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HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCE BILL

(Except clauses 1, 4, 8, 189 and 209, schedules 1, 23 and 33 and certain new clauses and new schedules)

Tenth Sitting

Tuesday 12 June 2012

(Afternoon)

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Saturday 16 June 2012

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 Jim Hood, † Mr Peter Bone

† Baldwin, Harriett *(West Worcestershire)* (Con)
† Barclay, Stephen *(North East Cambridgeshire)* (Con)
† Blenkinsop, Tom *(Middlesbrough South and East Cleveland)* (Lab)
† Burley, Mr Aidan *(Cannock Chase)* (Con)
† Elphicke, Charlie *(Dover)* (Con)
† Garnier, Mark *(Wyre Forest)* (Con)
† Gauke, Mr David *(Exchequer Secretary to the Treasury)*
† Gilmore, Sheila *(Edinburgh East)* (Lab)
† Gyimah, Mr Sam *(East Surrey)* (Con)
† Hamilton, Fabian *(Leeds North East)* (Lab)
† Hands, Greg *(Chelsea and Fulham)* (Con)
† Harrington, Richard *(Watford)* (Con)
† Hilling, Julie *(Bolton West)* (Lab)
† Hoban, Mr Mark *(Financial Secretary to the Treasury)*
† Jamieson, Cathy *(Kilmarnock and Loudoun)* (Lab/Co-op)
† Kirby, Simon *(Brighton, Kemptown)* (Con)
† Lavery, Ian *(Wansbeck)* (Lab)
† McKenzie, Mr Iain *(Inverclyde)* (Lab)
† McKinnell, Catherine *(Newcastle upon Tyne North)* (Lab)
† Malhotra, Seema *(Feltham and Heston)* (Lab/Co-op)
† Mann, John *(Bassetlaw)* (Lab)
† Mearns, Ian *(Gateshead)* (Lab)
† Mills, Nigel *(Amber Valley)* (Con)
† Morrice, Graeme *(Livingston)* (Lab)
† Morris, Grahame M. *(Easington)* (Lab)
† Pugh, John *(Southport)* (LD)
† Rees-Mogg, Jacob *(North East Somerset)* (Con)
† Reeves, Rachel *(Leeds West)* (Lab)
† Smith, Miss Chloe *(Economic Secretary to the Treasury)*
† Swales, Ian *(Redcar)* (LD)
† Syms, Mr Robert *(Poole)* (Con)
Williams, Stephen *(Bristol West)* (LD)
† Williamson, Gavin *(South Staffordshire)* (Con)
Wilson, Sammy *(East Antrim)* (DUP)

Simon Patrick, James Rhys, *Committee Clerks*

† attended the Committee

Public Bill Committee

Tuesday 12 June 2012

(Afternoon)

[Mr Peter Bone *in the Chair*]

Finance Bill

(Except clauses 1, 4, 8, 189 and 209, schedules 1, 23 and 33 and certain new clauses and new schedules)

Clause 21

Real estate investment trusts

4.30 pm

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

The Chair: I remind the Committee that with this we are considering:

That schedule 4 be the Fourth schedule to the Bill.

Sheila Gilmore (Edinburgh East) (Lab): I do not intend to detain the Committee too much longer.

A consideration of whether to use a real estate investment trust to raise investment for social housing has been made more necessary by the position in which a lot of housing associations and other providers find themselves. In 2011-12, only 15,700 affordable homes were started in England. If the Government's intention—or hope—to create 170,000 affordable homes by 2015 is to be achieved, something will have to be done, because some 42,500 homes need to be built in each of the four years from 2011-12 to 2015. The first year of that period has not delivered the required number, so there is a lot of ground to make up, and that is why housing associations and others are looking for other means of bringing investment into the sector to achieve these ends. It is worth considering using this mechanism to bring investment into the sector.

Charlie Elphicke (Dover) (Con): Getting investment into social housing is critical. The hon. Lady will know that the number of social housing units fell during the past decade or so, so more social housing units are needed to make up for that. The problem is that social housing rents are sub-market and REITs, as equity, have a return rate required by investors of about 10%, compared with a rate of 5% or 6% attached to other forms of debt or quasi-debt. Is it not a challenge to square the funding circle for sub-market rents for social housing on the one hand with the high return rate demanded by equity investors on the other?

Sheila Gilmore: I suspect that it may be a challenge. Although these changes may make it possible for charities and registered social landlords to choose to become part of a REIT, that might be extremely difficult in practice. The concept of affordable rent is at risk, not just because of this form of investment, but because of the general decline in grant assistance. The cost of building a new home has to be covered from somewhere and, unless costs are driven down substantially, lower grants mean that finance has to be raised another way.

In respect of the more traditional route of raising finance through bank loans, which I have already described as difficult, there is a feeling in the sector that if it is to create the same number of houses on a smaller grant—wherever the additional investment is coming from—there is a question about what the appropriate rent would be to finance such borrowing. If rents are to be raised, a question arises about the degree to which the homes that are built may still be called affordable homes. That might lead to a problem with the Government's welfare reform programme and the desire to drive down the cost of housing benefit, so a lot of things must be considered.

It would be wrong for the sector not at least to have opportunities to find out whether such a process is feasible. A REIT may work best for the private rented sector rather than the public rented sector.

Charlie Elphicke: I agree that that makes enormous sense for the private rented sector. My worry is that if the return rate is too high, there will then be pressure for higher rents, and that as the overwhelming majority of social rents are paid for by the taxpayer through housing benefit, we will—following the money—put more strain on the public finances. That is why we should be very cautious about introducing equity-style returns into the social housing sector, because it will be paid for by the taxpayer at a time when the public finances are under considerable pressure.

Sheila Gilmore: I very much share those concerns. We have to find ways of resolving these tensions. Indeed, the problem then becomes wider, because if we do not create more affordable homes that have low rents and rely increasingly on what has been traditionally the affordable sector producing housing at higher rents, or if we continue to rely as heavily as we have in recent years on the private rented sector to provide a place for people who can afford it only through housing benefit, we will create further pressures on the housing benefit budget and also considerable pressures on individuals. I think that we all share the belief that it is not right for people to be trapped into what always used to be described as the poverty trap; they are trapped in a situation in which they literally cannot afford to work because the rent on their home is so high.

We have not seen that happening so far in the affordable sector, but I think that we have seen it in the private rented sector. There is almost a kind of Hobson's choice if we are not prepared to subsidise fully affordable housing. However, I am moving further from the subject before us, so I simply say that there is a role for REITs in the residential sector. It may well be that they will be more appropriate for private rented provision, and they might indeed improve the quantity, quality and management of the private rented sector, which would be to everyone's benefit.

The Economic Secretary to the Treasury (Miss Chloe Smith): I am delighted to hear the Committee so chirpy on our first day back after Her Majesty's diamond jubilee.

If I may, I will go through what the clause does and the schedule it introduces, and I will also answer some of the questions that have been put. I welcome the interest that has been shown on both sides of the Committee in real estate investment trusts.

Clause 21 introduces schedule 4, which makes improvements to the REIT regime. It does so by reducing barriers to entry to the regime and by easing administrative burdens. Turning briefly to the wider context, these changes, alongside much wider planning reforms, will help to support the expansion of the property sector, encourage further investment and stimulate the construction industry. I suspect that we all welcome those aims, and I know that we all welcome the focus on increasing the amount of affordable housing, as has been shown in this debate.

To put the measures in context, hon. Members will be aware that Budget 2012 announced a consultation on the potential role of REITs to support the social housing sector and on the technical changes that would be required to enable REITs to invest in REITs. I add that the REIT regime is always kept under review to ensure that it is fit for purpose—it is, after all, something that has evolved since its introduction in 2007—and I know that that was the focus of the comments from the hon. Member for Kilmarnock and Loudoun.

For the benefit of those hon. Members who are not quite so clued up as the hon. Lady, I shall say a little more about what REITs do. REITs are tax-exempt vehicles that were introduced to encourage investment in the property sector. The response to the consultation on investment in the UK private rented sector in September 2010 set out that we would explore ways to improve the REITs regime, with a view to facilitating in the longer term the establishment of residential REITs. Further to consultation with interested parties, we announced at Budget 2011 that the barriers to entry for new REITs would be reduced to support the industry in general. During that informal consultation, we received 53 written responses from a wide range of interested parties including REITs, house builders, fund managers and property investment companies. Without exception, they saw the measures as a positive step. Draft legislation was published last December, and changes have been made in response to the comments that we received.

Schedule 4 relaxes a number of requirements on REITs to remove barriers to entering the regime, including the requirement that a REIT be listed on a recognised stock exchange. That will be relaxed so that REITs can be listed on trading platforms such as the alternative investment market and foreign equivalents.

There are two relaxations of the REIT non-close company requirement, which requires that a REIT be diversely owned. The first is that new REITs will be given three years from joining the regime to meet the non-close company requirement. The second is that certain institutional investors will not make a REIT a close company for the purposes of the REIT regime.

The schedule lists the type of institutional investors that will not make the REIT a close company. There is a power to make regulations to add, modify or remove categories of investors to or from the list. The hon. Member for Kilmarnock and Loudoun asked about that, and I can confirm that the Government looked at financial institutions that would be able to invest in a REIT and that would be attracted to the tax treatment offered by the regime. We wanted institutional investors to be investing on behalf of others and to have a degree of regulation. The hon. Lady will know that the Bill allows us to make changes as we go on.

I will dwell briefly on a couple of the hon. Lady's questions to ensure that I answer them. She asked about accounting periods, and I will try to make the position clear. There are various dates involved, and there is a good reason why: in simple terms, some measures affect new REITs, while some affect existing REITs. Some of the changes that affect new REITs will take effect from Royal Assent which, as she rightly identified, we hope will be later this summer. Some apply to existing REITs, so they need to apply to the relevant accounting period. That explains the difference in the timings that she identified in the schedule and the explanatory notes. For absolute clarity, I refer her to the HMRC information note, which makes the operative date clear. I shall read it out for the record:

> "The measure as it relates to the barriers to entry to the regime will have effect for companies that join the regime on or after the date of Royal Assent…For the balance of the measures they will have effect for REITs in the regime on or after the date of Royal Assent to Finance Bill 2012."

The hon. Lady also raised a broader point about the features of the property market, one of which can be—particularly in the private rented sector—relatively high turnover. Those issues may have been well considered in the consultations that I have referred to, but she makes a fair point. There are shorter and longer products on the market, which are convenient for different people. Short tenancies are one such product, and there are other types of tenancies that suit others. The changes made by schedule 4 will make REITs more able to take decisions that make commercial sense, and they can define for themselves what commercial sense means in the context of a market that in some cases has high turnover.

I took a detour from my explanation of what the schedule does to deal with the point about institutional investors, but I return to that explanation by saying that the balance of business test will be relaxed to require that property rental business assets and cash are 75% of a REIT's assets for the purpose of the test. The requirement to pay a conversion charge of 2% of the value of a REIT's property assets on joining the regime will be abolished, which is a particularly clear removal of a barrier to entry.

4.45 pm

The profit-finance cost ratio, which is also used to ensure that REITs do not over-borrow, will be simplified so that financing costs will consist only of interest and interest equivalents. The amount of tax paid when financing costs exceed the limit will be restricted to a proportion of the property profits. Finally, the legislation makes it clear that that treatment of assets that are disposed of will not apply where the disposal is to a company that is part of the same REIT group.

In summary, the changes introduced by clause 21 and schedule 4 address barriers to entry to the REIT regime and reduce administrative burdens on existing REITs. We hope that that will encourage greater investment in the property rental sector and will stimulate the housing market.

Question put and agreed to.

Clause 21 accordingly ordered to stand part of the Bill.

Schedule 4 agreed to.

Clause 22

Treatment of the receipt of manufactured overseas dividends

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

Catherine McKinnell (Newcastle upon Tyne North) (Lab): It is a pleasure to serve under your chairmanship again this afternoon, Mr Bone.

I seek a couple of points of clarification from the Minister on clause 22. The clause seeks to clarify the legislation on manufactured overseas dividends, thereby blocking a tax avoidance scheme. The legislation provides that, where MODs are received under deduction of tax, some or all of that tax may be treated as overseas tax. The clause makes it clear that, where there is a difference between the tax deducted and the tax treated as overseas tax, the difference is not treated as income tax. The clause makes a similar change for deemed manufactured payments under some stock lending arrangements.

The clause affects overseas dividends received on or after 15 September 2011, and I seek clarification on that date. Under the avoidance scheme, the recipient of a manufactured overseas dividend claims to have received it under deemed deduction of UK income tax, and seeks to set off the dividend against its corporation tax liability via double tax relief. Will the Minister clarify when the scheme was first disclosed to Her Majesty's Revenue and Customs? How soon after that disclosure did the Government take the action that they are now putting into statute to clamp down on the avoidance? What receipts are expected from the measure?

The Exchequer Secretary to the Treasury (Mr David Gauke): It is a great pleasure to serve under your chairmanship this afternoon, Mr Bone, just as it was this morning.

Clause 22 will ensure that manufactured overseas dividends cannot be used to claim repayment or to set off income tax that the Exchequer does not receive. The changes were announced in a written ministerial statement on 15 September 2011 and take effect from that date.

We introduced the clause to block an aggressive avoidance scheme that HMRC had been notified of under the rules requiring disclosure of avoidance schemes. The scheme involved the receipt of a manufactured overseas dividend that, it was claimed, entitled the recipient to repayment of income tax that had been notionally deducted from the dividend but that had not, in fact, been paid.

Clause 22 ensures that, with effect from 15 September 2011, companies cannot use MODs to obtain repayment of income tax that has never been paid. The changes affect only companies engaged in tax avoidance schemes involving MODs. The changes are expected to increase receipts by approximately £40 million per annum and also to protect against future revenue losses.

The Government launched a consultation on 27 March aimed at simplifying the tax rules on MODs and manufactured payments generally, with a view to making avoidance more difficult in future. Any changes following the consultation will not take effect before the Finance Act 2013. The hon. Lady asked when this particular arrangement was disclosed. It was disclosed in June 2011 and the statement was made on 15 September. The clause ensures that the MODs legislation works in the way that businesses not engaged in tax avoidance understand it to work. By blocking the disclosed avoidance scheme, it promotes fairness for all taxpayers.

Question put and agreed to.

Clause 22 accordingly ordered to stand part of the Bill.

Clause 23

Loan relationships: debts becoming held by connected company

Nigel Mills (Amber Valley) (Con): I beg to move amendment 13, in clause 23, page 14, line 36, leave out subsections (8) to (12).

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

Nigel Mills: I am sure that you have never been welcomed to the Chair as often as you have been today, Mr Bone. I tabled this amendment to secure a debate on the Government's use of retrospective taxation measures. The Select Committee on the Treasury noted that there were potentially four such measures in the Bill, of which this is the most significant, in terms of revenue raised. I would not like anyone to think that when I tabled the amendment, I was motivated in any way by sympathy for Barclays bank, which entered into aggressive tax avoidance arrangements. Given the esteem in which banks are held in this country and the way that they have been bailed out, Barclays was remarkably badly advised to have gone down the line of aggressive tax planning. If any body were not justified in tax planning, a bank would be top of that list.

Nevertheless, Government and Parliament should be careful about where we seek to use retrospective legislation. It is a pretty fundamental point of the rule of law that individual citizens or subjects should know what the law is and be entitled to plan their affairs based on the law. If the Government realise that that law is not appropriate or is not correct, then that law can clearly be changed, but that change should apply only from the point at which notice is given of the change. We could find numerous examples in the Bill where the Government have announced changes or the intention to introduce a change. Perhaps the detail will come along later, but clearly all taxpayers can understand that there is a potential change coming. What we have in this clause is a backdated change that effectively cancels the effect of a measure that may or may not have been in compliance with the tax code; the Government were clearly not entirely confident in the tax situation.

There is a real principle here about whether the Government should use retrospective taxation effectively to change the law to make it apply in a way that is different from how the person thought it would apply when they entered into a transaction. I suspect that in any field other than taxation, we would be very concerned. I do not think we would like to see the criminal law being amended retrospectively to make something we did yesterday a crime when it would not have been a crime then, based on the law as it stood. Not that all retrospective legislation is inappropriate; I think in the last Session both Houses of Parliament quite happily passed a retrospective bail law to put the situation back to what both the Government and most defendants thought it was. The clear point there was that that was restoring a situation that everyone had thought pertained, as opposed to creating a situation that perhaps one side wished was the case but may not have been.

It is important that the Government now set out when they are prepared to use retrospective legislation and when they are not. We have obviously had the Rees doctrine in place for a long time. My right hon. Friend the Member for Charnwood (Mr Dorrell) set out the principle when he was a Treasury Minister:

> "Where it is discovered that the tax law does not have the effect that the Government and taxpayers generally thought it had, there are circumstances in which it is right to introduce legislation to restore the position retrospectively to what it was thought to be."—[*Official Report*, 29 June 1992; Vol. 210, c. 378-79W.]

The key point is the effect that the Government and taxpayers generally thought a measure had, not simply the effect that the Government might have wished it had.

Those of us concerned about the use of retrospective legislation are in pretty good company. In 1987, the former Prime Minister, Tony Blair, said:

> "Parliament should oppose retrospective legislation, for a number of reasons. The principal democratic reason is that people are perfectly entitled to do whatever the law permits them to do and that it is wrong afterwards to make it unlawful."—[*Official Report*, 15 July 1987; Vol. 119, c. 1179.]

Who are we to disagree with Tony Blair? For those not convinced by what the former Prime Minister said, the Exchequer Secretary to the Treasury himself said the following in debate four years ago:

> "For investors, the idea that UK tax law is likely to be changed retrospectively is unattractive, and the UK is, for various reasons, acquiring a reputation for having an uncertain and unstable tax system, which is bad for the UK economy."—[*Official Report, Finance Public Bill Committee,* 22 May 2008; c. 367.]

He was entirely right four years ago.

I accept that sometimes compromises have to be made in government. Clearly, if there are large amounts of tax at stake as a result of aggressive tax schemes, there may be a need to close those promptly to protect the Exchequer, especially in the current situation. However, we must be careful that we do not create the impression of a tax regime in which people cannot plan their affairs based on what the law is, and in which there is a risk that the situation regarding what they may quite reasonably do today, thinking it legal, could somehow change retrospectively, with unfortunate tax results.

We may accept that where people are engaging in predominantly aggressive tax avoidance, that is fair game, but the risk is that people undertaking innocent transactions may get caught up in the crossfire. There is also the general reputational risk of a tax regime where that can happen. People might think, "I am not sure I want to invest there and expose myself to those vagaries." They want the Government to set things out, because they want a certain, stable and predictable tax regime in which people can invest with certainty and know what the situation will be. A combination of the use of retrospective legislation and having a general anti-abuse rule, which I know the Government are consulting on today, creates quite a poisonous mix. It is hard to know exactly what the law is that we are being expected to comply with. It can be changed by legislation, or it can be effectively changed by a tax inspector in the course of their job.

I am not the only one who is concerned. In paragraph 89 of its excellent report on the Budget, the Treasury Committee raised concerns. I am sure that the hon. Member for Bassetlaw was keenly involved in that. It asked the Government to set out a policy on when retrospective legislation should be used. I hope the Minister can do that.

On the rule on taxing a release of debt, I can see the logic; if there is a UK lender and a UK borrower, and the loan is impaired and written off, the UK lender gets a tax deduction. It is right that the borrower, who now owes a lot less, should get taxed on that effective profit. That symmetry is entirely reasonable in the tax regime, but the rule causes huge complexity for struggling companies that face insolvency, because if they enter a formal insolvency procedure, there is no tax on the waiver of the loan. If we try to apply this structure outside a formal process, that tax liability is triggered.

I was practising a few years ago and the insolvency issue used to come up. We had insolvent companies, and we tried to find a way to rescue the trade and make it viable, and to protect the jobs. We did not really want to go down the formal administration process, with all its costs and various horrors. This provision could make that quite hard. If someone goes down the administration route, they avoid the tax, so what people were trying to do was get into that situation without the full administrative procedure. I do not pretend that that is what the people we are talking about here were worried about. This is not perhaps an area where there is no commercial reason at all for concern about the operation of the rules, which is why I am a little concerned about why the Government decided that of all the tax avoidance issues that they have chosen to legislate on, this was the one that justified the full retrospective effect of backdating a change to before the Government announced that there might be some change.

It would be useful if the Minister set out the Government's policy on the use of retrospective legislation—when they think it is appropriate, and what criteria they use to decide that it is necessary—so that we can be sure that it is used only in exceptional circumstances where there is really abusive behaviour and significant amounts are at stake, and that it does not creep into being a general approach to tax policy for this Government.

5 pm

John Mann (Bassetlaw) (Lab): The Government Whip is not keen on Labour Members speaking in these debates. He wants to get through the business a lot quicker and to get votes through. That is his prerogative, but if he really wanted to do that, he would have a word with the Ministers, who have tabled more than 200 amendments. It is a bit rich for a Government Whip who is trying to manage business to kick off and say that we are not getting through business fast enough when they do not have Ministers who can schedule

[John Mann]

business properly. They have to keep amending the Bill—as I say, they have more than 200 amendments, unless they are withdrawing them. The Government Whip turned up late to one sitting; I would be more than happy to stay late tonight to debate the issues with him.

Richard Harrington (Watford) (Con): The hon. Gentleman is very experienced in parliamentary matters—far more so than I. From memory, can he tell me how many amendments the Labour Government tabled in such Bill Committees?

John Mann: As the hon. Gentleman might recall from pre-recess days, I was never invited to sit on a Finance Bill Committee, because of the Government Whips. That is why I was put on the Information Committee and Unopposed Bill Committees, as the hon. Member for Amber Valley will find out.

Nigel Mills: I have already had the pleasure of two years on the Administration Committee; I am not sure what else the Government could do to me.

John Mann: I suspect that the Government saw the hon. Gentleman coming and thought, "Here's someone who wants to speak for the country—someone independent-minded who will point out obvious flaws in Government business." So far, he is the only one on the Government Benches prepared to do that, but I can see others thinking that there are flaws that they wish to address. That is one good reason for supporting his amendment. A second good reason is the articulate way in which he introduced it. Who could not be convinced by his arguments? He has convinced me.

Richard Harrington: Again, I would like to record how grateful I am to the hon. Gentleman for giving way. His time is usually taken up by his own erudition. I would like to use this opportunity to ask whether one of the Ministers can tell us at some stage how many times the Labour Government tabled amendments to Finance Bills, and how many amendments there were. He has made the serious allegation that the Government are tabling a lot of amendments to take up our time. As one new to this parliamentary activity, I would be pleased to learn whether the number is far more or less than it used to be.

John Mann: Well, we will all await with interest the response to that intervention, myself included.

There are two good reasons to support the amendment. The hon. Member for Amber Valley, my would-be future neighbour, cited the most compelling one: Tony Blair, as a young MP in 1987, seeing democracy emerging before him, felt that it was appropriate to point out that retrospective legislation is a bad thing, and who are we to disagree with such an outstanding Prime Minister? I am virtually convinced for that reason alone.

The hon. Member for Amber Valley has had the courage to table the amendment. It strikes me that his proposal is sound and that the Government are unsound. Given that at least two Members present are on the Treasury Committee, deliberated on the issue and reached consensus, I know that he is looking forward to at least two votes in support of his amendment: one from me, and a second from a Member on the Government Benches. It is only right that we members of the Treasury Committee show consistency in our wisdom in criticising the Bill. I suspect that the Government feel that the amendment is so well worded that they have to accept it. I look forward to hearing that.

Catherine McKinnell: I wish not so much to comment on the amendment of the hon. Member for Amber Valley, although I join my hon. Friend the Member for Bassetlaw in commending him for tabling it, but to seek clarification on the clause, which affects debts held by connected companies and has retrospective effect from 1 December 2011. Before the legislation, profits made as a result of such arrangements were not taxable, and companies would regularly seek to exploit the tax loophole. The clause addresses such aggressive avoidance measures, as the Minister states, ensuring payment of more than £500 million in tax, protecting further billions of pounds in tax from being lost, and maintaining fairness in the tax system—laudable aims. As the impact note states, the measure could bring in as much as £385 million in the first year, although subsequent declines in revenue are anticipated as the schemes increasingly fall out of use.

Turning to the origins of clause 23, Barclays bank, which was revealed as the bank involved in that tax avoidance measure, disclosed its use of the two schemes to HMRC in February this year, prompting the Government to introduce the legislation and to take the unusual step of giving it retrospective effect so as to cover arrangements entered into as far back as 1 December 2011 and up to 27 February 2012, when the decision was taken. It has been widely documented that Barclays was surprised by HMRC's reaction to the two schemes, which it believed were in line with those employed by other banks. Barclays has subsequently voiced its concerns quite publicly. The hon. Member for Amber Valley has put on record his concerns about the use of retrospective tax avoidance action by the Government, and I shall be interested to hear the Minister's comments on the amendment.

I would like some clarity on the impact of the measures in the clause, given the importance of the matter. Is HMRC aware of any other companies or British banks entering into such arrangements? If so, is it intending to come to any settlement with them? Has HMRC investigated or at least estimated how many such schemes are being used, and how many will close as a result of the clause? Turning to the retrospective nature of the legislation, how was the date—1 December 2011—decided on, and what does HMRC intend to do about schemes in place before that date? If the scheme and the determination of its abusive nature came to light before the announcement was made in February, why in particular was the 1 December date chosen? Finally, as there have been no tax information and impact notes since the Budget, what are the confirmed revenue numbers for the closure of the scheme?

Nigel Mills: It would be useful to the Committee if the hon. Lady could set out the Opposition's view on the use of retrospective legislation. Labour used it occasionally while in government—is that something the Opposition now regret and wish they had not done, or is it something that they would like to see used more often?

Catherine McKinnell: I had reached the end of my comments, and it would be useful at this stage to hear from the Minister with the Government's response to the hon. Gentleman's amendment. A particular decision was taken in this case to apply the legislation retrospectively. That is what is encapsulated in my questions—why was 1 December 2011 chosen?

Charlie Elphicke: Let me put two points to the hon. Lady. First, did not the previous Government use retrospective legislation time and again? Secondly, when there is egregious tax avoidance by a large financial institution, should we not stop it—and stop it quickly—to safeguard taxpayers' interests?

Catherine McKinnell: I absolutely agree with the hon. Gentleman's second point. The point I am making is that the legislation is backdated to 1 December. If the tax avoidance scheme had come to light on 1 December, why did it take until February to take appropriate action to close it down?

The Government's use of retrospective tax avoidance action depends very much on each case, and we have discussed at length the circumstances in which tax avoidance is abusive, aggressive and egregious. All those matters need to be discussed at length, so I hope that the legislation on the general anti-avoidance rule that will be dealt with in the coming year will make things clearer. The hon. Member for Amber Valley raised valid points, and companies need to know where they stand with the law. Retrospective action is not ideal, but when circumstances mean that it is necessary, I agree with the hon. Member for Dover that action must be taken.

Mr Gauke: Clause 23 amends legislation that applies to debts that are held by a connected company. It introduces a targeted anti-avoidance rule and a retrospective provision in relation to arrangements designed to work around existing rules. During my remarks, I will address the amendment tabled by my hon. Friend the Member for Amber Valley.

It may help the Committee if I say a word or two about the background. Normally, a company is taxed on the commercial profit that arises when it must pay back less than the amount that it borrowed, but special rules apply to connected companies. In such cases, a tax charge arises when a company connected to the borrower buys the debt, or when debt is held between companies that become connected. Those rules were amended in the Finance Act 2010 to block schemes under which banks bought back their own issued debt that was trading at a discount in the market. In other words, they could buy their own debt for less than the amount they originally borrowed without paying tax on the difference.

At the time, the Government made it clear in two written ministerial statements that they expected such profits to be subject to corporation tax. Despite those clear statements, a bank entered into a scheme using contrived arrangements that, again, sought to ensure that the profit on the buy-back of its own debt was not subject to corporation tax, and a substantial amount of tax—around £300 million—was avoided. In a written ministerial statement on 27 February, I announced amendments to the rules so that companies cannot get round the legislation in the future.

The measure will take effect retrospectively to 1 December 2011 to ensure that banks and any other company that use this or a similar scheme after that date will be taxed on the transaction as it should be. The hon. Member for Newcastle upon Tyne North asked why the specified date was 1 December. That is essentially the first date on which HMRC was aware that the scheme or similar schemes were being used. The hon. Lady said that the scheme was notified on 1 December, but that is not the case. It was notified in February, but its use dated back to 1 December, so that is the date in the clause.

We did not take this action lightly. The scheme involves a large potential tax loss. There is a history of abuse of debt buy-back, as is shown by the written ministerial statements, and the bank in question has adopted the code of practice on taxation of banks, under which it commits not to engage in such tax avoidance schemes.

5.15 pm

Ian Mearns (Gateshead) (Lab): I am interested in the figures that the Minister cites. He said that something like £300 million involved just one bank. Has HMRC or the Treasury investigated how much could be recoupable from banks that use this mechanism?

Mr Gauke: HMRC is not aware of other examples of similar avoidance in this area. Of course, under disclosure of tax avoidance schemes legislation, it is necessary for a taxpayer to notify in such circumstances. Considerable attention has been placed on such schemes, so the current assessment is that HMRC is not aware of other taxpayers who have made use of the mechanism.

Ian Swales (Redcar) (LD): Will the Minister clarify whether the connected companies have to be UK companies, or is this intended to catch arrangements made overseas? There are some well documented cases of debt being held by related companies in countries such as Luxembourg, which is clearly designed to avoid UK tax.

Mr Gauke: This relates only to UK connected companies, if that provides clarification. For the reasons I have outlined, the Government believe that this is a wholly exceptional circumstance in which action to change legislation with full retrospective effect is justified.

I appreciate the points raised by my hon. Friend the Member for Amber Valley. It is right to make it clear that retrospection should be used only in wholly exceptional circumstances. He asked if I could set out in more detail the Government's position on retrospection. We set out our position in the protocol on unscheduled announcements of changes in tax law, which was published in "Tackling tax avoidance" at Budget 2011. The protocol makes it clear that the deterrent effect of making changes with immediate effect needs to be balanced against the need to maintain the UK tax system's reputation for predictability, stability and simplicity. It states:

> "In particular, changes to tax legislation where the change takes effect from a date earlier than the date of announcement will be wholly exceptional."

[Mr Gauke]

As we said in our announcement of 27 February 2012, we believe this is a wholly exceptional circumstance and that retrospective action is therefore justified. In this case, a very large amount was at stake, a part of the tax code that had been repeatedly exploited was involved, and the bank was in breach of its obligations under the banking code of practice. For fullness of disclosure, I should add that the Chancellor made it clear in his 2012 Budget statement that we are ready to take retrospective action if there are continued attempts to avoid stamp duty land tax, but I put on record that we will take that step only in wholly exceptional circumstances.

My hon. Friend the Member for Amber Valley brought his experience to bear on a point about a restriction of the use of debt buy-backs preventing company rescues. This measure would not prevent company rescues. HMRC has made clear in draft guidance that none of the current exceptions to the tax charge that arises on the acquisition of debt by connected companies have changed. The arrangements under which HMRC gives clearances in company rescue situations, such as debt equity swaps, will continue to apply. The retrospective legislation combats specific avoidance arrangements that were designed to avoid a tax charge that would otherwise have arisen and, as statements made when the legislation was last amended made clear, that should have arisen. The new provision will tax the full economic profit that a group makes when impaired debt of a debtor company becomes held by a connected company and is then released.

To return to the clause, in general it makes three changes to the existing legislation. First, when companies with existing debt become connected, the calculation of the deemed release is amended to prevent avoidance. In response to comments on the draft legislation, published on 27 February, clause 23 also amends the wording of the current legislation to iron out a feature that sometimes gives rise to queries about its application in the context of the loan relationships rules on connected companies.

Secondly, it introduces a targeted anti-avoidance rule, to prevent future tax avoidance in this area. Thirdly, to ensure that the particular avoidance scheme would not succeed, it introduces a retrospective provision to counter the contrived arrangements used by the scheme. This an appropriate point for me to address, in detail, the amendment that would remove subsections (8) to (12) of the clause, which introduce the retrospective element.

I have referred to the protocol on unannounced tax changes, and the Government have set out their policy on the area. The present case is an exceptional one, and, for the three reasons that I have outlined, we believe that it is justifiable to use retrospective legislation.

The Government are clear that aggressive tax avoidance schemes are unacceptable. The use of retrospective legislation demonstrates that we will not tolerate aggressive attempts by companies to abuse the tax system with contrived arrangements, to avoid paying their fair share. I therefore hope that my hon. Friend the Member for Amber Valley will be persuaded—having probed very effectively and shown all the diligence that one would expect, which no doubt he will demonstrate on the Information Committee in years to come—to withdraw his amendment. I hope that the clause will stand part of the Bill.

Nigel Mills: I am grateful to the Minister for that clarification. I think that we can all see that, given the example of a bank signing the agreement and entering into a scheme with the amounts of tax in question at stake, if any case was going to be in the line of acceptability for retrospective legislation, this would be it. Therefore I am happy in this situation to withdraw the amendment. I was trying to get the Government to clarify what they perceived as acceptable use, and we have had some progress on that, for which I am grateful.

I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

Clause 23 ordered to stand part of the Bill.

Clause 24

Companies carrying on businesses of leasing plant or machinery

Mr Gauke: I beg to move amendment 15, in clause 24, page 15, line 32, leave out ‘moving into tonnage tax’ and insert ‘joining tonnage tax group’.

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

Government amendments 16 to 22.

Clause stand part.

Mr Gauke: I am not sure whether this is the first time we have considered Government amendments to the Bill.

John Mann: It will not be the last.

Mr Gauke: It will not be the last, I confess.

Clause 24 makes changes to the sale of lessor company legislation to ensure that it remains effective. The sale of lessor company provisions were introduced to prevent groups from turning a temporary tax timing benefit into a permanent tax saving. Companies carrying on a business of leasing plant or machinery are able to defer profits for tax purposes through a claim to capital allowances. In many instances the capital allowances produce tax losses in the lessor company, which can then be used by the wider group to reduce its taxable profits.

Prior to the introduction of the sale of lessor provisions in the Finance Act 2006, the company could be sold to a loss-making group once the allowances were exhausted and the company was about to become tax profitable. Once in the loss-making group the tax profits could be reduced by the new owner’s losses. The sale of lessor provisions address the risk that the leasing profits might escape taxation in the new ownership by bringing an amount equivalent to the deferred profits into charge. After the sale a matching expense restores the timing benefit to the lessor company and prevents the deferred profits from being taxed again.

The changes introduced by the clause will target known schemes involving big ticket leases, where substantial amounts of tax could be at risk. The changes were announced at Budget 2012, with immediate effect to prevent forestalling and to protect other revenues at risk; draft legislation was also published. However, we have continued to engage with industry groups. That is why we have tabled amendments 15 to 22, which will preserve the intent of the clause, while preventing unintended consequences.

The first change introduced by the clause will prevent the lessor company from carrying back losses arising after the sale against profits derived from the sale of lessors charge. Using those losses against the charge means that the selling group keeps the timing benefit that it has enjoyed. However, the Exchequer has to wait until the losses of the buying group, augmented by the sale of lessors relief, are exhausted before tax can be collected on the deferred profits. The restriction will restore the intended effect of the legislation, in that it will prevent the temporary tax timing benefit from becoming a tax saving.

The second change targets arrangements that exploited a mismatch in definitions, which allowed a ship leasing company to join a tonnage tax group that included the lessee company without breaking its existing group relationship. No charge was calculated under the sale of lessors provisions and the lessor company was able to enter tonnage tax, where profits are computed for tax purposes on the basis of the tonnage of the ship and not on the normal corporation tax basis. As a result, profits deferred for tax purposes up to that point would have fallen out of charge unless special rules within the tonnage tax regime operated to calculate a balancing charge for an asset sold shortly after entry. As introduced, the clause countered that arrangement by triggering the sale of lessors provisions when the company entered tonnage tax.

Representatives of the shipping industry pointed out that that approach could affect companies that entered tonnage tax in circumstances where there is no change in group membership, the lessor company having always been a member of the same tonnage tax group. Amendments 15 to 22 address that, so that the clause will now ensure that, for the purposes of the sale of lessors provisions, there will be a change of ownership when a lessor company enters a tonnage tax group. The amendments will also prevent the possibility that profits could be taxed twice, by preserving any unused relief calculated under the provisions for use against certain balancing charges arising after the company enters tonnage tax.

The changes target contrived arrangements and situations in which there is a risk that tax on profits will be lost, and they preserve the revenue protection provided by the sale of lessors provisions. I hope that the clause will stand part.

Catherine McKinnell: I wish to comment on clause 24 in its entirety and on all the amendments. Earlier, my hon. Friend the Member for Bassetlaw pre-empted the Minister's introduction of this first set of Government amendments and eloquently stated his frustration at the Government's having to table such amendments at this stage. I accept that the amendments fall within the remit of clarification rather than of U-turn, which I am sure is a relief for the shipping industry and members of the public.

There has been no formal consultation process on the Bill, which explains why the amendments are necessary. The Government have justified having no consultation on the need to take quick action to implement a revenue-protection measure, which is a laudable aim. However, following the discussions with the shipping industry that the Minister has outlined, the amendments were tabled to obviate significant unintended consequences for companies, including the possibility of a potential double charge in certain circumstances. Will the Minister say whether the HMRC is now satisfied that, despite the lack of consultation on the clause and aside from discussions with the shipping industry about the amendments, the changes will not unfairly impact on relevant stakeholders? Does not the fact that the shipping industry felt moved to seek amendments to the clause show that some form of formal consultation prior to implementation was needed?

Given that there has been no consultation, has HMRC at least investigated how many businesses are involved in this type of tax avoidance? Has it investigated how many businesses have moved from the corporation tax method to the tonnage tax method as a result? Lastly, the impact note sets out the projected figures for the clause's Exchequer impact up to 2017, but no calculation has been provided for how much revenue the scheme could bring in. Will the Minister share that information with the Committee today?

5.30 pm

Mr Gauke: I am grateful for the hon. Lady's questions. She asked about consultation, and to a large extent, answered her own question by making it clear that this is anti-avoidance legislation. Such measures have a risk of forestalling, and the Government have taken many steps to increase the amount of consultation and the publication of draft legislation. By and large, most draft legislation is published in November and December in advance of the Finance Bill the following year, which gives interested parties an opportunity to analyse it and draw HMRC and the Treasury's attention to any unintended consequences or weaknesses in the drafting. That step taken by the Government has been widely welcomed, and it has contributed towards an improved quality of legislation.

However, there are difficulties with anti-avoidance measures because of the danger of forestalling. Publishing a measure for consultation without bringing an anti-avoidance measure into effect can, in some circumstances, put tax at risk. Having said that, even when the Government have been required to act quickly, we have been willing to listen and take action where necessary in response to any concerns that have been expressed.

We are content that the measure is appropriately targeted. It is supported by the shipping industry, which is content with the clause as amended by amendment 15, and amendments 16 to 22. The measure effectively targets the avoidance risk and will not have an impact on commercial situations, which means that we now have the appropriate legislation.

In answer to the hon. Lady's question about cost, or rather, the additional revenue that will be raised, we are talking about small sums of money. We are not making great claims. The impact assessment suggests that it is a negligible sum. It is more about protecting revenue in future, rather than bringing in additional sums. However, although the measure is designed more for revenue protection than anything else, it is none the less important that we protect revenue where we can.

[Mr Gauke]

The hon. Lady also asked about the scale of the impact and the number of companies that are likely to be affected, but I cannot give her the precise number. The provision only protects revenue, rather than raises additional sums, so it is difficult to make a precise assessment of the numbers that are likely to be affected. However, if I am able to provide additional information, I am happy to write to her and provide further clarification.

Amendment 15 agreed to.

Amendments made: 16, in clause 24, page 15, line 34, leave out 'moving into tonnage tax' and insert 'joining tonnage tax group'.

Amendment 17, in clause 24, page 15, line 36, leave out from 'if' to end of line 38 and insert '—

(a) on that day A becomes a member of a tonnage tax group for the purposes of Schedule 22 to FA 2000 without entering tonnage tax on that day, or

(b) the day ends immediately before the day on which, for the purposes of that Schedule, A both becomes a member of a tonnage tax group and enters tonnage tax."'.

Amendment 18, in clause 24, page 16, line 26, leave out 'moving into tonnage tax' and insert 'joining tonnage tax group'.

Amendment 19, in clause 24, page 16, line 28, at end insert—

'(7A) In Schedule 22 to FA 2000 (tonnage tax), after paragraph 79 insert—

79A (1) This paragraph applies if—

(a) a balancing charge under this Part of this Schedule arises to the company on the disposal of any plant or machinery, and

(b) the plant or machinery is taken into account in calculating income that the company is treated as receiving under section 383 or 417 of the Corporation Tax Act 2010 (sales of lessors) as a result of section 394ZA of that Act (company joining tonnage tax group).

(2) The balancing charge is to be reduced by the relevant part of the sales of lessors expense so far as relief has not previously been given for that expense (whether under this sub-paragraph or otherwise).

(3) "The sales of lessors expense" means—

(a) the expense which the company is treated as incurring under section 383 or 417 of the Corporation Tax Act 2010 as a result of section 394ZA of that Act, or

(b) if section 386 or 419 of that Act applies or has applied, the expense which derives from the expense within paragraph (a).

(4) If the sales of lessors expense is incurred at a time when the company is in tonnage tax, the "relevant part" of that expense is so much of it as, on a just and reasonable basis, is attributable to the matters set out in paragraph 56(1)(a) or (b).

(5) If—

(a) the sales of lessors expense is not incurred at a time when the company is in tonnage tax,

(b) that expense is taken into account in calculating a loss made by the company in a trade, and

(c) the loss is one to which paragraph 56 applies,

the "relevant part" of the sales of lessors expense is so much of the apportioned loss as, on a just and reasonable basis, is derived from the sales of lessors expense.

(6) The reference here to the apportioned loss is to the loss that is attributable to the matters set out in paragraph 56(1)(a) or (b)."'.

Amendment 20, in clause 24, page 16, line 30, leave out paragraphs (a) and (b) and insert—

'(a) where the income arises as a result of a company becoming a member of a tonnage tax group on or after 21 March 2012 and entering tonnage tax at the same time,

(b) where the income arises as a result of a company becoming a member of a tonnage tax group on or after 23 April 2012 without entering tonnage tax at the same time, or

(c) where the relevant day is on or after 21 March 2012 (in any case not within paragraph (a) or (b)).'.

Amendment 21, in clause 24, page 16, line 33, leave out from '(5)' to end of line 35 and insert 'and (7A) have effect—

(a) where a company becomes a member of a tonnage tax group on or after 21 March 2012 and enters tonnage tax at the same time, or

(b) where a company becomes a member of a tonnage tax group on or after 23 April 2012 without entering tonnage tax at the same time.'.

Amendment 22, in clause 24, page 16, line 36, leave out from 'effect' to end of line 37 and insert '—

(a) except in a case within paragraph (b), where the transfer day is on or after 21 March 2012, and

(b) in a case where the relevant change in the relationship occurs as a result of a company becoming a member of a tonnage tax group without entering tonnage tax at the same time, where the transfer day is on or after 23 April 2012.'.—*(Mr Gauke.)*

Clause 24, as amended, ordered to stand part of the Bill.

Clause 25

CORPORATE MEMBERS OF LLOYD'S: STOP-LOSS INSURANCE AND QUOTA SHARE CONTRACTS

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

Cathy Jamieson (Kilmarnock and Loudoun) (Lab/Co-op): I will be relatively brief, because the clause is perhaps not hugely controversial as far as politicians are concerned, although I am sure that there has been some considerable debate within the industry to ensure that the clause, eventually tabled by the Government, makes changes that it can at least live with, if not what the industry necessarily would have tabled.

The clause will amend the tax treatment of premiums incurred by the corporate bodies in Lloyd's for member-level stop-loss insurance. It aims to align the timing of the tax deduction for the premiums with the recognition of the profits to which they relate. The premiums incurred by the corporate bodies in Lloyd's for stop-loss insurance taken out at member level will be taxed on the declaration basis and not on an annual basis, as is currently the case.

It is important to recognise that the declaration basis is a tax treatment specific to Lloyd's. It allows the recognition of the profit or loss arising directly from the corporate body's syndicate membership for any particular underwriting year to be deferred for tax purposes until after that underwriting year has closed. The underwriting year closes after three years, with the result that the profit or loss is recognised for tax purposes in year four, the period in which the profit or loss is declared.

The measure also includes an anti-avoidance provision in respect of quota share contracts.

As I said at the outset, I do not intend to go through the whole history of the issue. However, following the announcement of the measure in Budget 2011, the Government held informal consultations, as I understand it, with Lloyd's and other interested parties. Following the consultation, when the draft legislation was published, the Government decided to make further provisions to deal with multi-year contracts and renewals of contracts taken out before 6 December 2011.

It is important to recognise that the new rules will affect only stop-loss policies, which are defined for such purposes as any insurance taken out by the corporate member against losses in its underwriting business except for quota share contracts.

I have a question for the Minister. The summary of impacts indicates that the measure is expected to

"increase receipts by approximately £200 million a year over the period in which the timing advantage unwinds. The final costing will be subject to scrutiny by the Office for Budget Responsibility".

Is the estimate still the same? Has any revision been made to that due to the work done so far, or will we have to wait to see how that plays out in future years?

The Financial Secretary to the Treasury (Mr Mark Hoban): It is a pleasure to serve under your chairmanship this afternoon, Mr Bone.

As the hon. Member for Kilmarnock and Loudoun said, the measure is a straightforward one, addressing the issue that emerges when corporates in Lloyd's take out cover against losses and have claimed the cost of that in advance of the profits being incurred, and the timing difference that works in their favour.

We have had quite extensive discussions with Lloyd's, as the hon. Lady referred to, so she got this point right: the measure has been greeted with a degree of support—"consent", I suppose, is probably a better way of describing it. It applies only to corporates, not individuals.

The estimate referred to by the hon. Lady is the estimate we gave at the time of the autumn statement. We have no reason to believe that the estimate is in any way incorrect. We expect it to raise the revenue that we indicated at that time.

Question put and agreed to.

Clause 25 accordingly ordered to stand part of the Bill.

Clause 26

Abolition of relief for equalisation reserves: general insurers

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

Cathy Jamieson: Clauses 26 to 30 relate to the claims equalisation reserves. With your permission, Mr Bone, and in order to make it easier for the Committee, I intend to speak to clauses 26 to 30 collectively, rather than individually, although I understand that we would have to vote on them individually.

The Chair: Order. If it is convenient for the Committee, we will take clauses 26 to 30 together.

Hon. Members: Yes.

Cathy Jamieson: Thank you, Mr Bone. I do not think that hon. Members would have been as excited if I had spoken to each individual clause for the same length of time. It would be helpful to take the clauses together, given that they all relate to the claims equalisation reserves.

The measures will repeal the current legislation for the tax treatment of claims equalisation reserves. For general insurance companies, the tax treatment of equalisation reserves is governed, as I am sure that all Government members of the Committee know, by sections 444BA to 444BD of the Income and Corporation Taxes Act 1988. Section 47 of the Finance Act 2009 and the Lloyd's Underwriters (Equalisation Reserves) (Tax) Regulations 2009 provide for same tax treatment for Lloyd's corporate and partnership members that maintain an equivalent reserve to that maintained by general insurance companies.

Because of European Union regulatory changes, the Government are abolishing the ability of corporate members of Lloyd's and insurance companies to obtain a tax reduction for transfers to equalisation reserves. Funds in existing equalisation reserves will be taxed, spreading the release evenly over the six years from the date that the solvency II capital requirement came into force. Clauses 26 to 29 make the changes in relation to general insurance companies, while clause 30 makes them in relation to secondary legislation with regard to Lloyd's.

The measure deals with the taxation impacts arising from the removal of the regulatory requirement for general insurers to maintain claims equalisation reserves as a result of the implementation of the solvency II directive. The measure repeals the current tax rules and the parallel rules for Lloyd's, and provides for a transitional period over which the built-up reserve will be charged to tax.

The measure was originally announced in the 2011 Budget and, again, an informal consultation with an industry working group took place between April and August 2011. Both the Association of British Insurers and Lloyd's—representing general insurance companies and corporate and partnership members at Lloyd's—were included in the consultation. It would be fair to say that some concerns were raised during the initial stages. Colin Graham, the UK insurance tax leader at PricewaterhouseCoopers, said:

"This could put UK-based insurers at a competitive disadvantage to insurers based in some other countries at a time when the Government is seeking to attract industry back to the UK. Relief already claimed will reverse, costing the industry £500m over six years from 2014 onwards."

Will the Minister address the importance of a competitive UK tax regime to attract investment, particularly at this point in time? Does he have any concerns about the competitiveness of the UK tax regime? What assessment has been made of the measure's impact?

To return to the point of the clauses, an equalisation reserve—also described as a claims equalisation reserve—is a reserve built up, generally from profitable years, as a cushion against periods with worse than average claims experience. Insurance companies in the UK—but not Lloyd's members—are required by the Insurance Companies (Reserves) Regulations 1996 to establish

[Cathy Jamieson]

equalisation provisions. Those provisions, which are in addition to the provisions required to meet the expected ultimate cost of settling claims outstanding at the balance sheet date, are required by the Companies Act to be included in technical reserves, even though they do not represent known liabilities at the balance sheet date.

5.45 pm

From 1996, general insurers were allowed to treat amounts transferred into CERs as tax deductible, and amounts transferred out were treated as taxable receipts. In 2009, rules were introduced to allow equivalent deductions for Lloyd's corporate and partnership members. Not every territory in Europe has a regulatory requirement to maintain equalisation reserves. Again, I wonder whether we can impress that on the Minister in the context of these clauses, because it could be argued, and indeed some people have taken the view, that CERs are not required because any business risks would be provided for in the company accounts.

I mentioned earlier that during the consultation process, industry groups were very unhappy about the proposals. They were calling for CERs to continue for tax purposes only, as I understand is the case in Luxembourg. However, I also understand that at that time Her Majesty's Revenue and Customs and the Treasury were not convinced by the arguments advanced by the industry groups. I think that it would be fair to say that they have now accepted the changes, but perhaps it is the case that they knew that the changes were coming and therefore have reluctantly accepted them, rather than rocking the boat.

I have a couple of points in relation to aspects of clause 30 that relate specifically to Lloyd's and Lloyd's corporate members. I have mentioned the regulatory requirement for general insurance companies—but not members of Lloyd's—to maintain CERs in respect of certain lines of business. It is important to recognise at this point that the clauses deal with both the situation in relation to Lloyd's and the wider insurance sector.

I may want to impress further points on the Minister, but it would be helpful if he could respond to those points. It is worth noting that clause 26 repeals existing tax legislation providing for tax relief for CERs maintained by general insurers and introduces transitional rules to tax built-up CERs over six years. Essentially, one sixth of a company's existing CERs will be brought into tax each year for a six-year period.

Clause 27 sets out a provision that an insurance company may make an irrevocable election to treat the built-up reserves as taxable in one calendar year as opposed to being spread. That will enable companies to plan the taxation of the reversal of CERs and potentially to optimise tax loss planning.

Clause 28 relates to double tax relief. The clause is relevant where a company has built up CERs that will be taxable and carries on business through a permanent establishment outside the UK for which DTR is due in respect of any income or gain. A proportion of DTR may be offset against the premium income.

Clause 29 specifies that where there is a transfer of whole or part of the business to another insurance company—within the charge to UK corporation tax—the transferrer and transferee may jointly make an irrevocable election within 28 days of the transfer for the deemed receipts to be allocated between them. For the year of transfer, an apportionment would be made between the transferrer and transferee based on the date of transfer. The remaining deemed receipts would then arise in the transferee. It seems that if such an election were not made, the deemed receipts would arise in the transferrer on the cessation of trade.

As I have mentioned a couple of times, not every part of Europe has that regulatory requirement. I wish to press the Financial Secretary on that point and ask him what further comments the industry has made, if any. Is he confident that there is consensus on this issue, as there was on the earlier ones? As I have said, I might have other questions on the clauses that I want to return to.

The Chair: I thank the shadow Minister for outlining clauses 26 to 30. I remind the Committee that we are debating clauses 26 to 30 together, so if anyone wants to speak on any of them, now is the time to do so. Does the Financial Secretary wish to speak?

Mr Hoban: I will say very little, Mr Bone, because the hon. Lady has done my job for me in setting out briefly but succinctly the point of each clause. I shall, however, make one or two comments.

For most insurers—not for Lloyd's—claims equalisation reserves flow from existing insurance regulations. What we are seeing is their replacement by the EU directive, solvency II, which is due to come into place in, I think, 2014. An extensive part of the Bill, to which we will come quite soon, I hope, deals with the broader reforms of life assurance taxation to reflect solvency II.

One thing that flows from solvency II is the removal of the need to have claims equalisation reserves, so there will be no regulatory requirement to hold them, but that prompts the question of what should happen to the taxation of such reserves in future. A number of industry participants have asked the question that has been asked here, about whether the measure would remove or erode UK insurers' competitive advantage. When we signalled our intention to remove the claims equalisation reserves, or change the tax treatment of them, we made the point that if insurers could provide strong reasons to maintain the tax treatment on competitiveness grounds we would listen to the arguments. The evidence that we received from insurers was not, however, strong enough to justify retaining the current treatment, so we opted to change it, but recognised that significant claims equalisation reserves had built up and that it was therefore appropriate to soften the impact on insurers by enabling the unwinding of the reserves to be spread over six years, so we did listen to the industry in that respect.

Cathy Jamieson: Perhaps the Financial Secretary has answered my question, by saying that the evidence was assessed as not being strong enough, but will he say a bit more about the arguments that the industry made at that point? Was it content that the six-year unwinding process was the solution?

Mr Hoban: The reality is that the industry accepted that its arguments were not that robust, and the industry's consent to introduce the changes has been gained.

Reserving systems vary from country to country, and a number of countries have yet to decide exactly how they will approach the issue under solvency II. One of the benefits of solvency II is to produce a single regime for solvency purposes across Europe, so one would hope that the tax treatment in individual countries would flow from that.

We have put in place changes to the taxation of foreign profits—particularly as a consequence of the reforms that my hon. Friend the Exchequer Secretary has driven through—that are particularly valuable to the insurance industry and to those who wish to take advantage of solvency II to use London as the headquarters of their European operations. The insurance industry supports our tax changes, and we are starting to see the benefits emerge, as companies decide to move their domicile to the UK. I am content that we have the right position.

My final point is on clause 30, which applies the rules to Lloyd's. As I pointed out earlier, it was the case that Lloyd's was not required to set up equalisation reserves, but the 2009 statutory instrument to which the hon. Lady referred provided the opportunity to do so. Clause 30 ensures that there is consistent treatment of those reserves across all insurers, including Lloyd's.

Question put and agreed to.

Clause 26 accordingly ordered to stand part of the Bill.

Clauses 27 to 30 ordered to stand part of the Bill.

Clause 31

Tax treatment of financing costs and income

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

The Chair: With this we may consider schedule 5 stand part.

Rachel Reeves (Leeds West) (Lab): It is a pleasure to serve under your chairmanship this afternoon, Mr Bone. Hon. Members will be aware that the debt cap rules that we are debating under clause 31 came into effect on 1 January 2010. They overhaul the taxation of multinationals and restrict the UK tax deduction for interest costs of UK companies that form part of a larger group. The rules are designed so that the aggregate UK corporation tax deductions—the financing costs—do not exceed the group's external financing costs globally. They are aimed at cash-rich UK-based groups with upstream loans into the UK from abroad, as well as non-UK parented groups that fund their UK operations via the route of debt finance.

Clause 31 represents a number of changes to those measures that were introduced in January 2010 and included in the Finance Bill that was considered last year by hon. Members. I understand that clause 31 arose from discussions with industry groups. I would like to ask the Minister a number of questions in relation to the clause. Will the Minister confirm that those discussions with industry groups referred to meetings of the debt cap working group, or did they refer to other industry group meetings on the issues raised by the clause?

Various questions were raised at the time of last year's Finance Bill that I am not sure have been fully addressed, which is why I ask the question about the meetings with various parties over the past year. Is the Minister confident that the changes we are debating in relation to clause 31 will ensure that the system that will stand in place if the Bill is passed will work effectively? If not, does the Minister envisage further changes or improvements in future Finance Bills, or is he confident that the changes set out in this Finance Bill to change what we discussed last year in Committee will complete the issue in hand?

In the Bill Committee on last year's Finance Bill, the Minister gave hon. Members an assurance and said:

> "The cost of the changes in the debt cap legislation are negligible for both businesses and HMRC"—[*Official Report, Finance (No.2) Bill Committee*, 26 October 2010; c. 73.]

Has that proved to be the case, and will the changes before us today affect that in any way? In other words, what are the financial implications of the changes that we are discussing today for tax revenues and the turnover or profits of the businesses that will be affected by these changes?

I also have some specific questions about financial service companies and whether they are captured. I do not think that they are. If not, why not? Is it still the case that HMRC, the Treasury and the Minister consider that clause 31 is unworkable in respect of financial service companies? What progress have the Government made on applying similar rules to financial service companies if, indeed, that is being looked at? If it is not being looked at, will the Minister set out why those rules would not be appropriate for those sorts of companies?

Can any mitigating measures be taken so that at least the spirit of clause 31 would be applicable to all companies, not just non-financial service companies? It is particularly important to consider this issue at a time when bank lending to small businesses in all our constituencies is drying up. Bank of England lending figures from May showed that net lending to British businesses has fallen year on year in every month since May 2010. With British businesses struggling in this double-dip recession—we saw the numbers for manufacturing this morning—we know that small businesses in our constituencies face difficult times. It is clear that we need to consider the issue of bank regulation extremely carefully.

6 pm

Stephen Barclay (North East Cambridgeshire) (Con): I am a little puzzled as to why the hon. Lady took the data from 2010, not 2008. Was it not a former Chancellor's understandable risk-averse requirements around capital for banks and his concern about taxpayer liability that changed those capital requirements and impacted on the banks' ability to lend?

Rachel Reeves: A number of things are impacting on the banks' ability to lend. It is partly down to the changes in capital requirements, but they are obviously a good thing, as banks will hopefully be less reliant on taxpayers if they get into difficulty in future.

Another thing that affects the banks' ability to lend is the continuing payouts of large bonuses and, in some cases, dividends. It is also about the lending targets and

[Rachel Reeves]

the framework that the Government set. After the current Government came to power, they set the Project Merlin agreements with the banks to get them lending again. With net lending falling, that clearly has not been the case, and that is one reason why we have argued for more robust and tougher arrangements not just for banks that have been bailed out by the taxpayer but for banks that have relied on quantitative easing and the insurance schemes that were put in place by both the current and the previous Government.

Stephen Barclay: I thank the hon. Lady for giving way for a second time. I note that she did not address the question regarding the material change in capital requirements for banks happening in 2008, not 2010. However, on bonuses, does she regret the guaranteed bonuses that were allowed by the regulatory regime under the last Government? It was those bonuses that meant that, even after the financial crash, banks were legally compelled to pay massive bonuses irrespective of their performance, because the previous Government allowed guaranteed bonuses to be decoupled from bank performance.

Rachel Reeves: I did address the hon. Gentleman's first point in my response. Having higher capital requirements of course affects the banks' ability to lend, but it is not the only thing affecting that ability. It is right that banks are being made to put aside more capital, because one reason why they had to rely on taxpayer bailouts in the face of the financial crisis is that they did not have the buffers of capital that would have been put aside had they been more prudent. I welcome higher capital ratios and the fact that banks must put more aside—although there are issues with it working in practice, to which the hon. Gentleman is perhaps alluding.

Bonuses should be just that. They should be awarded for exceptional performance, and it is right that the regulators—the Financial Services Authority and now the Bank of England—have more robust procedures for the regulation of remuneration packages. I would like shareholders to have much more say over the remuneration of top people in firms, which is why it is extremely disappointing that the Government are considering watering down shareholder responsibilities, perhaps with a three-year review rather than an annual review. Pay, bonuses and remuneration are set every year, and it is therefore right that shareholders should vote every year, not every three years. *[Interruption.]* If the hon. Gentleman wants to make another intervention, I am more than happy for him to do so.

The Chair: Order. I might be being unusually thick, but I really cannot quite see how this argument is relevant to the clauses that we are supposed to be discussing. However, I am sure that I should be informed more.

Rachel Reeves: I am happy to continue with the text, but when we talk about the changes to the way in which the debt cap rules are applied, it is important to consider that these rules do not apply to financial service companies. Such companies are a large part of the UK economy—part of the economy responsible for some of our current troubles, so it is right that we take time to focus on their tax treatment as well.

To go back to the specific issues in clause 31, members of the Committee will also be aware of the tax arrangements of Vodafone, which were revealed over the weekend, and of the fact that Vodafone pay little or no corporation tax in this country despite doing huge amounts of business here and making large profits in this country. The revelations were described as

"a series of legal accounting manoeuvres involving a complex net of offshore companies".

Part of clause 31 relates to companies in this country that are often financed by debt finance and are part of large multinational groups. Will the Minister confirm whether schemes such as the one set up by Vodafone, which has caused such an outcry over the past few days, will fall under the rubric of this amendment and whether its tax affairs would be changed in any way by the debt cap changes that we are debating under this clause? Specifically, what steps is he taking to consider passive income, which is income generated by multinational foreign subsidiaries from UK assets that are artificially located offshore for tax reasons? Furthermore, would any part of these debt cap rules apply to such circumstances?

Ian Mearns: My hon. Friend poses an important question. All of our constituents share the desire to ensure that those in high echelons of business, who are making significant profits, pay their share of the country's tax burden. The way in which this Bill Committee and this House deal with such issues will determine how we are judged by the ordinary citizens of this country. We must ensure that large companies pay the right tax.

Rachel Reeves: Part of the reason why these debt cap rules were put in place at the beginning of 2010 was to stop companies that are part of large groups from using offshore arrangements to avoid paying corporation tax in the UK by artificially moving income so that they can minimise their tax payments, thereby depriving the Exchequer of valuable income. It is particularly important to address such arrangements at this time when ordinary families and businesses are struggling with their tax burdens—whether it be the increase in VAT and national insurance contributions, the loss of working tax credits, or some of the new VAT changes. Despite some of the U-turns that we have seen, VAT will still be applied to things that were not previously subject to it.

In those circumstances and in that environment, it is even more important that all businesses, especially big businesses, are seen to, and do, pay their fair share of tax. That is why these debt cap rules were originally introduced at the beginning of 2010 and why the Government should go back, as they did in the previous Finance Bill and as they are doing this year, to ensure that those rules are working effectively. I hope that these changes will bring in more money for the Exchequer, and I look forward to hearing whether the Minister agrees with that.

Even now, despite efforts by the previous Government and by this Government to crack down on tax avoidance, companies such as Vodafone are still getting out of paying their fair share of tax. I therefore share my hon. Friend's frustrations, and those of his constituents who get particularly annoyed when they see their taxes going up yet some of the richest people not paying their fair share.

If Vodafone is not affected by these changes, how many of the estimated 1,800 companies or groups that I think fall under the rubric of clause 31 and the debt rules for large groups does the Minister think will be affected? How does he expect their tax liabilities to be changed because of the rules? How much money did the debt cap rules raise previously, and how much does he expect them to raise in the remaining years of this Parliament and beyond? Will some companies see their tax liabilities fall because of these changes, or will tax liabilities only increase? Are specific types of company likely to see their tax liabilities increase more than others? Will the rules affect larger groups or those with more offshore arrangements? Will particular industries be affected by specific changes to the rules? I hope that the Minister will clarify some of those important points on the debt cap rules because it is in the interest of all of us in the House that the measures work effectively for our constituents, small businesses and families.

Ian Mearns: Some hon. Members will be aware that I am currently doing a fellowship with the Industry and Parliament Trust that involves working with small and medium-sized enterprises, as well as some larger companies. I think there is a measure of incredulity among the owners of small and medium-sized enterprises, as well as some large businesses, when they see companies such as Vodafone not paying what everyone would regard as their share of this country's tax burden.

Rachel Reeves: I pay tribute to my hon. Friend for his work with the Industry and Parliament Trust. Those of us who have an association with the trust will know the excellent work that it does to ensure that Members on both sides of the House are in touch with industry and understand some of its concerns, and it is valuable to bring those experiences to the House and to Bill Committee such as this. My hon. Friend makes the point that small businesses, as well as many medium-sized and large businesses, try to do the right thing, invest, employ people, grow their businesses and pay their fair share of tax, and they want to see that everybody is doing that, not only them.

The businesses that I talk to in my constituency of Leeds West get frustrated because they do not have a choice about what taxes they pay. They cannot afford fancy lawyers and accountants to do the paperwork for them; they have to pay the taxes that they know they need to pay, and they cannot work the system to reduce their tax bill. It is therefore right to close loopholes, which is what the clause seeks to do. I welcome that and look forward to the Minister's response on the specific points that I have raised.

Nigel Mills: I shall speak briefly on this clause. While I was still in practice, I had the misery—it was an incredible misery—of trying to interpret how such rules would affect various groups of companies that were doing nothing remotely aggressive or making any attempt to avoid tax, but merely had a normal commercial level of debt and happened to be a subsidiary of a foreign group. The rules, I think, were an attempt to tackle some tax abuse that was clearly out there, but from memory I do not think that they were the Revenue's first choice from a menu of options to try and tackle that abuse, although all the other options were too difficult or could not be done. It was, therefore, left with this option, which was not even the second choice.

The calculations required to weave the legislation through the EU compliance the Minister spoke about earlier are incredibly complicated. They are trying to prove an incredibly bizarre concept. The UK group is allowed debt of up to the same amount as the worldwide group. If a worldwide group has £1 billion turnover and £500 million debt, a UK group with a £10 million turnover is okay as long as its debt does not exceed £500 million. The bizarre concept clearly catches a load of large groups—the hon. Lady quoted 1,800. The vast majority will have no adjustment.

6.15 pm

Looking back over the three years since the measure was introduced, does the Minister think that it was a very sensible measure? Was it a sledge hammer to crack a nut? Is the combination of all the other rules that tackle excessive debt and debt taken on for an allowable purpose or the new controlled foreign company rules sufficient to tackle the abuse? If it is not sufficient, will the general anti-abuse rule he wants to introduce be enough? Can the whole worldwide debt cap now be consigned to history as a badly conceived idea that was very hard to implement and very hard to comply with?

The amendments are largely sensible. There are some anti-avoidance ones, but also some that take out a few of the real anomalies in the calculations. Some groups that effectively have no net debt somehow have a disallowance, because they got some debt created by some very strange calculations that had to be done. I welcome the amendments, but I ask the Minister to see whether the tax that is really raised is sufficient to justify the compliance burden. There is a huge amount of other rules that could be used to tackle the abuse sufficiently, which I wholeheartedly agree needs to be tackled. Is this is one area of tax simplification that we could manage and so lose the rules completely?

Fabian Hamilton (Leeds North East) (Lab): It is a pleasure to serve under your chairmanship this afternoon, Mr Bone. I want to make a few comments on the clauses. They generally attempt to close down abuses and tighten up on tax avoidance. If I may, I want to refer to some points that my hon. Friend the Member for Leeds West made and some points that my hon. Friend the Member for Gateshead made in his interventions. I also want to refer to points that I made when we discussed corporation tax.

A number of Members this afternoon have made mention of the situation regarding Vodafone. My hon. Friend the Member for Leeds West especially drew attention to it, but we would all be highly concerned at a large multinational corporation continuing not to pay tax as it should in this country by arrangement through legitimate, and it seems legal, avoidance measures. Companies, such as the one I used to run and the many thousands of small businesses that are the seedcorn of job creation and economic growth, as my hon. Friend said, are forced to pay the taxes that they are required

[Fabian Hamilton]

and asked to pay, because they cannot afford the accountants and lawyers who might use existing and legitimate legal avoidance measures.

Clause 32 extends the definition of "normal commercial loan" to include loans that carry a right to conversion into shares or securities in quoted companies that are not connected to the company that issues the loan. That means that such loans will be within the definition of normal commercial loans and the holders of such loans will not be treated as equity holders.

The Chair: Order. Sorry to interrupt the hon. Gentleman, but we have not quite got to clause 32. We are still on clause 31.

Fabian Hamilton: I apologise, Mr Bone, you are right. I am looking at the wrong notes, but I think that the points I made still apply. I want to make a general point, but when we debate clause 32, I will come back to what I was about to say. My point is generally valid. *[Interruption.]* Thank you, I aim to entertain this afternoon.

Members of the general public will be baffled when they see some of the techniques that huge multinational corporations, which are making big profits not just in this country but in other countries throughout the world, are using to avoid paying the tax that smaller companies making similar profits would have to pay in this country. Clauses 31, 32 and 33 aim to close down those abuses, but the question is whether they do so accurately and whether it is in a way that most members of the public are able to comprehend. I know that my constituents, like the constituents of every hon. and right hon. Member in this room, will be completely baffled as to why some can get away with it and others cannot.

Cathy Jamieson: My hon. Friend is making a powerful case about what the general public would see as fair and reasonable. Does he, like me, welcome the fact that the Government are apparently going to take some action on stamp duty avoidance? If it is right to do it on the avoidance of stamp duty, it is also right to do it in the context of companies such as Vodafone.

Fabian Hamilton: I entirely agree with my hon. Friend. The impression and feeling that I get from my constituents and from others whom I meet is that nobody likes to pay more tax than they have to, but people do not object to paying tax if they believe that it is fair and equitable and that everybody pays the same, according to the rules that are laid down, and that no one is treated separately or with any sort of favour. The problem we have is that companies such as Vodafone—there are others—are treated separately. They have a privileged position, which undermines the views of most members of the public, who want to pay the tax that they believe that they should pay or they deserve to pay or need to pay. It must be fair and equitable. Anything that tightens up the rules that ensure that all companies and all organisations pay their fair share should be welcomed.

Ian Mearns: My hon. Friend is making a powerful point. This all underpins the credibility or otherwise of this House to legislate for fairness. If ordinary citizens and taxpayers out there do not feel that what is being done on their behalf—in their name—is fair, it calls into question whether they can find ways of dodging the tax system as well. We all like to think that the taxes that we raise are fair and are used to fund the public services that we all need and want to have. It undermines the system, however, if people do not believe that the whole system is credible.

Fabian Hamilton: I thank my hon. Friend for that very good point. It is not only that the public have to feel that paying tax is fair and that everybody pays their fair share but, if we are seen not to be ensuring—I hope that the clause will help this—that each company, each corporation, each business and each individual pays their fair share, that undermines this House too. We know that these days politicians are held in fairly low esteem, but if we can show the public that no one gets away without paying their fair share, that might do something to lift the reputation of hon. and right hon. Members from across the House.

When my hon. Friend the Member for Gateshead talks about fair taxation, I think about the documentary programmes and the knowledge that I have of that wonderful small country, Norway. When we look at the Norwegian system and listen to what earners at all levels say about the tax that they pay—in many cases, their tax burden is considerably higher than ours—they say that they are happy to pay that tax because they can see, openly and transparently, how it is spent on the services that they want. They can openly see that it is fair and that everybody pays their fair share according to what they can afford, and they can take advantage of the public services offered. It seems to me that we have a fair way to go before members of the public in this country feel the same way about our tax system.

Julie Hilling (Bolton West) (Lab): Does my hon. Friend agree that that sentiment is also shared by other Scandinavian countries, including Finland and Sweden, where the people want to contribute to the tax system because of the benefits that they receive back?

Fabian Hamilton: Yes, my hon. Friend is absolutely right. The Nordic countries offer a model for how taxation can be fairly collected and fairly spent in an open and transparent way that we perhaps have yet to achieve fully. I will add to her examples. In two weeks' time, I will be privileged to take a group of hon. Members to Iceland. It is a small country. *[Interruption.]* It is not a junket. *[Laughter.]* We know the reputation that Iceland has unfortunately had owing to the crisis in 2008, with the collapse of Icesave, Landsbanki and other Icelandic banks. We know also that in a referendum the Icelandic people refused to collectively pay back the amount of money that had been lost. However, the action taken by the Central Bank of Iceland has been exemplary. Iceland has turned its economy around, so that now its proportion of debt to GDP—it is obviously a much smaller country than the United Kingdom—has reduced considerably. Its percentage unemployment has gone down and it is turning the whole thing around very rapidly. That is a lot easier in a small country, but we would do well to consider the lessons that the governor of the Central Bank of Iceland can offer our

Government on how to turn these things around—how to pay debt off and how to ensure that everybody pays their fair share.

In conclusion, and perhaps we can refer to Iceland and the other Nordic countries soon—

Richard Harrington: I am listening very carefully to what the hon. Gentleman has to say and I am very sorry that I shall not be able to join him on that visit to Iceland. It seems that he is suggesting that the Government's economic policy to sort out our problems should be to default on our debts and then say that we are restructuring everything. Did I misunderstand the hon. Gentleman, because that is exactly what happened in Iceland?

Fabian Hamilton: I am sorry that the hon. Gentleman misinterprets what I am trying to say. What is impressive is that the Icelandic Government and the people of Iceland, while refusing to sign up to the referendum proposition that was put to them, have said that they will pay. The governor of the Central Bank of Iceland, who we will meet in two weeks' time, said to us last year that every individual who has lost money through the collapse of Icelandic banks will be repaid. It will not happen next year, but they will be repaid. As a nation and as a public, they are determined not to default on their debts. They will do that, but they want to be given time so that they can grow their economy sufficiently to ensure that that is done.

I hope to catch your eye as we go through the later clauses, Mr Bone.

Mr Aidan Burley (Cannock Chase) (Con): Before the hon. Gentleman finishes, I wish to say that I agree with the principle of what he is saying. Will he extend his argument about everybody paying their fair share of tax to civil servants who set up companies to avoid being on the payroll and to BBC presenters, some of whom are paid on the BBC payroll and some of whom set up their companies and are paid off the payroll? Will he extend that principle to everybody being paid on the payroll? Should the practice that grew up under the previous Government of highly paid civil servants, such as the head of the Student Loans Company, being paid through their private company rather than the payroll, be abolished as well? Is that the Labour party's position?

The Chair: Order. Clause 31, "Tax treatment of financing costs and income", can in no way be referenced to personal service contracts. Will the hon. Gentleman finish his speech?

Fabian Hamilton: Thank you, Mr Bone. I presume, therefore, that I may not answer.

The Chair: Correct.

Fabian Hamilton: Okay. Well, I will not. I will just thank the hon. Gentleman for his intervention and conclude by saying that I hope that clause 31 and the subsequent two clauses will do their bit to ensure that avoidance measures are tightened up so that everybody, from large corporations to small individuals, pays their fair share of tax openly and transparently.

Mr Gauke: Clause 31, for it is clause 31, makes a number of changes to the debt cap legislation and ensures that debt cap rules are simpler to apply and eliminate situations in which the rules apply unfairly. It also introduces schedule 5. Let me provide a little bit of background for Committee members. As we heard, the debt cap legislation was introduced in the Finance Act 2009. The debt cap rules restrict the amount of interest that large groups can deduct for the purposes of corporation tax. The restriction is made by comparing net UK financing expenses of the group with the amounts shown for finance costs in the consolidated accounts of the worldwide group. The debt cap rules apply only to 1,800 large groups. The majority of the changes are being made to ensure that the rules operate as intended, and their cost is nil. I hope that that answers one of the questions raised by the hon. Member for Leeds West.

6.30 pm

Rachel Reeves: So the benefit to the Exchequer from these changes will be zero: they will not bring in any additional revenue.

Mr Gauke: The intention is to ensure that the rules apply fairly. We do not expect this to be a revenue-raising measure. The financial implications of the debt cap changes are negligible, the changes will ensure that the rules work fairly, and we do not expect them to have an impact on business.

Rachel Reeves: Will the Minister give way again?

Mr Gauke: I will, but before I do, I should say that the changes will apply to all groups that have to submit debt cap computations for their accounting periods ending after the date of Royal Assent. Until those groups submit their tax computations, we cannot know how many of the 1,800 companies will be affected by the changes. Overall, we think that the measure will be neutral. Some groups will benefit from the relieving provisions, such as changes to the de minimis and some will have extra tax to pay, for example, if they are within the anti-avoidance rules. At the moment we have to make an assessment, which is that it is neutral. This is not a revenue-raiser. There will be a cost for some companies and a benefit for others.

Rachel Reeves: For what reasons would a company pay less tax? Although the Minister does not know yet what the tax implications will be, what is his and the Treasury's estimate of how many of the 1,800 companies will end up paying more, and how many will pay less?

Mr Gauke: I refer the hon. Lady to the comments that I made a moment ago.

One relieving provision contained in the Bill relates to the de minimis rules and may result in companies having to pay less tax. We will have to wait until the tax computations come in to find out about the number of companies involved. This is a complex area and the number of companies concerned will depend on their circumstances. Our assessment is that the measure is neutral.

Seema Malhotra (Feltham and Heston) (Lab/Co-op): Will the Minister clarify why he is proposing the changes and what was not fair about the previous arrangement?

Mr Gauke: If I may continue, I shall perhaps be able to answer the hon. Lady's question.

In the broadest terms, the changes make the debt cap operate more fairly. The consultation process was well received. The Law Society, the Chartered Institute of Taxation and Deloitte's all commented favourably on the engagement by HMRC and the Government in respect of this matter. The key issue raised by accountancy firms, law firms and representative bodies was the proposed form of the de minimis election, to which we have made changes as a result of the consultation. The election will not be backdated to 2010 because that would have meant increased compliance burdens and uncertainty for business, as tax returns for 2010 based on the old rules would already have been submitted to HMRC. Those changes were warmly welcomed and the measure was announced in Budget 2011. The changes being made deal with areas that created real difficulty for businesses, which were raised during consultation.

I will try to pick up some of the additional points that were raised during the debate. First, the debt cap rules commenced on 1 January 2010, so they were first applied to groups' accounting periods ending on 31 December 2010. As a result, HMRC is only just starting to see returns for that period and later ones. As a result, the amounts that the debt cap has brought in during this year cannot be fully quantified until later this year.

Nigel Mills: Perhaps it would be helpful if the Minister explained how easy it has been to roll out training for HMRC inspectors on that point. Has he any idea how many inquiries have been launched so far on that topic? My understanding is that the training process has taken some time, and I am not sure whether any inquiries have been launched.

Mr Gauke: I am not able to give my hon. Friend an answer for the moment, but I will ponder further while I speak and see whether inspiration arrives.

The hon. Member for Leeds West asked about the consultation process. I confirm that there were meetings with the debt cap working group, which represents large groups, and their advisers. There were 16 responses to the consultation and seven to the draft legislation, and the main respondents were accountancy firms, law firms and representative bodies.

The issue was raised about whether the clause applies to financial services companies, and why the rules were not being applied to such companies. Financial services companies are specifically excluded from the debt cap, because the application of the debt cap rules on banks' ordinary trading assets and liabilities would have had a disproportionate effect on their debt cap computations.

Having thought further about the number of inquiries on the debt cap—*[Laughter.]*—I can tell the Committee that evidence so far suggests that most groups are applying the debt cap rules correctly, so few inquiries have been made so far. Why that piece of information escaped me earlier I do not know, and I apologise to the Committee for not being on top of that.

A question was also asked about Vodafone. The hon. Member for Leeds West should not be surprised by the fact that I cannot comment on the affairs of individual taxpayers, and I would not have thought that she would expect me to do so. The tax affairs of the UK's largest businesses are dealt with by dedicated teams in HMRC who routinely risk-assess the returns of the companies they deal with. Those returns will include the debt cap computations, where the rules will apply to all relevant companies in exactly the same way.

Mr Hamilton: On the last point, can the Minister reassure us that the rules are genuinely applied equitably to the companies that fall within that special group in HMRC and to all the other companies that HMRC has to deal with?

Mr Gauke: Yes, HMRC seeks to deal with all taxpayers fairly, and to ensure that taxpayers pay the tax that is due under the law.

Stephen Barclay: Is it not the case that the deal with Vodafone, which was reached in July 2010 and which has caused concern to the Public Accounts Committee, was reached under procedures set up for the Department by the previous Government and was reached by officials without Ministers seeing the detail, because Ministers are excluded from seeing individual taxpayers' deals? If there are concerns in the House about this issue, they should be addressed to the officials responsible for that deal.

Mr Gauke: It is right, both as a correct assessment of the current situation and right in the sense that it is the right principle that Ministers are not involved in the affairs of individual taxpayers. I hope that principle—that it is not for Ministers to make decisions on the individual liability of a taxpayer—retains the support of all parts of this Committee.

With regard to the specific high-profile cases, my hon. Friend, who is a member of the Public Accounts Committee, will of course be aware of the work that Sir Andrew Park has been doing in making assessments of some of them. I understand that Sir Andrew, or the National Audit Office, will set out conclusions in the near future.

Fabian Hamilton: The Minister is absolutely correct—of course Ministers should not have a say or have any sight of any tax arrangements that are made. In that case, does he agree that it is utterly irrelevant which Government are in power, and if Government Ministers cannot influence a case—as they should not—why mention the fact that it happened to be the last Government under which the arrangements were made?

Mr Gauke: I am not attempting to make any party political point on this particular issue. It is for HMRC to administer the tax law. I believe that it seeks to do so and does so in a way that is fair and reasonable. I think that all parts of this House want to ensure that the correct amount of tax is collected, and that is the task for HMRC.

Ian Mearns: I know that the Minister will not comment on the tax affairs of an individual company, but there are some well advertised and documented cases where it seems to the man on the No. 53 Saltwell Park omnibus that some large organisations are not paying—from the perspective of the ordinary taxpayer—what would be a fair share of the overall tax burden. The problem is, and it is a problem for us all, is that that brings into question the legitimacy of the taxation arrangements that we come to as a Parliament.

Mr Gauke: The hon. Gentleman raises a number of interesting points. I will not spend long doing so, but let me make two points. First, it is of course right that everybody should pay the right amount of tax. The right amount of tax is, of course, what we determine by way of the law and taxpayers have a duty to comply with the tax law. I do not think that anyone would disagree with that and it is the role of HMRC to ensure that the right amount of tax is collected in accordance with the law.

Secondly, the hon. Gentleman makes an important point about legitimacy. There is a balance to be struck between scrutiny—ensuring that companies pay the right amount of tax—and recognising that there is sometimes a great deal of complexity in these matters. Very often, multinational companies have profits from a number of different countries and there is a question of which jurisdiction the tax should be paid in, as opposed to whether tax is paid at all. Sometimes companies have losses that they can use to set off against future profits, and very often these are quite complicated matters.

There is also a responsibility for all of us, in terms of the legitimacy of the tax system, to ensure that we choose our words carefully. Sometimes it seems to me that there have been some press reports where the allegations have been perhaps stronger than the evidence suggested.

Ian Swales: I will return to a point I raised earlier because it is more relevant to this clause. Does the Minister believe that these provisions will make it less likely that essentially UK-based companies will move their debt to jurisdictions such as Luxembourg, thereby lowering their tax bill through interest payments to what is actually a related company, with the interest receipts being taxed at the lower level in the country concerned? That practice has been highlighted in the media recently.

6.45 pm

Mr Gauke: My hon. Friend is taking me into technical measures when he asks whether the clause will have that effect. The Government's overall approach, as with previous Governments, has been to ensure that the right amount of tax, a fair amount of tax, is paid. The way that interest accountability operates is complex, so I do not want to be drawn too much on particular circumstances, although he raises an important point.

Charlie Elphicke: I thank my hon. Friend for giving way. He is generous in taking interventions and in not making party political points, which is a generosity that I do not share.

Having what the lawyers call a policy/operational dichotomy is fundamentally right. Ministers set the policy and the civil servants do the operations. Ministers cannot handle individual taxpayer cases because of the risk that they might do something that is arbitrary or unfair. That is the key principle: a separation of policy from the operations of individual taxpayers.

Nevertheless, there seems to be a lot of disquiet concerning the Vodafone and Goldman Sachs cases, and no doubt other cases, that the policy set by the previous Government seems to have been unduly lenient and allowed the Revenue to make some disgusting, cosy deals. The previous Labour Government allowed big business to rip off the tax system, and it seems to me that the policy should be reviewed. The coalition should not slavishly follow Labour's policy.

The Chair: Order. Interventions are supposed to be short; they are not supposed to be speeches.

Mr Gauke: All I will say is that Sir Andrew Park has been considering some of the high-profile cases, but there are circumstances in which it makes sense for HMRC to reach a settlement with a taxpayer, rather than going through the full process of litigation. That process, which has been in operation since 2007, has resulted in revenues that were not previously possible. Greater light will be shed on some of the individual cases in the near future. Clause 31 and schedule 5 ensure that the debt cap rules operate simply and fairly, and I hope that they may stand part of the Bill.

Question put and agreed to.

Clause 31 accordingly ordered to stand part of the Bill.

Schedule 5 agreed to.

Clause 32

GROUP RELIEF: MEANING OF "NORMAL COMMERCIAL LOAN"

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

Rachel Reeves: Clause 32 extends the definition of "normal commercial loan" to include loans that carry a right to conversion into shares or securities in quoted companies that are not connected to the company issuing the loan. I understand that that means that the group status of the company will not be affected if it issues that type of loan, because the holders of such loans are not considered to hold equity in the issuing company.

I have some specific questions for the Minister. First, will the change in definition have any knock-on effects for the commercial banking sector, and any impact on consumers, both individuals and small businesses, who take out loans as a matter of course? I presume the answer is no, but I would appreciate clarification on that point.

Secondly, if the holders of the loans covered by the clause will not be treated as equity holders, does that have any implications for the amount of risk that they hold and therefore the cost of the loans? Thirdly, will the Minister enlighten hon. Members as to how many such loans are made annually? What impact is clause 32 likely to have on the number of loans issued? Fourthly,

[Rachel Reeves]

what are the revenue implications of clause 32 and, specifically, what types of business are most likely to be affected in terms of both the size and the type of business they conduct?

The Chair: Did you wish to speak, Mr Hamilton?

Fabian Hamilton: I think, Mr Bone, that I have perhaps made the points that I wanted to raise.

Mr Hoban: This is quite a helpful clause. It is not meant to tackle evasion or some loophole. It is meant to encourage different forms of lending and to enable a situation where a lender can choose, rather than having their debt repaid in cash, to have it repaid through the issue of share capital. That is quite helpful, particularly given some of the challenges that businesses face in achieving funding. The current rules work against that in the sense that there is a risk that the issuing company may be de-grouped as a consequence of somebody else having a beneficial right to those profits. This is facilitating finance rather than working against the interests of businesses.

As the hon. Lady rightly suggested, the answer to her first question is no. With her second question she raised the capital treatment of this in the context of Basel II and then clearly Basel III and CRD4. With your agreement, Mr Bone, I will write to the hon. Lady on this. It is a technical, complex point, and I would want to come back on that. Her third question was whether this will help business. I think it will. I do not believe it will have an adverse impact on other groups. The tax impact note suggests that there is no adverse impact on small businesses. I think potentially it will help businesses. I think it will help to improve administrative processes, for example, for the issuer. It makes it easier to enter into this sort of loan agreement. It has no revenue implications and the tax impact note makes that point. I think it is a measure to be welcomed, which I think is the spirit in which she engaged in scrutiny of this clause.

Question put and agreed to.

Clause 32 according ordered to stand part of the Bill.

Ordered, That further considered be now adjourned.—*(Greg Hands.)*

6.53 pm

Adjourned till Thursday 14 June at Nine o'clock.