PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCE (NO. 3) BILL

(Except clauses 4, 7, 10, 19, 35 and 72)

Eighth Sitting

Thursday 19 May 2011

(Afternoon)

CONTENTS

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Monday 23 May 2011

STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY FACILITATE THE PROMPT PUBLICATION OF THE BOUND VOLUMES OF PROCEEDINGS IN GENERAL COMMITTEES

The Committee consisted of the following Members:

Chairs: †Mr Roger Gale, Mr Jim Hood

Aldous, Peter *(Waveney)* (Con)
† Barclay, Stephen *(North East Cambridgeshire)* (Con)
† Blenkinsop, Tom *(Middlesbrough South and East Cleveland)* (Lab)
† Blomfield, Paul *(Sheffield Central)* (Lab)
† Bradley, Karen *(Staffordshire Moorlands)* (Con)
† Creasy, Stella *(Walthamstow)* (Lab/Co-op)
† Crockart, Mike *(Edinburgh West)* (LD)
† Crouch, Tracey *(Chatham and Aylesford)* (Con)
† Dakin, Nic *(Scunthorpe)* (Lab)
† Esterson, Bill *(Sefton Central)* (Lab)
† Gauke, Mr David *(Exchequer Secretary to the Treasury)*
† Glindon, Mrs Mary *(North Tyneside)* (Lab)
† Goodwill, Mr Robert *(Scarborough and Whitby)* (Con)
† Greening, Justine *(Economic Secretary to the Treasury)*
† Hanson, Mr David *(Delyn)* (Lab)
† Harrington, Richard *(Watford)* (Con)
† Hoban, Mr Mark *(Financial Secretary to the Treasury)*
† Lee, Jessica *(Erewash)* (Con)
† Lewis, Brandon *(Great Yarmouth)* (Con)
† McCarthy, Kerry *(Bristol East)* (Lab)
† McCartney, Karl *(Lincoln)* (Con)
† McClymont, Gregg *(Cumbernauld, Kilsyth and Kirkintilloch East)* (Lab)
† McGovern, Alison *(Wirral South)* (Lab)
† Mearns, Ian *(Gateshead)* (Lab)
† Murray, Ian *(Edinburgh South)* (Lab)
† Nash, Pamela *(Airdrie and Shotts)* (Lab)
Parish, Neil *(Tiverton and Honiton)* (Con)
† Phillipson, Bridget *(Houghton and Sunderland South)* (Lab)
† Sharma, Alok *(Reading West)* (Con)
† Shelbrooke, Alec *(Elmet and Rothwell)* (Con)
† Smith, Julian *(Skipton and Ripon)* (Con)
Wharton, James *(Stockton South)* (Con)
† Williams, Roger *(Brecon and Radnorshire)* (LD)
† Williams, Stephen *(Bristol West)* (LD)
Wilson, Sammy *(East Antrim)* (DUP)

Simon Patrick, *Committee Clerk*

† attended the Committee

Public Bill Committee

Thursday 19 May 2011

(Afternoon)

[Mr Roger Gale *in the Chair*]

Finance (No. 3) Bill

(Except clauses 4, 7, 10, 19, 35 and 72)

Clause 26

Employment income provided through third parties

1 pm

Question (this day) again proposed, That the clause stand part of the Bill.

The Chair: With this we may discuss the following: Government amendments 102, 103, 10 to 70, 104, 71 to 93, 105, 106 and 94.

That schedule 2 be the Second schedule to the Bill.

Mr David Hanson (Delyn) (Lab): It is a pleasure to be back in Committee this afternoon. When we left off this morning, I had just cited the House of Lords Select Committee on Economic Affairs Finance Bill Sub-Committee sitting on 4 May with Mr John Whiting. We were debating the merits of the phrase

"Whoa, this is just getting too much",

which Mr Whiting elucidated to Members of another place. He said that with the 59 pages of provision, it was just getting too much,

"particularly when you need a lot more to change it. I go back"—

Richard Harrington (Watford) (Con): Will the right hon. Gentleman give way?

Mr Hanson: I will finish the quote and then I will certainly give way to the hon. Gentleman. Mr Whiting then said:

"The trouble is we are so far down the track I suspect we are committed to adding another half dozen pages to this 59."

Richard Harrington: I am grateful to the right hon. Gentleman for giving way and to you, Mr Gale, for your patience on this matter. This will be my final intervention on the issue. I tried to contact Mr Whiting's office at lunchtime to get clarification of what he meant by the word "Whoa". Unfortunately, he was out at lunch, and I can only assume that he was pursuing his hobby of driving a horse and cart, he told the horse to pull up and then continued dictating his article to his secretary.

Mr Hanson: Would that that were the case. The word "Whoa" was actually uttered in Committee in another place and is recorded in *Hansard*. It was used not in an article, but to indicate Mr Whiting's genuine level of shock at the number of pages in schedule 2 as constituted at the time, never mind how long it will be with the amendments—I think that there were 88 at the last count—that the Minister has tabled.

At the same sitting, Mr John Kimmer of the Association of Taxation Technicians said:

"The phrase in the draft legislation that I was particularly concerned about was, 'It is reasonable to suppose that in essence this is a tax avoidance motive'. That, to me, is far too woolly. We have now got to 59 pages of anti-avoidance legislation and I think the point my colleague made is why not start from somewhere else and say, 'These arrangements are fine, everything else is not'? I am sure that could be done in a lot less than 59 pages".

Also at the sitting on 4 May, Mr Richard Murphy of Tax Research UK said:

"There is more unanimity on this table than I expected to some degree, to be honest, because I entirely agree…These are not employee benefit trusts; they are tax-cheating arrangements. Let's be blunt about it. That is what they should be called. The way they are being sold is wrong."

He said that in December 2004, my right hon. Friend the Member for Bristol South (Dawn Primarolo)

"simplified the taxes for this country enormously by saying all employee remuneration would be subject to PAYE. It was a fantastic move. It worked in a very clear move to clamp down on these things. This should have been covered except for specific carve-outs. I cannot understand why we have not carried on with that principle now. She was right. We need to go that way again."

The key point is that the schedule is simply too complex for people dealing with it outside the House. The Minister may believe that he has simplified it. It consisted of 59 pages before the amendments. The number of pages may be more or less now; I have not had time to count them. However, he needs to recognise that there is real concern outside the House about the schedule and the clause.

Ian Murray (Edinburgh South) (Lab): I read the 88 amendments four times during lunch and after my face inserting itself into the bowl of soup I was having because I fell asleep, I still could not understand them. Is there not a danger that the complication that has been inserted into the legislation to deal with tax avoidance could in fact open up more loopholes as a result of the legislation being too complicated?

Mr Hanson: That is another of my key concerns. I am grateful to my hon. Friend for giving up his lunchtime to read the 88 amendments that the Minister has tabled. My purpose today is simply to say to the Minister—and I hope this answers my hon. Friend's point—that he has some clear objectives in the clause and in the schedule to tighten up anti-avoidance legislation. However, the way in which the schedule is drafted, and the way in which, even now, because he has realised it is very difficult, he has tabled amendments to try to clarify some of the exemptions, still means that it is a very complex piece of legislation. All he really seeks to do is to ensure that he tightens up on loans that are never likely to be repaid, tightens up on assets available to an employer by putting them into a trust without the employee paying tax on them, and make sure that the £50,000 pension cap is effective. Those are the three objectives he has set himself, yet he has taken 59 pages, a schedule and a clause with 88 amendments to get to a stage where he cannot yet even give me a guarantee that he will not amend the measure still further.

Nic Dakin (Scunthorpe) (Lab): After I read the 88 amendments this lunchtime, I began to read the briefs that have been issued. One is from the Institute of Chartered Accountants, which succinctly picks up the points made by my right hon. Friend:

"These highly complicated rules are difficult to understand, highly uncertain in their operation, likely to be very expensive to operate and practically very difficult for HMRC to administer. Further, many employers may find themselves caught by the rules due to ignorance".

Does my right hon. Friend share the institute's concerns?

Mr Hanson: I do, and I am grateful to my hon. Friend for looking through the amendments this morning. Let me try to be fair to the Minister. The Treasury has, in response to the consultation, tabled 88 amendments. I want to hear from the Minister when he makes his winding-up speech whether he is satisfied that those 88 amendments answer the concerns that have been expressed about clarity, complexity and objectivity, so that businesses will understand the final version of the schedule in a workable and practicable way.

In response to the concerns expressed by the Chartered Institute of Taxation, to which my hon. Friend has just referred, the Treasury said in a press statement to the *Financial Times* on FT.com:

"In line with the government's new approach to tax policymaking, the legislation was published for consultation at the end of the year".

Good—we applaud that. It may be something that previous Governments should have done. The Treasury press statement goes on:

"The amendments are clear evidence of the government's commitment to listening to consultation responses from representative bodies and industry experts".

Again, let us take that at face value. The Bill was published on 29 March. The consultation took place in December last year. Consultation finished, comments were made and the Bill was published. Then, four days before consideration in Committee, 88 amendments were tabled with no real explanatory notes, trying to support the changes that the Government believed they should make. We have received submissions from a number of bodies, which I quoted this morning and will not repeat, saying that they do not believe that those amendments have made a difference, clarified the situation or eased the complexity of the legislation. I simply say to the Minister that this is an extremely complex matter and the legislation needs to be very tight and understandable so that it can be taken on board and implemented downstream.

Again, the Quoted Companies Alliance sent a very helpful brief to Members of the Committee before the amendments were tabled in which it said:

"The current draft legislation on disguised remuneration in the Finance Bill 2008 is overly complex and not sufficiently targeted. This goes against the Government's current commitment and the coalition agreement to reduce red tape for businesses and to simplify regulation…The legislation is very difficult to understand even for experienced share scheme practitioners and is incomprehensible for many of those in companies responsible for operating the rules"—

"Incomprehensible" is a very strong word—

"This complexity, 60 pages of statute"—

It has increased by one, according to the alliance, from 59 pages—

"30 pages of explanatory notes, 19 pages of frequently asked questions, highlights the complete failure in the drafting and targeting of these provisions and a lack of co-ordination between the different sections of HMRC and those drafting the legislation".

If the Minister wants to intervene to say that that is not factually correct and that his 88 amendments will stop the "incomprehensible" nature of the legislation, he should do so.

I am not trying to cause the Minister difficulties—we share the sentiments behind his proposals. We want to see a tightening up, because people should not have loans paid to them that that they never pay back. People should not have assets put into trust and not pay tax on them, but that can be done in a much simpler and more effective way. I will happily give way to him if he believes that his changes do not make the scheme incomprehensible as the Quoted Companies Alliance suggests before, during and after his amendments. We will happily slow down our discussions and make progress on the Bill, but I do not believe he can. If wants to give his justification, I am happy to take an intervention.

The Exchequer Secretary to the Treasury (Mr David Gauke): I'll let you finish, David.

Mr Hanson: The Exchequer Secretary, helpful and charming as ever, will allow me to finish, so I shall progress, as they say, as there is more to discuss and examine. He will have received other briefings, such as the one that we have received from the Quoted Companies Alliance, suggesting a series of amendments. When he winds up the debate, I should like him to tell us whether all the points that have been made in the briefings have been dealt with to his satisfaction. We have a duty to explore and discuss the briefing from the Institute of Chartered Accountants in England and Wales, which states:

"We submitted a Parliamentary Briefing to members of the Public Bill Committee on 12 May 2011. This set out key concerns about these provisions.

The previous day the Government published an extensive list of amendments that have been tabled in respect of these provisions…we had not had the opportunity to review the latest set of amendments. In view of the general concern about these provisions and the requests that we have received about whether we have some more detailed comments, we have prepared this more detailed briefing".

The ICAEW said last week that it has not had an opportunity to consider the amendments in detail, yet the Committee is being asked to consider these matters and to support amendments that will impact on all our constituents and businesses throughout the United Kingdom in a worrying way.

Paragraph 4 of the ICAEW briefing states:

"Our major concerns with these proposed rules still remain."—

That is after the amendments were tabled—

"We believe that this legislation is still too widely targeted."—

That is after the amendments were tabled—

"It catches too many innocent and/or commercial transactions."—

That is after the amendments were tabled—

"It remains the case that as drafted tax liabilities will still arise in circumstances where the employee in question may receive no value from the arrangement, either when the taxable 'relevant step' is taken or at any later time."

That is after the amendments were tabled. I am not here to be a mouthpiece for the ICAEW, but its members

[Mr Hanson]

know what they are talking about, and they have a point to make. Although the briefing says that it has not received full details of the amendments, its assessment after an initial cursory glance is that they will not change anything.

I return to the Minister's speech on 27 January this year, in which he said:

"We need a simpler, more stable tax system".

That is what I should like to focus on today. Here is his opportunity to have a simpler, more stable tax system; withdraw the clause; withdraw the schedule; go back and talk to officials; look at the objectives he is trying to achieve and bring the measure back in a simplified and more understandable form on Report. He will have our support for that. He will then undoubtedly have the opportunity to consult the ICAEW, the Quoted Companies Alliance, Grant Thornton and a range of tax experts who are saying to me— and I am reflecting this to him in Committee—that the rules are overtly complex, do not achieve what they are intended to achieve, and will not be workable on the ground.

The ICAEW said:

"These are our views. In view of the short timescale for comments, we may return to this matter with a further a parliamentary briefing at report stage."

It that the way to legislate? Under the Minister's own terms, we have had consultation, amendments, a brief that people cannot comment on, and we hear that the matter might have to be looked at further on Report. If that is the case, does he intend to table more amendments on Report if the ICAEW or any other body make further comments?

1.15 pm

I mention that because, as the Minister and the Committee know, the Finance Bill is one of the few that does not travel to another place. One hundred years ago, the House of Commons fought hard to ensure that the unelected peers in another place did not influence and interfere with financial matters, and I am proud to say that Labour MPs, although few and far between at the time, were at the forefront of arguing for reform of the Lords and for the Finance Bill to be dealt with in the Commons.

If the Minister tables amendments on Report, or if proposals are agreed in Committee, there is no revising Chamber. We are making legislation. If the ICAEW or the Minister raise concerns, the Government could table amendments on Report that might not even be discussed as a result of time constraints. I remind the Committee that the Report stage might last one or two days—I do not know, as the usual channels have not discussed it. Amendments will be tabled on a range of matters, and we may raise topics that have been considered in Committee if we want to reflect on them again. We can debate these matters all day and all night, as he knows.

It may have taken a long time to make it, but my simple point is that it is important that we get this right. The fact that the Minister has consulted on the Bill, has had to amend it and is still receiving representations saying, "We're not happy. It's not going to work. We support the objectives but may need to bring forward further parliamentary briefings at report stage", as the ICAEW has said, suggests that this is not a very tight ship for the objectives and that he should look at it again.

I have received representations from Handelsbanken through McDermott Will & Emery LLP. Handelsbanken is one of Sweden's largest banks, headquartered in Stockholm with a market capitalisation of about £13.2 billion. It is established under Swedish law, but its key consideration regarding the proposals is about shares given to its employees collectively in recognition of the integral role that they play in generating bank profits. The brief raising Handelsbanken's concerns runs to about 11 pages, which I do not intend to read in full. [Hon. Members: "Go on."] If hon. Friends tempt me, I may do so. *[Interruption.]* And I will do it in Swedish. Handelsbanken makes a serious point that the Minister should consider in point 5.6 of its submission:

"For the bank, the new part 7a presents an unpalatable dilemma. Either gross up UK employees for their tax liabilities or subject UK employees to a less favourable position than their counterparts in other jurisdictions, which may lead to less quantifiable but potentially greater costs through demotivated staff."

Ian Murray: I am grateful to my right hon. Friend for being so generous. However, there is not only a European dimension to this; there is an international one. There is a Chinese company called Huawei that employs about 3,500 people in this country, and is owned by its employees. Although the company is not listed on the stock exchange, each employee is offered a certain degree of shareholding, based on longevity of service and their level in the company. Companies such as Huawei that are based in this country may find this legislation very difficult in terms of who owns the company and how shareholding is constructed. So it is not just about Europe; there is an international dimension as well.

Mr Hanson: I hope that my hon. Friend will be able to develop that point further during our discussions today. There are key issues which we need to consider. There are three objectives in the legislation, as I see them. First, that loans should not be made that are never likely to be repaid; we agree that that should be tightened up. Secondly, that making assets available to an employee by putting them into a trust without the employee paying tax on them is an important issue we need to tackle. Finally, we need to look at the pension cap.

I cannot see why, with the great power of the Treasury, the Minister cannot look at legislation that deals with those three issues without the list of exemptions that he has put down in the 59 to 60, 61 or 62 pages of the schedule that he has at the moment. I return to the fact that the rules proposed are too complex. The chairman of the Chartered Institute of Taxation employment taxes sub-committee, Colin Ben-Nathan, has said:

"We think that employers will face real difficulties in trying to assess how they stand with this new legislation and that they are likely to need to take advice to arrive at a considered view.

Even then that does not necessarily mean that HMRC will agree with the view that has been taken, leaving employers open to potential uncertainty on whether or not tax charges arise and at what point. We suspect many employers will want to seek clearance from HMRC on their particular arrangements and we wonder whether HMRC…"

—this is the key point—

"…has the resources to cope and what the turnaround time will be."

Before we sanction this legislation today, we need a clear indication from the Minister of the assessment he has from officials of the likely workload for HMRC staff, given the complexity of the clause and schedule 2. I am only reflecting views from outside the House, in a way that I hope is constructive for the Minister. If the chairman of the Chartered Institute of Taxation is saying that this will lead to a greater workload for HMRC, what assessment has the Minister made of that workload? What assessment has he made of the impact on HMRC staff? What assessment has he made of the level of resources he will raise from these measures versus the cost of enforcing them?

Nic Dakin: Is my right hon. Friend aware that there is a 15% overall resource cut in HMRC, with a further 25% efficiency savings? This is a very pertinent question. I hope that the Minister is able to pick up the point my right hon. Friend is making.

Mr Hanson: My hon. Friend anticipates what I am going to say. The CSR announced by the Chancellor of the Exchequer on October 20—I quote from Tax-News.com, which is an accurate reflection of these matters—

"aims to slash public spending by GBP80bn over the next few years, and means that HMRC will see its resource spending cut by GBP300m to GBP3.2bn by 2014/15."

The Minister has announced additional resources of around £900 million for HMRC, but overall that is replacing a cut elsewhere in the Budget. I think that it is important that the Minister answers my hon. Friend's point about what demands businesses will place on HMRC as a result of this clause and schedule 2.

Ian Murray: I am very grateful for my right hon. Friend's unstinting generosity in giving way. There is a bigger issue for HMRC. I am sure that every member of the Committee has had a significant increase in constituency casework, due to HMRC cases in which the administration is either breaking down or not operating at all. A key issue is that the number of employees and staff resources at HMRC seem inadequate for what they are doing. While I appreciate the points made about an increase in resources, the HMRC offices in Edinburgh are hugely stretched. Indeed, the number of cases relating to HMRC that I get through my surgeries is rocketing. That is a concern for the public, and certainly for small businesses in my constituency, who will have to deal with the regulations and might find it very difficult to establish a conduit with HMRC.

Mr Hanson: My hon. Friend makes a very important point. Looking at the impact of the potential reductions on HMRC, one thing that has been identified by tax professionals outside the House is that they expect that efficiencies

"will be achieved largely through efficiency savings, for example by automating a number of manual processes and reducing 'face to face' contact between the department and taxpayers".

I do not know whether that is accurate; I am putting it on the record so that the Minister can respond. If, however, we introduce complex schedules—I do not think anybody denies that they are complex—and new arrangements that impact on businesses, in order to tighten up two or three key issues that schedule 2 is designed to target, then people who advise businesses will tell them that they need to contact HMRC. More advice will be required, more exemptions will be sought, and more clarification will be needed. That will involve face-to-face contact. Has the Minister undertaken an assessment of the HMRC workload created by the clause and other parts of the Bill? We are concerned that it will have an impact.

Ian Mearns (Gateshead) (Lab): Considering the complexity of the schedule, has my right hon. Friend thought of asking the Minister whether he has made an assessment of the budget for training HMRC staff on its implications? The complexity of the schedule and its revisions has been reiterated by hon. Members from all parties today. How will HMRC staff be able to explain the clause to the taxpaying public?

Mr Hanson: I am grateful to my hon. Friend for his contribution, because there will be implications. There are implications in relation to HMRC staff understanding the clause and the schedule, and businesses, predominantly, understanding the clause and the schedule. The clarity in the clause and the schedule will not assist businesses. They will have to take further tax advice. Tax advisers, whose concerns over this clause have swamped my inbox with e-mails, say that it is too complicated and should be simplified.

I will go back to basics. In his response, the Minister should give a clear indication of his objectives for clause 26 and schedule 2. If his objectives are as I understand them, they are relatively straightforward and simple; he aims to tie up three loopholes. Why, then, do we have 59, possibly 60, pages to the schedule? Why do we have a clause in the Bill that brings the schedule into effect? Why do we have 88 or 90 amendments to the schedule, remembering that the Minister might table further amendments on Report, as might others? Why are we exempting a lot of business aspects while not focusing on the real issue? Why are we doing all of that when, with Opposition support, the Minister could simply bring back a revised clause that deals with the two or three issues that form the basis of the anti-avoidance measures that he is trying to introduce?

1.30 pm

I want to make two final points before the Minister responds—or my hon. Friends make some comments. We have discussed complexity, simplicity and understanding. Aside from that, how does the Minister intend to enforce this legislation? Accountants and others have told me that it is difficult to understand, so what is the mechanism for enforcing the clause in the country at large? How will HMRC undertake its enforcement role?

Mrs Mary Glindon (North Tyneside) (Lab): Before we move too far ahead, I have another point to make about HMRC staff. A recent survey found that only 25% of HMRC staff felt proud to be working there. The effect of the cuts and job uncertainty places a lot of stress on people who already have a stressful role in dealing with the public. As we know, most people are perhaps not in the best frame of mind when they speak to tax officers. A tax officer then has to deal with a complicated issue while keeping good customer relations. I fear that those relations may be damaged further if a more complicated scheme is implemented.

Mr Hanson: My hon. Friend backs up my point. The Minister established the Office of Tax Simplification, but, if members of the Committee look carefully at the 80-odd amendments before us, he is now introducing extremely complex legislation. I am not saying that—I am not a tax lawyer, and I have not spent my life looking at tax legislation—but tax lawyers and people who have spent their entire life looking at tax legislation are saying it. They have told me that this is the most complicated piece of tax legislation they have seen in the past 10 years. The legislation comes from a Minister who established the Office of Tax Simplification and who is trying to ease burdens on businesses. He has introduced a provision that will further complicate what should be simple measures.

Tom Blenkinsop (Middlesbrough South and East Cleveland) (Lab): My right hon. Friend makes an excellent case. I read the ICAEW representation to the Committee, and it refers to proposed new section 554A(1)(c) of the Income Tax (Earnings and Pensions) Act 2003, which will introduce tax on rewards or recognition. That could potentially drag in people such as waiters and other service sector workers, who would have to pay tax on tips. Earlier we heard how the Government are trying to take more people out of tax, but, potentially, there could be a ridiculous situation in which waiters would have to fill out self-assessment forms on the tips they receive.

Mr Hanson: My hon. Friend raises a key concern, which others have also raised with me. It is a question of definition, as well as a question of enforcement. He leads me to my second and final point, which is on the problem of definition. If something is defined as employee remuneration, it should be subject to PAYE, either because it is caught now or under the retrospective legislation that was promised earlier. The new rules are trying to target something that feels like employee remuneration, but technically is not. Will a season ticket loan that is repaid monthly to cover a train ticket, for example, fall within his proposed legislation?

Ian Murray: My right hon. Friend's generosity is fantastic, as is his contribution to this debate. He talks about employee loans, so I wonder whether he knows the answer, or could encourage the Minister to give an answer, to this question. Will Independent Parliamentary Standards Authority regulations fall under any of these clauses?

Mr Hanson: My hon. Friend makes a point, but I will address remuneration and other issues related to MPs when we get to, I think, clause 34. I would like to know whether IPSA has a view on the issues related to ourselves. Obviously, I declare an interest in that matter, Mr Gale.

My understanding is that HMRC is not seeking a definitive subjective test as to what "employee remuneration" is. Therefore it is trying, in the clause and the schedule, to catch everything and by the exemptions it is making a very big hash of this issue—hence the 80-odd amendments. Does the Minister believe that the matter before us today is clearly defined?

Tom Blenkinsop: Again, I go back to the document that the ICAEW presented to the Committee. That document mentions loans at one point, as my hon. Friend the Member for Edinburgh South said earlier. Loans have huge consequences for short-time working agreements. During the previous recession, I was a trade union official and I negotiated short-time working agreements to keep people in work and keep factories going, so that people were in work for temporary periods. But we also negotiated loans for those workers, from their employer or through a third party, to tide themselves over until production went back up again. Under the changes that the Government are introducing, the ICAEW says that such loans might now be taxable.

There is another point in relation to voluntary organisations. If an entity or an establishment is a trust, it might make loans to someone, for example so they can go to university. Are such loans taxable?

Mr Hanson: I would welcome clarification from the Minister, but my understanding is that the purpose of the measure is to tighten the arrangements for loans that will not be repaid. In my view, however, the clarity is not there and the complexity of the administration still leaves something to be desired.

Karl McCartney (Lincoln) (Con): I am pleased to hear that we will be talking about IPSA and I cannot wait to add my two penny-worth when that topic comes up.

The right hon. Gentleman has said at many points that he wants to be helpful. Back in 2000, the Government he was a part of introduced IR35. It took a full seven years before that was changed, with the managed service company regulations that were introduced exactly seven years later; I think that they were introduced on 6 April 2007. Obviously, those regulations were very complex, but many people in business wanted to see them introduced. It took the previous Labour Government seven years to make that change.

Mr Hanson: Unfortunately, in my big mound of papers I cannot put my finger on the information about IR35 to respond to that question. In some representations that I and other members of the Committee have received from outside the House, we were asked exactly how the legislation that is being proposed today relates to IR35. One of the reasons why there is a lack of clarity is that we do not know how the legislation proposed today and IR35 will match together.

We can all revisit the past. We are here today to scrutinise clause 26, schedule 2 and the 88 amendments that the Minister has tabled. I simply say to the hon. Member for Lincoln and to other members of the Committee that we are not speaking for ourselves; we are speaking for people outside the House and acting for them as a voice in the Committee. Those people outside the House are saying to the Minister, through members of the Committee, that these regulations are complex and unworkable, and they will create additional burdens for businesses. Moreover, they will not catch the targets that they are intended to catch and we will end up with businesses flouting the objectives and therefore crossing into enforcement issues. There will be greater pressure on HMRC staff to provide advice on this matter, simply because the legislation is so complex.

I do not want the Minister to throw these regulations out. I simply say to him that he should look at them again, bring them back to the Committee and consider

the complexities that the hon. Member for Lincoln has mentioned in relation to IR35, as well as the complexities in relation to all the other matters that we have discussed today.

I look forward to hearing what the Minister has to say. I have spent considerable time on the clause. That is not because I wanted to fill time. That is not the objective today, although it has been on some occasions. *[Laughter.]* The objective today is to reflect seriously the points that have been put to us by organisations outside the House. The Minister has a duty to explain the clause and his views on these issues. I hope that he will answer our questions. I urge him to reflect strongly on my request that he pulls the clause and brings it back at a later date.

Several hon. Members *rose—*

The Chair: Order. The Opposition Front-Bench spokesman has spoken for several minutes. I think it would help the Committee if we heard from the Minister now. That will not preclude any further debate.

Mr Gauke: I appreciate the manner in which the right hon. Member for Delyn has set out his case. He entitled to raise concerns about disguised remuneration, and to give voice to some of the criticisms that outside bodies have made. I appreciate the fact that he is supportive of what we are trying to do in principle, but perhaps I can flesh out the matter a little more and put the measures that we are debating today in some kind of context.

The Government are absolutely committed to tackling tax avoidance. We will take the necessary steps to protect the Exchequer and to maintain fairness, but we have to accept that tackling such issues is not easy. We know that an industry is dedicated to finding any weaknesses that exist in our defences, so we have committed ourselves to more effective consultation, to ensure that legislation is well targeted and minimises the impact on commercial activities. I believe that we are taking a big step forward.

Schedule 2 makes provision to address particularly troublesome and prolific efforts at avoidance by employers who disguise remuneration through a third-party relationship in a bid to avoid, defer or reduce tax relating to employment income. The scale of the attempted avoidance is extensive, complex and opaque, and perhaps that point has not been brought out fully in the debate until now. The Office for Budget Responsibility has certified that HMRC's estimate of the revenues generated by this measure—about £750 million a year—is correct. HMRC estimates that about 5,000 employers have implemented such schemes; the actual number of schemes is likely to be much higher as there has been extensive marketing. It is a problem that is growing, and without action we would expect significant further losses. To use a phrase that is familiar from today's debates, as far as the losses are concerned, "Whoa, this is getting too much."

The right hon. Member for Delyn has touched on the Government's approach, and, yes, we have sought to consult much more and to be more deliberative in how we make tax policy. I am pleased to hear the right hon. Gentleman's welcome for that general approach. If we can achieve consensus on how we make tax policy, that is all the better. There are particular issues with avoidance, and it has always been clear that avoidance creates difficulty in how we make tax law.

It is right that a measure such as this should focus on abusive arrangements and should not, as far as is practicable, affect those arrangements that do not seek to avoid tax. Let me first explain why we took the approach that we did, and specifically why we did not develop an anti-avoidance purpose test, as some have suggested we should have done. Our response to the problem of disguised remuneration aims to build on the lessons that have been learned from tackling avoidance on employment income over almost two decades by Ministers in Labour and Conservative Governments, because this is not a new problem. HMRC has learned that narrowly focused legislation is no obstacle to the ingenuity of the tax avoidance industry, no matter how sharp-eyed the official or draftsman. Where that approach has been taken in the past, avoidance in the employment income arena has simply adapted.

Ian Murray: I am grateful to the Minister for giving way at the beginning of his speech. Does he have any examples of financial institutions using such mechanisms to avoid paying banker's bonus tax by shifting some of the burden to third parties or through share schemes?

1.45 pm

Mr Gauke: I am not in a position to quote specific institutions. I am not informed of individual companies' tax affairs, as is right and proper. The hon. Gentleman is right to highlight the concern. Disguised remuneration is likely to apply where it is greater. There is no doubt that some of the schemes have applied in the financial services industry. I do not want to pick on one sector—and it is not possible for me to give a sector breakdown, if I might anticipate a future intervention. There is no doubt that disguised remuneration schemes have been used as a form of tax avoidance by some financial services institutions and others.

As I say, tax avoidance in this area is a long-standing concern. For example, from 1991 to 1998, various financial instruments were used for tax avoidance. After that, we saw gold bullion being used, platinum sponge, tradable assets, fine wine, gemstones, exotic tangible assets, slightly less exotic intangible assets and so on. Each time, the schemes got more complex with more steps to achieve the desired outcome, and so did the legislation. Yes, legislation in this area is already complex, but it has been driven by the complexity of tax avoidance behaviour.

Ian Mearns: As the Minister was speaking, I was thinking of the sort of places where people might want to hide the value of earnings. For instance, in sports clubs, there might be a wage ceiling in a sport. Because of the public image of sport, people might want to try to hide their true earnings. Is there not a simpler way to do this, by introducing some general tax avoidance rules and regulations?

Mr Gauke: The hon. Gentleman touches on one of the arguments made for an alternative approach, and I will come on to that in a moment. A lot of the debate is about whether this is the right way to do it. I want to set out the argument to show that we have a problem; tax avoidance is extensive in this area. The estimate of £750 million is something about which all Members of the Committee will be concerned and which they would seek to address. Until now, it has not been adequately

[Mr Gauke]

addressed; there has been a piecemeal approach that has not got to the heart of the matter. We have had a lot of targeted measures that have themselves been quite complex, as has the legislation. Each time Government have done that, the avoidance has moved to a different area, and disguised remuneration through third parties is the next chapter. We want it to be the last chapter, which is what we are trying to achieve today.

Bridget Phillipson (Houghton and Sunderland South) (Lab): I understand that the Minister wishes to simplify a complicated system, with all measures put in place to ensure effective operation. Will he describe the conversations he has had with HMRC to ensure it has the capacity and work force to enforce the measures?

Mr Gauke: I intend to turn to HMRC's work force and its capacity, after explaining what we are trying to do a little more. The right hon. Member for Delyn and others also put that fair question. First, I will set out how we are addressing the situation in the legislation.

We have had to adopt a broad approach that captures the essence and range of avoidance activity. We have used carefully targeted carve-outs to ensure that arrangements that do not involve tax avoidance are not affected. The hon. Member for Gateshead asked why we should not have a purpose test or smaller targeted measures, as suggested by the Chartered Institute of Taxation and the Institute of Chartered Accountants in England and Wales. Our proposal is an alternative way of articulating that broad approach. However, having looked at that suggestion closely over some time, we are not convinced that it would be effective against the widespread, diverse and, in particular, informal avoidance that occurs. While any rule would no doubt be more succinct, it would have to apply to all instances where a third party provided a loan or other asset to an employee, where that provision related to the employment. It is our view that such a rule would be insufficient on its own to provide clarity and certainty to businesses about how the legislation would operate in any given situation. Instead, taxpayers would have to rely on detailed but non-statutory guidance. There is a role for non-statutory guidance, and there is a role under the approach that we are taking here. I will say a little more about that in a moment, but we do not believe that that solution would be simpler or more certain, and it would certainly be less transparent.

Nic Dakin: The Exchequer Secretary is carefully spelling out his approach, which is helpful to the Committee. Will he reassure us that this measure is simple for businesses to understand and simple for HMRC to administer?

Mr Gauke: As I acknowledged in my opening remarks, the simplicity in this context is all relative. I will not claim that the proposal is hugely simple. It is not. It is complicated and complex, but we believe that complexity is necessary and justified in these specific circumstances, because the measure is trying to address avoidance that is in itself very complex. If there was an approach available that was simpler and more effective, we would it, but that option is not available to us. That is why we have not taken the approach advocated by some of the professional bodies and suggested by Opposition Members. We do not think that it would work, and we would find ourselves coming back in a year or so and still facing similar problems as the debate and the focus of avoidance move on. Targeted anti-avoidance rules in this area, partly because of the informal nature of some of the arrangements, would not be as effective as the measures that we have set out.

Nic Dakin: Are concerns being expressed outside the House that the complexity may mean that people who are trying to follow the law do things incorrectly through ignorance and, therefore, find themselves in trouble? Is that a likely result of this approach?

Mr Gauke: Perhaps I can address that point later, because we have sought to ensure that there are sufficient carve-outs in the right places, so that people are not inadvertently brought in. It is also right to say that the vast majority of remuneration arrangements that do not involve payments through third parties will be excluded from the arrangements. They will not be swept up, and that should not be a problem. It will be an issue only in a minority of cases.

Ian Murray: This is obviously an incredibly complex area, and the whole Committee is grappling with not only the clause and the schedule, but the amendments to the schedule. Will the Exchequer Secretary give us a practical example of where he thinks tax avoidance is taking place, in terms of how companies operate? How would the clause stop that?

Mr Gauke: The type of arrangement that we are talking about is where a third party makes what looks like a loan to an individual—it does not immediately look like employment income—but it is not intended that the loan will be repaid, and the money ends up in the hands of the individual. No tax is paid, so economically, it is the same as income being paid, but without the tax. That is a very simple example of the mischief that we are trying to address.

Ian Murray: May I probe a little further? In that example, would the loan from the third party not sit on the third party's accounts as a long-term liability, and would drilling down into that long-term liability not show whether there was any intention of the loan being repaid?

Mr Gauke: The difficulty is how that is enforced by HMRC. What is its capability fully to identify that, and what if, for example, that loan comes from an offshore entity? There is no simple solution to that problem.

Bill Esterson (Sefton Central) (Lab): I am glad that my hon. Friend the Member for Edinburgh South gave that example, because in my understanding, that issue has been dealt with in previous legislation relating to directors. I wonder if a simpler measure that extended that legislation beyond directors to other employers would deal with that specific example. Moreover, he is right that drilling down into accounts would address the problem. Surely ensuring that sufficient staff are employed in HMRC would be the way to achieve that goal.

Mr Gauke: As I say, our view is that expanding a targeted anti-avoidance rule would not work, nor would trying to extend the existing system. The solution needs to get to the heart of the problem. The legislation is complex; I do not deny that in any way, and I think that all hon. Members would agree. I get the impression that every member of the Committee spent their lunchtime reading through the amendments, and I think that there is unanimity on the point that the proposals are complex. We would argue, however, that they are necessary.

The argument that we have heard today is that the measure should be delayed, and a small, targeted measure introduced, but that would really only be dancing round the issue; it would leave us pretty well in the position from which we started, with the broader elements of the avoidance passing by unaddressed. The approach taken in the legislation before us may not be preferred by many, but we believe that it will work.

Mr Hanson: We propose that the Minister withdraws the clause and the schedule, and considers a revised, simplified proposal over the next few weeks. He could talk to bodies outside about the practicalities and implementation, and then bring back proposals on Report. I know that that can be done from my experience in government. It would not delay matters any further, because the measures do not come into effect, although they are backdated, until Royal Assent.

Mr Gauke: Let me say a word or two about the process that we have followed and why I believe that we are on the right track. We have consulted very widely. This is the first anti-avoidance measure that has been subject to consultation; that has never happened before. We published a draft schedule on 9 December 2010, which generated considerable interest, and we rightly made amendments as a consequence. There has been a very constructive dialogue, which I welcome, and I want to take this opportunity to thank all who contributed to it. The legislation is undoubtedly in much better shape than it was on 9 December.

In response to that dialogue, HMRC made significant changes to the legislation, which was published on 31 March 2011, to ensure that various commercial arrangements were not brought into the charge. The consequent amendments built on the feedback provided to ensure that the scope and detail of the exclusions are appropriate. Yes, we have come forward with various additional amendments in Committee; as the hon. Member for Gateshead pointed out, this is the stage at which that should be done. It is not unprecedented. My hon. Friend the Member for Watford, with his extraordinary recall of detail, pointed out that while the Government have tabled 90 amendments on disguised remuneration, in 2008, the previous Government tabled 226 amendments on residence and domicile. I did an informal check on the response of the official Opposition, and my hon. Friend the Financial Secretary to the Treasury, who was the shadow Minister leading then, said that we welcomed the amendments and indeed had called for a number of them.

2 pm

Moreover, 2008 was not a one-off. In 2009, there were 166 amendments to the Finance Bill. Governments should listen and make amendments to reflect constructive comments. Yes, we have tabled a number of amendments, and in an ideal world we would not need to do that. We would publish legislation with which no one found fault. However, it is important that we continue to listen and engage. Indeed, a number of sensible and constructive comments came in after 31 March, and we have tried to reflect them.

It is important to look behind the headline numbers and focus on what these amendments really involve. As I set out in my letter advising the Committee of the amendments, they fall into eight themes or strands and certainly do not represent 90 substantive new ideas or free-standing changes. A significant number of the amendments are consequential, and all of them result from the consultation carried out by HMRC. It is right to say that most of the amendments relate to relieving provisions. They describe the types of transactions that will not be caught by the schedule. This will give taxpayers clarity about what is not included. We recognise the risks of people trying to find and exploit loopholes, so they are underpinned by anti-avoidance measures.

The right hon. Member for Delyn highlighted section 554Z16 and asked me to explain it. I will not attempt to do so in full, but it is worth pointing out that the provision disapplies much of the chapter. It is a simplifying measure—it is not simply written, I agree—that makes the practical operation of the legislation much simpler, because it makes it clear that the other provisions can be ignored for this purpose.

Tom Blenkinsop: I return to paragraph 11 in the document from the Institute of Chartered Accountants, which is on the five-year rule that applies to share options for employees. It refers to

"the existing 5 year rule for forfeitable shares in Chapter 2 of Part 7",

and states:

"If an employee receives forfeitable shares and the forfeiture period lasts more than 5 years, the employee must pay tax on (at least) the 'actual' market value at the date of grant… By contrast, the new Part 7A provision imposes tax at the 5 year point even though the employee at no time receives any benefit, and may have no funds with which to pay the tax."

That has obvious consequences for not only employee share schemes and social enterprises, but the Government's policy on a 10% employee share scheme for the Royal Mail when it is privatised.

Mr Gauke: Indeed. If I understand correctly, there is an amendment that extends that to 10 years, because we have listened to some of the concerns on the issue.

It might be useful for me to say a word or two about some of the areas that we have specifically carved out, including deferred remuneration arrangements using third parties, group company transactions, employee car ownership schemes and refinement of conditions on benefit packages. The changes that have been made since December ensure that existing pension funds in unregistered arrangements retain their existing tax treatment, rather than being covered by this legislation.

The hon. Member for Middlesbrough South and East Cleveland has asked about waiters and tips. Tips have always been taxable, and the proposal does not affect that. Season ticket loans have also been mentioned. They should not be affected; they tend to be provided by the employer or a group company, and that is clearly

[Mr Gauke]

carved out. The hon. Member for Edinburgh South mentioned IPSA, at which everybody's shoulders dropped. Loans are made for rental deposits, for example, and IPSA is a third party—he was astute in identifying it as the type of third party that could be covered—but there is a carve-out for that, simply because of the peculiar arrangements that are involved for MPs and because remuneration is paid through a third-party statutory body. I do not intend to be detained at great length on that point.

Ian Murray: I will not mention IPSA, but the Minister has mentioned third parties. I refer him to what the document that my hon. Friend the Member for Middlesbrough South and East Cleveland mentioned said about what might constitute a third party. The document lists a whole plethora of potential third parties that are all, in fact, very much in line with normal, day-to-day business, particularly for small businesses that do not have the capacity to run their own payroll. The document mentions bodies such as an employee benefit trust, a vendor or purchaser, a payroll agent, a liquidator, a relocation agent, a conference organiser, and even travel agents or lawyers and accountants, all of which small businesses may look towards. How can we ensure that small businesses that use those third parties, which might make a transfer such as a loan to an employee, are indemnified against being accountable for that in such third-party relationships?

Mr Gauke: To use the example of waiters, we need to remember that if an employee is being paid income from a third party, it should be taxed as such. We intend this legislation to apply, for example, to a loan where there is some question over whether it will be repaid. We have tried to include the necessary carve-outs to reflect proper commercial arrangements. We have responded to some of the constructive comments that have been put to us, to ensure that arrangements that involve a third party for good commercial reasons are not swept up into this legislation.

HMRC has published two sets of frequently asked questions addressing the main themes that have been raised by respondents. Those will be updated shortly, and full guidance will be provided. The advantage of guidance is that it can give examples, which legislation is ill suited to do. I hope that that will assist businesses.

Julian Smith (Skipton and Ripon) (Con): Does my hon. Friend agree that guidance for businesses, particularly small businesses, is vital, as is the clarity and simplicity of that guidance? Will he encourage those who are drafting the guidance to make it as simple as possible? I should like to mention the Anderson review on guidance, which was carried out under the previous Government. It was a positive report, and I encourage him to look at it.

Mr Gauke: My hon. Friend is right to mention that point. We intend the guidance to be as clear as possible, so that it assists businesses in interpreting the legislation.

We had a useful consultative process, but I acknowledge that we did not accept every suggested change. Doing so would have compromised the protection against avoidance, especially where the use of loans is an issue. Loans are used in some of the most common forms of avoidance, so there cannot be a blanket exclusion. I should add that the legislation contains a power to make regulations for further exclusions. That is needed to take account of future changes to the way in which employers choose to reward their work force. Although businesses might need to adjust their behaviour to satisfy themselves of the impact of the legislation, we do not believe that any innocent arrangements will be caught.

The mischief that we are talking about involves diverting the rewards of employment through intermediaries, most commonly an employee benefit trust. Many of those are based in foreign tax havens. The purpose of those arrangements is to avoid tax by providing what is actually employment income in a disguised form via a third party, rather than it going from an employer to an employee directly.

The arrangement can appear to mean that the employee has no absolute entitlement to reward. Some of the more egregious instances have involved the trustees acting as little more than a corps de ballet following carefully choreographed and predetermined steps mapped out by tax advisers. The purpose of that is to disguise the true nature of the employment income they help provide. That avoidance can also occur in employment-related share schemes. Clauses 66 and 67 limit how much tax-privileged deferral of remuneration is available through registered pension schemes. That will raise £4 billion a year. Without the action we are taking here, unregistered occupational pension arrangements would have greater tax advantages than their registered counterparts for savings above the new annual and lifetime allowances.

Schedule 2 will ensure that third-party arrangements used by employers to provide reward to employees cannot be used for tax avoidance. It creates an income tax charge where a third party provides an employee with reward, recognition or a loan in connection with the employment. The tax charge will be based on the full amount of the sum, the money used to deliver value to the employee, or cost or market value—whichever is higher—where an asset is used. The legislation will mean that employees benefiting from such schemes will have to pay more tax, but no more than employees who receive their reward directly from their employer. In addition, regulations will be brought forward to apply a class 1 national insurance contribution charge to amounts taxable under the measure.

Ian Murray: What happens if one of the loans is given to an employee and is seen as a salary reward, but an agreement is put in place between a third party and the employee to pay back that loan at 1p a month for the next 640 years? Would that constitute repayment, and therefore not be a benefit?

Mr Gauke: My understanding is that such an arrangement would be caught by the measures we set out in schedule 2. The hon. Gentleman demonstrates the ingenuity that exists in this area. An arrangement that was clearly uncommercial in its repayment terms would not be a means of avoiding the legislation.

Ian Murray: I want to probe that further. My right hon. Friend the Member for Delyn made the point about how complex the regulations are, and 88 amendments

are proposed to an already complex piece of the Bill. We are seeing over-complex regulation for a good cause. That essentially just sets hares running when it comes to avoiding this complex legislation. Once all those layers are put on top of each other, a very smart QC and an accountant will ensure that large businesses can avoid the regulations through loopholes, while small businesses will be completely drowned in paperwork with no support from HMRC to help them through.

2.15 pm

Mr Gauke: In the example that the hon. Gentleman provides, the loan would be from a third party. Under schedule 2, that is caught as remuneration, and consequently the tax charge would apply to that remuneration. Whatever the repayment terms, the arrangement would be caught, unless it falls into one of the carve-outs we have set out in the legislation. The purpose of the carve-outs is to address genuine commercial arrangements, which that would not be.

The hon. Gentleman says that the proposal will be difficult and that there may be loopholes, but that is what we are trying to address. Our belief is that the approach in schedule 2 is a more effective way of preventing loopholes that allow those who can afford expensive lawyers to fight this and that and wriggle out of paying the proper amount of tax. Our approach minimises that risk and puts the Government in a stronger position to address what, as I say, is a substantial level of avoidance—£750 million a year—and that is why we are determined to proceed with the measure.

Tom Blenkinsop: I have a general query about the exemption of car ownership schemes in proposed new section 554N. Would that also include employees of taxi firms, which technically loan the vehicle to the individual, and delivery drivers and other employees who are given a vehicle to look after and to drive from home to work? Would that now be taxed?

Mr Gauke: I would have to reflect on the hon. Gentleman's example, and if I reflect quickly enough, I may find that I am able to respond to him in the course of the debate. If I cannot, I assure him that I will write to him, but I shall see if I can find inspiration to address his concern.

If we are looking at those who may be innocently caught by the arrangements, which is the hon. Gentleman's broader point, in situations where there is any remuneration and where the employee pays the tax as it currently stands, they will not be affected. If an employee is paying the tax on that remuneration, they should be fine. It is when they try to avoid paying the tax that schedule 2 will apply. The legislation does not prevent people paying remuneration in a particular way. It just ensures that the tax is paid. I will think further about the example that he gave, but if an individual receives remuneration through the form of a loan, they need to fall within one of the carve-outs. Those carve-outs are designed to pick up genuine commercial arrangements, and during the process we have refined, improved and expanded the list of carve-outs, so that we catch those who should be protected.

Nic Dakin: The Minister mentioned people being innocently caught by the arrangements and carve-outs being made to pick them up. Is he saying that he and officials are engaged in a continuous process to ensure that nobody is disadvantaged as they go about their proper business?

Mr Gauke: We believe that have reached the point where we have protected all the commercial arrangements that we can without jeopardising the essence of the measure. We do not currently intend—to answer the question of the right hon. Member for Delyn—to come back with further amendments on Report. There is a provision in schedule 2 that allows further regulations to be made to provide further relieving measures and additional carve-outs. We think that we have got there, but the reason for the provision is that remuneration packages can evolve and develop, and it is right that we have the opportunity to examine those new developments and refine the carve-outs to pick up genuine commercial arrangements.

Ian Murray: The Minister is spending a considerable amount of time explaining the measure to the Committee, and it is very useful for us. Many of the letters in the stacks of paper in front of me are from organisations concerned about the clause, and he is doing a great job answering some of those concerns.

May I take the Minister back to my previous intervention? I am concerned by the loan example that he gave. He said that if the loan was not repayable on a commercial basis then HMRC, through these clauses, would have an opportunity to look at it. Two questions fall from that. First, who determines what a commercial basis is? Employees often get a preferential or even interest free rate for loan repayments. Secondly, if such a loan repayment plan was put in place, and HMRC thought that it was inappropriate, could it be changed? What if there was a condition on that loan that it was repayable in full from the borrower's estate at death?

Mr Gauke: We are trying to pick up those loans that are paid out but never paid back. In schedule 2 we have a series of carve-outs designed to pick out arrangements that are clearly made for genuine, non tax-driven commercial reasons. That is the structure of schedule 2. We believe that a broad treatment that will pick up most loans coming from third parties, and then carve-outs, is the best way to address the issue.

May I put the clause in context, and remind the Committee that we think that around 5,000 employers use these arrangements, but most employment income will not be affected. Normal remuneration structures involving another company in the same group will not affected. We have made that clear in the Bill, and will do so in the HMRC guidance as well.

Thinking further on this issue, I would also like to make a point about taxi drivers. It will depend on whether the taxi driver is employed or self-employed. If the car is already a benefit of the employee then it will not be affected. It is not remuneration if the owner is using the car to be a taxi driver. If, however, the car is taken home at the end of the day then it is taxed as a benefit, but schedule 2 should not be relevant, as it relates to third parties.

Tom Blenkinsop: What if a taxi driver has access to multiple cars and flexibility in taking it home?

Mr Gauke: That is an issue that is already within the tax system. Is this a benefit in kind already? There is nothing in schedule 2 that should change that arrangement, nor whether it is taxable. I do not think that that will be affected by schedule 2.

Nic Dakin: While the Minister is dealing with these concerns, I thought it might be useful for him to deal with something highlighted by the Institute of Chartered Accountants. It says that there is a likely problem, in that the employer

"can still be a 'third person' if he acts as a trustee. This is not qualified in any way so an employer that is a trust (something which is common in the charitable and voluntary sector) and which gives an employee a season ticket loan would be caught and the loan subject to tax when advanced even though it will be repaid."

This is a good opportunity for the Minister to reassure the Institute of Chartered Accountants on this concern.

Mr Gauke: As long as there were no circumstances that cast doubt over the genuine nature of the employment, a trustee that is also an employer would not be viewed as a trustee when acting in their capacity as an employer.

Ian Murray: Will the Minister give way?

Mr Gauke: I want to make some progress, but the hon. Member intervened so charmingly that I will give way. *[Laughter.]*

Ian Murray: I hope that the hon. Member for Watford, who has a photographic memory, will remember that the word "charming" was used, so he can remind us of it in 10 years' time.

I wanted to make a point about the make-up of organisations and companies. What happens if a director of a company puts money into it as loan stock, and then the company, during the course of the repayments of that loan stock, is sold, which would mean that the company was sold without that directorship? The director would become a third party of that business, and the business would start to repay the loans, perhaps. How would that be looked on in terms of the HMRC regulations? The loan would, at first sight, seem as if it were going to an individual from an unconnected third party, but essentially, a commercial transaction would be taking place between the third party company and the original director from the first business.

Mr Gauke: I am always slightly nervous about trying to give detailed advice, almost, on specific circumstances. What the hon. Gentleman has described does not sound like something that the legislation should affect, because the proposals cover a loan going to an employee from a third party. Loans from directors to companies, and so on, do not seem relevant. If I have misunderstood what was described, I will let him know. I may need to write to him, but I do not think that the proposals would be caught up in the circumstances that he has mentioned.

Ian Murray: The word "director" has perhaps confused the issue. A director of a company has put a loan into company A, but company A is sold to company B, and that director therefore becomes an employee. He is no longer a director. He has become an employee, so for the sake of what the Minister is describing this afternoon, an employee would be receiving a loan from a third party.

Mr Gauke: As the hon. Gentleman describes it, I think that the loan would be going from the employee, first, to one company, and then there would be some corporate restructuring, and the flow of funds at that point would be going from the company to the employee, not the other way round. As I say, if I have understood that correctly, I do not see that those circumstances would be affected by schedule 2. I must press on and say a word or two about the amendments; after all, there are a few of them.

The changes have been made in response to the ongoing dialogue with representative bodies, and they will ensure that the legislation is better targeted. The changes will provide greater exclusions, where relevant, or they will clarify the existing position, and we want to do so in a way that retains the target of avoidance and does not increase the risk to the Exchequer. The changes will relax some conditions that excluded a tax charge; expand the definition of a group; ensure that the tax position that follows permanent "unearmarking" is right; and, better allow settlements with HMRC.

In relation to pension arrangements, schedule 2 provides an up-front tax charge where employers pay contributions to unregistered pension schemes to avoid the new restrictions on pensions tax relief. We are removing the possibility of unintentionally imposed tax charges, depending on the value of the security provided and not on the value of the contributions the employer was to pay. Such concerns are dealt with by the relevant amendments, ensuring that the tax charge is appropriately focused.

There are also amendments that ensure that the legislation does not interfere with the legitimate use of deferred remuneration and share schemes to reward employees. Although there were a number of exclusions within the initial draft legislation, in some cases, those were too narrow. The related amendments mean that the employers can continue to use employee share schemes and pay remuneration in genuine deferred arrangements, without unexpected tax charges.

The Government amendments demonstrate the benefit of our commitment to consult and to listen to what interest groups have to say, and they will ensure that the legislation is effective and that unintended consequences will be avoided.

Stella Creasy (Walthamstow) (Lab/Co-op): This debate is interesting, because it throws up a number of anomalies. Will the Minister say what discussions there has been about how the proposals might impact on dividends? The Government are keen to promote co-ops of various types, and as a Labour and Co-operative Member, I feel the need to speak up for the Co-operative movement. I am concerned that there has not been much thought about the impact on the payment of dividends for different models of co-op. For example, what impact might it have on a workers' co-op as opposed to what might be called the John Lewis model? Will the Minister say a little about how the amendments would affect them?

2.30 pm

Mr Gauke: We have tried to respond to concerns raised about share schemes and similar arrangements. I am not conscious of any representations received about co-operatives. However, ordinary dividends will not be caught by these arrangements; they are not covered by schedule 2. Concerns have been raised about the application of schedule 2 to share schemes and we have, as far as possible, tried to accommodate them.

A number of hon. Members asked about the practical impact on Her Majesty's Revenue and Customs, and the resources it will have to monitor and enforce schedule 2. A lot of resources are currently devoted to monitoring existing schemes. I accept that the change will take some time to bed in. We do not envisage a long-term change for resourcing in this area, because we think this is the right approach to address the concern. HMRC will need to provide guidance and advice as the rules bed in. However, resources will be released because it will no longer have to monitor and challenge the schemes on a case-by-case basis. That should strengthen HMRC's ability without increasing demands on it. It does not create any new requirement for HMRC to identify and deal with avoidance and non-compliance; that is already there. Instead, it strengthens the tools that it has available.

Stella Creasy: I would like to add my experience as a member of the Public Accounts Committee. I am sure my fellow member, the hon. Member for North East Cambridgeshire, will also want to comment. PAC report 27 scrutinises the ability of HMRC to deal with investigations and compliance. I have the Treasury minutes—which the Minister's officials were keen to see—and the Government partially agree with the Committee's concerns that the Department does not have sufficient understanding of the costs and returns of different enforcement activities. What analysis has the Minister made of HMRC's ability to enforce these proposals. Does he expect the matter to come before the Public Accounts Committee in due course?

Mr Gauke: As I say, the assessment, approved by the Office for Budget Responsibility, is that the measures in schedule 2 will prevent losses of £750 million a year, with a significant increase in revenues coming through that. The hon. Lady is right to highlight that point. Working closely with HMRC, I can say that its understanding of the benefits of enforcement action has improved. HMRC welcomes the additional powers, and we believe that they will be effective.

Several hon. Members *rose—*

Mr Gauke: I really want to make progress. I will make this point regarding the cost of the resource required to intervene in the area. Savings will be available to HMRC, so it will be less expensive to monitor this area. We will be losing a significant cost.

Nic Dakin: The Minister is beginning to reach the crux of the matter regarding HMRC—whether it has the capacity, skills and knowledge, when it is under such budgetary pressure, to do the additional job that this complex system will put on it shoulders.

Mr Gauke: As I say, we are confident that it does. The system strengthens HMRC's ability here. It is a complex area, but it involves a substantial saving of tax, and we believe that this is the right approach.

Bridget Phillipson: Even if the Minister is right that HMRC will have the capacity to cope with the changes, am I right in thinking that staff may require training? What assessment has he made of possible additional training to ensure that staff are fully aware of the changes? If further training is required to ensure that HMRC staff fully understand the rules that they are expected to enforce, what estimate has he made of its cost?

Mr Gauke: Of course, HMRC staff need to have an understanding of the law as it changes, but we have a Finance Bill every year, and it is a matter that can be addressed within the existing HMRC training budget. I must remind the Committee of the expense and difficulties involved in monitoring and enforcing the law in this area, and schedule 2 will strengthen HMRC's ability in that.

Ian Murray: Will the Minister give way?

Mr Gauke: No, I want to conclude at this point. Tax avoidance is a significant issue and a substantial risk to the Exchequer. It is a widespread problem that is difficult to target. We do not want to dance around the issue any more. For every step, the avoidance industry makes a counter-step, but we have marked its card and taken a big step forward. We have consulted widely and have further targeted the legislation in response, but the risk tackled by schedule 2 is broad and long-standing. Schedule 2 is needed to maintain a fair tax system. I hope that I will have the support of the whole Committee in accepting the amendments, the clause and the schedule.

Ian Murray: Today's debate has highlighted the complex nature of a Finance Bill in these particular circumstances. One of the overarching aspects from this morning is that my right hon. Friend the Member for Delyn, who introduced the debate, is merely the asking the Treasury team and the Minister to reflect a little on the complex nature of not only schedule 2 but the 88 or so amendments to it, and to bring back a more coherent and understandable approach on Report.

When it comes to financial knowledge and Finance Bills, we are all lay people, and I have found it difficult to follow what the amendments are trying to achieve. There are some phrases in the amendments, such as

"554Z19 Valuation of step within section 554Z18"

in amendment 105, that use terminology that I have not come across before. I am not really sure exactly what it relates to and how we should cross-reference it. At the very least, the Treasury team could bring back on Report a coherent analysis of what the provisions actually mean, what they meant in December, what changes the consultation exercise allowed the Treasury team to make and the consequences of those changes. That would provide the Committee and, indeed, the House with some kind of explanation about which direction we are travelling in.

Ian Mearns: I have been in this place for a year, but I am still daily finding things that are part of the steep learning curve. When the Bill was originally presented to us, it came with a good set of explanatory notes, and they helped us to understand the implications of the clauses, subsections and schedules. However, the Government amendments do not come with explanatory notes, and that makes it difficult for us as financial lay people, as my hon. Friend pointed out, to understand the implications of things that the Minister is asking us to agree to.

Ian Murray: I am grateful to my hon. Friend, who is often my partner on a Thursday travelling north on the east coast line, when we discuss these matters in detail. I am happy to give way to the Minister on the question of my travelling partners.

Mr Gauke: I actually wanted to intervene on the hon. Member for Gateshead to say that explanatory notes on these amendments were sent to the Committee.

Ian Murray: I am grateful to the Minister for drawing that to our attention. While we have been enthralled by the debate, I have been reading some of the provisions and still have no idea what they mean. I am disappointed that my hon. Friend the Member for Gateshead has the Adjournment debate this evening on the east coast line, because otherwise we would be sitting for three hours on the train north discussing the schedule in great deal and no doubt musing over some of the provisions and trying to understand them a little bit better.

My hon. Friend makes a good point. While the schedule is in the Bill and there are the explanatory notes—and the Minister generously told us that there is another explanatory note on the amendments—I am still not sure exactly what we are doing here and how that relates to what we had before. Many of my hon. Friends, who have been asking direct questions, are throwing up practical examples that may be useful in this particular complicated sense.

Bill Esterson: The reason for my intervention is that I was not aware of the additional explanatory notes. I wonder whether my hon. Friend had received them.

Ian Murray: I am not aware that I have received them, although there have been numerous e-mails from a host of providers and third-party lobbyists who are concerned about this. If the Minister could get copies to us now that would be incredibly useful. I am sure his team can rustle them up.

Richard Harrington: This is certainly not the reason for my intervention, but we were all e-mailed the additional explanatory notes and there is a copy that we could pass on to the hon. Gentleman as a matter of courtesy. The point I wanted to make was that we have now gained some idea from the Minister of the complexity of the anti-avoidance industry. We all agree that the purpose of the legislation is to avoid some of the tricks which, although legal, we want to exclude. By definition, the legislation should be complicated for lay people such as the hon. Gentleman and me, because it is meant to deal with the complexities of the anti-avoidance industry. Would he agree that this kind of complexity is necessary for highly detailed tax legislation?

Ian Murray: I am grateful for that intervention. We all agree that the anti-avoidance measures in the Bill are welcome. The Opposition's contention is that they are so complex that they will swamp not only small and medium-sized enterprises but HMRC. Indeed, the main people we want to catch with these regulations are the bigger offenders and they will find ways and loopholes around them. There is perhaps a small democratic deficit if members of the Committee are not really sure what we are talking about and what we are agreeing to in a very complicated Finance Bill. We should have that explanation.

Tom Blenkinsop: The real factor is that yes, it is complex, but employees seem to be most caught in this web of complexity. As a trade union officer in the steel industry, I relocated people and negotiated relocation packages with Tata to move people from places like Workington or Hartlepool to Scunthorpe and other steelworks, and such loans may now be taxable under these regulations. In industries such as chemical and steel, self-employed contractors are often given money to provide their own personal protective equipment, which is part of health and safety regulation. Would that be taxable? We are looking at practical examples of how the changes will affect the average working person.

2.45 pm

Ian Murray: My hon. Friend makes the pivotal point that we are looking at employees who may be innocent bystanders in the examples that have been highlighted. The taxi driver example emphasised how employees might be the unintended recipients of a large bill from HMRC, given that employers put together a complex remuneration package for such employees. Things such as moving home or, to coin a phrase, "getting on your bike" to get work and employers paying for that package of measures may be taxable under these proposals.

Although the Treasury Minister is, without question, very much on top of his brief, the fact that he has had difficulties answering some very basic questions at the coalface shows the complex nature of the subject. I can imagine small and medium-sized enterprises all over the country scrabbling for the hotlines to HMRC as soon as the Bill is enacted, to try and get some information about what is going on.

The document from the Institute of Chartered Accountants in England and Wales has been referred to in great detail today, and I am sure that the Scottish equivalents will be similar. The institute questions at great length, on several pages, when an employer is a third party. I am not quite sure about all the specifications that it gives, but several examples are provided; we can all think of small businesses or employees in our constituencies who might fall into those categories. The document mentions at great length benefits such as share plans; it mentions shareholders; and it mentions dividends. The Minister dealt specifically with dividends in his answer to my hon. Friend the Member for Walthamstow, but the Institute of Chartered Accountants states that although tax on the dividend is now collected in PAYE, arrangements for recognition or award to an employee may be put in place that will result in those problems. Indeed, it mentions that

"shares acquired from, eg, an EMI option exercise, and dividends that flow from those shares, are arguably part of the same 'arrangement'."

Where do we draw the line? The document describes, as I have highlighted, the way in which small and medium-sized enterprises use third parties to deliver basic services:

"Many employers engage external suppliers to perform administrative functions such as operating the payroll, bookkeeping, company secretarial services (completing share transfer forms and submissions to Companies House, etc), administering employee share plans, stockbroking, etc."

A plethora of third-party organisations determine individual remuneration packages in various ways without being involved in the business themselves. The Institute of Chartered Accountants provides a list, which is not exhaustive; I will not read it all out, but it includes, for example:

"Founder/new investor/shareholder…Flexible benefit administrator …Payroll agent, Relocation Agency…Conference organiser…Subsidiary LLP."

The relocation agency goes back to the point that was raised by my hon. Friend the Member for Middlesbrough and—

Tom Blenkinsop: Middlesbrough South and East Cleveland.

Ian Murray: That one. Limited liability partnerships are interesting, because HMRC has had to put in place a plethora of additional information because they fall under both partnership and limited company rules, so they are dealt with differently. The list continues with

"Pension plan trustees, stockbroker, Government department"

and little things such as

"Travel agent, Lawyer with a client account"

when they are dealing with buying and selling either property or businesses. All those—there are, indeed, more on the list—can potentially be seen as

"'relevant third parties' whose involvement in holding, earmarking and transferring cash, shares and other assets, may create tax charges that would not otherwise arise."

The Institute of Chartered Accountants in England and Wales thinks that many third- party organisations may force employers to take potentially offending services back in-house to avoid falling foul of HMRC regulations. I do not think that the institute is saying that everyone operating in those types of business will fall within the regulations—far from it. However, the last thing a small or medium-sized business needs, when it complies with every piece of legislation and regulation, is HMRC crawling all over their accounts and books to try to determine a complicated matter that that business is using for day-to-day operational purposes.

Stella Creasy: It is important to think about how practical some of the arrangements will be, and what they will mean for HMRC. I hope that the Minister has read the original report and the response to the Treasury, because we found that only 20% of cases referred to the dedicated investigation teams were adopted. That created a high level of disillusionment among HMRC employees. Part of the problem had to do with training, understanding the tax codes, and understanding how to deal with compliance. That is one reason why a quarter of the civil investigation cases undertaken were completed within the 18-month target. Does my hon. Friend share my concern that if it is not clear to the Committee and those working in the tax industry how the measures will work, it will have a further de-motivating effect on HMRC staff, who have to tackle compliance to ensure that we get all the money owed to the Exchequer? Does he agree that one of the problems with complexity is that enforcement is also harder?

Ian Murray: My hon. Friend makes a valuable point. The more regulation put in place, the more difficult it is to enforce. I bet that everyone on the Committee has had two constituents come to their surgery with similar cases where HMRC has advised different things. That must be part of the training at HMRC. Staffing and staff morale are key issues. Many employees who work in the HMRC offices in Haymarket Yards in Edinburgh have come to my surgeries to express their concern at the lack of not just financial resources, but staff resources. Although the Government have committed to putting in extra resources, at a local level—I concede that this might not be the case across the country—more experienced HMRC staff members on higher salaries are being moved on, retired, or made redundant. They are being replaced by younger, cheaper graduates and trainees. The brain drain from the HMRC office in Edinburgh is having a significant effect on personal taxation. Indeed, if that kind of personal taxation problem is not dealt with, all these complex rules coming in on top of those problems will make HMRC's work very difficult.

There are two other things that I would like to mention. The first is the red tape challenge that the Secretary of State for Business, Innovation and Skills has championed. If anybody visits the red tape challenge website at redtapechallenge.cabinetoffice.gov.uk, they will see that the Government particularly intend to cut red tape and regulation for small and medium-sized businesses. That is the thrust of the Chancellor's growth package. The website shows various aspects of regulation and legislation that they want to cut.

An example is hallmarking, a practice that has gone on for many hundreds of years and is renowned around the world. Indeed, the assay offices across the UK—there is one in Edinburgh where many of my constituents work—are concerned that scrapping hallmarking will cost jobs in Edinburgh, and we will lose an ancient industry. The Minister is looking at Mr Gale for some guidance as to whether I am keeping to the amendment. On the one hand the Government are saying, "Let's scrap 600 years of tradition to cut red tape for small businesses," and on the other they are producing a plethora of documents and regulation that people cannot understand or will not be able to follow. In addition, there are concerns that the people at HMRC who could give guidance to small businesses will not be able to do so in the current economic environment.

A second point on the red tape challenge relates to the Equality Act 2010. Along with other Members of the Business, Innovation and Skills Committee, I have pushed the Business Secretary to denounce the front page of the red tape challenge website, which asks whether the Equality Act should be scrapped to reduce regulation for small business. The Act provides for growth and employment opportunities across the equality spectrum. Do the Government want to slash and burn what is being called red tape, but I consider a significant move in primary legislation towards a progressive society? At the same time, they are throwing in all these regulations

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to try to close loopholes related to tax avoidance—regulations that are so complex they are in danger of not doing the job for which they are needed.

Bill Esterson: Having run a small business for many years under both a previous Conservative and a Labour Government, I must say that I was not aware of any great difference between the two in the level of regulation or red tape. I wondered whether my hon. Friend was suggesting that there was a deliberate ploy by Government to push the burden away from Government and on to small business. For instance, the reduction in staff employed to enforce the rules would force small businesses to take on the role of policing such regulations.

Ian Murray: My hon. Friend makes an incredibly important point about where the liability lands. My right hon. Friend the Member for Delyn earlier made a point about enforcement. Any tax or company law avoidance is a criminal offence and should be dealt with properly. People who try to avoid tax in the ways set out in the legislation are committing a criminal offence that should be treated as such.

The Minister mentioned the Office for Budget Responsibility in response to an earlier intervention. Has the OBR factored in the additional burden on business, and will any of this affect the growth agenda? The OBR has obviously assessed the Bill as a whole, through the Chancellor's Budget statement in April. However, I wonder if it has assessed whether this particular part is a stimulus for growth or not. Everyone would want us to close loopholes that enable tax avoidance and evasion. However, how compatible are the £750 million going to the Treasury, the additional moneys to HMRC, the additional burdens on small business, the potential impact on growth, and the contradiction between the red tape challenge and the additional burden of complex regulations?

Paul Blomfield (Sheffield Central) (Lab): My hon. Friend makes an important point about growth, to which it would be helpful to hear the Minister's response. The Institute of Chartered Accountants says:

"These highly complicated rules are difficult to understand, highly uncertain in their operation, likely to be very expensive to operate and practically very difficult for HMRC to administer. Further, many employers may find themselves caught by the rules due to ignorance."

It goes on to make the crucial point:

"We believe that this measure therefore fails to meet the Government's own growth agenda benchmark and is likely to hamper rather than support growth."

It would be helpful to hear the Minister's response.

3 pm

Ian Murray: My hon. Friend really gets to the nub of the Chancellor's Budget. The Chancellor proclaimed and trumpeted that this would be "a Budget for growth". He championed in the press a few days before the Budget that it would add "fuel to the economy". It was probably the only time in the history of the world when a Chancellor has come to any Dispatch Box in any Parliament and championed a Budget for growth that has reduced growth every year; the independent Office for Budget Responsibility has adapted the growth figures. That is the nub of the point that my hon. Friend the Member for Sheffield Central made.

Ignorance is no defence in law, but some employees will be trapped by the proposals and will get a bill from HMRC. To go off on a slight tangent for a second, the biggest complaint I get about HMRC is that it is incredibly aggressive in claiming back money and dealing with individuals. As ignorance is no defence in law, employees could be caught in the provisions through ignorance, and HMRC will go after them quite vociferously. Indeed, I had an 82-year-old man at my constituency surgery a few months ago who had received a letter from HMRC saying—I paraphrase—that it would be sending HMRC officers to his house to pin his valuables and assets in order to pay off his debt of £56.73. That debt did not actually exist; it was an administrative error.

Stephen Barclay (North East Cambridgeshire) (Con): Does the hon. Gentleman believe that HMRC was aggressive in its pursuit of Vodafone during the term of the last Government?

The Chair: Order. I am the most tolerant of Chairmen, as you all know, but I think there are boundaries to this discussion.

Ian Murray: Thank you, Mr Gale. You are a very good Chair, and I will follow your guidance and treat the last intervention with the silence it deserves.

Alison McGovern (Wirral South) (Lab): My hon. Friend was making an important point about the functioning of HMRC, especially where there is complexity, as there is in the provisions before us. I, too, have had people coming to my surgery about that. Would he agree that part of the problem is sometimes the language that is used by HMRC in its communications, and that this complexity will not make things any better?

Ian Murray: My hon. Friend gets to the heart of the problem with HMRC. Indeed, we have all experienced problems with it. While tax collection, the closing of tax loopholes and stopping tax avoidance are important, HMRC does not always get it right, and it goes after people aggressively. That makes these complex regulations all the more disheartening for small businesses. All they really want to do, particularly in the current climate, is run the business, tread water, do well, get through this particular bit of uncertainty, re-elect a Labour Government and allow the economy to grow disproportionately after that.

Bridget Phillipson: Before my hon. Friend moves on, I am sure he shares my view that the staff who work for HMRC are dedicated, very knowledgeable people who will adapt to any circumstances. However, does he share my concern that the Minister is perhaps being unduly optimistic when he makes the assessment that additional training above and beyond that normally undertaken following a Budget will not necessarily be required, especially given the complexity of what we are dealing with?

Ian Murray: I am grateful for that intervention. Indeed the Minister is an optimistic person. There is always a ray of sunshine over the Dispatch Box when he comes

into the Chamber to answer questions. I do not mean to come across as criticising HMRC staff, because they do a marvellous job under incredibly difficult circumstances. I think it was my hon. Friend the Member for Middlesbrough South and East Cleveland who mentioned that when the public or small businesses—or anyone, in fact—contacts HMRC, they do so, in the main, for all the wrong reasons. From the start, therefore, the circumstances are particularly difficult, and the vast majority of HMRC staff do a marvellous job dealing with such problems, often in situations that are incredibly stressful and hostile.

Finally, I would like to discuss loans.

Bill Esterson: Before we move on to loans, my hon. Friend made a point about how the changes will impact on staff. Surely the key issue is that there will be fewer staff, due to the very high numbers of redundancies being pushed through by the Government. That will put staff under increasing pressure. The levels of training and new knowledge required, therefore, will be far higher than would normally be the case after a Budget. That is the key issue; there is more information for fewer people to learn and apply.

Ian Murray: My hon. Friend is absolutely right, and the information that has come directly from the Treasury about HMRC is that there will be a 15% overall resource cut, and a 25% efficiency saving, which has been mentioned already. The £900 million for tax avoidance is certainly not new money, because it is a replacement for those efficiency savings, or for that shrinking budget. That was emphasised by the Chartered Institute of Taxation, and we have heard this already, but it bears repeating. It has said that as it stands,

"the legislation, which includes 14 separate tax avoidance tests, was likely to leave employers seeking clearances from Revenue & Customs on their particular circumstances."

Considering how complicated those circumstances may be, we could reach a situation where every single business in the country—whether small, medium-sized, or bigger, and whether the people in them are self-employed or otherwise—might contact HMRC with incredibly complex personal circumstances. HMRC would have to give a judgment on their concerns. That judgment may not necessarily be correct, because the regulations that the Minister is promoting are so complex that they would make an insomniac sleep. As we have discussed, they were incredibly complicated to run through at lunchtime.

HMRC therefore has a problem. I feel sorry for its staff, and I would be interested to hear how the Public and Commercial Services Union would respond to issues that we have raised, from the point of view of supporting the majority of the work force at HMRC, whom it represents.

Nic Dakin: My hon. Friend makes a powerful point about capacity at HMRC. Does he feel that HMRC can no longer do more with less, and that that needs thinking about very carefully?

Ian Murray: It seems a strange irony that the body responsible for collecting all taxation in the country, and for regulating the collection of taxation, whether through self-assessment, PAYE, corporation tax or VAT, has a shrinking budget. In times of austerity, people may think that HMRC would be given more resources. This statistic is from memory, so it may be incorrect, but for every HMRC employee, around £400,000 is collected for the Exchequer—my memory is not as good as that of the hon. Member for Watford, even though I studied law, too. I cannot remember why I studied it in the first place.

There is a real dilemma here. In times of financial difficulty, when every single penny coming into the Exchequer is needed, and there is somewhere between £40 billion and £120 billion of either uncollected tax or tax avoidance in the economy, depending on what estimates are used, we should plough money into HMRC, so that it has the resources to collect those funds. In my view, the legislation is overly complex, because HMRC is under-resourced, and if it were not under-resourced, it would be far easier to look at tax avoidance measures.

I will now move on to loans, which the Minister has discussed in great detail. The Institute of Chartered Accountants in England and Wales made its view clear in the first sentence of its response to the proposals:

"The exemption for loans is not broad enough."

The Minister spoke eloquently and at great length about carve-outs, but the ICAEW has stated that the exemptions for loans are not broad enough. It mentions reward and recognition for employees in that regard, and the issue of what could constitute an unpayable loan.

Let us take the example of an employee who is awarded £1,000 in a reward scheme. Who determines whether that is a loan? Who determines whether that is to be repaid? Who determines whether there is tax avoidance in that payment? The business that gives that reward and recognition to that employee would have to phone up HMRC and—I do not say this flippantly—perhaps spend half an hour, 45 minutes or an hour trying to get through. It will then speak to an adviser and have to be put on to a specialist unit, because not all HMRC staff can be retrained. That specialist unit will have to ring them back, as anyone who has recently dealt with HMRC will know, and they often ring back with a different perspective on the question asked, instead of replying to the one that needs answering. This whole churn is going on while the poor employee is waiting for the bonus, and while the squeaky-clean employer is, quite rightly, going round trying to find an answer to their questions about the perceived loan that is being given. That is why I thought that it was important to press the Minister on loans that are given to employees.

An employer could give a loan of £1,000 through a third party to an employee and that could be repaid at £50 a month with no interest. Is that market value for loan repayment? I would suggest not, because the amount paid for a £1,000 loan over a period of time would certainly be more than that if interest were payable on it. If it was determined that that was not market value, would the employee be hit with anything up to 40% tax on that loan as a benefit through the payroll system? What happens if the loan is constructed so that it is paid back at 10p a week for life and then, when the employee passes on, the remainder of that loan is repayable from the estate? That is a commercial loan, and many loans—perhaps not even through companies—are constructed in that way. Indeed, buy-back mortgages for elderly people work in that way. They can borrow money on

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their house, and the house then reverts to a third party. I know that that is slightly different, but it is a practical example of how people in their day-to-day lives view such benefits, and they could be caught in the middle.

To conclude, my hon. Friend the Member for Sheffield Central mentioned that the proposal fails the small business agenda, and it certainly does. If anyone has run a small a business or knows someone who has, it will be clear to them that all the owner wants to do is run the day-to-day affairs. Every single small business owner in the country has a great affection for their employees and vice-versa—I am not sure that there are many exceptions to that—and they want, therefore, to reward employees in the best way possible. They do not want to avoid tax or go through loopholes, but they may be reluctant to reward, given the complexity of the proposal. Even after the amendments were brought forward following the consultation, the Institute of Chartered Accountants in England and Wales said:

"We still believe that the current structure and fundamental principles…are wrong. While we understand the wish to avoid leaving scope for abuse we do not accept that it can be right to impose severely penal tax charges on a wide range of very common commercial remuneration arrangements."

I repeat that this clearly fails the small business agenda.

We have had a long debate today on what everyone will agree is an important clause. I re-emphasise that any tax avoidance measures are welcome, but they have to be clear, as simple as possible and understandable. That is why we are asking the Treasury team to go away before Third Reading and find a simplified way of presenting the information, so that we can make a proper determination on it. That would be the best way to proceed. Some of the debate that we have had today highlights the complexity of the legislation and why we need to reflect on what we are trying to achieve.

3.15 pm

Mr Hanson: We have had a useful discussion of the concerns about clause 26 and schedule 2. On some issues, I wish the Minister harm politically, and we debate those concerns. On this occasion I do not, and I hope that he will accept that. We are simply trying to reflect strongly the concerns outside the Committee on these key issues. My hon. Friend the Member for Edinburgh South has reflected those concerns very well on behalf of people outside the House.

I am acutely aware that we are dealing with serious matters in trying to tighten up three areas. As we have discussed, those areas are: loans that will not be repaid; making assets available to an employee via a trust; and questions on an effective pension cap. Clause 26 and schedule 2 will bring about £750 million into the Treasury, and they will tighten up the existing loopholes. I do not oppose the principle behind what the Minister has said, and for that reason I will not oppose the Government amendments. This might seem illogical, but I want to give him an opportunity to have a break over the next four to five weeks to look at the issues seriously. *[Interruption.]* The Minister says "a pause," and in the current spirit of cross-party co-operation, let me say that pauses for thought are often worth while. We are having them on Trident, on the health service and on a range of other issues. It is important that the Minister uses the next four to five weeks to look at the matter seriously.

Although I will not oppose the amendments, if the Minister is not willing to withdraw the clause and schedule as amended, I will ask my hon. Friends to vote against them. That is not because we want to forgo the £750 million. If the Minister decided after the pause that he wanted to bring back the clause in the same form, we would not oppose it on Report or Third Reading. I want to give him an opportunity to reflect on what the Opposition have said on behalf of a number of organisations outside the House.

I conclude by saying that the Institute of Chartered Accountants states in paragraph 4 of its latest submission, which was written after the amendments were tabled:

"Our major concerns with these proposed rules still remain. We believe that this legislation is still far too widely targeted. It catches far too many innocent and/or commercial transactions. Our particular concerns…are set out below."

There are three pages of concerns, which are not addressed by the amendments, including about definition, enforcement and complexity. On those questions, the schedule will fall short of achieving the objectives that we both share, even when amended.

There are real concerns about definition in the Bill. For example, the words "reasonable chance", which will not be amended, are used on page 65. "Reasonable chance" is open to so many definitions and so much legal interpretation that the resulting lack of clarity will damage the Minister's objective. The Minister could reconsider the Bill and discuss it with colleagues outside the House before bringing back clear legislation that meets the three tests that he has set. Then we would not have to have the range of exclusions in the Government amendments. Those exclusions will ultimately lead to further confusion and complexity downstream.

The Minister should not take our opposition to his revised clause as a spending commitment or as a concern for the loss of that revenue, because it is not. Let me be clear about that. If the Minister will not accept our suggestion of a pause for thought, that is our attempt to force him into one. If that fails, we will look at it outside, and might table our own amendments on Report to clarify the matter. I could have tabled hundred of amendments to this legislation; I chose the task of applying a "delete" option to the clause, because we feel the clause needs a substantial rethink. We will not oppose the amendments, but if the Minister will not withdraw the schedule and the clause, we will vote against and give him a chance to reflect more comprehensively over the next few weeks.

Mr Gauke: I can understand why the Opposition would want to raise questions about legislation, particularly when it is complex and controversial. I can understand representative bodies raising concerns. However, I have to underline to the Committee the fact that we are talking about an independently verified assessment that the measures will bring in additional revenues of £750 million. If there were an easy way to do it in simple terms, we would have done it. I would rather the legislation were on two pages, not 66. However, we do not believe those other options would be as effective, or, if they were, they would be equally complex.

It is important that we move on, and that the Committee shows its determination to tackle this form of tax avoidance. Were we to reject this legislation, the signal we sent would be most unfortunate, suggesting a lack of willingness. If there were an alternative way to do it, the Opposition could have tabled amendments. This matter has been debated, it has been out in the open and we introduced the draft legislation in December. If there is an easier solution, we would welcome constructive amendments. We do not believe that is the case. The Committee would make a significant mistake if it struck down this clause and schedule. If hon. Members want to address this serious problem and loss of revenue to the Exchequer, there are better ways of allocating £750 million than opposing the legislation. I urge the Committee to support the clause and schedule.

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

The Committee divided: Ayes 16, Noes 14.

Division No. 4]

AYES

Barclay, Stephen	Hoban, Mr Mark
Bradley, Karen	Lee, Jessica
Crockart, Mike	Lewis, Brandon
Crouch, Tracey	McCartney, Karl
Gauke, Mr David	Sharma, Alok
Goodwill, Mr Robert	Shelbrooke, Alec
Greening, Justine	Smith, Julian
Harrington, Richard	Williams, Stephen

NOES

Blenkinsop, Tom	McCarthy, Kerry
Blomfield, Paul	McClymont, Gregg
Creasy, Stella	McGovern, Alison
Dakin, Nic	Mearns, Ian
Esterson, Bill	Murray, Ian
Glindon, Mrs Mary	Nash, Pamela
Hanson, rh Mr David	Phillipson, Bridget

Question accordingly agreed to.

Clause 26 ordered to stand part of the Bill.

Schedule 2

EMPLOYMENT INCOME PROVIDED THROUGH THIRD PARTIES

Amendments made: 102, page 54, line 6 [Schedule 2], leave out 'Subject to section 554B(5), in' and insert 'In'.

103, page 55, line 21 [Schedule 2], leave out from beginning to end of line 8 on page 56.

10, page 56, line 35 [Schedule 2], after '420' insert 'for the purposes of Chapters 1 to 5 of Part 7'.

11, page 58 [Schedule 2], leave out lines 35 to 38.

12, page 59, line 15 [Schedule 2], leave out from beginning to end of line 44 and insert—

"(2) Subject to subsection (4), subsection (3) applies to a relevant step taken by a person ("P") if—

(a) the relevant step is not taken under an arrangement mentioned in subsection (1)(a) to (c), and

(b) there is no connection (direct or indirect) between the relevant step and a tax avoidance arrangement.

(3) Chapter 2 does not apply by reason of the relevant step if the step is taken solely for the purpose of—

(a) acquiring or holding shares—

(i) to be awarded under an approved SIP, or

(ii) to be provided pursuant to options granted under an approved SAYE option scheme or an approved CSOP scheme, or

(b) providing shares pursuant to—

(i) an award of shares under an approved SIP, or

(ii) an option granted under an approved SAYE option scheme or an approved CSOP scheme.

(5) Subsection (3) does not apply to the relevant step if, immediately before or after the step is taken—

(a) the total number of shares of any type held, in relation to the approved SIP, the approved SAYE option scheme or the approved CSOP scheme, by P and any other persons for purposes within subsection (3)(a) and (b), exceeds

(b) the maximum number of shares of that type which might reasonably be expected to be required, in relation to the approved SIP, the approved SAYE option scheme or the approved CSOP scheme, for those purposes over the period of ten years starting with the day on which the relevant step is taken.'.

13, page 59, line 46 [Schedule 2], leave out ', 8 or 9' and insert 'or 8'.

14, page 59, line 46 [Schedule 2], at end insert—

"(5A) Chapter 2 does not apply by reason of a relevant step taken by a person ("P") if—

(a) the relevant step is taken for the sole purpose of—

(i) granting qualifying options under an EMI arrangement,

(ii) acquiring or holding shares to be provided pursuant to qualifying options granted under an EMI arrangement, or

(iii) providing shares pursuant to qualifying options granted under an EMI arrangement, and

(b) there is no connection (direct or indirect) between the relevant step and a tax avoidance arrangement.

(5B) But subsection (5A) does not apply to the relevant step if, immediately before or after the step is taken—

(a) the total number of shares of any type held, in relation to the EMI arrangement, by P and any other persons for purposes within subsection (5A)(a)(i) to (iii), exceeds

(b) the maximum number of shares of that type which might reasonably be expected to be required, in relation to the EMI arrangement, for those purposes over the period of ten years starting with the day on which the relevant step is taken.

(5C) In subsections (5A) and (5B) "EMI arrangement" means an arrangement under which qualifying options are granted.

(5D) Terms used in subsections (5A) to (5C) have the same meaning as in Chapter 9 of Part 7.'.

15, page 60, line 3 [Schedule 2], leave out '(1)(e)' and insert '(3) or (5A)'.

16, page 60, line 6 [Schedule 2], leave out from 'for' to 'but' in line 7 and insert 'purposes within subsection (3)(a) and (b) or (5A)(a)(i) to (iii),'.

17, page 62, line 27 [Schedule 2], leave out 'B awards A' and insert 'A is awarded'.

18, page 62, line 34 [Schedule 2], leave out from 'terms")' to first 'the' in line 38 and insert 'the main purpose of which is to defer the provision to A of the deferred remuneration to a specified date ("the vesting date") which is after the award date, while providing that'.

19, page 63 [Schedule 2], leave out lines 11 to 15.

20, page 63, line 16 [Schedule 2], leave out 'mentioned in subsection (1)(c)(ii)' and insert 'relating to revocation required by subsection (1)(c)'.

21, page 64, line 26 [Schedule 2], leave out from 'terms' to end of line 42.

22, page 65, line 9 [Schedule 2], leave out 'shares' and insert 'certain shares or securities'.

23, page 65, line 10 [Schedule 2], leave out 'shares' and insert 'certain shares or securities'.

24, page 65, line 11 [Schedule 2], leave out 'Section 554L is' and insert 'Sections 554L and 554LA are'.

25, page 65, line 12 [Schedule 2], leave out 'shares' and insert 'certain shares or securities'.

26, page 65, line 13 [Schedule 2], leave out 'shares' and insert 'certain shares or securities'.

27, page 65, line 14 [Schedule 2], leave out '554L' and insert '554LA'.

28, page 65, line 17 [Schedule 2], leave out from '393B(2)(a),' to end of line 22 and insert—

'"relevant shares" means—

(a) shares (including stock) in B,

(b) instruments issued by B which are securities for the purposes of Chapters 1 to 5 of Part 7 within section 420(1)(b), or

(c) units in a collective investment scheme (as defined in section 420(2)) managed by B which are securities for the purposes of Chapters 1 to 5 of Part 7 within section 420(1)(e), and

"trading company" means a company the business of which consists wholly or mainly in the carrying on of a trade.

(5) If B is a member of a group of companies, in the definition of "relevant shares" in subsection (4) references to B are to be read as including references to any other company which is a member of that group.

(6) For the purposes of sections 554K and 554LA an exit event occurs if—

(a) shares in the relevant company are admitted to trading on a stock exchange,

(b) all the shares in the relevant company, or a substantial proportion of them, are disposed of to persons none of whom are connected with any of the persons making any disposal,

(c) if the relevant company is a trading company (as defined in subsection (4)), the company's trade, or a substantial proportion of it, is transferred to a person who is not a relevant connected person,

(d) the relevant company's assets, or a substantial proportion of them, are disposed of to a person who is not a relevant connected person,

(e) the winding up of the relevant company starts, or

(f) a person ("P") who controls the relevant company ceases to control it, so long as no person connected with P starts to control it.

(7) For the purposes of subsection (6)—

(a) "the relevant company" means—

(i) if the relevant shares mentioned in section 554K(1)(a)(i) or (ii) or 554LA(1)(a)(i) or (ii) are shares (including stock), the company in which they are shares, or

(ii) if the relevant shares so mentioned are instruments within paragraph (b) of the definition of "relevant shares" in subsection (4), the company by which those instruments are issued,

(b) "relevant connected person" means a person who—

(i) is connected with the relevant company, or

(ii) is a shareholder in the relevant company or is connected with a shareholder in the relevant company,

(c) the relevant company's trade, or a substantial proportion of it, is transferred to another person if—

(i) the relevant company ceases to carry on the trade or the proportion of it, and

(ii) on that occurring, the other person starts to carry on the trade or the proportion of it, and

(d) section 12(7) of CTA 2009 applies for the purpose of determining when the winding up of the relevant company starts.'.

29, page 65, line 26 [Schedule 2], leave out 'B may make to A an award' and insert 'an award may be made to A'.

30, page 65, line 35 [Schedule 2], leave out from 'terms")' to 'the' in line 41 and insert 'the main purpose of which is to defer the receipt of the shares by A, or the payment of the sum of money to A, to a specified date ("the vesting date") which is after the date ("the award date") on which the award is made, while providing that'.

31, page 65, line 43 [Schedule 2], leave out 'five' and insert 'ten'.

32, page 66 [Schedule 2], leave out lines 1 to 5.

33, page 66, line 6 [Schedule 2], leave out 'mentioned in subsection (1)(c)(ii)' and insert 'relating to revocation required by subsection (1)(c)'.

34, page 66, line 20 [Schedule 2], leave out '(subject to subsection (2))'.

35, page 66, line 25 [Schedule 2], leave out '(subject to subsection (2))'.

36, page 66, line 37 [Schedule 2], leave out 'which is three months after' and insert 'falling immediately after the period of three months starting with'.

37, page 67, line 44 [Schedule 2], leave out from 'shares' to end of line 48 and insert ', or the payment is made from another source and, correspondingly, the shares are no longer held by any person in relation to the award.'.

38, page 68, line 5 [Schedule 2], leave out from 'correspondingly,' to end of line 8 and insert 'the shares are no longer held by any person in relation to the award.'.

39, page 68, line 23 [Schedule 2], leave out from 'B,' to end of line 26 and insert 'an award may be made to A of—

(i) relevant shares, or

(ii) a sum of money the amount of which is to be determined by reference to the market value of any relevant shares at the time the sum is to be paid,'.

40, page 68, line 28 [Schedule 2], at end insert—

'(ba) the relevant shares would be—

(i) shares (including stock) in, or

(ii) instruments within paragraph (b) of the definition of "relevant shares" in section 554I(4) issued by,

a trading company or a company which controls a trading company,'.

41, page 68, line 30 [Schedule 2], leave out from beginning to 'and' in line 32 and insert 'the main purpose of which is to ensure—

(i) that the relevant shares are received, or

(ii) that the sum of money is paid,

only if a specified exit event, or an exit event within a specified description, occurs,'.

42, page 68 [Schedule 2], leave out lines 36 to 50.

43, page 69, line 7 [Schedule 2], after first 'of' insert 'relevant shares or'.

44, page 69, line 10 [Schedule 2], leave out '(subject to subsection (3))'.

45, page 69, line 12 [Schedule 2], after first 'of' insert 'relevant shares or'.

46, page 69, line 16 [Schedule 2], leave out '(subject to subsection (3))'.

47, page 69 [Schedule 2], leave out lines 17 and 18.

48, page 69, line 30 [Schedule 2], leave out 'which is three months after' and insert 'falling immediately after the period of three months starting with'.

49, page 70, line 20 [Schedule 2], leave out 'subsection (11) does not apply' and insert 'neither subsection (10A) nor subsection (11) applies'.

50, page 70, line 26 [Schedule 2], at end insert—

"(10A) This subsection applies to any earmarked shares if—

(a) A receives the shares before the end of the exit period, and

(b) the receipt of the shares by A gives rise to employment income of A which is chargeable to income tax or which is exempt income.'.

51, page 70, line 28 [Schedule 2], leave out '(1)(a)' and insert '(1)(a)(ii)'.

52, page 70, line 34 [Schedule 2], leave out from 'shares' to end of line 38 and insert ', or the payment is made from another source and, correspondingly, the shares are no longer held by any person in relation to the award.'.

53, page 70, line 39 [Schedule 2], after '(10)' insert ', (10A)(a)'.

54, page 70, line 40 [Schedule 2], leave out 'three' and insert 'six'.

55, page 71, line 7 [Schedule 2], leave out 'B may grant A a right ("a relevant share option")' and insert 'a right ("a relevant share option") may be granted to A'.

56, page 71, line 16 [Schedule 2], leave out from 'terms")' to 'the' in line 21 and insert 'the main purpose of which is to ensure that the relevant share option is not exercisable by A before a specified date ("the vesting date") which is after the date ("the grant date") on which the grant is made, while providing that'.

57, page 71, line 24 [Schedule 2], leave out 'five' and insert 'ten'.

58, page 71 [Schedule 2], leave out lines 30 to 34.

59, page 71, line 35 [Schedule 2], leave out 'mentioned in subsection (1)(c)(ii)' and insert 'relating to revocation required by subsection (1)(c)'.

60, page 71, line 44 [Schedule 2], after 'providing' insert 'relevant'.

61, page 71, line 49 [Schedule 2], leave out '(subject to subsection (2))'.

62, page 72, line 5 [Schedule 2], leave out '(subject to subsection (2))'.

63, page 72, line 18 [Schedule 2], leave out 'which is three months after' and insert 'falling immediately after the period of three months starting with'.

64, page 72, line 20 [Schedule 2], after 'at' insert 'the end of'.

65, page 73, line 4 [Schedule 2], after 'before' insert 'the end of'.

66, page 73, line 21 [Schedule 2], leave out from 'A' to end of line 22 and insert '—

(i) which is chargeable to income tax or would be chargeable apart from section 474, or

(ii) which is exempt income.'.

67, page 73, line 30 [Schedule 2], leave out from 'A' to 'and' in line 31 and insert '—

(i) which is chargeable to income tax or would be chargeable apart from section 474, or

(ii) which is exempt income,'.

68, page 73, line 33 [Schedule 2], leave out from 'shares' to end of line 37 and insert ', or the payment is made from another source and, correspondingly, the shares are no longer held by any person in relation to the relevant share option.'.

69, page 73, line 42 [Schedule 2], leave out from 'correspondingly,' to end of line 45 and insert 'the shares are no longer held by any person in relation to the relevant share option.'.

70, page 74, line 3 [Schedule 2], leave out from 'correspondingly,' to end of line 6 and insert 'the shares are no longer held by any person in relation to the relevant share option.'.

104, page 74, line 8 [Schedule 2], leave out 'five' and insert 'ten'.

71, page 74, line 19 [Schedule 2], at end insert—

554LA Exclusions: earmarking for employee share schemes (4)

(1) This section applies if—

(a) there is an arrangement ("B's employee share scheme") under which, in respect of A's employment with B, a right ("a relevant share option") may be granted to A—

(i) to acquire relevant shares, or

(ii) to receive a sum of money the amount of which is to be determined by reference to the market value of any relevant shares at the time the sum is to be paid,

(b) the main purpose of the grant of the relevant share option would not be the provision of relevant benefits,

(c) the relevant shares would be—

(i) shares (including stock) in, or

(ii) instruments within paragraph (b) of the definition of "relevant shares" in section 554I(4) issued by,

a trading company or a company which controls a trading company,

(d) the grant would be made on terms ("the deferred grant terms") the main purpose of which is to ensure that the relevant share option is exercisable by A only if a specified exit event, or an exit event within a specified description, occurs, and

(e) as at the time the grant is made, there would be a reasonable chance that the specified exit event, or an exit event within the specified description, will occur.

(2) Chapter 2 does not apply by reason of a relevant step within section 554B (by reason of which it would otherwise apply) taken by a person ("P") if—

(a) the subject of the relevant step is relevant shares ("earmarked shares") which are earmarked, or otherwise start being held, solely with a view to providing relevant shares, or paying a sum of money, pursuant to—

(i) a relevant share option granted to A under B's employee share scheme as mentioned in subsection (1)(a) in relation to which the requirements of subsection (1)(b) to (e) are met, or

(ii) a relevant share option which is expected to be granted to A under B's employee share scheme as mentioned in subsection (1)(a) and in relation to which the requirements of subsection (1)(b) to (e) would be met,

(b) the number of relevant shares of any type which are earmarked shares does not exceed the maximum number of relevant shares of that type which might reasonably be expected to be needed for providing shares, or paying a sum of money, pursuant to the relevant share option which is granted or expected to be granted, and

(c) there is no connection (direct or indirect) between the relevant step and a tax avoidance arrangement.

(3) If the relevant step mentioned in subsection (2) is taken in relation to an expected grant of a relevant share option as mentioned in subsection (2)(a)(ii), subsection (4) applies if—

(a) the grant is not made before the end of the date ("the final grant date") falling immediately after the period of three months starting with the date on which P takes the relevant step, and

(b) as at the end of the final grant date, any of the earmarked shares continue to be held by or on behalf of P solely on the basis mentioned in subsection (2)(a).

(4) This Part has effect as if a relevant step within section 554B were taken at the end of the final grant date—

(a) the subject of which is—

(i) the shares which continue to be held as mentioned in subsection (3)(b), and

(ii) any relevant income in relation to those shares (see subsection (14)), and

(b) by reason of which Chapter 2 is to apply (subject only to section 554A(4)).

(5) Subsection (6) applies if, at any time ("the relevant time")—

(a) any of the earmarked shares cease to be held by or on behalf of P solely on the basis mentioned in subsection (2)(a), but

(b) the shares continue to be held by or on behalf of P on the basis mentioned in section 554B(1)(a) or (b).

(6) This Part has effect as if a relevant step within section 554B were taken at the relevant time—

(a) the subject of which is—

(i) the shares mentioned in subsection (5), and

(ii) any relevant income in relation to those shares (see subsection (14)), and

(b) by reason of which Chapter 2 is to apply (subject only to section 554A(4)).

(7) Subsection (8) applies if—

(a) the relevant step mentioned in subsection (2) is taken in relation to a grant of a relevant share option made as mentioned in subsection (2)(a)(i), or

(b) the relevant step mentioned in subsection (2) is taken in relation to an expected grant of a relevant share option as mentioned in subsection (2)(a)(ii) and the grant is made before the end of the final grant date,

and the specified exit event, or an exit event within the specified description, occurs.

(8) This Part has effect as if a relevant step within section 554B were taken at the end of the exit period—

(a) the subject of which is—

(i) any of the earmarked shares to which none of subsections (9) to (11) applies, and

(ii) any relevant income in relation to any of the earmarked shares mentioned in sub-paragraph (i) (see subsection (14)), and

(b) by reason of which Chapter 2 is to apply (subject only to section 554A(4)).

(9) This subsection applies to any earmarked shares if—

(a) A exercises the relevant share option (wholly or partly) before the end of the exit period and, as a result, receives the shares, and

(b) the receipt of the shares gives rise to employment income of A—

(i) which is chargeable to income tax or would be chargeable apart from section 474, or

(ii) which is exempt income.

(10) This subsection applies to any earmarked shares if—

(a) A exercises the relevant share option (wholly or partly) before the end of the exit period and, as a result, a sum of money is paid to A as mentioned in subsection (1)(a)(ii),

(b) the payment of the sum gives rise to employment income of A—

(i) which is chargeable to income tax or would be chargeable apart from section 474, or

(ii) which is exempt income, and

(c) the payment represents the proceeds of the disposal of the shares, or the payment is made from another source and, correspondingly, the shares are no longer held by any person in relation to the relevant share option.

(11) This subsection applies to any earmarked shares if—

(a) the relevant share option becomes exercisable by A before the end of the exit period but the option lapses (in whole or in part) at or before the end of that period, and

(b) correspondingly, the shares are no longer held by any person in relation to the relevant share option.

(12) In subsections (8), (9)(a), (10)(a) and (11)(a) "the exit period" means—

(a) the period of six months starting with the date on which the exit event occurs, or

(b) if it ends earlier, the period during which the relevant share option is exercisable by A in accordance with the deferred grant terms.

(13) If the exit event is an event within section 554I(6)(a), in subsection (12)(a) the reference to six months is to be read as a reference to five years.

(14) In subsections (4)(a)(ii), (6)(a)(ii) and (8)(a)(ii) "relevant income", in relation to any earmarked shares, means any income—

(a) which, before the relevant step is treated as being taken by subsection (4), (6) or (8) (as the case may be)—

(i) arises (directly or indirectly) from the shares, and

(ii) is the subject of a relevant step within section 554B taken by P by reason of which Chapter 2 would apply apart from section 554P, and

(b) which, at the time the relevant step is treated as being taken, continues to be held by or on behalf of P on the basis mentioned in section 554B(1)(a) or (b).'.

72, page 74, line 43 [Schedule 2], after '421E(1),' insert '429, 443,'.

73, page 74, line 44 [Schedule 2], at end insert—

"(6A) Subsection (6E) applies if there is an acquisition of an asset within section 554C(4)(a) or (b) ("the relevant asset") and—

(a) relevant consideration is given by A for the relevant asset of an amount equal to or greater than the market value of the relevant asset at the time of the acquisition, or

(b) ignoring any relevant consideration given for the relevant asset, the acquisition gives rise (or would give rise) to earnings of A within Chapter 1 of Part 3 from A's employment with B—

(i) the amount of which is equal to or greater than the market value of the relevant asset at the time of the acquisition, and

(ii) which are not exempt income.

(6B) In subsection (6A) "relevant consideration"—

(a) means consideration—

(i) which is given before, or at or about, the time of the acquisition, and

(ii) which is money or money's worth, but

(b) does not include—

(i) a promise to do anything, or

(ii) the performance of any duties of, or in connection with, an employment.

(6C) If section 437(1) or 452(1) applies in relation to the acquisition, or would apply if Chapter 3 or 4A of Part 7 (as the case may be) applied in relation to the acquisition, in subsection (6A) references to the market value of the relevant asset are to be read as references to that value determined on the basis mentioned in section 437(1) or 452(1) (as the case may be).

(6D) Subsection (6E) also applies if—

(a) there is an acquisition of an asset within section 554C(4)(a) or (b) ("the relevant asset"),

(b) the acquisition is pursuant to an employment-related securities option (within the meaning of Chapter 5 of Part 7, but ignoring section 474(1)) acquired by reason of A's employment, or former or prospective employment, with B, and

(c) the acquisition is a chargeable event for the purposes of section 476 or would be a chargeable event apart from section 474(1).

(6E) Chapter 2 does not apply by reason of a relevant step taken after the acquisition if—

(a) the subject of the relevant step is the relevant asset, and

(b) there is no connection (direct or indirect) between the relevant step and a tax avoidance arrangement.

(6F) In subsections (6A) to (6E) "acquisition" is to be read in accordance with section 421B(2)(a).'.

74, page 75, line 4 [Schedule 2], leave out 'a share option' and insert 'an employment-related securities option (within the meaning of Chapter 5 of Part 7)'.

75, page 75, line 7 [Schedule 2], after 'tax' insert 'or would be chargeable apart from section 474'.

76, page 75 [Schedule 2], leave out lines 11 and 12.

77, page 75, line 28 [Schedule 2], leave out from beginning to 'is' in line 30 and insert 'of 40 days starting with the day on which the relevant step mentioned in subsection (7)'.

78, page 77, line 17 [Schedule 2], leave out '554L' and insert '554LA'.

79, page 77, line 39 [Schedule 2], leave out from beginning to end of line 40 and insert—

'(d) subsection (1A) does not apply.

(1A) This subsection applies if it is reasonable to suppose that, in essence—

(a) at the time of the acquisition of sum or asset T, the value of sum or asset T is greater or less than the value of sum or asset S, and

(b) the difference (or any part of the difference) in the values might not have been expected applying the assumption that all relevant connected persons are acting at arm's length of each other.

(1B) In subsection (1A)—

(a) the reference to sum or asset S is to sum or asset S so far as sum or asset T is acquired out of it, and

(b) "relevant connected person" means a person with a connection (direct or indirect) to the arrangement under which sum or asset T is acquired.'.

80, page 77, line 43 [Schedule 2], at end insert—

"(2A) Subsection (3) applies if, on its acquisition, sum or asset T is the subject of a relevant step within section 554B taken by P.'.

81, page 77, line 44 [Schedule 2], leave out 'mentioned in subsection (1)(d)'.

82, page 78, line 4 [Schedule 2], at end insert 'and'.

83, page 78, line 7 [Schedule 2], leave out from '(b)' to end of line 18.

84, page 78, line 20 [Schedule 2], leave out from beginning to 'and' in line 23 and insert—

'(a) on its acquisition, sum or asset T—

(i) is the subject of a relevant step within section 554B taken by P by reason of which Chapter 2 applies or would apply apart from subsection (3) above or any of sections 554H to 554LA, 554P or 554S, or

(ii) if sub-paragraph (i) does not apply, is held by or on behalf of P on the same basis as that on which sum or asset S was held by or on behalf of P immediately before the acquisition,'.

85, page 84, line 42 [Schedule 2], at end insert—

"(5A) And for that purpose, section 170(2) to (11) is to be read as if for "75 per cent" (wherever occurring) there were substituted "51 per cent" (with section 1154(2) of CTA 2010 applying accordingly).'

86, page 88, line 8 [Schedule 2], after 'section' insert 'or section 554Z6'.

87, page 88, line 9 [Schedule 2], leave out 'sections 554Z5 to' and insert 'section 554Z5 or'.

88, page 88, line 43 [Schedule 2], after '(10)' insert 'or 554LA(4), (6) or (8)'.

89, page 89, line 2 [Schedule 2], leave out 'B may grant A a right ("a relevant share option")' and insert 'a right ("a relevant share option") may be granted to A'.

90, page 89, line 36 [Schedule 2], after '554L(10)' insert 'or 554LA(8)'.

91, page 90, line 9 [Schedule 2], leave out 'which is three months after' and insert 'falling immediately after the period of three months starting with'.

92, page 90, line 11 [Schedule 2], after 'at' insert 'the end of'.

93, page 96, line 20 [Schedule 2], at end insert—

"(10) In relation to times after the relief is given, the Tax Acts have effect as if this Chapter had never applied by reason of the original relevant step.'.

105, page 96, line 29 [Schedule 2], at end insert—

CHAPTER 3

UNDERTAKINGS GIVEN BY EMPLOYERS ETC IN RELATION TO RETIREMENT BENEFITS ETC

554Z15 Application etc

(1) This Chapter applies if there is an undertaking ("the relevant undertaking") that a contribution to which subsection (2) would apply will be paid.

(2) This subsection applies to a contribution if—

(a) the contribution is paid to an arrangement which is not a registered pension scheme,

(b) in connection with that arrangement (directly or indirectly), relevant benefits are to be provided (directly or indirectly) out of the contribution by a relevant third person,

(c) the provision of the relevant benefits would be a relevant step, and

(d) the contribution is neither a tax-relieved contribution nor tax-exempt provision.

(3) In subsection (2)—

"relevant benefits" has the same meaning as in Chapter 2 of Part 6, but ignoring section 393B(2)(a),

"relevant third person" means a person within section 554A(7)(a) to (c) (ignoring this Chapter), and

"tax-exempt provision" and "tax-relieved contribution" have the meaning given by paragraph 3(3) and (4) of Schedule 34 to FA 2004.

(4) In this Chapter references to an undertaking include references to—

(a) an undertaking which is not legally enforceable, and

(b) an undertaking which is to be performed only on or following the meeting of a condition (including a condition which might never be met).

554Z16 Employer etc to be treated as relevant third person etc

(1) If B takes a step within section 554Z17 or 554Z18, Chapters 1 and 2 have effect in relation to the step—

(a) as if B were a relevant third person for the purposes of section 554A(1)(d), and

(b) as if the step were a relevant step within section 554B (if it would not otherwise be).

(2) For the purpose of determining whether Chapter 2 applies by reason of the step, Chapter 1 has effect—

(a) as if sections 554F to 554N, 554R to 554T, 554V and 554W were omitted,

(b) if the step is within section 554Z17, as if sections 554P(2)(d), (3) and (4) and 554Q(1)(c) and (d), (1A) and (1B) were omitted, and

(c) if the step is within section 554Z18, as if sections 554P and 554Q were omitted.

(3) If Chapter 2 applies by reason of the step, Chapter 2 has effect as if sections 554Z6 to 554Z11 were omitted.

(4) If Chapter 2 does not apply by reason of the step by virtue of section 554E(3) or (5A), section 554E(6) and (7) does not apply in relation to the step.

(5) For further modifications of Chapters 1 and 2, see sections 554Z17(3) and (4), 554Z18(5) and (6), 554Z19 and 554Z20.

(6) Regulations under section 554X may (in particular) make provision covering cases in which Chapters 1 and 2 have effect as provided for by this section.

(7) In this Chapter—

(a) references to B do not include references to B acting as a trustee,

(b) if B is a company and is a member of a group of companies, references to B are to be read as including references to any other company which is a member of that group, and

(c) if B is a limited liability partnership, references to B are to be read as including references to any company which is a wholly-owned subsidiary (as defined in section 1159(2) of the Companies Act 2006) of B.

554Z17 Earmarking etc

(1) B takes a step within this section if—

(a) a sum of money or asset held by or on behalf of B is earmarked (however informally) by B with a view to the relevant undertaking being performed at a later time (wholly or partly) out of—

(i) that sum of money or asset, or

(ii) any sum of money or asset which may arise or derive (directly or indirectly) from it, or

(b) a sum of money or asset otherwise starts being held by or on behalf of B, specifically with a view, so far as B is concerned, to the relevant undertaking being performed at a later time (wholly or partly) out of—

(i) that sum of money or asset, or

(ii) any sum of money or asset which may arise or derive (directly or indirectly) from it.

(2) For the purposes of subsection (1)(b) it does not matter whether or not the sum of money or asset in question has previously been held by or on behalf of B on a basis which is different to that mentioned in subsection (1)(b).

(3) Subsection (4) applies if, in the application of section 554P or 554Q in any case, the relevant step mentioned in section 554P(2)(a) or 554Q(3)(a) is a step within this section taken by B.

(4) In section 554P(2)(c) or 554Q(3)(c) (as the case may be) the reference to section 554B(1)(a) or (b) is to be read as a reference to subsection (1)(a) or (b) above.

554Z18 Provision of security

(1) B takes a step within this section if B provides security for the performance of the relevant undertaking.

(2) For the purposes of this Part, the sum of money or asset which is the subject of the step is to be taken to be—

(a) any sums of money which, as at the time the step is taken, are the subject of the security, and

(b) any assets which, as at that time, are the subject of the security,

and references to the sum of money or asset which is the subject of a relevant step are to be read accordingly.

(3) If, when the step is taken, the security covers other undertakings as well as the relevant undertaking, the sums of money and assets within subsection (2)(a) and (b) are to be apportioned between the relevant undertaking and the other undertakings on a just and reasonable basis.

(4) Subsections (2) and (3) are subject to section 554Z19(7).

(5) Section 554P does not apply in any case in which the relevant step mentioned in section 554P(2)(a) would be a step within this section taken by B.

(6) Section 554Q(3) does not apply in any case in which the relevant step mentioned in section 554Q(3)(a) would be a step within this section taken by B.

(7) In this Chapter references to providing security for the performance of an undertaking are references to providing such security in any way, however informal.

554Z19 Valuation of step within section 554Z18

(1) This section applies if, by virtue of section 554Z16, Chapter 2 applies by reason of a step taken by B within section 554Z18.

(2) Section 554Z2 has effect as if subsections (3) and (4) below were substituted for subsections (1) to (6) of that section.

(3) The value of the relevant step is—

(a) the amount to be paid as a contribution under the relevant undertaking determined, as at the time the step is taken, on a just and reasonable basis assuming that any condition to be met before any payment is made will be met, or

(b) if lower, the value of the security.

(4) For the purposes of subsection (3)(b) the value of the security—

(a) consists of—

(i) the total amount of the sums of money included in the subject of the step (see section 554Z18(2)(a)), and

(ii) the total market value, as at the time the step is taken, of the assets included in the subject of the step (see section 554Z18(2)(b)), but

(b) is to be subject to a just and reasonable reduction to take account of any term of the security which limits the total amount which may be made available under the security for the performance of the relevant undertaking to an amount which is lower than the amount determined under paragraph (a).

(5) The following subsections apply if, as at the end of the day of an anniversary of the taking of the step ("the anniversary day"), B continues to provide the security for the performance of the relevant undertaking.

(6) This Part has effect as if B's continuing to provide the security were a new step ("the anniversary step") within section 554Z18—

(a) which is taken by B at the end of the anniversary day, and

(b) by reason of which Chapter 2 is to apply by virtue of section 554Z16 (subject only to section 554A(4)).

(7) If the total amount of the sums of money which are the subject of the security ("the security sums") varies from time to time, for the purpose of determining the sums of money included in the subject of the anniversary step, in section 554Z18(2)(a) the reference to the time the step is taken is to be read as a reference to the time during the preceding year at which the total amount of the security sums is at its highest.

(8) For the purposes of subsection (4)(a)(ii) the market value of any asset included in the subject of the anniversary step may be determined as at any time during the preceding year (so long as the asset is the subject of the security, or one of the assets which is the subject of the security, as at that time).

(9) In subsections (7) and (8) "the preceding year" means the year ending with the anniversary day.

554Z20 Relief for earmarking or security not followed by contribution or relevant benefit

(1) This section applies if, by virtue of section 554Z16, Chapter 2 applies by reason of a step taken by B within section 554Z17 or 554Z18.

(2) Section 554Z13 has effect in relation to the step with the following modifications.

(3) Subsection (1)(b) has effect as if for "not a relevant step in relation to a relevant sum or asset" there were substituted "neither the payment of the relevant contribution (or any part of it) nor the provision of any relevant benefit".

(4) Subsection (1)(c) has effect as if for the words from "no further relevant step" to "any relevant sum or asset" there were substituted "the relevant contribution (or any part of it) will not be paid or a relevant benefit will not be provided".

(5) Subsection (1) has effect as if subsection (6) below were substituted for subsection (3).

(6) In subsection (1)—

(a) "the relevant contribution" means the contribution to be paid under the relevant undertaking (within the meaning of Chapter 3), and

(b) "relevant benefit" means a relevant benefit to be provided out of the relevant contribution as mentioned in section 554Z15(2)(b) and (c).'".

106, page 111, line 5 [Schedule 2], at end insert—

57A (1) This paragraph applies if—

(a) B takes a step within section 554Z18 of ITEPA 2003 before 6 April 2011 by providing security ("the early security") for the performance of an undertaking ("the early undertaking"),

(b) on or after 6 April 2011 at a time when B is continuing to provide the early security, there is a change in the terms of the early undertaking which does not amount to the giving of a new undertaking, and

(c) as a result of the change, the amount to be paid as a contribution ("the early contribution") under the early undertaking increases, or will increase.

'(2) Chapter 3 of Part 7A of ITEPA 2003 has effect—

(a) as if the change in the terms of the early undertaking were a new undertaking to pay a contribution covering the increase in the amount of the early contribution as determined on a just and reasonable basis, and

(b) as if B, in continuing to provide the early security, provides security for the performance of the new undertaking at the time of the change in the terms.

(3) Section 554Z16(7) of ITEPA 2003 applies for the purposes of this paragraph as it applies for the purposes of Chapter 3 of Part 7A of that Act.'.

94, page 111, line 18 [Schedule 2], leave out from 'earnings' to end of line 28 and insert

'of A from A's employment with B within Chapter 1 of Part 3 of ITEPA 2003 for the pre-6 April 2011 tax year, or the tax payable by A for the pre-6 April 2011 tax year was otherwise decided on the basis that the pre-6 April 2011 step was to be treated as giving rise to earnings of A from A's employment with B within Chapter 1 of Part 3 of ITEPA 2003 for that tax year,

(i) the tax payable by A for the pre-6 April 2011 tax year was otherwise decided on the basis that the pre-6 April 2011 step was to be treated as giving rise to earnings of A from A's employment with B within Chapter 1 of Part 3 of ITEPA 2003 for that tax year,

(e) before the chargeable step is taken, A or B has paid, or otherwise accounted for, any tax which A or B is required to pay or otherwise account for as a consequence of—

(i) the agreement mentioned in paragraph (d)(i), or

(ii) the tax payable by A for the pre-6 April 2011 tax year having otherwise been decided on the basis mentioned in paragraph (d)(ii), and

(f) after any reductions under sections 554Z3 to 554Z7 of ITEPA 2003, it is determined on a just and reasonable basis that the value of the chargeable step represents (or still represents after any such reductions) to any extent—

(i) the earnings treated as arising from the pre-6 April 2011 step as mentioned in paragraph (d)(i) or (ii), or

(ii) any return on those earnings since the taking of the pre-6 April 2011 step (whether income or capital, direct or indirect or realised or unrealised).

'(2) After any reductions under sections 554Z3 to 554Z7 of ITEPA 2003, the value of the chargeable step is to be reduced (but not below nil) by an amount reflecting the extent to which, as determined under sub-paragraph (1)(f), that value represents (or still represents) the earnings mentioned in sub-paragraph (1)(f)(i) or any return on those earnings mentioned in sub-paragraph (1)(f)(ii).

(3) In sub-paragraph (1)(f)(ii) "return" does not include any return so far as, it is reasonable to suppose, the return exceeds the return which might have been expected applying the assumption that all relevant connected persons are acting at arm's length of each other.

(4) In sub-paragraph (3) "relevant connected person" means a person with a connection (direct or indirect) to an arrangement (within the meaning of Part 7A of ITEPA 2003) by virtue of which the return arises.'.—*(Mr Gauke.)*

Question put, That the Schedule, as amended, be the Second schedule to the Bill.

The Committee divided: Ayes 16, Noes 14.

Division No. 5]

AYES

Barclay, Stephen	Hoban, Mr Mark
Bradley, Karen	Lee, Jessica
Crockart, Mike	Lewis, Brandon
Crouch, Tracey	McCartney, Karl
Gauke, Mr David	Sharma, Alok
Goodwill, Mr Robert	Shelbrooke, Alec
Greening, Justine	Smith, Julian
Harrington, Richard	Williams, Stephen

NOES

Blenkinsop, Tom	McCarthy, Kerry
Blomfield, Paul	McClymont, Gregg
Creasy, Stella	McGovern, Alison
Dakin, Nic	Mearns, Ian
Esterson, Bill	Murray, Ian
Glindon, Mrs Mary	Nash, Pamela
Hanson, rh Mr David	Phillipson, Bridget

Question accordingly agreed to.

Schedule 2, as amended, agreed to.

The Chair: Before we proceed to clause 27, I wish to make an observation. According to the information provided to me by the usual channels, which might have been updated since in the light of experience, we are running considerably behind schedule. It is not the Chairman's job to dictate the terms of the business of the House, and I do not wish or intend to do so. It is, however, my job to protect the well-being of those serving on the Committee. If, therefore, we have not reached a point by 4 o'clock at which the usual channels deem it appropriate to adjourn, I shall suspend the sitting for half an hour for the comfort of staff and Officers of the House. That will mean that we will sit again at 4.30 pm for a period of time as yet to be determined.

Clause 27

Tainted charity donations

Kerry McCarthy (Bristol East) (Lab): I beg to move amendment 96, in clause 27, page 19, line 3, at end add—

'(2) The Treasury shall prepare a report by 1 January 2012 on the impact of Schedule 3 on charities and community amateur sports clubs.'.

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

Kerry McCarthy: The clause introduces schedule 3 to allow the new anti-avoidance measures to prevent the abuse of tax reliefs on charitable donations for income tax, corporation tax and capital gains tax. I think we all agree that the whole point of charitable donations should be to benefit a charity, so it is right to continue to crack down on misuse for tax avoidance purposes. Our amendment is designed to ensure that the Treasury reviews the impact of the new rules to determine the most appropriate and effective means of doing so.

The Finance Act 2006 introduced the substantial donor rules, which applied where a donor made a charitable donation of at least £25,000 over 12 months or at least £100,000 over six years. The substantial donor rules limited tax relief where the donor entered into a subsequent transaction with the charity from which the donor benefited. It is necessary to tackle such tax avoidance measures, of course, but charities raised concerns about the application of the 2006 rules in practice. Some reported that innocent donations were being wrongly caught and that the rules had the potential to deter much-needed and genuine substantial donors.

Given the increased burden on the charitable sector from the big society agenda and the cut in local authority grants, charities are basically being asked to do more for less money. Now is the time when charities can least afford to lose potential donations. Charities also reported that the substantial donor rules added to their administrative burden, as they were required to hold records on both substantial donors and their connected parties. As the charities were responsible for ensuring compliance, it was they who were held responsible for any penalties.

3.30 pm

Following consultation with charities, it was clear that there was scope for improvement, and that was why the 2009 pre-Budget report announced the intention to replace the substantial donor rules with new rules to deny tax relief on donations to charities when the donor was party to an arrangement the purpose, or one of the main purposes, of which was to extract value from the charity. That is the context of schedule 3, which accordingly introduces a purpose test and sets out the three criteria that must be met for a donation to be classed as tainted and consequently as ineligible for tax relief.

The Treasury's consultation on the draft legislation stated:

"The new legislation is intended to catch only donors (or persons connected to them) who, in respect of a donation to charity, have entered into arrangements with the purpose of receiving an advantage from the charity."

The intention of schedule 3 is, accordingly, to ensure that anti-avoidance legislation targets only people who have made a donation for personal gain, does not wrongly catch out or discourage genuine philanthropic donors and does not penalise the charitable organisation unless they have knowingly entered into the avoidance arrangement. Can the Minister tell us how many, or what proportion of, charitable donations over the past five years have been deemed to breach the existing substantial donor rules, and whether the Government have an estimate of the proportion of them that were wrongly judged to have broken the rules?

I am also interested to know whether the Government have any indication of the number of potential substantial donors who were deterred by the regulations, because it is important to have as much information as possible about the apparent weaknesses of the previous system to ensure that the provisions in schedule 3 are the appropriate solution.

A common concern raised during the 2008 consultation was that the substantial donor rules were complex and insufficiently targeted, and it is not clear—as I shall come on to discuss—whether schedule 3 addresses that concern. The Government published draft legislation in December on the tainted charitable donations provisions

and the consultation on it was welcomed. The responses were informative but, although many of them welcomed the review of the substantial donor rules, the draft proposals did not receive a glowing endorsement. For example, Russell-Cooke solicitors noted that:

"on a close analysis, these new rules may also catch genuine donations (for example, a sale at an undervalue), and many are now querying whether or not the tainted charity donations rules will improve the current position."

James Kessler, QC, the author of "Taxation of Charities", described the proposals as

"lengthy, complicated and wide ranging",

and concluded that

"the tainted donation rules are unfit for purpose, and…would seriously damage charities and charity fundraising."

Worryingly, he also highlighted a number of inaccuracies in the explanatory notes, including the wrongful assertion that a donation to a hospital in return for treatment would qualify for gift aid. Under the Income Tax Act 2007 that is clearly not the case, as there is an obvious benefit attached to the donation. I am glad to say that that inaccuracy has been corrected in the final version of the notes, but it raises questions about the level of consideration given to the existing legislation and to the draft proposals.

The intention is clearly to ensure that innocent donors and charities are not penalised, but James Kessler unfortunately came to the conclusion that the tainted donor regulations

"are not better for the charitable sector than the substantial donor rules. They are in fact worse."

Similarly, the Law Society warned that the suggested replacement of the substantial donor rules is complex, and the uncertainties that are likely to result seem contrary to the Government's stated aim to promote greater predictability, stability, simplicity, scrutiny and transparency in the UK tax system. That body has also expressed its concern that the legislation may not be easy to follow and apply in practice.

Some modifications have been made to the draft legislation—the Minister might want to comment in more detail about the changes that were made in response to the consultation—but things that the Law Society, and others, have reservations about, including the lack of a minimum level for donations that could be considered tainted, and the potential for charities to be held jointly and severally liable, remains in schedule 3. Although many people criticised the previous rules for being insufficiently targeted, it seems that they are now concerned about the potential impact of broadening the scope of the anti-avoidance measures to include all donations, not just, as within the substantial donor rules, donations of more than £25,000 or £100,000 in the given period. Have the Government given any consideration to whether that might discourage donors? Also, will charities have to be cautious with all donations to ensure that none of them may be considered tainted?

A prime objective in replacing the substantial donor rules seems to be to ensure that charities do not pay the penalty for a donor's mistake or abuse of the system. However, it seems that that objective will not necessarily be achieved. Proposed new section 809ZN, which is in schedule 3 of the Bill, makes it clear that a charity will be held liable only if it was "party to" the arrangements, but whether a charity was or was not aware of such arrangements could be open to misinterpretation. Will the Minister give more information about where the burden of proof will fall and what criteria will be used to judge a charity's liability? Are the Government satisfied that there are sufficient safeguards to ensure that charities are not wrongly accused?

Regarding the three Conditions set out in proposed new section 809ZJ in schedule 3, the Institute of Chartered Accountants expressed concerns that Conditions A and B could bring within the new provisions many arrangements that are not the intended target of this new legislation. It is important to ensure that the regulations do not target genuine philanthropic donors, and Condition A accordingly requires some proof of intent. Although the explanatory notes to the Bill provide a number of examples in which Condition A may or may not apply, the term "reasonable to assume" that Condition A relies on to a large extent seems rather vague and open to subjective interpretation. Will the Minister provide more information about who will be the arbiter of that issue and the criteria they will use?

In contrast to the substantial donor rules, the tainted donation rules include only people living together as husband and wife or civil partners, trustees and connected companies, rather than most immediate family members. Although that may represent a simplification, the new rules introduce the problem of associated donations, whereby all tax reliefs are disallowed on donations connected to the tainted donation even if they are not tainted directly. Accordingly, doubts have been raised about whether that achieves the Government's aim of focusing on the purpose of an arrangement.

On publishing the draft legislation, the Treasury estimated that the tainted charity donation provisions would cost £10 million per annum, due to the projected rise in tax relief claims. Will the Minister say how that estimate was arrived at, how many donors the provisions are expected to affect and by how much charitable donations are expected to increase?

It is also unclear how the rules on tainted donations will be applied and how tainted donations will be monitored if the starting point is to be tax return audits. With no limit on donations, it seems that every donation on which relief is claimed could be examined, so how will HMRC decide which claims should be investigated and how will HMRC apply the purpose test?

If new rules are to reduce the administrative burden on charities, they need to be simple to understand and administer, but they have been described as user-unfriendly and the Treasury itself concedes that they could mean that donors incur more costs in seeking accountancy advice on the validity of their donation arrangement. Therefore, we want to ensure that schedule 3 is not unnecessarily complex and represents a significant improvement on the substantial donor rules in terms of ease of administration for HMRC, the administrative burden placed on charities, the incentive for potential donors and, of course, the reliability of the test.

The reservations that I have outlined indicate that there are doubts about how the tainted donation rules can be applied in practice and about the impact that they will have on charities. It is also clear that the consultation on the substantial donor rules proved very informative in highlighting the weaknesses and unintended consequences of that regime. Therefore, I encourage the Minister to consider our amendment, so that the impact, effectiveness and scope for potential improvement to the provisions are kept under review.

The Economic Secretary to the Treasury (Justine Greening): Clause 27, along with schedule 3, introduces new anti-avoidance rules to replace the anti-avoidance rules on substantial donors to charities. As we have heard, the path that we have taken to the clauses that we are discussing started back in 2008, when the first formal consultation on the existing anti-avoidance legislation was undertaken. In Budget 2009, there was an announcement that further informal consultation would take place with charities, their representative bodies, large donors to charities and charity tax professionals to develop a replacement for the existing rules. That informal consultation took place during the summer of 2009.

In the 2009 pre-Budget report, there was an announcement that the existing rules would be replaced with new rules based on a purpose test. As part of clause 27 and schedule 3, we set out that purpose test. On coming to office, the Government confirmed in the June Budget our commitment to replacing the existing rules.

It is probably worth setting out why it is important to take donor abuse seriously. Charities and their donors receive a generous package of tax reliefs designed to encourage and support charitable giving, in fact in total the reliefs are worth more than £3 billion each year. Unfortunately, as the Committee can imagine, that generosity attracts not only people who wish to support charitable activities but those who seek to gain a financial advantage for themselves by avoiding tax, so we need anti-avoidance legislation to ensure that we can counter that abuse.

A significant area of abuse of charitable tax reliefs is donors' abusing their control of a charity. Large donors are often in a position of influence and may look for ways to extract the funds that they have donated to the charity after they have received tax relief on them. It is worth pointing out that the vast majority of such donor-controlled charities act with complete propriety, but a small minority are involved in abusive behaviour, which puts at risk the good name of all charities in the UK. The new rules will counter that behaviour. They will also mean that the taxpayer's money that we, as a country, want to use to support charities will go more holistically towards doing so, and we will not see an element of it being, in effect, siphoned off to people who should not have been eligible for tax relief in the first place.

It is widely accepted that the rules were poorly targeted. The burden was on the charity, both administratively and financially, and it, not the offending donor, was liable for any tax loss if an offending donor was caught. Furthermore, the rules caught unintended transactions and discouraged large, genuinely philanthropic donations to charity. Quite simply, the substantial donor rules were not fit for purpose, and work on reforming them rightly began under the previous Government.

HMRC's consultation has been broad and inclusive, and everyone agrees that, although it is essential to counter real abuse of tax reliefs, we cannot leave legislation in place that deters genuine donors from supporting charities. The change is supported. Nicola Evans, of the law firm Bircham Dyson Bell, said that it

"removes many of the problems that previously existed around perfectly legitimate arrangements".

The Chartered Institute of Taxation said in written evidence to the House of Lords Select Committee on Economic Affairs that the

"evolution of the improved rules...is a good example of how anti-avoidance legislation can be improved through consultation".

The hon. Member for Bristol East mentioned James Kessler, and he is a part of the HMRC working group looking at the rules, but most people in the working group have welcomed the changes. Those who oppose them generally do not approve of any anti-avoidance rules at all. Therefore, the opinions that she quoted are, first, not the views of the majority and, secondly, certainly not the views of the Government, because we want to ensure that the £3 billion of taxpayers' money for tax relief on charitable giving has integrity. The new rules are the culmination of an extensive consultation, which ensures that unintended transactions are not caught.

At the centre of the new rules is a new purpose test that must be satisfied before they are triggered. First, has the donor, or someone connected with them, entered into arrangements with the intention of receiving some sort of financial advantage from the charity over and above any tax relief properly due on the donation? Secondly, would the donation and the arrangements have been made independently of each other? If the donor would not have made the donation without the prospect of a financial advantage, the donation will be deemed to be a "tainted donation", and the tax relief that would have been due on it will be denied.

The vast majority of donations to charity are not caught by the legislation, because the vast majority of donors do not donate to gain a financial advantage. When abuse occurs, it will be the dodgy donors, rather than charities, who will have to pay the additional tax. The one exception is when a charity knowingly becomes involved in an arrangement that results in a tainted donation, but it is not possible to obtain the tax from the donor. That, however, would be a last resort and it is only in place to prevent such deliberately contrived arrangements that would seek to undermine the rules.

3.45 pm

The new legislation will also largely repeal, in two years' time, the current rules in relation to substantial donors to charities. In the meantime, there will be a transitional period, during which people who have made donations before 6 April 2011 may still be caught by the substantial donor rules. The only limited scope for a substantial donor to be caught after the two-year transition period is when they enter into a contract before April 2013, but payment under that contract is deferred until after that date. This is anti-avoidance legislation and not catching that situation would allow people to circumvent the old and the new rules.

The new rules will cost an extra £10 million to the Exchequer, but that is an extra £10 million in tax relief, because donations that have been disallowed or discouraged under the old rules will no longer be caught. Effectively, that means that more will be given to charity. The hon. Member for Bristol East has asked what impact the clause will have. It is anticipated that it will mean an extra £10 million in tax relief to charities.

As I have said, the consultation undertaken over a number of years, under both this Government and the previous one, has helped to develop the underlying

principles for the new rules. The group of interested parties that we set up to work alongside HMRC helped significantly in the development of those principles, and their comments on the draft clauses have resulted in several significant changes, ensuring that the rules target real abuse of charity tax relief.

On amendment 96, the impact of all the measures has been published in their respective tax information and impact notes. The note for this measure was published alongside the draft legislation on 9 December. I shall explain it further for the benefit of the Committee and hope to resolve any remaining queries. Charities will be helped by the new rules, because they move the compliance burden away from charities and on to donors. As I have said, the cost of £10 million to the Exchequer represents additional tax relief on donations, so those charities that will benefit will do so, all together, by £10 million each year.

We have not made an estimate of the additional cost for individual donors, but it is likely to be very small. Obviously, most donors simply make a donation and then enter into an arrangement with the charity. Those donors will be unaffected by the new rules and will incur no costs. The majority of donors who enter into arrangements with a charity will not be caught by the new rules, because their purpose will not be to obtain a financial advantage. They will not, therefore, need to consider this legislation. As for those individuals who seek to gain a financial advantage, HMRC does not generally estimate the administrative burden of trying to avoid tax. Presumably, the harder and higher, the better.

My final point on the amendment is that the door has not closed on this legislation. The impact of the new rules will be reviewed by a sub-group of the HMRC charity tax forum, which has proved helpful in working with me as a Treasury Minister and with HMRC over recent months to help us develop not just this legislation but the whole philanthropy package that we introduced in the Budget. I am sure that we will discuss that package later. The first meeting of the HMRC charity tax forum to review the new rules is anticipated by the end of the year. If it becomes apparent that innocent donors are being caught by the new rules—although we do not anticipate that—we will, of course, look at what changes we might need to introduce in a future Finance Bill. I hope that I have reassured the hon. Lady that we keep a watching brief on the issue. We want to make sure that, although they are complex, the rules operate as intended.

In conclusion, the new tainted charitable donation rules represent a huge improvement on the substantial donor rules. The new rules have been broadly greeted by a number of charity representatives, who are keen for them to be included in the Bill. The new rules remove the administrative burdens imposed on charities by the substantial donor rules. The vast majority of donors will be unaffected. A donor will always know if they have entered into arrangements with the purpose of getting a financial advantage in return for a donation. It will be the donor, not the charity, that is liable for any tax charge. The new rules will protect the Exchequer from the abuse of the UK's generous charity tax reliefs, leaving charities to concentrate on building their relationships with donors and making their contribution to the country and our big society. This is but one measure that has led the Charities Aid Foundation to say that the Chancellor

"delivered for charities and those who want to support them."

I therefore reject the hon. Lady's amendment, but I hope that she will concede that we have some safeguards in place. We believe that these rules will work much more effectively.

Kerry McCarthy: It certainly was my intention to press this amendment to a vote, but in view of the assurances that the Economic Secretary has given on the measures that will be taken with the working group to keep the provisions under review, I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Clause 27 ordered to stand part of the Bill.

Schedule 3 agreed to.

Clause 28 ordered to stand part of the Bill.

Schedule 4 agreed to.

Clause 29

LOAN RELATIONSHIPS INVOLVING CONNECTED DEBTOR AND CREDITOR

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

Mr Hanson: I have just one question. The clause appears to apply to controlled foreign companies, which we will consider later in the Bill. How do the new rules interact with the CFC reforms from 2012 onwards?

Mr Gauke: I am grateful for that question.

Mr Hanson: It is not a point of substance. Perhaps the Minister could clarify that in a note following the Committee? I would be happy with that.

Question put and agreed to.

Clause 29 accordingly ordered to stand part of the Bill.

Clause 30 ordered to stand part of the Bill.

Schedule 5 agreed to.

Clause 31

COMPANY CEASING TO BE MEMBER OF GROUP: AVAILABLITLY OF RELIEF

Mr Gauke: I beg to move amendment 107, in clause 31, page 20, leave out lines 14 and 15 and insert—

'(c) subsection (2) may operate to prevent subsection (1) applying by virtue of paragraph (b), unless subsection (2AB) applies.

'(2AB) This subsection applies if company A's ceasing to be a member of the first group at the same time as one or more associated companies forms part of arrangements the main purpose, or one of the main purposes, of which is the avoidance of a liability to corporation tax.'

Briefly, the amendment improves the targeting of the anti-avoidance measure introduced by clause 31. It does so by ensuring that the new rule has no adverse impact on commercial transactions that do not have a main purpose of avoiding corporation tax.

[Mr Gauke]

The amendment responds to comments on the clause from a number of accountants and from the Law Society, for which we are grateful. I urge the Committee to accept the amendment.

Mr Hanson: I have a question on clause 31 as a whole. The clause amends an aspect of de-grouping charge rules in the corporation tax regime for chargeable gains. I want to raise the issue of intangible assets, which are not included in the clause. I am interested as to why they have not been included. For example, if I bought a hotel, I might also buy the goodwill for that hotel. If I sell the hotel, the intangible asset will still attract a tax charge if the goodwill was bought after April 2002. There seems to be an inconsistency between the pre and post-2002 intangible arrangements. There seems to be no sensible reason not to revise the intangible asset rules to harmonise the treatment of tangible and intangibles in this matter. I welcome the Minister's comments now, or, if not now, I would welcome some reflection post-Committee.

Mr Gauke: Clause 31 ensures that companies cannot avoid corporation tax on chargeable gains by using complex arrangements that seek to exploit a perceived loophole in the de-grouping charge rules. A de-grouping charge ensures that tax is paid on gains when, instead of selling an asset directly, a group of companies sells a company that owns an asset. Otherwise, there could be a loss of tax, whether as a result of normal commercial arrangements or through tax avoidance.

The right hon. Member for Delyn asked me about intangible assets. I understand that that is not relevant to clause 31. When we consider clause 45 in due course, intangible assets will be relevant in that context. However, that is not the case in the context of a company ceasing to be a member of a group and the conditions under clause 31.

Amendment 107 agreed to.

Clause 31, as amended, ordered to stand part of the Bill.

Clause 32 ordered to stand part of the Bill.

Schedule 6 agreed to.

Clause 33 ordered to stand part of the Bill.

Clause 34

INVESTMENT COMPANIES

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

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

Government amendments 113 to 117.

That schedule 7 be the Seventh schedule to the Bill.

Mr Gauke: These amendments make changes to ensure that schedule 7 applies to controlled foreign companies in the same way that it applies to UK investment companies. Schedule 7 allows companies, including CFCs, to elect prospectively to change the currency in which they prepare their accounts—their functional currency—for tax purposes. It also stops changes in companies' functional currency having a tax effect until the accounting period following the change. The deferral of a tax effect to the change in functional currency blocks an avoidance scheme that allowed companies retrospectively to crystallise foreign exchange losses for tax purposes. Following the publication of the Bill, it came to HMRC's attention that certain provisions in the CFC code prevent the restriction on the timing of the tax effect of a functional currency election from applying to CFCs.

The amendments ensure that UK resident companies with interests in CFCs will not be able to change the functional currency of the CFC with the benefit of hindsight to realise a foreign exchange loss for tax purposes to reduce or avoid a CFC apportionment. The amendment will apply to multinational groups with CFCs and protects tax revenue in the low hundreds of millions per year.

Although the amendments may at first sight appear to be pre-empting the wider CFC reform, their effect is to ensure that schedule 7 applies to CFCs in the same way as it applies to UK investment companies. Schedule 7 benefits companies by allowing them to elect prospectively to change their functional currency for tax purposes. The amendment is, therefore, not counter to the direction of CFC reform. The amendments ensure that the avoidance opportunity that the original measure was designed to close is blocked for controlled foreign companies in the same way that it is blocked for UK investment companies. I therefore urge the Committee to accept the amendments.

Question put and agreed to.

Clause 34 accordingly ordered to stand part of the Bill.

Amendments made: 113, page 157, line 2, at end insert—

'Amendments of ICTA

In Schedule 24 to ICTA (assumptions for calculating chargeable profits, creditable tax and corresponding United Kingdom tax of foreign companies), in paragraph 4 (reliefs under Corporation Tax Acts dependent upon the making of a claim or election), after sub-paragraph (2) insert—

"(2B) For the purposes of sub-paragraph (1) an election under section 9A of CTA 2010 (designated currency of a UK resident investment company) is not to be regarded as an election upon which relief under the Corporation Tax Acts is dependent, and sub-paragraph (2)(b) does not apply in relation to such an election.

(2C) But if, by notice given to an officer of the Board, the United Kingdom resident company which has or, as the case may be, any two or more United Kingdom resident companies which together have, a majority interest in the company so request, the company shall be assumed (subject to section 9A(2) of CTA 2010) to have made an election under section 9A of that Act in the form specified in the notice (and accordingly that section and section 9B of that Act apply to determine the effect (if any) of that election)."'

Amendment 114, page 157, line 15, after 'arises' insert '("the relevant period")'.

Amendment 115, page 157, leave out lines 16 to 19 and insert—

'(b) a change in the company's functional currency (within the meaning of section 17(4) of that Act) as between the relevant period and a period of account ending in the 12 months immediately preceding that period.'.

Amendment 116, page 157, line 31, after 'arises' insert '("the relevant period")'.

Amendment 117 , page 157, leave out lines 32 to 35 and insert—

'(b) a change in the company's functional currency (within the meaning of section 17(4) of that Act) as between the relevant period and a period of account ending in the 12 months immediately preceding that period.'.—*(Mr Gauke.)*

Schedule 7, as amended, agreed to.

Ordered, That further consideration be now adjourned. —*(Mr Goodwill.)*

3.59 pm

Adjourned till Tuesday 24 May at Nine o'clock.