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)

Third Sitting

Thursday 11 January 2018

(Morning)

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Monday 15 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)
† Rutley, David *(Lord Commissioner of Her Majesty's Treasury)*
† Smith, Jeff *(Manchester, Withington)* (Lab)
† Stride, Mel *(Financial Secretary to the Treasury)*
† Thewliss, Alison *(Glasgow Central)* (SNP)
† Whately, Helen *(Faversham and Mid Kent)* (Con)

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

† attended the Committee

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(Morning)

[ALBERT OWEN *in the Chair*]

Finance (No. 2) Bill

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Clause 18

PARTNERSHIPS

11.30 am

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

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

Amendment 50, in schedule 6, page 88, line 32, at end insert—

"PART 6

RETURNS: PAYMENT ON ACCOUNT

16 (1) TMA 1970 is amended as follows.

(2) After section 12AC (notice of enquiry), insert—

"12AD Review of proposal for power to require payment on account

(1) Within one month of the passing of the Finance Act 2018 the Chancellor of the Exchequer must commission a review into the effects of introducing a power to allow HMRC to require payment on account for returns where an enquiry has been given under section 12AC(1) in respect of a return.

(2) The review under this section must consider—

(a) the administrative implications for HMRC,

(b) the impact on the taxation regime for partnerships, and

(c) the potential revenue effects of the change.

(3) The Chancellor of the Exchequer must lay the report of this review before the House of Commons within six months of the passing of the Finance Act 2018.""

This amendment requires the Chancellor of the Exchequer to review the effects of introducing a power to require partnerships to make a payment on account in respect of a return when there has previously been a notice of an enquiry in connection with a return.

That schedule 6 be the Sixth schedule to the Bill.

The Financial Secretary to the Treasury (Mel Stride): A very good morning to you, Mr Owen. Once again, it is a pleasure to serve under your chairmanship. It is a great pleasure to be again in the company of the Opposition Front Benchers. On Monday we debated the customs Bill; on Tuesday we had the Finance (No. 2) Bill Committee here; on Wednesday we debated a statutory instrument, which was quite interesting; today we have the Bill again; and on Monday we will meet again to consider a statutory instrument. I am delighted that we are all here.

Before I address the Labour amendment, I will set out the general background and aims of the clause. Clause 18 and schedule 6 provide additional clarity about aspects of the taxation of partnerships. The changes and clarifications in the clause seek to address areas of uncertainty and complexity identified as problematic by stakeholders, and to reduce the scope for non-compliant taxpayers to avoid or delay paying their tax. The changes also facilitate the digital transformation of partner taxation using information in the partnership return.

Partnerships in the UK are required to file a partnership tax return in the UK once a year. This partnership return ensures that Her Majesty's Revenue and Customs has the information it needs so partners are correctly taxed on the profits and losses allocated to them. The return should summarise the profits and losses allocated to each partner, and HMRC uses it to audit the tax returns made by the partners.

The clause changes the partnership return in the following ways. First, it clarifies the treatment of partners who are in bare trust arrangements—trusts in which the beneficiary has the absolute right to income and capital from the trust—by confirming that beneficiaries of such trusts are treated as partners for tax purposes. It also clarifies the tax treatment for partners who are themselves partnerships, by providing a statutory definition of an indirect partner and setting out the basis period rules—the basis period being the period for which a partner pays tax each year—and how they apply to indirect partners.

To ensure all partners can complete their returns accurately, and to facilitate HMRC's assurance work, a partnership that has indirect partners will be required either to report details of all the indirect partners or to submit the four possible profit calculations for UK resident and non-UK resident companies and individuals. The clause simplifies the rules for investment partnerships in the UK that already provide the information that HMRC requires under the common reporting standard or the Foreign Account Tax Compliance Act; it reduces the reporting requirements for investment partnerships where the information has been reported under those other international obligations. Finally, it introduces a new process to allow disputes over the correct allocation of profit for tax purposes to be referred to the first-tier tax tribunal to be resolved. That will ensure that partners have a dedicated method for resolving disputes that does not rely on HMRC assurance processes.

On the amendment, I assure hon. Members that the Government have carefully considered the risk of non-compliance in drafting this legislation. In addition to the clarifications that the clause provides to address areas of uncertainty for partners, HMRC already has the power, subject to certain conditions, to require payment on account, in the form of an accelerated payment notice, from taxpayers who are involved in schemes disclosed under the disclosure of tax avoidance schemes rules or counteracted under the general anti-abuse rule.

HMRC has issued more than 79,000 accelerate payment notices since 2014, which have brought in more than £4 billion to the Exchequer. They have changed the economics of tax avoidance, and there is strong evidence that they have had significant impact on marketed avoidance, as the Office for Budget Responsibility noted in its September 2017 report. The Government do not consider it necessary or proportionate to extend such notices where there is no clear indication of avoidance and a partnership's tax returns are simply the subject of an inquiry. It is therefore equally unnecessary to review the effect that such an extension would have.

I hope that reassures hon. Members that HMRC has sufficient powers to address non-compliance by partners, and that the amendment calling for a review on whether to extend those powers is neither necessary nor proportionate. The clause provides additional clarity about aspects of the taxation of partnerships; I therefore commend it to the Committee.

Anneliese Dodds (Oxford East) (Lab/Co-op): It is a pleasure to serve under your chairmanship, Mr Owen. I am grateful to the Minister for his kind comments, and look forward to future iterations of our debates, on other matters.

I want to give some context on the use of partnerships in the UK economy. Obviously, in some sectors they have proliferated, especially in forms such as limited liability partnerships. There is a broad question about unintended consequences of the proliferation of limited liability partnerships, particularly in accountancy, but I am well aware that that form of governance was created in 2001, so that growth can hardly be viewed as the result of the Government's activity.

There are ways in which we can and should seek to ensure that partnerships are put on to as equal as possible a footing with other corporate forms. I appreciate that the package of measures on partnerships in the Bill is intended to do just that, as well as to simplify tax law on partnerships. However, our amendment would revive a measure that was initially floated by the Government, but appeared to have been rejected later: the notion of introducing, where one partner is absent, a payment-on-account system in relation to partnerships whose income is derived from trading or property, as described by the Minister.

The proposal would be similar to the system used for the self-employed, in which half the previous year's tax bill is due in advance, and payable in July, to protect HMRC's revenue. The proposal was No. 4 in a consultation document set out by HMRC. It received some negative responses in the consultation, I admit; however, some respondents were positive about its potential. We agree with them. It is important properly to incentivise the reporting of partners.

The Government maintain that the existence of penalty provisions for incomplete and late submission of partnership returns would be sufficiently dissuasive to prevent the non-reporting of partners to HMRC. They maintained that in the response to the consultation, and the Minister has done so again now. Our concern is that the penalty or fine could be lower than the tax due, and that could potentially open a loophole that we would rather was closed.

Our amendment would require the Government to rethink their position. However, I took on board the Minister's comments just now, particularly about the applicability of the general anti-avoidance rule in this context. Because of that, we are willing not to push the amendment to a vote, but I hope that in the light of our discussion, the Minister will keep the matter under informal review in the Treasury.

Mel Stride: I thank the hon. Lady for those comments and for not pressing the amendment to a vote. I shall certainly keep the matters under review, as she urged, and would be happy of course to take directly any representations that she may want to make on them in future.

Question put and agreed to.

Clause 18 accordingly ordered to stand part of the Bill.

Schedule 6 agreed to.

Clause 19

RESEARCH AND DEVELOPMENT EXPENDITURE CREDIT

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

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

New clause 4—*Review of the impact of increasing Research and Development Expenditure Credit—*

'(1) Within one month of Royal Assent to this Act, the Chancellor of the Exchequer shall commission a review of the impact of increasing the Research and Development Expenditure Credit from 11% to 12%.

(2) The review shall consider—

(a) the effect of the 1% increase on companies' research and development spending in the UK, and

(b) what effect the increase in Research and Development Expenditure Credit will have on changes to companies' research and development spending in the UK as a result of leaving the EU.

(3) The Chancellor of the Exchequer shall lay the report of this review before the House of Commons within six months of this Act receiving Royal Assent.'

This new clause would require the Chancellor of the Exchequer to commission a review of the effect of the increase in Research and Development Expenditure Credit from 11% to 12% on companies' research and development spending and what effect the increase will have on any changes to companies' R&D spending as a result of the UK leaving the EU.

New clause 9—*Review of change to level of research and development expenditure credit—*

'(1) No later than 31 March 2019, the Chancellor of the Exchequer must review the effects of the change to the level of research and development expenditure made by section 19(1).

(2) The review under this section must consider—

(a) the revenue effects of the change, and

(b) the effects on levels of research and development expenditure.

(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 change to the level of research and development expenditure credit.

Mel Stride: Clause 19 makes changes that support the Government's ambition to drive up research and development investment across the economy to 2.4% of GDP by 2027. R and D tax credits are a key element of the Government's support for innovation and growth. To support businesses further, the Government will increase the rate of R and D expenditure credit from 11% to 12%. Investment in R and D is vital for increasing productivity and promoting growth. R and D tax credits support businesses in investing, by allowing companies to claim an enhanced corporation tax deduction or a payable credit on their R and D costs.

Laura Pidcock (North West Durham) (Lab): Will the Minister explain the severe imbalances in research and development across the country and how he will address them?

Mel Stride: As the hon. Lady knows, several announcements were made in the Budget about productivity, not least of which was the announcement about the national productivity investment fund; billions more pounds will be put in, raising its total investment level to around £30 billion. Initiatives such as the northern powerhouse and the infrastructure that will be put in place in the north and the midlands are evidence of our intent to make sure that productivity is levelled out across the country. We recognise that productivity is stronger in London, the south and the south-east, so particular attention is being placed on the midlands and the north of England.

There are two schemes for claiming R and D tax credits: the research and development expenditure credit—RDEC—scheme, and the small and medium-sized enterprise—SME—scheme. The SME scheme is more generous than the RDEC. The RDEC was introduced in 2013, featuring a new above-the-line credit. Businesses value it for several reasons, including because they can benefit from it whether or not they make a profit in the year in which they claim the credit. As R and D is often risky or pays back years after investment, this is a well targeted initiative. In 2015-16, the Government provided innovative businesses with more than £1.3 billion through the RDEC, which supported almost £16 billion of research and development.

In spring Budget 2017, it was announced that a review of the R and D environment had concluded that the UK's R and D tax credits regime is an effective and internationally competitive element of the Government's support for innovation. The changes made by clause 19 will provide around £170 million of additional support for innovative businesses every year from 2019-20. Increasing the rate of RDEC will make the UK even more competitive.

New clause 4 seeks to commission a review of the effect of this change on companies' research and development spending, and of the effect of the increase on any changes to companies' R and D spending as a result of the UK leaving the European Union. Since 2010, the amount of support that the Government have provided through R and D tax credits overall has more than doubled, reaching £2.9 billion in 2015-16.

Dan Carden (Liverpool, Walton) (Lab): What research has been done on the potential loss of EU investment in scientific research funding? I understand that the review will be forthcoming, but this is a modest increase from 12% to 13%. Does the Minister think that gets anywhere near to plugging that hole?

Mel Stride: The hon. Gentleman raises an important issue; inevitably, as we leave the European Union there will be economic consequences in both directions. He will be aware that a motion was recently passed in the House requesting various assessments. Those have been delivered to the Exiting the European Union Committee, so I point him in that direction. If he is implying that it will all be disaster once we exit the European Union—

Dan Carden *indicated dissent.*

Mel Stride: The hon. Gentleman is shaking his head; I am pleased, because there will be many opportunities as we go forward. Of course, one of the reasons why the question of impacts is difficult and challenging is that, at this stage, we do not know exactly where the negotiation will land, exactly what the treaty arrangements will be between us and the European Union after our exit, and what our customs arrangements and new trading arrangements with the rest of the world will be, and so on. We await those details.

Returning to the Bill, the amount of R and D expenditure supported through the tax credits doubled to £23 billion between 2010 and 2015-16. At the autumn Budget 2017, the Government announced a further £2.3 billion of additional direct R and D spending in 2021-22. That is on top of the record investment of £4.7 billion by the national productivity investment fund in R and D that was announced in the autumn statement 2016. Taken together, total Government support for R and D will increase by a third from 2015-16 to 2021-22. I am clear that the change in this Bill, along with the wider support that the Government are providing, will give valuable help to businesses investing in R and D in the period in which we will leave the EU. The change reaffirms our ambition to increase total UK investment in R and D to 2.4% of GDP.

Alison Thewliss (Glasgow Central) (SNP): The briefing from the Chartered Institution of Taxation points out that there may be merit in expanding R and D relief to product commercialisation, because we do lots of development in the UK but not necessarily all the commercialisation, and some of that benefit goes overseas. Will the Minister explore whether that might be possible?

11.45 am

Mel Stride: The hon. Lady makes an extremely important point about the development of innovation and new ideas, and about ensuring that they are capitalised on in our country, rather than perhaps being bought up to a certain stage and developed further elsewhere, as she suggests. The patient capital review under Sir Damon Buffini was very much focused on ensuring that those important schemes—venture capital trust schemes, enterprise investment schemes and so on—moved away from being what we might call capital preservation schemes, in which money does not go into high-flying businesses but which are simply ways of preserving capital while reaping the rewards of the tax benefits, into more innovative, higher-growth and more risky ventures, of which we need more in this country. In answer to her well made question, I point her towards that patient capital review and our work there, which we continue to do and to monitor, to address precisely the concerns she expresses about companies as they go from small to mid-cap and further on in their lifecycle.

New clause 9, however, seeks to commission a review of the revenue effects of the change and the effects on R and D expenditure. When the RDEC was last increased in 2015, innovative businesses benefited from an additional £200 million, and that supported an extra £1 billion in R and D expenditure. Furthermore, a recent valuation conducted by HMRC in 2015 found that for every £1 of tax forgone, between £1.53 and £2.35 of additional R and D is stimulated. That shows that R and D tax credits are effective at encouraging additional investment in R and D. I commend the clause to the Committee.

Kirsty Blackman (Aberdeen North) (SNP): It is a delight to be in Committee discussing a Finance Bill again, although we seem to be discussing one every week. I hope we can move to a single fiscal event, and that we will have a single fiscal event this year, and not an extra one or two, as we have previously.

On the change to research and development expenditure credit, I completely agree with the comments about the need to encourage our companies to create good research and to develop excellent and innovative products. That need can be clearly shown by the lack of productivity growth in the UK in relatively recent years by comparison with our international comparators. Part of that is because companies have not been able to create or bring forward changes, including in how they run themselves, in order to improve productivity; and part is because the Government have been good at increasing employment, but those jobs are low paid and have low productivity. Increasing research and development is therefore a very positive thing.

As was mentioned by the hon. Member for Liverpool, Walton, the UK leaving the EU comes with an awful lot of added negatives, particularly in the area of research and development. One is to do with universities and their research. A lot of our universities do absolutely excellent research that brings forward products. A number of universities have spin-off companies that have been innovated as a result of research, and they are brilliant places for such research to be developed. A lot of that could not have happened without the level of international collaboration that has been possible. A big concern is that there could be a backward step.

Another thing is that companies will find it more difficult to export to the EU. Although the Government are clear that we will have frictionless borders, a very small number of people believe that. There will instead be more barriers to exports, whether tariff or non-tariff, so companies will struggle to find the profitability and extra cash to put money into research and development that they do now. That is a big concern for the future. Frankly, increasing research and development expenditure credit by 1% will not cut it as the fix, to make that change that we need.

My hon. Friend the Member for Glasgow Central mentioned the issue of ensuring that research and development can be monetised by companies. It is not good enough simply to create an excellent product; that excellent product or innovation needs to be brought to market and exported. Companies in my area have struggled with taking that step. They have got to the stage where they have been able to innovate, but either their intellectual property has been bought or they have not managed to get encouragement from banks to increase their capital. I appreciate what the Minister says about the patient capital review, which is a welcome step because of the funding gap. Companies being able to convert their excellent research into a product that can be sold and exported is a really positive thing.

Companies around Aberdeen in my constituency are involved in the research and development of oil and gas initiatives, particularly in the super-mature basin that we have in the North sea. We are one of the first oil and gas basins to reach the super-mature stage. We have the ability to innovate, and to do research and development that creates products that can be exported around the world when other basins come to that mature stage. It is appreciated that there is a research and development credit, but the Government need to continue to work to support businesses in making the next leap, so that they can take advantage.

Dan Carden: Does the hon. Lady agree that membership of the European Union has fostered a culture of research and development? We have innovation cities and other such initiatives. A 1% increase from 12% to 13% is not enough. We need the Government to show how they will innovate and work with companies to rebalance the economy from south to north when it comes to research and development and other such issues.

Kirsty Blackman: I agree with the hon. Gentleman. We have had many benefits from the EU, and just one of them is the level of innovation. As a result of the level of free movement that we have had, we have been able to get excellent people in to improve our research and development, and to collaborate with places overseas. Our universities, companies and hubs of expertise have been an incredible success story in recent years in terms of the research that they have been able to do. There is a brilliant hub around Edinburgh that is involved in robotics. It is hugely important to take those steps.

The Government need to ensure that they continue to foster that culture. Leaving the EU is a big problem, in terms of us not being able to bring those people here. The Government need to not only increase the research and development expenditure credit by 1%, but make changes so that the UK can be a nation that welcomes scientists and encourages them to come here and make a positive economic contribution, as they already do. We do not want to lose those people.

Alison Thewliss: The point about not losing what we have is absolutely crucial. The Strathclyde Technology and Innovation Centre at the University of Strathclyde in my constituency has had £89 million, including money from the European regional development fund, to set up cutting-edge industries. Anything that loses that or puts it at risk will have a hugely detrimental effect on Glasgow and Scotland's wider economy.

Kirsty Blackman: I very much agree with my hon. Friend. A lot of these projects have been brought to fruition because of the benefits of EU money. The UK Government have not committed to filling the EU funding gap that there will be, particularly for universities and for the research and development of vital products that UK companies can sell on.

It is welcome that the Government are putting some focus on research and development expenditure. That is a positive thing. However, it is not in any way the end of the story. To simply stand still, the Government need to make significantly more commitments. We would appreciate the Westminster Government being much more positive about the innovation culture. They need to put their money where their mouth is and make sure they fund these things more appropriately.

Peter Dowd (Bootle) (Lab): Again, it is a pleasure to serve under your stewardship, Mr Owen. I want to speak first to the points made by the hon. Member for Aberdeen North and then go on to my substantive comments on

[Peter Dowd]

our amendment. It is worth noting what the hon. Lady says about funding research. Bill Gates, who knows a thing or two about research and development, said:

"I believe in innovation and that the way you get innovation is you fund research and you learn the basic facts."

Are the Government funding research and development sufficiently? The answer, quite simply, is no. Neil Armstrong said:

"Research…is creating new knowledge."

When set against that, the amount of research and development that the Government are funding, or indeed encouraging, is not creating that much more new knowledge.

Following on from the comments of the hon. Member for Aberdeen North about new clause 4, I am deeply concerned about the level of the Government's research and development expenditure, particularly once we have left the European Union. The important question is not whether we are in or out—we are moving out; we recognise that—but how we fill that gap.

There is a rightly held concern that as a result of Brexit, the UK risks losing its reputation as a scientific powerhouse. In November, the Chair of the Public Accounts Committee stated that we are "sorely lacking" in leadership from the Government to maintain Britain's position as a leader in robotics and in research to tackle climate change. She was responding to a National Audit Office report that highlighted that between 2007 and 2013, the UK was a "net recipient" of EU research funding and received more than £7.9 billion. In 2015, the UK Government's expenditure on research and development was £8.7 billion, so it is almost equal.

The Government will have to make up the funding shortfall once we leave the European Union if the UK is to keep its status as a world leader in research and development.

Laura Pidcock: Even within the European Union, the north-east has suffered grave inequalities when it comes to research and development jobs, of which there are 5,300 compared with 36,000 in the south-east. Does the hon. Gentleman agree that the Bill does nothing to get rid of that disparity? The worry is that outside the European Union, it will be further exacerbated.

Peter Dowd: That is an important point. As I said, it is irrelevant—academic—where someone stands on Europe or whether they were in or out, because we are moving out of the European Union. There are all sorts of debates about the customs union, the single market and all the rest of it, but the bottom line is: what will the Government do to plug that gap? Will they give the commitment that they have given to other industries, such as agriculture, to plug that gap?

Dan Carden: One of the reasons that there is scepticism on this side of the Committee Room is because European money has been funnelled towards cities such as Liverpool. We have seen great investment from Europe, whereas this Government have cut council budgets in Liverpool and across the north by more than 70%. Does my hon. Friend share my scepticism?

The Chair: We are tending towards a general debate about the European Union rather than a specific debate about the Bill. Please keep to the amendments and new clauses under discussion.

Peter Dowd: I appreciate that reminder, Mr Owen. My hon. Friend the Member for Liverpool, Walton makes a good point that goes to the heart of our wish to have a review of how the Government's proposal will affect research and development. That is absolutely crucial.

Research and development expenditure credit is used to encourage companies to invest in technology and research in the UK. Will the Bill do enough for that? The 1% increase announced in the autumn Budget will not be enough. Historically, the Government's investment in research and development as a proportion of GDP has been woeful. The UK spends less on research and development than many comparable nations do, which is why we need a review of the implications of the Government's proposal.

12 noon

Our expenditure on R and D last year was 1.7% of GDP, while the EU average was 2%. That is a significant difference. Denmark, Austria and Sweden spend more than 3%, and Finland and Germany are not far behind. The CBI argues that the Government should commit to spending at least 3% of GDP on research and development, particularly as a way—these are the CBI's words, not mine—of "Brexit-proofing" our economy. In a report last year, it highlighted key areas in which the UK should invest, including gene editing, space tourism, self-driving vehicles, robotic limbs, floating farms and travel methods that will enable people, for example, to fly from London to Sydney in four hours. There is a genuine fear that we will be left behind if we do not invest in cutting-edge research and in the first-rate scientific researchers that our universities produce. Will clause 19 actually help with that? On the basis of evidence and history, no, it will not. That is why, as I will keep reminding Members, we want a review.

There is of course the added factor of international science collaboration, particularly our continued collaboration with EU countries on research and development once we leave the EU. International collaboration has become increasingly important in science. In fact, its importance to the development of our industries is axiomatic. The requirement for multidisciplinary approaches and the combination of intellectual and physical resources means that more than half of the UK's research output is the result of international collaboration. Will the Government's proposals help that collaboration to continue once we are outside the EU—or, indeed, if we are still in the EU? No. They just do not go far enough.

Some 60% of the UK's internationally co-authored papers are authored with EU partners. Although the United States is the most frequent partner for UK-based researchers, seven of the top 10 strongest collaborators are EU countries. We must ask ourselves how the proposals in the Bill will help that to continue. I am genuinely not convinced that they will.

No one is criticising the Government for putting some inducement in their proposals, but is that inducement enough? No, it is not. Although increasing the research and development expenditure credit will encourage companies to use the cutting-edge research that is formulated in UK universities to create jobs for the future, the quality and quantity of that research will dry up if grants are cut. That is another factor that the Bill does nothing about.

The UK has long been a hub for worldwide talent in the scientific community, which produces research that allows companies to invest in cutting-edge research and development projects. Will the Bill do anything significant to help that continue? No. We cannot escape the fact that the UK's scientific community is dependent on international talent, both European and non-European. For example, 28% of academic staff in UK universities are non-UK nationals—16% are from the European Union and 12% are non-EU citizens—half of PhD students in the UK are non-UK nationals, and 30% of UK Nobel prize winners are non-British. That talent pool will be at risk if the Government do not get their skates on and provide further support for research and development.

The Government must do more to encourage and incentivise the best scientists in the world to continue to work in the UK and collaborate with UK universities and research facilities, otherwise there will be a brain drain, which will have a direct impact on the number of companies that choose to invest in research and development projects in the UK. Again, is there anything in the substance of the Minister's proposals that will help with that? No. That is why we want a review. We need to look at this area in more detail. I imagine it will be a far bigger factor than whether the Government increase the research and development expenditure credit by one percentage point. The question of the workforce—the scientists who will undertake the research and eventually work on the projects—is very important, because without them, the UK will be a far less attractive place to invest.

Dan Carden: This relief means a hell of a lot, especially to some larger companies, which sometimes make hundreds of millions of pounds from it. We have seen artificial schemes designed to secure the tax relief whereby it has not been appropriately used. Would not a review also help to sort out that problem?

Peter Dowd: It would, and I will come to that in my final comments in relation to the speech by the hon. Member for Aberdeen North. There is a wider point, which the hon. Lady has highlighted perfectly. How much difference will raising the expenditure credit by one percentage point make to companies investing in the UK? That is the question, and we need to know the answers to it, hence the proposal for a review. I sound like a stuck record, but this issue is very important. It is only right that the Minister should come back to the House at a later stage and provide it with that information.

Laura Pidcock: Does my hon. Friend think that the Government have calculated the one percentage point figure on the basis that we are exiting the European Union and on formal calculations about what the net consequence of removal from the EU will be, or is this just an arbitrary figure?

Peter Dowd: The honest answer is that I do not know. If I can be the postperson for that question, I will pass it on to the Minister and perhaps he will answer it. I am sure that he will be able to do so, if not today, certainly in due course.

On new clause 9, the research and development expenditure credit gives corporation tax relief to companies that undertake research and development, as the Minister said, as well as to small and medium-sized enterprises subcontracted to undertake work of that nature. The current rate of relief for those companies is, as everyone knows, 11% of their qualifying expenditure, through either reduced liabilities or cash payments. As the Minister set out, clause 19 increases that to 12% of qualifying expenditure.

On Second Reading and today, the Minister has talked about the contribution that research and development makes to our nation's productivity. It is worth our while to reflect on the Government's record when it comes to productivity, because that goes to the heart of the matter. If we are to raise productivity, how do we know that it is linked somehow with research and development, or vice versa? If the figure is being moved from 11% to 12%, how do we establish the interaction, the causal links and the correlations? How do we do that? We do not do it, which is why we need a review.

As you know, Mr Owen, productivity has flatlined, and it has remained lower than its peak under the last Labour Government for the full eight years of the current Government and the coalition. The Office for National Statistics has found that since this Government took office, they have presided over the worst period of productivity growth since the Napoleonic wars. I think that was the last time we came out of Europe—well, perhaps not the last time, but one of the times. *[Laughter.]* That was a dodgy link, I have to say.

At present, UK productivity lags behind that of most of the G7 nations, notably the United States, France, Germany and Italy. What the Germans produce in four days, Britain achieves in five. We have heard that so many times, and the question that arises is: does the Government's proposal do anything to enhance productivity? We do not know. Do the Government have any proposals for us to suggest how they might do that via a review? No, they do not. That is why we want a review.

This is not a mere technicality; it has serious consequences. As the Nobel prize-winning American economist Paul Krugman once said,

> "Productivity isn't everything, but in the long run it is almost everything."

More than many other indicators, our productivity has a huge impact on both our future economic growth and the living standards of millions of British workers, who rely on productivity gains to improve their pay and conditions. We know that investment in research and development can, and does, enhance productivity. The question is: do the proposals do that? We do not know. Why do we not know? Because the Government—I suspect—will not agree to our review today. We will persist on that. As far as I can see, we do not have any information from the Government on the correlation.

Sadly, we are heading in the wrong direction. The Office for Budget Responsibility predicts that the Government's plans will leave us with a 17-year period of wage stagnation. The Institute for Fiscal Studies agrees, arguing that we face two decades of lost pay growth. Will the Government's proposals do anything significant to deal with that? We do not know, but we do not think so.

Time and again, the Chancellor has watered down the Government's promise of increases in the wage floor. That will not help, either. We know that the most sustainable way to ensure a return to wage growth is to boost productivity, as well as ensuring that there is a

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strong framework of other worker representation to make sure that gains are shared evenly across any enterprise. That is also important. Research and development not only helps companies to grow, helps profits and helps income tax and tax generation, but helps workers and wage growth. Are the Government doing anything in the proposals to assist with that? No.

The Prime Minister recognised the importance of economic democracy and worker representation all the way back when she became Prime Minister. It is also important that workers can see what research and development investment there is, and what the Government's proposals on it will do to help. It is difficult to establish what gains there will be under the proposals, and that is why we need to check and challenge the Government time after time on this one.

Of course, while research and development investment is not going into businesses, companies can rely on large pools of pretty cheap and expendable labour. That is important. In the past, the Minister has referred to us having quite high levels of employment, but we come back to the issue that the levels of employment per se—

The Chair: Order. We are straying a little bit and having a general discussion on the economy rather than on research and development expenditure credit under new clause 9.

Peter Dowd: I appreciate that, Mr Owen. The point I am trying to make is this: in relation to the increase from 11% to 12%, what will the Government's proposals do that will help any of these elements of the economy? We must set it in this context. What is the purpose of the increase from 11% to 12% if not to increase economic growth? We are trying to establish what the link is, and we cannot find it at this stage, hence the need for a review of the proposals. We fear that, unless we have significant increases in research and development, we will not get out of the difficult economic circumstances we face.

There is the further issue of regional research and development, which my hon. Friends have alluded to. A recent report from Sheffield Hallam University shows vast regional disparities in research and development funding. Today, we are asking the Government to produce a review that would also cover those regional disparities, because that is crucial. None of the Bill's proposals come in isolation. We acknowledge that the report from Sheffield Hallam included universities and charity sector organisations, which, of course, are exempt from the research and development expenditure credit. It is nevertheless pertinent to highlight that in relation to regional disparity and overall Government research and development expenditure. The university also demonstrated that the Government expenditure on research and development is spent in the south-east, which employs 36,500 people in research and development, compared with the west midlands, which employs only 3,100. We propose including that in any review of the impact of the increase from 11% to 12%.

12.15 pm

Laura Pidcock: That disparity in investment does not make sense, because economic growth, employment rates and average earnings are all worse than average in the north-east. I do not see any mechanism to redress that disparity; I wonder whether my hon. Friend does.

Peter Dowd: Again, I do not think there is anything in the Government's proposals that helps to address that disparity. We do not know. That is part of our reason for making our proposal, and I suspect it is also the reason behind the proposal made by the hon. Member for Aberdeen North: to try to tease out those particular issues and get information from a review that would help us to determine that. It is important to make the point that we are restricted by the amendment to law proposals and can only ask for reviews. It is a concern that we are not able to push this more. That is why, to some extent—with your consent, Mr Owen—we are slightly widening the debate. We need to widen it out to be able to focus, in a bizarre sort of way, on the specifics of the Government's proposals and how they might enable research and development, and the 11% to 12% increase, to help.

In talking about regions and trying to make those important comparisons, the question is what the 11% to 12% increase will do for those regions. The Cambridge area has twice the research and development jobs of the entire north-west, for example, where my Bootle constituency is. Even when we exclude Cambridge University, as this credit does, the Cambridge area has twice as many such jobs as the midlands, more than Scotland and Wales combined, and only 2,000 fewer than the north of England. One has to ask the question, "What do the Government's proposals do to help that?" We cannot see what they are doing to help it, hence the need for a review. I persist with the issue of the review, hence the new clause. We can push on and increase the 11% to 12%, but what is the evidence that it will be not only evenly spread across the country, but rebalanced? I do not see that at all in the proposals, which is why we must look at them in more detail.

To take another example, we talk about the northern powerhouse, but eight years on the economy is still not rebalanced and there is nothing in the proposals to help with that. In that regard, it is difficult not to comment on Lord O'Neill's resignation over that particular matter, because he did not see the Government in any way pushing the issue of research and development in some of the regions. Take, for example, the fact that only two of the 20 most expensive infrastructure projects being financed by the Government are in the north-east, the north-west or Yorkshire and the Humber. We could look at all the other cities in the broader sense—I will not go there—but the point is that research and development expenditure does not seem be going to the areas that perhaps need it most to help their economy.

I have asked the Minister, as have other hon. Members, whether the Government plan to redress that imbalance in regional research and development expenditure. If the extended credit being debated today might contribute to rebalancing, will he tell us the percentage change in regional distribution that that might account for, rather than generalisations? We need details. Some regions right across the country are calling out to know what this will do specifically for the regions. We have heard a lot from the Government about rebalancing, but that has not yet been translated into action.

That is why we tabled the new clause: to enable us to review the change and better to understand both the revenue effects of the proposal and its effects on research and development expenditure more generally. Should the new clause succeed—we will press it to a vote—we hope it will encourage the Government to reflect on the scale of the productivity challenge and the action required to address it properly. We hope that, if the Government agree to the review, it will also give us some insight into the revenue forgone in specific parts of the country.

I hope that hon. Members consider supporting the new clause for the reasons I have set out. If they will not support it, I exhort them to push the Government to give us more detail about how this is going to impact on all the regions and nations of the United Kingdom. There will be a consistent and persistent belief that we are not a one-nation country and that not everybody is in it together. An awful lot of people are out there on their own, and the Government must give us information through a review to show in solid terms how this increase from 11% to 12% is going to help those communities.

The Chair: I call the Minister to respond within the parameters of the three proposals under discussion.

Mel Stride: Thank you for calling me to speak, Mr Owen. You have been very generous in your interpretation of the scope of the debate.

The Chair: I am going to be equally generous with the Minister.

Mel Stride: I am sure you will be entirely obliging. This has been a wide-ranging debate, covering just about everything. We have had an absence of the biblical references and classical quotations that normally enliven our discussions at this time of the day.

We all agree about the essential role that productivity plays, and, in turn, the essential role that R and D plays in driving productivity. Paul Krugman is entirely right that, in the long run, productivity is almost everything, because if we do not get a rise in productivity we do not get a rise in real wages, living standards and all the things that Governments ensure happen. It is not just our country that has had a productivity challenge since the crash in 2008. The productivity rates of most of our competitor countries are all well down on where they were prior to that point. We certainly have a particular challenge in the United Kingdom, which is why we are doing so much in the productivity space. R and D tax credits are but one element of that. We have now set an R and D target: as I said earlier, 2.4% of GDP will be R and D expense by 2027.

It is useful to note that much was made of how this Government are performing relative to the past, as if in the past we were doing incredibly well with R and D. The reality is that over the past 30 years there has never been a single year in which R and D expenditure as a proportion of GDP has exceeded 2%. That is a simple fact. That goes for this Government, the coalition Government and the Labour Governments who preceded them, so in a sense we are all in the same boat.

I do not accept that we are not doing enough in this area. R and D tax credits are but one example. The amount going in since 2012-13 has doubled to £2.9 billion. In 2016, we announced direct R and D expenditure of £2.3 billion by 2020 to 22. We have had major announcements on infrastructure and roads and rail. As I said in my opening remarks, in the previous Budget we expanded the national productivity investment fund to £31 billion.

On the specific issue that the hon. Member for Aberdeen North—and others, by way of intervention—raised, we totally accept that support for our universities is absolutely critical. That is why we are doing things on the immigration side. We are seeking to get the balance right to attract the right kind of talent. Equally, we are underwriting the Horizon 2020 programme, such that any Horizon 2020 projects agreed by the European Union prior to our departure will be underwritten by the UK Government, irrespective of whether that money is being spent at the time that we exit.

Alison Thewliss: Some of the money for Strathclyde University is coming through the European Regional Development Fund, rather than Horizon 2020. Will ERDF money also be guaranteed?

Mel Stride: The hon. Lady knows that we are reviewing that specific point in the context of the negotiations. Those are decisions, among others, that we will have to take in future. My point is about that critical flagship programme, Horizon 2020. The hon. Member for Bootle suggested that we have not treated universities in the way that we have the agricultural sector, to which guarantees have been provided, but this is a clear example in the universities sector of where we are doing precisely that.

I will not dwell on those matters; I am aware that they are more directly related to R and D tax credits, but the patient capital review is a commitment that we put a lot of money, effort and research and development into. The intellectual property issue was mentioned in the debate. There is the patent box, which provides a lower rate of taxation for those businesses that develop intellectual property, so that we make sure that that is developed and exploited in this country.

The hon. Member for Aberdeen North quite rightly mentioned the North sea, which is absolutely critical to her part of the United Kingdom. There are measures in the Bill that we will come to shortly that further ease tax pressures in that sector, and certainly there were measures in the last Finance Bill, when she and I both served on the Committee.

Peter Dowd: I know that the Minister is aware that the Public Accounts Committee reported that the cost of R and D tax relief increased from around £100 million in 2001 to more than £1 billion in 2011 and 2012, while the actual amount of business expenditure on research and development stayed more or less the same. We have seen large increases in the costs as a result, potentially—I am not saying there was, but potentially—as a result of some abuse. The question I want to try to tease out is, how do the Government know that the increase in research and development reliefs will achieve the desired result, without having a proper review?

Mel Stride: In my opening remarks—I will not re-rehearse them—I talked about the evidence of the amount of money going into R and D and the return per pound. There is a relationship between the amount that goes into R and D tax credits and the amount of R and D spend that is occurring, but the one does not solely cause the other. Many externalities impinge upon why companies may or may not invest in research and development, the most obvious being the general state of the economy and business confidence. That should not take away from the fact that it is demonstrably the

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case and will continue to be the case that if we provide attractive taxation reliefs aimed at encouraging companies to invest in research and development, we will see a displacement of activity towards those activities, which is what we so strongly want to see in our country.

I shall leave it there and say that we have had an extremely wide-ranging and interesting debate. I hope that we can move on to put the question.

Question put and agreed to.

Clause 19 accordingly ordered to stand part of the Bill.

Clause 20

Intangible fixed assets: realisation involving non-monetary receipt

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

The Chair: With this it will be convenient to discuss clause 21 stand part.

Mel Stride: Clauses 20 and 21 will prevent companies from claiming unfair tax relief on their intellectual property. Clause 20 will ensure that income received in non-monetary form is fully taxed under the intangible fixed asset regime, and clause 21 will amend the rules where a licence in respect of intangible fixed assets is granted between related parties.

The clauses tackle arrangements where companies sell intellectual property assets or grant a licence in respect of intellectual property, and try to gain a tax advantage by receiving shares or some other form of consideration—what is known as money's worth rather than cash. Accounting rules can mean that a disposal is accounted for by the seller at the original or base cost of the asset disposed of—effectively, the book value of the asset disposed of—rather than the actual value of what has been received.

That type of accounting is used by related parties in what are known as step-up avoidance schemes to create a difference between one company's taxable income and another company's tax deduction. In step-up schemes involving licensing arrangements, the licensor accounts for the disposal at the lower net book value and is not taxed on the full value of the consideration, while the licence recognises the higher or stepped-up commercial value of the asset acquired and claims tax relief on the higher amount. Such transactions can occur commercially when setting up joint ventures but can also be used for avoidance and can involve intellectual property leaving the United Kingdom.

There are several reasons why multinational enterprises may move their intellectual property between companies in a group. The Government's view is that the rules should ensure that the right amounts are taxed and deducted when intellectual property is moved. Clause 21 will ensure that that always happens, including when intellectual property leaves the United Kingdom.

The changes that clauses 20 and 21 will make are fairly simple. They will counter step-up avoidance schemes by ensuring that all non-cash disposals and related party licensing arrangements are taxed fairly, consistently and in line with cash transactions. They will have no effect on the vast majority of trades because transactions set up in such a way are rare; in many cases they are set up to gain an unfair tax advantage. The clauses will apply retrospectively from 22 November 2017. I commend them to the Committee.

12.30 pm

Anneliese Dodds: The Opposition have not tabled any amendments to clauses 20 and 21, but I have a question for the Minister about a specific matter that I raised briefly on Second Reading. It was not satisfactorily resolved at the time, so with the Committee's permission I will raise it again.

I am grateful to the Minister for his explanatory remarks, but a pertinent question remains. As I said on Second Reading, the clauses essentially grab at what in many cases may be the holy grail: the assigning of market value to certain kinds of intangible for tax purposes. In that regard, the clauses seem to contradict the direction of travel in the Finance (No. 2) Act 2017, in which the tax impact of intra-group transactions was limited rather than regulated—I refer specifically to the measures to restrict the tax deductibility of interest payments to intra-group companies. Hon. Members will remember that the Government decided on a limit of 30% of earnings before interest, taxes, depreciation and amortization, which was the upper bound of the OECD's suggestion. We questioned that, but at least they adopted the OECD position of restricting such payments. However, rather than limiting the admissibility of intra-group payments as a means of reducing tax, the Bill attempts to regulate their calculation. I think such an attempt may be flawed.

The Minister has covered this to some extent, but let me provide some further background. Related parties, including subsidiaries, affiliates, joint ventures or associated companies, may transfer among themselves intangibles such as patents, know-how, trade secrets, trademarks, trade names, brands, rights under contracts or Government licences and other forms of intellectual property. The attempt to regulate market value may be flawed because it assumes a market value for such intangibles. For most people, the image underlying such a view is one of an active market with buyers and sellers in it, but there is often no such market for intangibles that are transferred—sometimes entirely legitimately, but sometimes as an attempt to pay less tax by shifting to a lower-taxed or differently taxed jurisdiction. For example, I have been looking at statistics on global biotech. As I understand it, about 10 corporations control two thirds of the industry, including the intellectual property in it, so there is no normal market and enormous mental gymnastics are necessary to determine the market value of intangibles.

Firms that wish to exploit the situation can make rather wild claims. I hope Committee members will remember as a particularly egregious example the facts revealed by the European Commission's case against Starbucks, in which vastly inflated assessments were made of the value of intellectual property held by a firm that had no employees. However, the Starbucks case was unusual in the sense that such manipulations of the value of intangibles normally remain, sadly, unchallenged. In connection with that, I understand that HMRC had, as of 2016, just 81 transfer pricing specialists. Surely that is dwarfed by the number of advisers employed by the big four firms who, potentially, would advise large companies that might well seek to reduce their tax perfectly legally by manipulation of the location of intangible assets into lower-tax jurisdictions.

Clauses 20 and 21 do not define intangible fixed assets. In accounting terms, of course, an asset is something that generates future cash flows, revenues or benefits, but there are no other qualifying criteria. The woolliness of such a definition has been recognised in the courts as problematic. For that and many other reasons, the European Union is moving towards a unitary system of corporate taxation. I appreciate that that is a matter for another day, so I will not open a discussion on it now—probably no political party would want to state its position on it in a Finance Bill Committee. We should note it here, however, because it indicates how our country may be merely entrenching problems that the EU27 are moving towards resolution.

Will the Minister introduce legislation to provide clearer guidance about how an intangible asset should be defined for tax purposes? Will he give us any further information about how he will prevent the measures from being exploited and alleged market value from being manipulated to avoid tax?

Mel Stride: I thank the hon. Lady for her speech. She raised the interplay of the corporate interest restriction and various rules, including the 30% EBITDA rule in the Finance (No. 2) Act 2017. As I am sure she appreciates, there is a distinction between that legislation and what we want to do in the clauses before the Committee. In the case of the corporate interest restriction, we are thinking about making sure that groups of companies do not abuse the borrowing of money by moving it around the group, thereby artificially reducing their tax burden. The clauses that we are considering are about regulating inter-group transfers of intangible assets, and getting the right values imputed in the circumstances.

The hon. Lady is right to say that assessing and establishing true market value is extremely complicated. A market value rule is applied in the relevant circumstances. As to whether we shall return to the matter in future and address in legislation questions of guidance and of definition of the value of intangible assets, I am happy to ask officials to look at various no doubt deep and dark parts of the UK tax code, where such definitions and other useful information may lurk, and provide the hon. Lady with what I can.

Overall, despite the complexities of the clauses and their deeply technical nature, they are important and worthy anti-avoidance measures, which we need to add to those—more than 100 of them—that the Government have introduced since 2010, saving the taxpayer £160 billion and giving us one of the lowest tax gaps in the world, and in the history of our recording such gaps.

Question put and agreed to.

Clause 20 accordingly ordered to stand part of the Bill.

Clause 21 ordered to stand part of the Bill.

Clause 22

OIL ACTIVITIES: TARIFF RECEIPTS ETC

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

Mel Stride: Clause 22 amends the definition of tariff receipts that are taxable to ring-fence corporation tax and the supplementary charge. Tariff receipts are income that oil companies receive from third parties for the use of their oil and gas assets. It is common for oil and gas producers to share the use of pipelines, terminals and other facilities, and tariffs are one type of commercial arrangement used in those cases.

The clause clarifies the fact that activities by petroleum licence holders in the UK and on the UK continental shelf that give rise to tariff income are oil extraction activities. That ensures that their treatment is in line with current industry practice. As a result of the change, oil and gas companies will have the certainty they need to continue investing in infrastructure. The change will also ensure that the Government can deliver on the Budget 2016 commitment to expand the investment and cluster area allowances so that they can be activated by tariff receipts. Delivering that commitment will encourage more investment in the strategic infrastructure that is crucial to the longevity of our vital national industry.

The Government introduced the investment and cluster area allowances at Budget 2015, simplifying the system for investors and driving new investment. The allowances replaced the complicated system of bespoke oil and gas field allowances. They give oil and gas companies tax relief by reducing the amount of profit that is taxable to the supplementary charge. The allowances are generated on investment expenditure on UK oil and gas assets and can be activated by income from the oilfield. The allowances therefore reward successful investment in UK oil and gas production.

At Budget 2016 the Government went further, announcing that they would expand the scope of the investment and cluster area allowances so that they could be activated by tariff receipts, in addition to the production income from the field. Including tariff receipts within the scope of the investment and cluster area allowances will encourage infrastructure owners to continue investing in the North sea's vital infrastructure, for the benefit of third parties and to support the "Maximising Economic Recovery" strategy. Before the Government can deliver that commitment, however, it is essential that the current law is consistent with the objective of the policy.

Following an informal consultation with industry and analysis of the legislation, a degree of ambiguity was found in the current legislation, making it difficult to deliver the expansion as intended. The measure will resolve that ambiguity by clarifying that tariff receipts are treated in line with broad industry practice. The Government's intention to clarify the legislation has been welcomed by the industry.

The changes made by clause 22 will provide oil and gas companies with the right conditions that they need to continue investing in the industry's infrastructure. The clause amends the existing definition of tariff receipts to confirm that all tariff income earned by UK licence holders is an oil extraction activity, and therefore in the scope of the oil and gas ring fence tax regime. The clause also confirms that for ring fence corporation tax and supplementary charge purposes, there is no distinction between tariff receipts arising from old oilfields that are subject to petroleum revenue tax and new, non-PRT oilfields.

The UK oil and gas industry makes a significant contribution to the UK economy, supporting more than 300,000 jobs and providing about half our primary energy needs. To date, it has paid about £330 billon in production taxes. By clarifying the tax treatment in law for tariff receipts, whether they are generated from new

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or old oilfields, the clause will allow the Government to deliver their Budget 2016 commitment. That should encourage investment in the UK continental shelf. I therefore commend the clause to the Committee.

Kirsty Blackman: I congratulate the Minister on getting through that speech, because the subject of oil and gas taxation is incredibly technical and complicated. As the Minister has said, the clarification is welcome. Also incredibly welcome was the promise in the Budget this year to institute the transferable tax history changes that are required, and I appreciate the fact that that has happened. Industry has been calling for that for a while, as I have done quite a number of times in this room and in the main Chamber.

On "Maximising Economic Recovery", which the Minister mentioned, it is two years since former Prime Minister David Cameron came to Aberdeen and said that an oil and gas ambassador would be appointed, but we still do not have that ambassador. Will the Minister let us know when we are likely to get the ambassador, or has the idea been shelved permanently?

Mel Stride: I thank the hon. Lady for her recognition of the moves that we are making on transferable tax history. I agree that they are important for the sector, particularly given its current state of development. It is important to make sure that we keep the oil industry going in her part of the country. On her question about the oil and gas ambassador, I will make inquiries and come back to her. In terms of industrial strategy, as I mentioned in detail in my opening remarks, her part of the world and the oil and gas sector are extremely important to the Government and will remain so.

Question put and agreed to.

Clause 22 accordingly ordered to stand part of the Bill.

Clause 23

Hybrid and other mismatches

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

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

Amendment 49, in schedule 7, page 96, line 22, at end insert—

"Review of operations

18A After section 259M, insert—

'259O Hybrid and other mismatches measures: review of operation

(1) Within 12 months after the passing of the Finance Act 2018, the Chancellor of the Exchequer must review the operation of the measures in this Part.

(2) The review under this section must consider—

(a) the impact of the measures on the use of hybrid transfer arrangements;

(b) the impact of the measures on the revenue effects of the use of hybrid transfer arrangements to reduce a person's tax liability;

(c) possible alternative or additional measures to reduce the use of hybrid transfer arrangements to reduce a person's tax liability;

(d) whether the measures constitute application of EU Directive 2016/1164 ("The Anti Tax Avoidance Directive"), including in what ways the measures do not constitute an application of that directive.

(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 amendment provides for a review of the measures against hybrid transfer arrangements to reduce a taxpayer's tax liability, and that this review consider whether alternative or additional measures would be more appropriate, and how these measures compare to the EU Anti Tax Avoidance Directive.

That schedule 7 be the Seventh schedule to the Bill.

12.45 pm

Mel Stride: Clause 23 makes changes to ensure that the hybrid and other mismatch rules introduced in 2016 operate as intended. It does so by introducing a small number of technical amendments to those hybrid rules.

The hybrid and other mismatches regime was introduced in the Finance Act 2016 and deals with mismatches involving entities, permanent establishments and financial instruments. The regime is a set of anti-avoidance rules that tackle certain tax planning arrangements by multinationals. The regime addresses arrangements that give rise to hybrid mismatch outcomes and generate a tax mismatch. In doing so, it fully implements and, as a matter of policy, in some areas goes further than the OECD base erosion and profit shifting action 2 recommendations.

Mismatches can involve either double deductions for the same expense or deductions for an expense without any corresponding receipt being taxable. A consultation with stakeholders identified some practical and technical changes necessary to ensure that the UK regime fulfilled the policy intention. The clause amends the UK hybrid rules to clarify how they should be applied.

The changes made by the clause ensure that the hybrid and other mismatch rules operate as intended. Those changes and the hybrid regime in general will affect multinational groups with UK parent or subsidiary companies involved in cross-border or domestic transactions involving a mismatch in tax treatment within the UK or between the UK and another jurisdiction. The changes do not alter the overall effectiveness of the hybrid regime and will protect the expected yield from that regime. In some cases, as a matter of policy, the UK regime goes beyond OECD recommendations.

The detailed changes set out in schedule 7 to the Finance Bill make it clear that withholding taxes are to be ignored for the purposes of the regime, disregard taxes charged at a nil rate, ensure that capital taxes can be taken into account in appropriate circumstances, ensure that a counter-action in relation to partnerships will be proportional, clarify the scope of the rules in relation to companies with overseas branches, provide for certain intra-group transactions to be taken into account when quantifying mismatches, ensure that in appropriate circumstances income taxed in two jurisdictions can be taken into account in relation to imported mismatches, and provide for accounting adjustments that reverse or reduce mismatches to be taken into account.

Amendment 49 asks for a review into the hybrid and other mismatches legislation, focusing particularly on the rules that deal with hybrid transfer arrangements. Hybrid transfers are one of the several types of hybrid and other mismatch arrangements within the scope of the hybrid mismatch rules introduced by the Finance Act 2016. The rules that deal with hybrid and other tax mismatches, including hybrid transfer arrangements, have been implemented in line with the OECD BEPS recommendations. Likewise, the hybrid rules within the EU anti tax avoidance directive were designed to be consistent with, and no less effective than, the OECD BEPS recommendations on hybrid mismatches. The UK was instrumental in ensuring that the ATAD rules met that requirement, and the UK rules on hybrid transfers are consistent with the ATAD requirements.

In broader terms, the expected yield from the hybrid and other mismatches regime has been certified by the Office for Budget Responsibility, and those figures will be kept under review as part of the normal process for fiscal forecasting and monitoring of receipts. A review, in short, is unnecessary and will not strengthen our understanding of the legislation. As clause 23 demonstrates, the Government are already monitoring the operation and impact of the hybrid mismatch rules and making any changes necessary to ensure that they work as intended. I therefore commend the clause to the Committee.

Anneliese Dodds: I am grateful to the Minister for his explanation of the measures. As he explained, hybrid mismatch arrangements exploit differences in the tax treatment of instruments, entities or transfers between two or more countries. Sadly, those arrangements have proliferated in a number of countries, as sophisticated taxpayers and tax advisers have spotted opportunities to reduce the tax payable by what might otherwise be profitable companies.

The result has often been double non-taxation, whereby neither country involved in the arrangement can receive revenue, or the deferral of tax over many years, which is in practical economic terms similar to double non-taxation. That is just one part of the international dimension of tax avoidance that is, sadly, generally not picked up in statistics on the UK's tax gap, but which experts maintain runs at a high level, denying our public services the revenue they need and placing small and medium-sized British businesses at a tax disadvantage.

Hybrid mismatch arrangements not only deny countries tax revenues but distort economic activity. They mean that investment decisions can be driven by tax-related criteria, not by effectiveness and efficiency. They can also lead to financial instability by encouraging tax-favoured borrowing and by reducing the transparency of company and taxation structures.

The Minister rightly referred to the groundswell of activity against these hybrid mismatch arrangements over recent years, from within the EU code of conduct group when it was chaired by the Labour MP Dawn Primarolo, and from 2013 onwards in the OECD and G20's base erosion and profit shifting action plan. As colleagues will know, action 2 of the BEPS project, as referred to by the Minister, is focused on neutralising the effects of hybrid mismatch arrangements. The Minister referred to the fact that the most recent changes in this Bill build on those from last year. They were originally tweaks to the 2016 Bill, which amended the Taxation (International and Other Provisions) Act 2010, as I understand it.

I think we in the Opposition would agree that the general direction of travel appears to be the right one—considering the tax treatment in our own country and the corresponding jurisdiction, aligning our roles with the OECD's approach and ensuring that measures have direct effect. As I understand it, in the past any measures had to be initially notified to the company before HMRC could take action. It is good that we now have a different approach. Above all, it is important that the new measures relate the tax treatment here to that in the corresponding jurisdiction. That means we need a more complex set of rules, but they are more appropriately targeted at dealing with the scourge of hybrid mismatch arrangements. It is precisely because of the need to continue to eliminate these arrangements that we believe a review is necessary.

I will quote here from an OECD report from 2012. It is, admittedly, from just before the BEPS process started, but I think it is still relevant. The report was specifically on hybrid mismatch arrangements, and it stated:

> "Country experiences…show that the application of the rules needs to be constantly monitored. Revenue bodies have noticed that arrangements may become more elaborate after the introduction of specific rules denying benefits in the case of hybrid mismatch arrangements."

The OECD report offers the example of Denmark, which in 2011 was required to amend its rules as sophisticated taxpayers and their advisers wised up to previous attempts to close loopholes.

I know that these specific rules are the result of successive rounds of finessing, from 2016 and through last year until now, but we would like a commitment to ensuring that the process continues through the mechanism of a review. I note that in discussions about the BEPS process, participating countries have expressed concern that without widespread acceptance and implementation of the new rules, the difficulties could be exacerbated by them. We really need more information about how they will operate in practice.

Of course, we must also bear in mind that the operation of these rules is affected by the foreign tax treatment of any companies concerned. In some ways, the Minister was absolutely right to say that such problems may have been reduced with the engagement of the OECD and EU in the adoption of consistent approaches to the treatment of hybrid mismatches. However, I note that there has been some suggestion that there is a different approach in the EU rules, as compared with the OECD rules, to the specific issue of which country is responsible for characterising the entity or instrument in the member state where the payment has its source. If that is still the case, our Government need to indicate to what extent our rules comply with the measures in the EU's winter 2016 tax package relating to hybrid mismatches. The Minister stated that he felt that those measures were coherent, but we would like to see a more thorough assessment of that.

On a related note, I refer to my previous comments. It would be helpful for the Government to indicate the relative merits of their current approach to hybrid mismatches compared with formula-based approaches—or at least to reflect on that, given that the EU's common consolidated corporate tax base programme is continuing at EU level. For all those reasons, I hope that the Minister and Government Members will agree to our sensible demand for a review of the effectiveness of these measures 12 months after their introduction.

Mel Stride: Once again, I thank the hon. Lady for a thoughtful contribution. I think we agree that hybrid mismatches are a form of avoidance and we need to clamp down on them as they operate between different tax jurisdictions. That is precisely why we are debating

[Mel Stride]

these measures today. She has reflected on the fact that they have come out of OECD and BEPS project activity, in which we have been absolutely at the forefront.

The hon. Lady said that she was satisfied with the general direction of travel. She made the important point that the work is, in effect, never done, because whenever we come up with new legislation to clamp down on loopholes, other, more ingenious, individuals out there come up with ways of working around it. By way of example, she raised the issue of identifying the effective country of origin for the hybrid mismatch and the different approaches that the OECD and the EU might have.

I reassure the hon. Lady that we agree with her on everything up to that point, and that we will continue to monitor the measures. There is no necessity to have some wide-ranging review that will go into things over time and report back while we wait for the outcome, because day in, day out we are monitoring exactly what is happening. The best evidence that I can provide for our approach and its efficacy is the fact that we have this clause at all. It is a perfect example of the way in which Government have put out some legislation to clamp down on tax avoidance—we are determined to do that—watched what has happened, identified some issues and come back to legislate quickly and in a timely way to ensure that we close new loopholes as they occur.

I ask the hon. Lady to withdraw her amendment and the Committee to accept the clause.

Question put and agreed to.

Clause 23 accordingly ordered to stand part of the Bill.

Amendment proposed: 49, in schedule 7, page 96, line 22, at end insert—

'*Review of operations*

18A After section 259M, insert—

"**259O Hybrid and other mismatches measures: review of operation**

(1) Within 12 months after the passing of the Finance Act 2018, the Chancellor of the Exchequer must review the operation of the measures in this Part.

(2) The review under this section must consider—

(a) the impact of the measures on the use of hybrid transfer arrangements;

(b) the impact of the measures on the revenue effects of the use of hybrid transfer arrangements to reduce a person's tax liability;

(c) possible alternative or additional measures to reduce the use of hybrid transfer arrangements to reduce a person's tax liability;

(d) whether the measures constitute application of EU Directive 2016/1164 ('The Anti Tax Avoidance Directive'), including in what ways the measures do not constitute an application of that directive.

(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."'—*(Anneliese Dodds.)*

This amendment provides for a review of the measures against hybrid transfer arrangements to reduce a taxpayer's tax liability, and that this review consider whether alternative or additional measures would be more appropriate, and how these measures compare to the EU Anti Tax Avoidance Directive.

Question put, That the amendment be made.

The Committee divided: Ayes 9, Noes 10.

Division No. 5]

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
Rutley, David
Stride, rh Mel
Whately, Helen

Question accordingly negatived.

Schedule 7 agreed to.

The Chair: Does the Government Chief Whip wish to make a remark?

The Lord Commissioner of Her Majesty's Treasury (David Rutley): Chief Whip? *[Laughter.]*

Ordered, That further consideration be now adjourned.—*(David Rutley.)*

12.58 pm

Adjourned till this day at Two o'clock.