CLAUSE 20 AND SCHEDULE 6 OF FINANCE (NO.2) BILL 2017 – TRADING AND PROPERTY ALLOWANCE

Comments from the Association of Taxation Technicians

1 Background and introduction

1.1 These notes have been prepared by the Association of Taxation Technicians (ATT) following the publication of the Finance Bill on 20 March 2017. They concern the provisions of Clause 20 and Schedule 6 - the Trading and Property Allowances.

1.2 They build on and refer to both the ATT's response[1] (our Response) to the draft provisions that were published by HMRC on 5 December 2016 and the subsequent conference call of 11 February between representatives of HMRC and ATT (our Conference Call).

1.3 We welcome the changes that have been made to give greater clarity to the provisions and are pleased to have been of assistance in that process.

1.4 In these notes, our focus is on those matters where we think that further amendment may be required (or clarification provided in published departmental guidance) in order to ensure that the provisions work as intended and as well as possible in practice.

1.5 Our detailed comments in the following sections are grouped under subject headings.

1.6 Where there are parallel provisions in relation to the Property Allowance, our comments below in relation to the Trading Allowance apply equally.

1.7 References to the Explanatory Note are to the relevant Note within the Explanatory Notes published by HM Treasury on 20 March alongside the Finance Bill.

2 Asymmetry between Chapters 1 and 2 in the treatment of partnerships

2.1 Section 783AA in Chapter 1 of the Schedule excludes from the definition of *relevant trade* any trade carried on in partnership. There is no comparable exclusion within Chapter 2 in the definition of a relevant property business.

[1] The ATT's response of 1 February 2017 to the draft provisions can be found at: https://www.att.org.uk/technical/submissions/draft-fb17-clause-19-schedule-5-trading-property-allowances-att-comments

2.2 We noted in section 3.5.1 of our Response that HMRC's *Policy Paper* of 5 December 2016[2] indicated that 'The new allowances will not apply to partnership income from carrying on a trade, profession *or property business* in partnership' (emphasis provided). The consistency of treatment indicated in that statement is not currently delivered by the Schedule.

2.3 In our Conference Call of 11 February, we understood HMRC to reason that the non-exclusion of partnership activities from the Property Allowance was related to the informality of property owning arrangements. If that understanding was correct, we have to say that we find it unconvincing. We consider that it would be at least as easy (and probably easier) for individuals to be unwittingly *trading* in partnership as it would to be unwittingly carrying on a property business in partnership.

Suggestion One:

2.4 Unless there has been a change in policy intention since the *Policy Paper* of 5 December, we think, for the reasons set out in section 3.1 of our Response, that the objectives of simplicity and certainty (as well as consistency between the two Allowances) would be best served by applying the partnership exclusion only in respect of partnerships of more than two people. That would then have the effect of making the Trading Allowance available to a couple who were carrying on a cottage industry partnership trade of equal monetary value to the Property Allowances available to a couple who were (for example) conducting an *AirBnB* activity as a partnership.

2.5 In our Conference Call, HMRC expressed concern about both the revenue cost to the Treasury and the requirement for anti-avoidance provisions in connection with our suggestion concerning two-partner partnerships. Given that the Allowances will in our opinion largely legitimise the existing (non-compliant) non-declaration of income, we are doubtful whether our suggestion would involve a significant reduction in Treasury receipts. In relation to the requirement for anti-avoidance provisions, we are doubtful whether the level of the Allowances is sufficiently large to encourage significant avoidance activity. On that point, we also note that the addition of new section 783AP should itself discourage misuse of the allowances in the context of partnerships.

3 Accommodating *Generally Accepted Accounting Practice* (GAAP)

3.1 In sections 3.2.1 to 3.2.3 of our Response, we drew attention to the lack of clarity as to what constituted 'the receipts which would, apart from this Chapter, be brought into account in calculating the profits of the trade for the tax year'. We note that section 783AC(2) replaces the words 'the receipts' with the words 'all the amounts'. Our reading of the revised wording (and before considering the application of section 783AE (2) to (4)) is that the *amounts* in question might be established either under GAAP or on the 'cash-basis' depending upon whether a section 25A election had been made in respect of the particular trade or trades. That reading is supported by paragraph 7 of the Explanatory Note.

[2] The HMRC Policy Paper can be found at:
https://www.gov.uk/government/publications/income-tax-new-tax-allowance-for-property-and-trading-income/income-tax-new-tax-allowance-for-property-and-trading-income

3.2 Consistent with our reading of section 783AC(2) (see section 3.1 above), full relief is available in accordance with section 783AE(1) where the relevant income (determined in accordance with GAAP or the cash-basis as appropriate) does not exceed the individual's trading allowance.

Suggestion Two:

Given the uncertainty following publication of the draft provisions, we think that it will be helpful if the published departmental guidance makers it clear that the Trading Allowance applies equally to both GAAP and cash-basis scenarios.

4 New 783AE(2) to (4)

4.1 The newly introduced subsections 783AE(2) to (4) extends the availability of full relief to the situation where the individual's relevant income exceeds the individual's trading allowance but would not do so if the relevant income was established on the assumption that a section 25A (cash-basis) election was made in respect of each of the GAAP trades. This effectively extends the availability of full relief without imposing the wider consequences of a deemed section 25A election. As such, that appears to be an elegant solution but we comment in sections 4.2 to 4.6 below on various points of detail.

Explanatory Note 9

4.2 We note that paragraph 9 of the Explanatory Note includes the statement:

> 'Subsection (2) and (3) of 783AE provide that for the purposes of calculating the relevant income, cash basis is used rather than GAAP. '

That appears to us to mis-state the effect of the subsections. It would mean for example that if the relevant income calculated on a GAAP basis was less than the individual's trading allowance but that the relevant income would exceed the trading allowance if it were assumed that the cash basis applied, then full relief would not be available.

Suggestion Three:

We think that the Explanatory Note and any subsequent departmental guidance need to make it clear that the deemed election provision only applies where its impact is to *reduce* the relevant income so that it does not exceed the trading allowance. We do not think that any redrafting of section 783AE is required in relation to this point.

Electing out of the consequences of 783AE(2) and (3)

4.3 Our reading of section 783AE(2) and (3) is that an individual qualifies automatically for full relief where the 783AE(2) conditions are satisfied. No election is required. Consider then the situation of an individual who had:

- A GAAP-calculated and tax adjusted trading loss for a tax year (in respect of which they wished to claim tax relief) and

- A GAAP-calculated relevant income for that trade for the year which exceeded their trading allowance but
- A relevant income that was below their trading allowance if it were assumed they had made a section 25A election.

In that scenario, section 783AE(2) and (3) in conjunction with section 783AF(2) would operate to treat the losses of the trade as Nil unless the individual elected in accordance with section 783AL for full relief not to be given. So, an individual who might have chosen to follow GAAP might be obliged to make an election to avoid the consequence of a section 25A election which they had already decided not to make. That seems like an unhelpful complexity for such a conceptually simple relief.

Suggestion Four:

We think that the process would be more intuitive if the provisions of section 783AE(2) and (3) only applied if the individual elected *positively* for their application.

Time limits for electing out of full relief

4.4 As just noted in sections 4.1 and 4.3 above, section 783AE(2) and (3) *automatically* extend an individual's qualification for full relief through the assumed application of a section 25A election. Does that mean that an individual in the bulleted circumstances outlined in section 4.3 above who had simply given no thought to the implications of the Trading Allowance and (quite legitimately) not reported that trading detail to HMRC would be precluded from claiming loss relief if they did not within the time limits imposed by section 783AL(2) make an election for full relief not to be given?

Suggestion Five:

We think that departmental guidance should explicitly address the implications of such understandably missed elections.

New trades and 783AE(2)

4.5 As one of the conditions for the availability of full relief under section 783AE(2), subsection (e)(ii) requires that the individual was eligible to make a section 25A election in respect of each of the relevant GAAP trades for both the tax year and the immediately preceding tax year. Paragraph 9 of the Explanatory Note explains the reason for including the preceding year provision as follows:

> 'Subsection (2)(e) of section 783AE is to prevent trades with receipts of higher than the cash basis relevant maximum in the preceding year from qualifying for full relief because of subsection (2) and (3) of 783AE.'

Of itself, that is an understandable policy position. However, what it appears to overlook is that the tax year for which the individual is seeking to use the Trading Allowance might be their first year of trading. As we read it, the preceding year eligibility condition in section 783(2)(e)(ii) appears to prevent full relief where the individual's relevant income in the first year of trading (on a GAAP-basis) exceeds the trading allowance but would not do so if a section 25A election was assumed.

Suggestion Six:

We think that this apparent anomaly could be addressed simply by the insertion in subsection 783AE(2)(e)(ii) before the words 'for the immediately preceding tax year' of words along the lines of 'unless the GAAP trade in question started in the tax year,'.

New sections 227B and C

4.6 We note the introduction (as new sections 227B and 227C of ITTOIA 2005) in the Finance Bill version of the Schedule of provisions required to neutralise an advantage that would otherwise arise from the operation of section 783AE. That inevitably adds to the complexity created by the deemed section 25A election imposed by section 783AE(2) and (3). From our initial reading , we think that an individual could avoid those complexities by:

- electing (under section 783AL) out of the imposed full relief and
- electing (under section 783AM)into partial relief (on the basis that their GAAP-based relevant income exceeded their trading allowance).

We cannot see any reason in principle why such a dual election should be prevented (the individual is only getting the allowance that they would have received had section 783AE(2) and (3) not been introduced) but conceptually it feels somewhat odd.

Suggestions Seven and Eight:

- We think that it would be helpful if published departmental guidance made it clear whether such a dual election was possible.
- On a more general point, we think that it will essential for published departmental guidance to draw attention (with examples) to the future implications of sections 227B and 227C where the provisions of section 783AE(2) and (3) apply.

5 Capital Allowances

5.1 In section 3.3.2.2 of our Response, we noted that the Schedule as originally drafted contained no mention of capital allowances. We observed that it was unclear whether an individual whose profits or losses were treated as 'Nil' through the operation of full relief would nevertheless be entitled to claim capital allowances and thus create an allowable loss. (This obviously assumed that the individual had not made a section 25A (cash basis) election.) We cannot see that the point has been addressed in the Finance Bill version of the Schedule.

If the Nil profit or loss is *inclusive* of any capital allowance or charge, there needs to be identification of the amount of that charge or allowance for future computation purposes. If, on the other hand, the Nil profit or loss is *exclusive* of any allowance or charge, it needs to be clear how relief of that allowance (or charging of that charge) is made.

Suggestion Nine:

We think that it will be important to spell out in published departmental guidance whether a GAAP-trader who has a Nil profit/loss by reason of full relief will nevertheless be able to claim loss relief in respect of available capital allowances or what allowances or charges are assumed to be made in that calculation of the Nil profit or loss.

6 The connection test

6.1 In the 5 December 2016 draft, relief was excluded (under what was section 783P) where an individual's relevant income included a payment 'made by, or on behalf of, a person at a time when the individual is (i) an employee of the person, or (ii) connected with an employee of the person'. That exclusion is now found in section 783AO.

6.2 In the Finance Bill version, the exclusion of relief is extended (by sections 783AP and 783AQ) to situations where the individual's relevant income includes a payment from a firm in which the individual (or a person connected with the individual) is a partner or a payment from a close company in which the individual (or an associate of the individual) is a participator.

6.3 Section 783AQ applies the same meaning to the words 'associate' and 'participator' as are given by identified sections of Part 10 of CTA 2010. If an individual was able to access that legislation, they might thereby appreciate that it meant that if as little as a single pound of their relevant income came from a close company in which their relative (spouse, civil partner, parent or remoter forebear, child or remoter issue or sibling) was a shareholder (or loan creditor) they would not qualify for the Trading Allowance.

6.4 By contrast, neither section 783AO nor section783AP give any indication of the meaning of 'connected with'. Paragraph 20 of the Explanatory Note states that 'Persons connected is defined by section 993 Income Tax Act 2007 (ITA) to include spouse, civil partner, relative (brother, sister, ancestor and lineal descendants) etc.' We believe that section 878(5) of ITTOIA 2005 is the authority for the statement but think that a direct cross-reference in the legislation would assist understanding of the exclusion.

6.5 Assuming that an individual was able to locate section 993, ITA 2007, they might discover that qualification for the Trading Allowance was excluded if as little as a single pound of their relevant income came from (as examples):

- The employer of an 'in-law' of their spouse or civil partner (see section 993(2)(e) or
- A partnership in which their sibling, ancestor or lineal descendant is a partner (see section 993(4)(c).

6.6 In relation specifically to the partnership connection exclusion, we read section 993(4) to provide a self-contained definition of what constitutes connection with a partner. By that we mean that the generic connection test in section 993(2) which is used in determining connection through employment (section 783AO) has no part in determining connection with a partner. We can see, however, that the similarity of wording between sections 783AO(b)(ii) and 783AP(b)(ii) could lead a reader to an alternative conclusion.

Suggestion Ten:

We think that it will be essential for the departmental guidance to provide clarity on this point.

6.7 Overall, we are concerned that the three exclusion provisions may adversely impact the effectiveness of the new allowances. We consider that:

- The complexity of the exclusion provisions may deter some unrepresented individuals from considering their eligibility;
- Other unrepresented individuals may ignore the provisions and incorrectly assume eligibility;
- The complexities will make it uneconomical for tax practitioners to provide clear advice concerning entitlement to the allowance.

Suggestion Eleven:

On the assumption that the exclusion provisions are seen as essential in order to prevent abuse of the allowances, we wonder whether it might be possible to by-pass the complexity of the connection tests by only applying them in more clearly defined circumstances. We suggest that their application could sensibly be restricted to where more than a defined percentage of an individual's relevant income was (in aggregate) from the excluded sources. We think that a percentage of between perhaps a third and a half might be considered reasonable. That would avoid the anomaly of denial of the allowance where the source of only a minority of the relevant income was from a connected source.

7 Voluntary Notification of Use of the Allowances

7.1 The legislation as drafted requires no claim for the allowances. They apply automatically in the specified circumstances. That is wholly appropriate in respect of allowances which are intended to be simple and certain - particularly so in the case of allowances that are designed to remove a reporting requirement. For many taxpayers, we envisage that the allowances will serve to convert current non-compliant non-reporting of minor sources of income into compliant behaviour.

7.2 The absence of any notification procedure does, however, have two adverse consequences:

- Taxpayers who make use of the allowances will receive no focused guidance from HMRC on their operation. We think that many would find such guidance helpful.
- HMRC will be unable to identify whether a taxpayer who (from other sources) is known to be in receipt of income is correctly using one of the allowances to relieve that income or is failing to declare income. This has implications for the deployment of HMRC's scarce resources.

Suggestion Twelve:

We think that a *voluntary* notification procedure could help to counter the adverse consequences noted in section 7.2 above at the same time as supporting the principles of simplicity and certainty referred to in section 7.1 above. If a taxpayer could use their Personal Tax Account to notify HMRC of their use of an allowance, it would mean that HMRC could provide appropriate customised guidance about the allowances through prompts and nudges ('is your relevant income still no greater than your trading allowance?', etc). It could also avoid the need for HMRC to enquire into what might otherwise appear to be a possible non-declaration of an income source.

8 Published Departmental Guidance

8.1 We have referred a number of times in this note to the role of published departmental guidance. As always, we would be pleased to review any pre-publication draft if that would be helpful.

9 Contact

9.1 Should you wish to discuss any aspect of this note, please contact our relevant Technical Officer, Will Silsby, on 01905 612098 or at: wsilsby@att.org.uk

Yours sincerely

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Co-Chair of the ATT's Technical Steering Group

10 Note

10.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 8,000 members and Fellows together with over 5,700 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.