HMRC's registration and the Pensions Regulator's authorisation processes for master trust schemes will provide more effective protection for individuals.

The proposed amendments to schedule 3 would require pension schemes to provide additional information about the investment strategy of the scheme before HMRC decides to register the scheme and require the scheme to publish an annual report of costs in connection with the investments of the scheme to maintain its registration. The Government agree that transparency is integral to good governance and delivering improved member outcomes. However, the amendments would add little and largely duplicate existing requirements. The additional information required would not help HMRC to perform its role in collecting tax and ensuring that pension schemes are adhering to the tax rules. It would duplicate existing requirements by other regulatory bodies and add burdens and costs to pension schemes.

The amendments also propose that an annual report of costs in connection with the investments of the scheme be published. The Government consulted last year on legislation requiring transaction costs and other charges to be published for every investment option offered by defined contribution schemes, not just master trust schemes, and given to members. We plan to bring regulations for that into force in April this year.

The clause will ensure that HMRC can prevent scam pension schemes from being established and that it has the powers to take action where an existing scheme is discovered. That enables HMRC to protect people who have saved money for their retirement from the threat of pension scams. It supports the Government's efforts to tackle abuse across the tax system, and I therefore commend the clause to the Committee.

Peter Dowd (Bootle) (Lab): It is a pleasure to see you in the Chair, Sir Roger. The Minister referred to scams. To some extent, I am glad that he used the word "scam", because I suspect that if I had used it, people would have said it was Labour again attacking companies, pension companies and investments. It is not the word I would have used, but I understand the point he makes, and it goes to the heart of what we want to discuss today, which is transparency.

Amendment 41 seeks to improve the transparency of master trust pension schemes, to ensure that they are at the forefront of changes taking place across the defined contribution sector. There is an argument to say that one cannot be transparent enough in these sorts of situations. We have had all sorts of institutional dodginess—let us put it no stronger than that—in the past, and whether through endowment schemes, personal protection plans, or the stuff now going on with leaseholds and property, people's faith in some institutions is, I suspect, being challenged a little. That is why we want to push the envelope, so to speak.

The changes proposed in the amendment are twofold: first, it would ensure that a clear and coherent investment strategy is presented to HMRC before registration, which would go beyond the Government's proposal; secondly, a clear annual report on the costs and charges being applied to saver pots must be presented to the trustees and, we hope, be made available to savers. We think that that will modernise the approach towards the fiduciary management of savers' assets, updating the statement of investment principles approach that is currently required by master trusts. It will also bring master trusts in line with wider Government policy on reporting costs and charges—we are finally beginning to see some progress on that, following many years of campaigning by various bodies and organisations, as well as by many Members on both sides of the Committee and by other organisations.

Subsection (2) of amendment 41 requires a master trust to include an investment strategy in its application for registration to HMRC. Until now, every occupational pension scheme has been legally required to prepare and maintain a statement of investment principles, and that is expected to cover the trustees' plans for securing compliance with their statutory duties, and their policies on investments, risks, returns and how they will exercise their voting rights. The amendment would ensure that such practice is embedded in the master trust sector, and enhanced to encourage trustees to strategically consider—a split infinitive there—factors that they believe will influence the financial performance of their investments, as well as, importantly, looking more closely at socially responsible investment.

We know that companies with strong environmental and social governance credentials have better long-term performance—that goes without saying. A company that is committed to environmental sustainability, and which cares about its staff and is well run and managed should, in the long term, always profit over a company that does none of those things. We have only to look at the Sports Direct share price over the past two years, or at Volkswagen following the 2015 emissions scandal. People react to what they perceive as non-environmentally friendly, or non-socially friendly approaches to their staff or product. Of course, Her Majesty's Revenue and Customs has an interest in ensuring that the schemes that register with it for taxation purposes have a clear and transparent strategy for guaranteeing pension scheme members a secure retirement. That is a big responsibility for HMRC, and we should support it with the appropriate resources.

As long as pension funds can show that any investment or policy decision was made on a fiduciary basis and consulted on with members, they can avoid the charge that they have not considered their members' best interests. The amendment will help HMRC to feel confident that the scheme being registered is legitimate, and it will also have secondary effects. Public opinion tends to position the average citizen as a helpless bystander in this drama, when in fact public money underpins the entire system. Anyone with a pension is indirectly an owner of Britain's biggest companies, and the amendment envisions a world in which people feel that their savings give them a positive stake in the economy, and a voice in how the companies that they invest in are run.

The rise of private pension savings has led to a democratisation of company ownership, but when it comes to control of ownership rights the reverse is true. Power has become increasingly concentrated in the hands of a relatively small number of opaque and unaccountable financial institutions. As the Kay report showed, these institutions often face systematic pressures to act in ways that may not serve savers' best interests. Direct accountability to savers is therefore a vital component of a healthy economic and financial system. As millions of savers have entered the capital markets through pension auto-enrolment, now is the right time, in our opinion, to build a more accountable system. We are talking 10, 20, 30 or 40 years ahead—let us start now.

In June 2011 the Government invited Professor John Kay to conduct a review into equity markets and long-term decision making. As I recall, the final report was published in July 2012. His review considered how well equity markets were achieving their core purposes: to enhance the performance of UK companies and to enable savers to benefit from the activity of these businesses through returns to direct and indirect ownership of shares in UK companies. The review identified the fact that short-termism is a problem in UK equity markets. Professor Kay also recommended that company directors, asset managers and asset holders adopt measures to promote both stewardship and long-term decision making. In particular, he stressed:

> "Asset managers can contribute more to the performance of British business (and in consequence to overall returns to their savers) through greater involvement with the companies in which they invest."

He concluded that adopting such responsible investment practices would prove beneficial for investors and markets alike. When it is put in those simple terms, who could argue? It seems to me axiomatic.

In practice, responsible investment could involve making investment decisions based on the long term, as well as playing an active role in corporate governance by exercising shareholder voting rights. Master trusts will want to consider the Kay review's findings when developing

[Peter Dowd]

their proposals, including what governance procedures and mechanisms would be needed to facilitate long-term responsible investing and stewardship through the funds they choose for members to save in.

The UK stewardship code, published by the Financial Reporting Council, has seven principles and also provides master trusts with guidance on good practice when monitoring and engaging with the companies in which they invest. Amendment 41 seeks to make sure that the trustees are cognisant of these issues, and we hope that where possible they will engage with their scheme members during the decision-making process.

In recent decades, efforts to improve the way in which companies are run have focused heavily on making directors more accountable to their shareholders—for example, the recent introduction of a binding say on pay—but this job is only half done. Ownership rights are exercised largely by institutions that are themselves intermediaries and accountability to the underlying savers who provide the capital remains weak. The logical next step must be for institutional investors to extend the same accountability that they expect from companies to the savers whom they represent. Indeed, such accountability is essential to the success of recent measures to encourage more engaged and responsible shareowners.

The UK stewardship code was introduced in the aftermath of the financial crisis to address concerns that shareholders were behaving as—I think this was the quote—"absentee landlords". Rather than being enforced by regulators, it is a voluntary code that relies on scrutiny from below to promote compliance, mirroring the corporate governance code for companies. Yet while shareholders are given extensive rights to hold companies to account for their governance practices, savers are not equipped to play the same role in relation to institutional investors. The investment regulations currently require master trusts to set up, within the statement of investment principles, the extent to which social, environmental or corporate governance considerations are taken into account in the selection, retention and realisation of investments, and these policies should be developed in the context of consultation with the scheme members and should enhance the engagement with them over these crucial issues.

Ruth George (High Peak) (Lab): Does my hon. Friend agree that this helps to encourage workers to engage with pension investment, in particular those on low pay for whom auto-enrolment and pension contributions can require a substantial portion of the earnings that they have left over after essential bills? Before coming here, I was engaged in setting up a pension scheme for low-paid nursery workers. It was important to them that they could see how their money was being invested, because they did not have very much of it. The more transparency we have, the more it will encourage such low-paid workers to feel secure that their money is safe and to make the investments that they need to make for their retirement.

2.15 pm

Peter Dowd: My hon. Friend makes an important point. We want to move away from the passivity and disempowerment that people in that situation feel and towards their having the confidence to engage, if they so choose. We have to ensure that the mechanisms are there for them to choose. It is a little bit like democracy at the end of the day: we have elections, and if someone does not want to participate in them, that is a matter for them, but at least we have them. People are given the capacity to participate, which is no different, in principle, from the point my hon. Friend was making.

As well as better protecting savers' long-term financial interests, this will be good news for those who believe that part of the current system of capitalism has lost a little bit of its moral compass in certain situations; I alluded to that a little earlier with some of the scams that the Minister referred to. It is a bit like this House, where we have to feel accountable to the people who send us here. Whatever the system is—politics, business or pensions—we have to feel accountable, and more importantly, we have to be accountable.

In addition, savers who feel connected to their money are more likely to see it as a medium for the expression of their values. That goes to the heart of what my hon. Friend touched on, and indeed to the point I made earlier about how transparency and accountability should matter to those whose only concern is making markets work more efficiently. It has to go beyond that. Efficient market theory presumes that consumers act in their own interests. However, in the capital markets, decisions are being made not by consumers but by intermediaries acting on their behalf, so there is a disconnect to some degree there as well.

Moreover, consumers themselves are deeply disconnected from their money, and the opt-out mechanism of pensions auto-enrolment is predicated on that fact. That means that intermediaries themselves are subject to limited market discipline. The pensions market may never be dominated by active and engaged consumers, which comes back to the point I made before, but the more consumers are active and engaged, the better the market will work. I do not think there is any question about that.

In addition, accountability should build trust in the system, even among those who choose not to engage, thus encouraging people to keep saving in effect. This is an important consideration in a market in which just 70% of retail investors trust investment firms to "do the right thing" and consumers cite lack of trust as the No. 1 reason for opting out of private pension saving, which is a real shame.

Ruth George: My hon. Friend makes excellent points that are absolutely true while auto-enrolment contributions are 1%, and will be even more true when they rise to 3% and then 5%. We are looking to individuals, often on low pay and often at quite an early stage in their working life, to contribute a substantial sum towards their pension, which is for a time they cannot see, so it is vital that these are transparent decisions for them.

Peter Dowd: My hon. Friend again makes an important point, and that arrow goes to the heart of things.

There are practical objections on the grounds that savers are not interested in, or capable of, engaging with their money, which simply perpetuates a vicious circle of disengagement. That is the passivity I talked about earlier—almost an institutional passivity on the part of savers. Savers may be put off by the language of investment, but that does not mean that they are not interested in where their money goes; they are.

Likewise, savers may lack understanding of the technicalities of investment, but there are many matters on which they are qualified to comment, including the way the scheme behaves as an owner of major companies, or its policies on social, environmental and governance issues. We see that to an extent, in an institutional way, in the Church of England, among other organisations; it puts those things at the heart of its approach. Savers should be allowed to do that as well. Indeed, emphasising the positive contribution that schemes are making to a better economy, through their exercise of ownership rights, could be a way to engage people with saving money more widely.

The onus must be on the master trusts and the wider investment sector to take the lead in developing a clear and engaging investment strategy. Making such a strategy a requirement of registration with HMRC will ensure that no master trust will slip through the net. The recent local government pension scheme regulations follow a similar path and require the administration authorities to create investment statement strategies. There is no reason why that good practice cannot be extended to defined contribution schemes.

I turn to the reporting of costs and charges—a subject that my hon. Friend the Member for High Peak touched on, and which is addressed in proposed new subsection (3) in amendment 41. For far too long, the pensions market has had a single glaring dysfunction: no one knows how much a pension pot costs. Members of this House would not go into a marketplace to buy anything without understanding the basic information relating to a product: its price, its essential properties, and the promises made about it. Strangely, this information, which is so fundamental to consumer choice and the operation of any market, remains largely absent in the pension market. Master trusts must establish what each investment choice costs and what their drawn-down product costs. Anything short of that is not helpful for millions of citizens.

We have a duty to ensure that a reporting line is open between a master trust, HMRC regarding a trust's tax affairs, and the trust's members on the costs they incur while saving for retirement. Again, Labour Members have campaigned for many years on this issue and it seems that the Government are beginning to catch up, not simply because of what we have been doing but also because of what Government Members and other organisations have been doing. We are not trying to claim all the credit; to some extent, this has been a team effort, right across the piece.

In the consultation on defined contribution pension schemes, under which master trusts operate, the Government requested evidence on how they might improve transparency in reporting information on the transaction costs and charges for members of workplace pension schemes. Amendment 41 would be a clear step forward, in line with the calls that we have been making alongside the industry, trustees, savers and Government Members, for transparency of costs and charges when it comes to pension savings. This issue affects us all.

I am afraid to say that the Government have seen fit to replace action with rhetoric here—a pattern that we see a little bit too often. However, I do not want to push that argument too much. We have to encourage and prod. The architecture to get the data, analyse it and present it is being discussed, with a view to its being built. It can be a platform from which other projects, including the value-for-money analysis needed for all workplace pensions, can be developed—and it can be delivered.

Amendment 41 helps to embed a process that is already under way, thanks in no small way to years of campaigning by many organisations and political parties. There is no reason why the Government should not take this opportunity to do something that is in line with their stated objectives. We must ensure that every person auto-enrolled into a master trust is given the opportunity to understand what pension system they are going into, how much it will cost and how much they will get. To do otherwise would be a clear breach of the fiduciary duty owed to scheme members.

The Financial Conduct Authority's asset management market review said that evidence suggests that

"there is weak price competition in a number of areas of the asset management industry",

which has a material impact on investors' returns through their payment for asset management services. One of the FCA's conclusions was that there should be a requirement for increased transparency, and standardisation of costs and charges information for institutional investors. That word "transparency" crops up time after time, for good reason.

The Government have agreed to implement the FCA's recommendations in full. We can enshrine that guarantee in the Bill. Quite frankly, it is a fundamental market failure that no pension fund can understand its cost basis. If one does not understand costs, the investment strategy set out in proposed subsection (2) of amendment 41 cannot be evaluated.

It is also a sensible proposition that a scheme's outgoings on costs and charges be evaluated during the process of tax registration by HMRC. The risk and responsibility will continue to rest with the pension saver; charges for ongoing administration and investment management will be deducted from their account—another reason why transparency and low charges are important.

If a scheme member loses money in retirement, it is extremely difficult—if not impossible—to get it back again, as their sources of income may be limited and a return to work might not be an option. Ultimately, members could run out of money. That has happened before with some of these schemes. The member is responsible for their decisions and the outcome the scheme generates. It is therefore essential that the member can see the cost of their pension pot. The efficient management of pension funds is critical to ensuring that we stave off a pensions crisis.

Dan Carden (Liverpool, Walton) (Lab): My hon. Friend is making an excellent contribution. Pensions are incredibly complex; I am sure that most of us would be happy to admit that we do not have any great understanding of their workings. When we speak to our constituents, we hear that this is about confidence. Many people choosing between taking money home and investing money for the future—we look at this money as deferred wages—do not have confidence in the system because it is not transparent. Anything that we can do, through the amendment, to make the Government act sooner and not engage in more consultations on what is a rather obvious solution, which is to open up the industry to scrutiny and to give greater understanding to our

[Dan Carden]

constituents of how their pensions are invested, is a good thing. We ask the Government to agree to this amendment, so that we can get there quicker.

Peter Dowd: My hon. Friend makes a very important point.

To draw to a conclusion, I reiterate the point that I was making when my hon. Friend intervened. The efficient management of funds is critical to ensuring that we stave off a pensions crisis that citizens will be forced to endure in their retirement if we are not careful. The Government will fail in their duty of care if we do not get cost reporting on to the statute book. Transparency—there is that word again—is now an objective of all parties across the House. In our view, the Government must back this amendment and replace a little bit of rhetoric with action to protect pension savers.

Mel Stride: The hon. Gentleman has set out a comprehensive set of reasons for supporting his amendment. He will be pleased to know that I wholeheartedly agree with many elements of what he shared with us. Both sides of the Committee agree on our enduring belief that we should ensure that sufficient transparency is available and that we should do all we can to protect the life savings—in many cases—of those who invest in any form of pension, let alone master trust schemes, some of which have fallen foul of the kind of issues that we have been debating.

Unfortunately, I cannot agree with all the hon. Gentleman's assertions. He spoke about the importance of transparency—I have said that I agree with that—but he also said that we cannot be transparent enough. That is an important maxim to operate by, but that cannot allow us to be led into a situation where we have overly burdensome additional costs as a consequence. That is the nub of our objection to his amendment.

The amendment would bring in a duplication of the regulatory body's function of reviewing investment plans at the time that schemes are set up. The kinds of issues that the hon. Gentleman wants to be addressed are being addressed; I would be happy to share that information with him at a future date. The Financial Conduct Authority is consulting at the moment; the consultation closes on the 12th of this month—a few short days away. We have regulations planned for April that will ensure that we look into these issues and move into the area of the publication of costs and the way these schemes are run.

Returning to the clause, I hope we are united in believing that HMRC should be given additional powers to refuse the registration of schemes where it feels that they are deficient, and to withdraw registration where that is appropriate. I ask the hon. Gentleman to consider not pressing his amendments, and commend clause 13 to the Committee.

2.30 pm

Peter Dowd: We have taken considerable time in outlining our proposal, which the Minister was gracious enough to say was comprehensive. The onus is on us to push the matter to the vote. We want to put down a marker. I am sure the Minister and his colleagues will appreciate that there are no traps here, or attempts to force the Government down paths that they do not want to go down; I suspect that they would in due course like to go down these paths. Like John the Baptist, we are laying out that path before them. *[Interruption.]* Yes, and look what happened to the guy who followed him. I will push the matter to a vote in due course, Sir Roger. I hope that the information I have provided will resonate with hon. Members.

Question put and agreed to.

Clause 13 accordingly ordered to stand part of the Bill.

Amendment proposed: 39, in schedule 3, page 65, line 28, at end insert

"or

(j) the pension scheme is a Master Trust scheme which has not complied with the relevant requirements of section 159E(2)."

This amendment paves the way for Amendment 41.—(Peter Dowd.)

Question put, That the amendment be made.

The Committee divided: Ayes 9, Noes 10.

Division No. 4]

AYES

Blackman, Kirsty
Carden, Dan
Dodds, Anneliese
Dowd, Peter
George, Ruth
Lee, Ms Karen
Pidcock, Laura
Smith, Jeff
Thewliss, Alison

NOES

Burghart, Alex
Chalk, Alex
Clarke, Mr Simon
Graham, Luke
Kerr, Stephen
Maclean, Rachel
Philp, Chris
Stride, rh Mel
Stuart, Graham
Whately, Helen

Question accordingly negatived.

Schedule 3 agreed to.

Clause 14

EIS, SEIS AND VCT RELIEFS: RISK TO CAPITAL

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

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

Clause 15 stand part.

Clause 16 stand part.

That schedule 4 be the Fourth schedule to the Bill.

Clause 17 stand part.

Government amendment 1.

That schedule 5 be the Fifth schedule to the Bill.

New clause 6—*Review of risk to capital changes*—

'(1) Within fifteen months after the first exercise of the power to make regulations under section 14(4), the Chancellor of the Exchequer must review the effects of the changes made by section 14.

(2) The review under this section must consider—

(a) the revenue effects of the changes, and

(b) the effects on the long-term growth and development of companies.

(3) The Chancellor of the Exchequer must lay before the House of Commons the report of the review under this section as soon as practicable after its completion.'

This new clause provides for a post-implementation review of the changes in Clause 14.

New clause 7—*Review of changes to EIS and VCT reliefs for knowledge-intensive companies*—

'(1) Within fifteen months after the first exercise of the power to make regulations under paragraph 10 of Schedule 4, the Chancellor of the Exchequer must review the effects of the changes made by that Schedule.

(2) The review under this section must consider—

(a) the revenue effects of the changes, and

(b) the effects on the policy objective to facilitate and encourage additional investment in innovative companies developing and exploiting new technologies.

(3) The Chancellor of the Exchequer must lay before the House of Commons the report of the review under this section as soon as practicable after its completion.'

This new clause provides for a post-implementation review of the changes in Schedule 4.

New clause 8—*EIS, SEIS, SI and VCT reliefs: review of operation*—

'(1) Within twelve months after the passing of this Act, the Chancellor of the Exchequer must review the operation of the reliefs established under Parts 5, 5A, 5B and 6 of ITA 2007.

(2) The review under this section must consider—

(a) the revenue effects of the reliefs and changes made to those reliefs since the passing of the Finance Act 2012,

(b) the employment effects of the reliefs and those changes,

(c) other economic effects of the reliefs and those changes, and

(d) the extent to which trusts or other entities have been created to secure benefits from the reliefs and those changes without providing wider employment or economic benefits.

(3) The Chancellor of the Exchequer must lay before the House of Commons the report of the review under this section as soon as practicable after its completion.'

This new clause provides for a review of the operation of the enterprise investment scheme, the seed enterprise investment scheme, income tax relief for social investments and venture capital trusts income tax relief.

Mel Stride: Clauses 14 to 17 and schedules 4 and 5 make changes to the tax-advantaged venture capital schemes as part of the Government's response to the patient capital review. They also correct minor technical flaws in the legislation, to ensure that the legislation works as intended. The changes aim to drive more than £7 billion in new and redirected investment into high-growth companies over the next 10 years.

Responses to the patient capital review consultation pointed to the continuing importance of these schemes in incentivising investment in early-stage companies that would otherwise struggle to receive investment to help them grow and develop. However, evidence provided during the consultation, backed up by Sir Damon Buffini's industry panel, suggested that knowledge-intensive companies, which are particularly research and development-intensive, still struggle with some of the most acute funding gaps, despite their growth potential. This is because they often require a large amount of capital up front to fund their growth, and it can be many years before their products can be brought to market. Evidence provided through the consultation also highlighted a large subset of low-risk capital preservation investments structured around the tax reliefs. One response showed that £467 million of funds raised by enterprise investment scheme funds in 2016-17 were aimed at schemes that could be described as capital preservation.

Clause 14 introduces a new "risk to capital" condition for the enterprise investment scheme, the seed enterprise investment scheme and venture capital trusts, in response to evidence of continuing capital preservation investments using the venture capital schemes. The condition takes a principles-based approach to deny tax relief to these investments. Investments will be excluded where it is reasonable to conclude that the company does not have the objective of growing and developing its trade in the long term and there is no significant risk that any loss of capital will be greater than the net return on the investment. The measure would take effect from Royal Assent.

Clause 15 makes technical changes to ensure that the rules on determining the amount of funding a company may receive in its lifetime, under the EIS, VCTs or social investment tax relief, work as intended. The clause ends certain transitional provisions introduced in 2007 and 2012, which excluded certain investments from counting towards the lifetime limit, and ensures all risk finance investments are counted towards the lifetime funding limits for the EIS, VCT and SITR schemes. This will apply to new investments on or after 1 December 2017.

Clause 16 and schedule 4 make three changes in response to the patient capital review. The changes will significantly expand the support offered to knowledge-intensive companies through the EIS and VCTs. The annual limit on how much an investor can invest through the enterprise investment scheme will be raised from £1 million to £2 million. Any investment over £1 million must be invested in knowledge-intensive companies.

Knowledge-intensive companies often need large funding rounds as they are highly capital-intensive. With this in mind, we are doubling the annual investment limit for knowledge-intensive companies using the EIS and VCT schemes to £10 million. Under the current EIS and VCT rules, knowledge-intensive companies must be broadly under 10 years of age when receiving their first qualifying investment. The clock starts when the company makes its first commercial sale. Knowledge-intensive companies sometimes find this point difficult to identify. Clause 16 introduces flexibility to this rule by allowing knowledge-intensive companies to choose to start the clock at the point they reach an annual turnover of £200,000.

Before I turn to Government amendment 1 to schedule 5, I will give some background, if I may, to introduce clause 17 and the schedule. Clause 17 and schedule 5 make changes to the VCT rules. Schedule 5 corrects a technical flaw and changes some of the rules to encourage VCTs to invest more of their funds in qualifying growth companies and to invest those funds more quickly. Government amendment 1 introduces new rules on qualifying loans to encourage VCTs to make longer-term investments in higher-risk companies. Some VCTs have used loan structures as a method of capital preservation, charging prohibitively high interest rates and including other conditions in the terms of the loan. The effect is to secure a return of capital well before the end of the five-year minimum period. Amendment 1 is intended to prevent the use of low-risk loans to minimise risk to the VCT and to its investors, including where the terms

[Mel Stride]

involve very high interest rates, redemption premiums and other charges. I commend Government amendment 1 to the Committee.

I turn to the rest of the provisions in schedule 5. The schedule corrects a flaw in an anti-abuse rule introduced in 2014 to prevent investors from being punished for mergers they did not know were about to occur. The changes will apply retrospectively, from the introduction of the anti-abuse rules in April 2014. The proportion of VCT funds that must be invested in qualifying companies will be raised from 70% to 80%. This will ensure that a greater proportion of VCT funds reaches the target companies. Once a VCT realises a gain by disposing of an investment, it must reinvest that gain within six months. Many VCTs currently pay out the proceeds as a dividend instead. To encourage more reinvestment by VCTs, schedule 5 raises the reinvestment period to 12 months. These last two changes take effect from April 2019 to allow VCTs time to adjust their investment portfolio.

VCTs currently have up to three years to invest funds after those funds are raised. A new rule will require them to invest at least 30% of funds in qualifying companies within one year of the end of the accounting period in which they were raised. This will accelerate investment of money raised from investors and will apply to funds raised from 6 April 2018.

Many previous changes to the VCT rules have been grandfathered. This means new investments can still be made under the old rules that applied when the money was originally raised. These transitional provisions enable some VCTs and their investors to access a range of generous tax reliefs on low-risk investments. The schedule will ensure that all VCT investments meet the current rules, regardless of when the original money was secured. These changes will take effect for investments from 6 April 2018.

New clauses 6 to 8 call for reviews into some of the changes made in this legislation, as well as a review of the efficacy of the venture capital schemes as a whole, but the changes made in the legislation are the result of a thorough review of all the venture capital schemes as part of the patient capital review. The review concluded that the schemes did vital work in providing capital for high-growth companies but that certain changes would make the schemes more effective and fairer for the taxpayer. Because we are committed to making the schemes work better, the Government have already committed to a report on the changes. An initial report to the Chancellor of the Exchequer for Budget 2018 will set out how the different measures in the Government response are being implemented. Then, in autumn 2020, a report will assess the impact of the policies set out in the Government response, including the clauses in this Finance Bill.

A review of this condition any earlier than 2020 would not be able to make any reasonable assessment of the effect of the changes on the scheme. It would be working from a single year's data on the impact on Government revenue and would be unable to assess the impact on the long-term growth and development of businesses. In the meantime, HMRC publishes statistics on the use of venture capital schemes every year. The information includes details of amounts invested and company activities. The first figures reflecting the effect of the new changes for the tax year 2018-19 will be available in April 2020. These will be closely monitored. I therefore urge the Committee to reject the new clauses.

Sir Roger, these changes significantly expand the venture capital scheme's innovative, knowledge-intensive companies while reducing the scope for low-risk investment within them. They will drive more than £7 billion of investment towards high-growth companies over the next 10 years and ensure the smooth operation of these important schemes. I therefore commend clauses 14 to 17 and schedules 4 and 5 to the Committee.

Peter Dowd: I will speak to our amendments to schedule 4, which also affect clauses 14, 15, 16 and 17.

May I start by telling the hon. Member for Middlesbrough South and East Cleveland, who was slightly confused as to which way he should vote, I am not sure whether if I had a spoken a little less he might have come our way, or perhaps he would have done so if I had spoken a little longer. We will never know, alas.

Clause 14 seeks to amend the requirements for investment to qualify for relief under the enterprise investment scheme, seed enterprise investment scheme or the venture capital trust scheme. As indicated, it also introduces an overarching risk-to-capital condition to deter investment companies whose activities are mostly geared towards protecting capital through minimising risk rather than supporting long-term growth and development of UK enterprise. It is important to start with that proposition.

Clause 14 also introduces a new principle-based risk-to-capital test that would change the current regime in which HMRC provides assurances for investments in advance. In the not too distant future, I am also going to introduce the T word—the transparency factor—I am giving notice of that.

Under this measure, HMRC would no longer provide advance assurance for investments that would appear not to meet the terms of the new rule. The Treasury has stated that if the new test proves effective in simplifying the conditions, this approach may be used to simplify further aspects of venture capital schemes legislation. It is clear that the current legislation is a maze of complexity that makes it difficult for businesses and advisers to establish that qualifying conditions are met with certainty, and also for HMRC to ensure that the reliefs are being used correctly and are not subject to abuse.

2.45 pm

The current complexity creates a scenario whereby cash-strapped start-up companies have to use their limited funds to purchase professional advice on how to access the relief. The Chartered Institute of Taxation, for example, has argued that this creates a conundrum, where ultimately the success of the start-up and its ability to access these funds is simply down to whether it can afford professional advice.

The new principle-based risk-to-capital test will mean that start-up companies are largely dependent on the guidance issued directly by HMRC on its website. This guidance will be wholly dependent on whether HMRC decides to update the website. It may also be contingent on the fact that HMRC has seen funding and staffing levels cut consistently in the past few years. I have referred to my own constituency as a victim of that practice. I think those cuts will continue. This is why the advance assurance service currently in use is under pressure and it appears that the Treasury is seeking to pursue a cheaper option that will ultimately require fewer staff and, importantly, result in a lower-quality service.

The very people the relief is intended to help struggle to access it. The changes outlined will only make it harder. In my experience, and I suspect the experience of many members of the Committee, very few start-ups can afford the expensive and technical financial advice that will be needed to access this cash. Therefore, it is more likely to be taken up by companies that are established and may be in less need of the relief.

That poses a particular concern for tax accountants who will have to interpret the guidance on the HMRC website and make a judgment call as to whether the client is entitled to the relief. The withdrawal of the advance assurance service in relation to the new test has the potential to undermine certainty and practicability for these tax advisers, unless there is detailed guidance from HMRC that provides real-life examples. There appears to be a lack of confidence among professional bodies representing tax accountants on the reliability of HMRC in issuing this guidance. There is a fear that investors and accountants could contravene the conditions for the relief and have to pay expensive penalties.

Those conditions lead to the wider question that underpins new clauses 7 and 8 on the operation of the reliefs. As we were told by the Chancellor in the Budget, the UK's public finances are in a precarious place. Our finances are so limited that we must expect a further decade of belt tightening and more cuts to public services. With that economic background in mind—low growth, all the stuff we have discussed before, and so on—it is only right for the Opposition to ask the Government to provide a review of the operation of these reliefs and their effectiveness against the stated aims.

The Minister talks about 12 or 19 months not being an appropriate period of time. The problem with that is that if we had said two, three or four years, I suspect the Government would still have declined our generous offer for a review, but there we are. The Minister may not have the figures to hand—he often does, I must say—but I would like to try to establish how many individuals have benefited from the EIS, SEIS, SI and VCT reliefs since their introduction; the value of these reliefs in terms of the tax breaks given; and in what sectors these reliefs have been made, as well as any economic assessment of their impact on the economy. To be fair, I think the Minister touched on some figures.

New clause 8 raises those questions, which go to a deeper question of tax transparency for the Government. The Government have been handing out millions of pounds each year in tax breaks and what has become known as corporate welfare to private companies, wealth corporations and wealthy investors who operate in the UK economy yet refuse to publish a clear list of where that money has gone, to whom it has been given and its direct impact on the economy. That is particularly important, given the fact that some of these investors will take their profits and put them offshore. It is a strange set of circumstances where the ordinary taxpayer is held to a higher level of transparency through the disclosure of huge amounts of detail to HMRC than wealthy investors who are able to gain large tax reliefs through investing in venture capital trusts.

New clause 7 seeks a review of changes to EIS and VCT reliefs for knowledge-intensive companies. That review would require the Minister to report to Parliament on whether those tax reliefs have been effective in encouraging more investment in innovative companies that exploit new technologies which have ultimate benefit for the UK economy—and, importantly, for UK taxpayers and workers. As the Opposition made clear in our response to the Budget, we do not believe that these measures alone represent anything near the level of investment we are going to need if we are to revitalise the economy, and trickle-down economics is not working. The Government have argued that tax cuts and tax reliefs will somehow generate growth and wealth for all; yet living standards continue to fall. Some 7.4 million people in working households live in poverty; they work harder and longer, on lower wages, and have little money of their own to invest, yet they will not receive such a generous tax break from the Government. It is imperative that their tax money is used responsibly and that there is transparency over who benefits from these reliefs and what effect, if any, they have on the wider economy and the ordinary person's daily life.

Mel Stride: Briefly, the hon. Gentleman raised a few points, including one being about HMRC and its effectiveness, particularly in advance assurances. As we know, advance assurances are a service provided on a non-statutory basis by HMRC, where a company can be given assurance on proposed investments that qualify for relief, unless the circumstances of the investment or, indeed, the law were to change. Here, assurance is being provided for investments that have not yet occurred. Clearly, HMRC cannot provide assurances for investments which, by the time they are made, may not meet a new condition that is going through Parliament. That has been a situation recently. HMRC has published a response to its advance assurance consultation, which sets out the steps it is taking with the aim of dealing with the vast majority of cases in 15 working days by this spring. That includes taking the action that we have been discussing on capital preservation.

In terms of reviews, assessments and the new clauses that are proposed, I come back to my earlier points that this whole set of changes that we are looking at around VCTs, EIS and so on, have come out of an extensive period of consultation led by Sir Damon as part of the patient capital review, in which the very questions that the hon. Member for Bootle was rightly asking in his speech were asked and consulted on in great detail. As I said earlier, there will be a report to the Chancellor on the implementation of these measures. That will happen in the Budget this year, in 2018. By autumn 2020, we will have the assessment report on the policies, including the measures that are covered in the Bill. For those reasons, I urge the Committee to reject the new clauses, and I commend clauses 14 to 17 and Government amendment 1.

Question put and agreed to.

Clause 14 accordingly ordered to stand part of the Bill.

Clauses 15 and 16 ordered to stand part of the Bill.

Schedule 4 agreed to.

Clause 17 ordered to stand part of the Bill.

Schedule 5

Venture capital trusts: further amendments

Amendment made: 1, in schedule 5, page 75, line 36, at end insert—

"Non-qualifying loans

6A (1) Section 285 of ITA 2007 (interpretation of Chapter 3 etc of Part 6) is amended as follows.

(2) In subsection (2)—

(a) omit "(whether secured or not)";

(b) at the end of paragraph (b) insert ", or

(c) any liability of the company in respect of a loan to which subsection (2A) applies that has been made to the company."

(3) After that subsection insert—

"(2A) This subsection applies to a loan if—

(a) the return on the loan represents more than a commercial rate of return, or

(b) the loan is made on terms which grant to a person or allow a person to acquire—

(i) any security or preferential rights in relation to assets of the company, or

(ii) the ability to control the company.

In sub-paragraph (ii) "control" has the meaning given by sections 450 and 451 of CTA 2010.

(2B) The return on a loan is not to be treated as representing more than a commercial rate for the purposes of subsection (2A)(a) if—

(a) the return on the loan during the period of 5 years from the making of the loan does not exceed 50% of the amount lent, and

(b) the total return on the loan does not exceed—

where—

N is the number of years (including any fraction) in the term of the loan;

A is the amount lent or, in a case where some of the loan is repaid during the term of the loan, the average amount outstanding during that term.

(2C) The Treasury may by regulations substitute a different figure for a figure that is at any time specified in subsection (2B)(a) or (b).

(2D) In subsections (2A)(a) and (2B) "return" means interest, fees, charges and other amounts payable in respect of the loan.

(2E) Where it is to any extent not known, before the end of the term of a loan, what amounts will be payable in respect of the loan—

(a) subsections (2A)(a) and (2B) apply, until the relevant matters are ascertained, on the basis of what amounts can reasonably be expected to be payable;

(b) when those matters are ascertained, any necessary adjustments must be made by making or amending assessments or by repayment or discharge of tax (regardless of any limitation on the time within which assessments or amendments may be made).""—*(Mel Stride.)*

Schedule 5, as amended, agreed to.

Ordered, That further consideration be now adjourned.—*(Graham Stuart.)*

2.54 pm

Adjourned till Thursday 11 January at half-past Eleven o'clock.

Written evidence reported to the House

FB01 Association of Accounting Technicians

FB02 LEVC

FB03 Institute of Chartered Accountants in England and Wales (clause 10)

FB04 Institute of Chartered Accountants in England and Wales (clauses 11 and 12 and schedules 1 and 2)

FB05 Institute of Chartered Accountants in England and Wales (clause 23 and schedule 7)

FB06 Institute of Chartered Accountants in England and Wales (clause 35 and schedule 10)

FB07 Institute of Chartered Accountants in England and Wales (clause 38)

FB08 Association of Taxation Technicians (clause 14)

FB09 Low Incomes Tax Reform Group (clause 6)

FB10 This person wishes to remain anonymous

FB11 This person wishes to remain anonymous

FB12 Peter Lamberti

FB13 Chartered Institute of Taxation (clauses 7 to 17)

FB14 The Association of Member Nominated Trustees

FB15 Chartered Institute of Taxation (clause 18)

FB16 Chartered Institute of Taxation (clause 38)

FB17 Institute of Chartered Accountants in England and Wales (clause 18 and schedule 6)

FB18 Chartered Institute of Taxation (clauses 19 to 32 and related schedules)

FB19 This person wishes to remain anonymous