Chartered Institute of Taxation
Excellence in Taxation

Reliefs for Business
Clauses 18-20 and Schedules 2-4

Executive Summary

Clause 18: Temporary extension of periods to which trade losses may be carried back
We welcome this measure which will give businesses with a track record of making profits and paying tax, but which have suffered during the pandemic, a much-needed cash injection. There is a case for extending the measure to property businesses as well as trading businesses. We have a concern relating to the potential interaction of any tax refund with Universal Credit.

Clause 19: R&D tax credits for SMEs
We support the government's work to counter fraudulent attempts to claim the SME R&D scheme payable tax credit and consider that the proposed cap will assist in deterring abuse. We welcome the aspects of the measure that have been incorporated as a result of consultations.

Clause 20: Social Investment Tax Relief
We support the decision to extend the life of this relief, but believe that the government needs to do more to increase its take-up. Although some obstacles to using social investment tax relief to invest in social enterprises have been removed (albeit that effect has yet to bed in), significant barriers to take up remain. Principally it is an over complex relief for the smaller organisations it is designed to support. A two year period to address the current barriers is unlikely to be sufficient and may put off some long-term investors.

1 Clause 18 and Schedule 2: Temporary extension of periods to which trade losses may be carried back (Overview)

1.1 Clause 18 of the Finance Bill introduces Schedule 2, which makes provision for a temporary extension of periods to which trade losses may be carried back for corporation tax and income tax. This measure is being introduced in response to the COVID-19 pandemic to assist businesses that have suffered economic harm because of restrictions placed upon them. The measure is intended to provide a cash flow benefit to affected businesses by providing additional relief for trading losses.

1.2 For corporation tax, the extension applies to trading losses arising in a relevant accounting period ending from 1 April 2020 to 31 March 2022. For income tax the rules are extended in relation to a trade loss (including a loss in a profession or vocation) made in tax years 2020/21 and 2021/22.

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1.3 Trading losses up to £2,000,000 per 12-month period for both companies and unincorporated businesses can be carried back for the extended period.

2 Clause 18 and Schedule 2 - CIOT comments

2.1 We welcome this provision, which temporarily extends the trading loss carry-back rule from one year to three years. This is something the CIOT has been suggesting over the past year, including in a Budget representation in January[1]. Allowing businesses to benefit from a three-year carry back of trading losses arising during the pandemic will give businesses with a track record of making profits and paying tax – a good proxy for long-term viability – but which have suffered during the pandemic, a much-needed cash injection.

2.2 In our view the measures will also be cost-effective. In many cases (where the business would ultimately have recovered in any event), it will be a cash flow (rather than absolute) cost to the government which will reverse as the business, having used up its losses by carrying them back, makes profits and pays tax sooner in the future.

2.3 We note the cap of £2m on the amount of losses that can be carried back to the additional two years and recognise that this does permit a maximum cost to the Exchequer to be calculated. However, we would be surprised if the measure would have cost significantly more over the economic cycle if it had been unlimited. This is because it is likely to be the largest companies that have losses in excess of £2m per accounting period, and for these companies the reversal of the cost (which will occur when the companies will begin to pay corporation tax again on profits earlier than would have been the case if they had the losses to carry forward) will be at the higher rate of corporation tax that will apply from April 2023.

2.4 The combination of the corporation tax rate increase and extended loss carry-back may give some businesses a dilemma – use current losses for relief on past corporation tax bills at 19 per cent, getting the money now, or banking on profits returning in future and keeping the losses to get relief at 25 per cent in a few years' time. But most businesses will probably think it better to have that choice than not.

2.5 We note that the extended carry back of losses is limited to trading losses, replicating the existing rules permitting a twelve month carry back (by excluding property income losses and non-trading loan relationship deficits). We recognise that these measures have been costed and the decision about where to target relief has been made in terms of supporting businesses that have incurred losses because of the COVID-19 pandemic. However, many landlords are incurring losses, for instance because their trading tenants are making losses. Property businesses will be an important part of the economic recovery – they will need to re-purpose the high street. Property businesses that have incurred losses would benefit in the same way as trading businesses from an ability to carry back losses to achieve a cash flow injection, noting that the cash flow cost to the government will reverse as the property business returns to profit in the future.

2.6 One issue identified by the Institute's Low Incomes Tax Reform Group is the potential interaction of any tax refund with Universal Credit (UC). There has been a significant increase in claims for UC during the pandemic, including from self-employed individuals and

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[1] See https://www.tax.org.uk/sites/default/files/210113%20Chartered%20Institute%20Of%20Taxation%20Budget%20representation%20on%20changes%20to%20the%20tax%20rules%20affecting%20companies.pdf

limited company directors who may not have needed to claim such support before the pandemic. Under UC legislation (UC Regulations 2013, Reg 57), self-employed income for a UC monthly assessment period is calculated by taking the actual receipts in that assessment period and deducting any amounts allowed as expenses, any tax and NI paid and any relievable pension contributions in that assessment period. Receipts specifically include any refund or repayment of income tax, VAT or NIC relating to the trade, profession or vocation. Any tax refund made as a result of this provision may therefore fall to be treated as income for UC purposes in the assessment period it is received which, in most cases, will lead to a reduction of UC of 63p for each £1 of refund.

2.7 In addition, if the refund is large enough, it may trigger the surplus earnings rules meaning that any 'excess' income in one assessment period can be carried forward and treated as income in the next assessment period (up to a maximum of 6 months). It would be helpful if the Minister could say whether the government are aware of this issue and what plans they have to raise awareness of it with UC claimants so that they can understand that, if the refund is received when they are in receipt of UC, they will need to report it as income for UC purposes and how it might impact their award.

3 Clause 19 and Schedules 3-4: R&D tax credits for SMEs (Overview)

3.1 Clause 19 and Schedules 3 and 4 introduce a new restriction to the payable element of the research and development (R&D) tax credit for companies which are small or medium sized enterprises (SMEs).

3.2 Schedule 3 applies the new cap to the payable R&D tax credit for SME companies. Schedule 4 makes similar changes to the legislation for R&D tax credits that would apply if the Northern Ireland Assembly were to vary the rate of Corporation Tax for Northern Ireland companies.

3.3 The restriction – referred to as the cap – is based upon the Pay-As-You-Earn (PAYE) and National Insurance Contributions (NIC) that the company is required to pay for its own employees, as well as some PAYE and NIC of connected companies. The legislation also incorporates a threshold of £20,000 so that the smallest claims will be uncapped. The change has effect for accounting periods beginning on or after 1 April 2021.

4 Clause 19 and Schedules 3-4 - CIOT Comments

4.1 The government are right to be working to counter fraudulent attempts to claim the SME R&D scheme payable tax credit. The proposed cap on the amount of SME payable R&D tax credit that a business can receive in any one year by reference to the company's total PAYE and NICs liability will assist in deterring abuse.

4.2 The proposal for a cap to the payable R&D tax credit was initially announced in Budget 2018. Following consultation in 2019, Budget 2020 announced the introduction of the cap would be delayed until 1 April 2021 and that there would be further consultation on the details of the proposal to mitigate any impact on genuine businesses. We welcome the aspects of the measure that have been incorporated as a result of the two consultations, and consider that these changes will minimise the impact and the deterrent effect on genuine businesses undertaking genuine R&D. In particular, the legislation includes an exemption from the cap where a company is creating, preparing to create, or managing intellectual property and where less than 15% of the R&D expenditure is with other connected companies (a new CTA 2009 section 1058D).

4.3 We also welcome the continued recognition by the government of the importance of R&D to increasing productivity and the commitment to ensure that the UK remains a competitive location for cutting-edge research. Reviews of reliefs are an oft-forgotten stage of the tax policy-making process, and we were pleased to see at the Budget the government's review of whether the reliefs remain up-to-date, competitive and well-targeted.

4.4 We also continue to encourage HMRC in their efforts (alongside the professional bodies) to improve standards in part of the R&D advice sector, to ensure that only legitimate claims are made by advisers who adhere to strict professional standards such as Professional Conduct in Relation to Taxation (PCRT).[2]

5 Clause 20: Extension of social investment tax relief (SITR) for further two years (Overview)

5.1 Following consultation, at Budget 2021 the government announced it would extend SITR[3] in its current form beyond the current sunset clause of 6 April 2021, for a further two years - to 6 April 2023.

5.2 The social enterprise market is a small but important one, bridging the gap between charities and businesses. Many smaller social enterprises rely heavily on grant-funding and donations. SITR encourages them to look at more 'commercial' forms of financing such as equity and debt.

5.3 However, take up of SITR has been low. HMRC's last statistics in May 2020 state that since 2014 when SITR was launched, 110 social enterprises have raised funds of £11.2 million through SITR[4].

6 Clause 20 – CIOT Comments

6.1 We support the decision to extend the life of this relief, but believe that the government needs to do more to increase its take-up.

6.2 The relief itself is relatively new. As with other investment reliefs, it takes time for the relief to become 'normalised' in the investment community. Establishing a SITR fund to attract investors interested in systematic investment instead of supporting a one-off project (see 1.6 below), is similarly a longer term initiative. Some barriers to investment have been removed relatively recently although the effects have yet to take root. For example the limit on investment was only raised to the current level of £1.5million (over the lifetime of the

[2] See https://www.tax.org.uk/professional-standards/professional-rules/professional-conduct-relation-taxation

[3] In broad terms the tax reliefs are income tax relief (30 per cent of a qualifying investment subject to conditions and a maximum of £1m), capital gains tax relief on disposal of the qualifying investment or deferral of chargeable gains on other assets by investing in a qualifying SITR investment, sheltering the gain until the social investment is sold, matures or is redeemed.

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/887546/May_2020_Commentary_EIS_SEIS_SITR_National_Statistics.pdf

enterprise) from April 2017. Before that the maximum was much lower and designated in euros.

6.3 Furthermore, significant obstacles to take up remain:

- SITR is (partly) modelled on the Enterprise Investment Scheme (EIS) framework - it is therefore complex, much too complex for the smaller organisations it is designed to support.

- SITR reliefs (based as they are on the EIS model which is only available for equity investments) are less suited to investment made by way of loans (anecdotally loans to social enterprises are more common than equity investment), for example there is no income relief for interest and no inheritance tax relief for a SITR loan. With that in mind, it would be very helpful to probe the level of SITR loan investment compared to equity investment:

  Of the total funds raised of £11.2 million since 2014 through SITR, what proportion is in the form of loans?

- A single direct investment by an altruistic individual who does not wish to have any hands-on involvement in the social enterprise is rare; the conditions for SITR restrict that involvement so take up by this category of investor is likely to remain low.

- There is limited relief for losses if the investment proves unsuccessful.

- The need to consider making a disclosure under the Disclosure Of Tax Avoidance Scheme (DOTAS) rules for a SITR investment has the potential to jeopardise any investment that requires a sponsoring bank. We suggest that SITR should be specifically excluded by regulation from DOTAS to remove this potentially significant barrier to investment. By contrast, for example, there is a specific exclusion by regulation for EIS for the standardised tax products hallmark.

- Low awareness of the relief. Easy access to practical guidance and qualitative research such as that found on the Big Society Capital website would encourage potential investors.

6.4 A two year period to address the current barriers, and to allow recent changes to bed in, is unlikely to be sufficient in part because some of the issues can only be resolved by consultation and legislative change. The limited extension may put off some long-term investors despite the stated purpose[5] of the extension being to continue supporting investment to social enterprises.

6.5 We suggest the government should consult more widely on how investment in social enterprises can be facilitated. This would go broader than tax matters, but one such element should be the extent (if any) that the tax system should incentivise such investments and, if so, whether SITR is the best model to use. An alternative model based on Gift Aid instead of the over-complex EIS could be explored.

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[5] Summary of responses para 4.3 https://www.gov.uk/government/consultations/social-investment-tax-relief-call-for-evidence

6.6 We welcome the fact that the government have evaluated this relief. We favour a more systematic approach to reviewing the effectiveness of tax reliefs and other tax measures. In the 2017 paper, *Better Budgets*, published jointly by the Chartered Institute of Taxation, the Institute for Government and the Institute for Fiscal Studies, we said:
"There needs to be effective and routine post-legislative review of whether measures are achieving their objectives at an acceptable cost, and Parliament should hold government to account for this. Data need to be more accessible to allow outside researchers to evaluate policy."

6.7 We noted in *Better Budgets* that, in March 2008, the Government committed to a new system of post-legislative scrutiny but exempted Finance Acts from that discipline. Three to five years after Royal Assent of a bill, government departments must submit a memorandum to their House of Commons committee with a preliminary assessment of the Act's effects, from which the committee can choose to conduct a further inquiry. However, the NAO has drawn attention to the lack of systematic effort put into evaluating the impact of tax measures.

7 The Chartered Institute of Taxation

7.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

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The Chartered Institute of Taxation
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