PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

FINANCE BILL

(Except clauses 16, 17, 43 and 45 and schedules 2 and 3)

Third Sitting

Tuesday 13 October 2015

(Morning)

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Clauses 18 to 23 agreed to, one with an amendment.
Schedule 4, as amended, agreed to.
Clauses 24 and 25 agreed to, one with amendments.
Schedule 5 agreed to.
Clause 26 agreed to.
Schedule 6 agreed to.
Clauses 27 to 31 and 33 agreed to.
Schedule 7, as amended, agreed to.
Clause 32 agreed to.
Clause 34 under consideration when the Committee adjourned till this day at Two o'clock.

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

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The Committee consisted of the following Members:

Chairs: † Sir Roger Gale, Mr George Howarth

† Baldwin, Harriett *(Economic Secretary to the Treasury)*
† Berry, Jake *(Rossendale and Darwen)* (Con)
† Burgon, Richard *(Leeds East)* (Lab)
† Burns, Conor *(Bournemouth West)* (Con)
† Caulfield, Maria *(Lewes)* (Con)
† Cummins, Judith *(Bradford South)* (Lab)
† Dakin, Nic *(Scunthorpe)* (Lab)
† Frazer, Lucy *(South East Cambridgeshire)* (Con)
† Garnier, Mark *(Wyre Forest)* (Con)
† Gauke, Mr David *(Financial Secretary to the Treasury)*
† Hall, Luke *(Thornbury and Yate)* (Con)
† Hoare, Simon *(North Dorset)* (Con)
† Kerevan, George *(East Lothian)* (SNP)
† McDonald, Andy *(Middlesbrough)* (Lab)
† McGinn, Conor *(St Helens North)* (Lab)
† Mak, Mr Alan *(Havant)* (Con)
Malhotra, Seema *(Feltham and Heston)* (Lab/Co-op)
† Marris, Rob *(Wolverhampton South West)* (Lab)
† Matheson, Christian *(City of Chester)* (Lab)
† Menzies, Mark *(Fylde)* (Con)
† Merriman, Huw *(Bexhill and Battle)* (Con)
Mullin, Roger *(Kirkcaldy and Cowdenbeath)* (SNP)
† Philp, Chris *(Croydon South)* (Con)
† Sherriff, Paula *(Dewsbury)* (Lab)
† Streeting, Wes *(Ilford North)* (Lab)
† Stride, Mel *(Lord Commissioner of Her Majesty's Treasury)*
† Thewliss, Alison *(Glasgow Central)* (SNP)
Thomson, Michelle *(Edinburgh West)* (SNP)
† Tolhurst, Kelly *(Rochester and Strood)* (Con)
† Warman, Matt *(Boston and Skegness)* (Con)

Matthew Hamlyn, *Committee Clerk*

† attended the Committee

Public Bill Committee

Tuesday 13 October 2015

(Morning)

[Sir Roger Gale *in the Chair*]

Finance Bill

(Except clauses 16, 17, 43 and 45 and schedules 2 and 3)

Clause 18

Banking companies: expenses relating to compensation

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

9.25 am

The Economic Secretary to the Treasury (Harriett Baldwin): What a pleasure it is to serve under your chairmanship this morning, Sir Roger, after our short break. I welcome the hon. Members for Wolverhampton South West and for Leeds East to the Opposition Front Bench. I hope that they remain there for a long time. I also pay tribute to the work of the hon. Members for Worsley and Eccles South (Barbara Keeley) and for Wirral South (Alison McGovern), who worked so hard in that role before the break.

The changes made by the clause mean that banks will no longer be entitled to tax relief for compensation payments made in relation to their misconduct and mis-selling. That will protect the Exchequer from banks' past management failures and ensure that the sector makes an appropriate contribution to restoring the public finances.

Let me start by providing some background to the tax rules in this area. Fines are generally treated as non-deductible expenses in calculating companies' profits liable to corporation tax. That means that the fines imposed on banks as a result of their conduct have had no direct impact on UK tax receipts; in fact, they have actually benefited the Exchequer due to a change in rules enacted by the Government. That is not the case, however, for banks' customer compensation payments. Such payments are generally treated as deductible expenses for corporation tax purposes, reflecting the fact that they are non-punitive and often the straightforward reimbursement of income on which businesses have already been taxed. As a result, compensation payments made by banks in relation to the mis-selling of financial products have, until this point, impacted directly on corporation tax receipts.

The scale of banks' compensation payments in recent years has been unprecedented. More than £25 billion has already been paid out or provided for in relation to the mis-selling of payment protection insurance, with a further £1.8 billion paid or provided for in relation to the mis-selling of interest rate products. Crucially, the exceptional levels of banking sector compensation are persisting. New PPI provisions exceeded £2 billion in the first half of 2015 alone, with cumulative provisions now well in excess of initial market expectations and continuing to grow. In that context, the Government believe that the existing tax rules have become unsustainable. It is not acceptable that post-crisis corporation tax receipts continue to be depressed by conduct failures that in some instances took place more than 10 years ago. The clause therefore makes a change to address that.

The clause makes banks' compensation payments in relation to misconduct and mis-selling non-deductible for tax purposes from 8 July 2015. That will apply to compensation material enough to have been disclosed in banks' accounts, albeit with an exclusion for compensation relating to administrative errors, system failures and the actions of unconnected third parties. The changes will also capture administrative expenses associated with that compensation, but will achieve that indirectly by requiring banks to apply a 10% uplift in calculating their non-deductible compensation expenditure. That will help to ensure that the changes are proportionate. It will also ensure that the Exchequer is protected from the large-scale compensation seen in recent years, but in a way that is administrable and recognises that banks, like other industries, will inevitably make compensation payments as part of their ordinary course of business. Overall, this is a fair and workable set of rules, which is forecast by the independent Office for Budget Responsibility to increase banks' corporation tax payments by £1 billion over the next five years.

We have already taken action to reduce the sensitivity of corporation tax receipts to losses incurred by banks during the crisis. The changes made by clause 18 now do the same in respect of banks' past misconduct and the exceptional levels of compensation it has given rise to. This is crucial in ensuring that taxpayers get a fair deal from the banking sector, which they stood behind during the crisis. I therefore commend clause 18 to the Committee.

Rob Marris (Wolverhampton South West) (Lab): What a pleasure it is to appear in Committee before you, Sir Roger. It has been a good many years. I thank the Minister for her kind words and pay tribute to my predecessors in this role, who worked hard, including on this Finance Bill. It is a particular pleasure to be shadowing the hon. Member for South West Hertfordshire. He and I have crossed swords in previous Committees—it is getting on for 10 years ago. I always think it is a bit like that Texas festival, South by Southwest—we are South West Hertfordshire and Wolverhampton South West. I look forward to our debate.

It will not surprise the Committee, and in particular my hon. Friends, that the Labour party thinks that clause 18 is rather a good idea. I will not detain the Committee for long, but I want to make one point and raise one issue. It was on this very day in 2008 that one of the major banks in this country was nationalised—I believe it was Lloyds bank. I remember, because I remarked in the Commons, as a then Government Back Bencher, that happy days were here again, because we were nationalising a bank on Margaret Thatcher's birthday. It seems to go with the zeitgeist of the current Labour party leadership.

Harriett Baldwin: On that point, I am keen to explore whether the hon. Gentleman supports that leadership.

The Chair: Order. I am going to throw the hon. Gentleman a lifebelt. That is strictly not part of the Bill.

Rob Marris: Thank you, Sir Roger. As a shadow Minister, I think the Minister knows my response.

I have a question for the Minister—one that has just occurred to me, so I hope she will indulge me, as I have not had a chance to research it. The explanatory notes seem to suggest that this clause refer to banking, but the wording seems to suggest that it refers to corporation tax and deductions for compensation. All hon. Members will be aware that the largest car company in Europe—the second largest in the world—has been doing precisely what banks were doing leading up to the crash in 2008. Starting in 2009—which shows that the capitalists never learn and need regulating—the Volkswagen Audi group has been using computer algorithms and deception to con consumers. My personal view is that the Government, with the prosecuting authorities, should look at prosecuting Volkswagen executives if there is a case to answer that they obtained pecuniary advantage by deception—a breach of section 15 of the Theft Act 1968. However, my question for the Minister is this. Would clause 18, on the deductibility or non-deductibility from corporation tax of payments made by cheating companies, cover a company such as Volkswagen if it were adjudicated formally to have cheated?

Harriett Baldwin: Let me answer the hon. Gentleman's question by agreeing that clause 18, given the way it is worded, applies only to banks. Clearly, it was introduced in response to the fact that the scale of bank compensation, to which I referred in my opening remarks, has been so significant. More than £25 billion has already been paid out, which has had a material and meaningful impact on the corporation tax receipts of Her Majesty's Treasury. We have always been clear that we want banks to make a fair contribution to their historic costs and their potential impact on future risks to the economy.

The hon. Gentleman asked about compensation relating to the Volkswagen emissions scandal, which, as he is right to highlight, is a complete scandal. There is currently no intention to extend this measure. It is obviously early days in terms of the full scale of potential actions regarding Volkswagen, in particular Volkswagen in the UK and where the company pays corporation tax. However, I can assure the hon. Gentleman that the Government reserve the right to act decisively through legislation such as Finance Bills when they need to take steps to protect the public finances.

Mark Garnier (Wyre Forest) (Con): On a point of clarification, the Minister mentioned that the costs of expenses incurred in addition to fines would also not be tax deductible. As she knows, under a section 166 agreement, the Financial Conduct Authority can ask a bank, at its own expense, to investigate an alleged misdemeanour. As I understand it from what she is saying, if that results in a fine, the section 166 cost is not tax deductible, but what would happen if it did not result in a fine and came off with a negative result? Would the section 166 undertaking be recoverable under tax?

Harriett Baldwin: My hon. Friend speaks with great insight and authority from his position on the Select Committee on the Treasury. I can explain to him that these measures are designed to tackle the material costs of compensation that are reflected, or provisioned for, in a bank's accounts. In addition to that, a further 10% for the general costs of administration is attached. Were the costs that my hon. Friend refers to significant enough to require provision in the company's accounts, they would be captured by this measure.

Question put and agreed to.

Clause 18 accordingly ordered to stand part of the Bill.

Clause 19

Banks established under Savings Bank (Scotland) Act 1819: loss allowance

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

The Chair: With this it will be convenient to discuss clause 20 stand part.

Harriett Baldwin: The changes made by clauses 19 and 20 ensure that special provisions for building societies in the loss-relief restriction legislation extend to savings banks, which share many of the same characteristics. This is a very narrowly targeted change to the legislation to ensure that it applies fairly across the sector and delivers on its stated policy objectives. Clause 20 makes a change to the definition of a bank for the purposes of bank-specific tax legislation, helping to ensure that it is aligned with regulation and delivers the intended policy outcome.

Let me start by explaining the background to clause 19. When a company makes a loss for corporation tax purposes, it is entitled to carry forward that loss and offset it against taxable profit arising in future periods. Legislation was included in the Finance Act 2015 to restrict the amount of profit that banks and building societies can offset with historical losses to 50% from 1 April 2015. This is designed to reduce the sensitivity of corporation tax receipts to losses incurred by banks during the financial crisis and subsequent misconduct and mis-selling scandals. The loss-restriction legislation includes a special provision for building societies, meaning that the restriction applies only to profits they make in excess of £25 million. That reflected a concern that the smallest building societies could otherwise be disproportionately impacted by the restriction, due to the fact that they are non-profit maximisers and reliant on retained earnings to build regulatory capital.

It has been brought to the Government's attention that this provision does not accommodate banks incorporated under the Savings Bank (Scotland) Act 1819, which share many of the same characteristics as building societies and thus have the potential to be affected in the same way. The changes made by clause 19 therefore address that by ensuring that, from its inception, the legislation applies fairly and consistently across the sector. The changes will have a negligible impact on tax receipts. The independent OBR still forecasts that the loss restriction will increase banks' tax payments by around £4 billion across the next five years, helping to ensure a fair deal for the taxpayer.

I will now turn briefly to clause 20. The Government have taken a number of steps to ensure that banks make a fair contribution to the public finances. That includes the bank levy, a tax on banks' balance sheet equity and

[Harriett Baldwin]

liabilities. The measures also include a restriction on the amount of profit that banks can offset by carried-forward corporation tax losses.

These policies, which will have raised over £30 billion in total by 2020-21, rely on there being a suitable definition of a bank within tax legislation. That definition needs to be able to take account of the differences between retail banks, investment banks and building societies. The current definition, which is based on regulatory concepts and supervision responsibilities, has been successful at targeting tax measures in accordance with the Government's policy objective. However, as part of the modernisation of financial regulation, there have been recent changes to the regulatory terms used. Clause 20 aligns the definition used within tax legislation with those changes, and so ensures that investment banks supervised by the FCA remain within the definition, in line with the stated policy objective. The amended legislation will continue to apply to the same population and will continue to operate in the same manner.

Clause 19 represents a narrowly targeted change to the loss restriction legislation to ensure that it applies consistently across similar institutions. It is consistent with existing policy and immaterial in terms of sector-wide tax receipts. Clause 20 is a technical change to the bank tax legislation to ensure that it remains appropriately targeted and appropriately aligned with regulation.

Rob Marris: We seem to be dealing with the progressive clauses early on in our proceedings. That suits me and my party rather well: we like building societies, and I suspect that, were we to know more about savings banks in Scotland, we would like them as well, because they are not driven solely by profit, but do wish to make a surplus. I therefore encourage my hon. Friends to support clause 19.

As for clause 20, I have to confess—and this will not be the last time—that some of the technical matters are beyond me, although I appreciate that there is considerable expertise on the Committee and I thank the Minister for her explanation of this technical change. I have one question for her about the clause. It is a troubling one, but she may be able to allay my fears; if she cannot, I will be encouraging my hon. Friends to abstain.

As I understand it, the effect of clause 20, if enacted, would be retrospective to 1 January 2014—that is, a year and a half before the Budget on 8 July 2015. As a lawyer and as a Member of Parliament, I am always acutely concerned about retrospective legislation. I know it happens in Finance Acts in particular; it is common to backdate things to the date of the Budget, for example, and, on occasion, to the beginning of the tax year of that Budget. However, this is the second Finance Bill this year—one hopes it will be the last—and it is concerning to have retrospectivity, even if the measure is a very technical one.

Harriett Baldwin: The hon. Gentleman is absolutely right that, where possible, we always try to ensure that this type of legislation has no retrospective effect. He is also right that that is an important principle that we apply in dealing with such Bills. However, I can reassure him that, as he will see from the impact assessment, there will be no change to the effect of the legislation in terms of its financial impact. The legislation will continue to apply to the same population as before and will continue to operate in the same manner. He is right to raise a general principle that we would seek to observe with regard to the Bill, but in this example, because the institutions in question are already being treated in this manner for tax purposes and for regulatory purposes, it is simply a case of the legislation catching up with the real world.

Rob Marris: Is the Minister suggesting, by talking about catch-up, that the regime has been acting outside the law for the best part of two years?

Harriett Baldwin: The wording in the legislation is being changed to reflect the way in which the system has been operating, and so the change will have no material or measurable impact. Given the regulatory changes that came into effect with the Finance Act 2012, the legislation was ambiguous, so I would describe the change as a clarification of the wording to provide certainty in the legislation to match what has been happening in the real world.

9.45 am

George Kerevan (East Lothian) (SNP): I welcome clause 19, which fits in with the drift of the previous discussion we had about not all banks being the same and about how treating them the same under the new levy was therefore the wrong approach. We also agreed that savings banks should be encouraged. I am happy to tell colleagues that they are not simply a Scottish invention, but grew out of the savings movement in the 19th century following the industrial revolution. Given the experience of banking in this country in recent years, the savings movement is to be encouraged at all levels.

Question put and agreed to.

Clause 19 accordingly ordered to stand part of the Bill.

Clause 20 ordered to stand part of the Bill.

Clause 21

PENSIONS: SPECIAL LUMP SUM DEATH BENEFITS CHARGE

The Financial Secretary to the Treasury (Mr David Gauke): I beg to move amendment 13, in clause 21, page 32, line 44, at end insert—

'( ) In paragraph 16 of Schedule 32 to FA 2004 (benefit crystallisation event 7: defined benefits lump sum death benefit is a "relevant lump sum death benefit")—

(a) in the first sentence, in paragraph (a), after "benefit" insert ", other than one—

(i) paid by a registered pension scheme in respect of a member of the scheme who had not reached the age of 75 at the date of the member's death, but

(ii) not paid before the end of the relevant two-year period", and

(b) in the second sentence, for "sub-paragraph" substitute "paragraphs (a)(ii) and"."

The Chair: With this it will be convenient to discuss clauses 21 and 22 stand part.

Mr Gauke: It is a great pleasure to serve under your chairmanship again, Sir Roger. I add my words of welcome to the hon. Member for Wolverhampton South West. As he said, we crossed swords in Finance Bills many years ago and I am delighted to see him back. I know that he will be an assiduous and thoughtful scrutiniser of the Bill and I am delighted to see him in place following his overdue promotion to the Front Bench. I also welcome the hon. Member for Leeds East to his Front-Bench position, as well as the hon. Member for St Helens North to the important role of Opposition Whip—although I note that the hon. Member for Scunthorpe is still present to provide any necessary words of guidance. Given his additional Front-Bench duties, that is to be commended. He clearly cannot keep away from Finance Bill debates—an attribute that both I and the hon. Member for Wolverhampton South West appear to share.

Clauses 21 and 22 will reduce the 45% tax on lump sums payable from a pension of individuals who die aged 75 or over to the marginal rate of income tax. These changes will ensure that individuals receiving taxable pension death benefits are taxed in the same way regardless of whether they receive the funds as a lump sum or as a stream of income. April this year marked the introduction of the Government's radical reforms to private pensions. The historic changes included the removal of the 55% tax charge that used to apply to pensions passed on at death. Under our reforms, lump sums payable from the pension of someone who has died before age 75 are now tax-free. That was not previously the case: the recipient of the lump sum had to pay the 55% tax if the pension had been accessed. We also reformed who can take a pension death benefit.

Individuals can now nominate anyone they want to draw down the money as pension, paying tax at their marginal rate. However, for 2015-16, individuals receiving the money as a lump sum from the pension of someone who has died aged 75 or over pay tax at a special rate of 45%. These clauses meet the Government's commitment to reduce that special rate to the recipient's marginal rate from April 2016. That will align the income tax treatment of individuals who take the money as a lump sum with those who receive it as a stream of income.

Around 320,000 people retire each year with defined contribution pension savings. Their beneficiaries could now potentially benefit. Clause 21 removes the 45% tax charge that applies when certain lump sum death benefits are paid to individuals, and clause 22 applies the marginal rate of income tax instead. The 45% tax charge will remain in place where the lump sum death benefit is not paid directly to an individual.

For individuals who have such a payment made to them through a trust, clause 21 ensures that when the money is paid out, the individual will be able to reclaim any excess tax paid. That means that they will ultimately pay tax at their marginal rate, as though they had received it directly. For many people receiving these lump sum death benefits, clauses 21 and 22 will therefore mean a reduction in the tax payable. However, we must of course safeguard the Exchequer. These clauses will therefore ensure that people who leave the UK for a short period, receive the lump-sum death benefit and then return here will not escape UK tax charges, nor will they be able to escape UK tax charges because the member transferred their pension savings overseas in the five tax years before they died. UK tax charges will still apply in such cases, to make sure that people pay the right amount of tax.

Government amendment 13 removes potential unfair outcomes for individuals who have a defined benefit, lump-sum death benefit paid to them by removing the test against the lifetime allowance where the lump sum is subject to another tax charge. That means that any such lump-sum death benefit will be subject to one tax charge only.

Clauses 21 and 22 will make the tax system fairer and ensure that individuals who receive death benefit payments from the pension of someone who dies aged 75 or over are taxed in the same way, regardless of whether the death benefit is paid as a lump sum or a stream of income.

Rob Marris: I knew that we would hit the buffers sooner or later, but I thank the Minister for his kind words. To get it out the way, it will not surprise him to know that we support amendment 13, because taxation should not happen twice. Perhaps he might tell me at some point whether this was another difficulty spotted by Mrs Gauke, who has been known to grace this Committee in the past with her insights and specialties.

Mr Gauke *indicated dissent.*

Rob Marris: The Minister says it was not.

I am uneasy, however, about clauses 21 and 22, which are twins. As I understand it—I may have misunderstood—an individual who as a beneficiary would previously have been paying tax at 45% on a windfall will in future be paying tax at their marginal rate, whether 20% or 40%. I am uneasy about that for two reasons. First, we have historically tended to impose taxes on death calculated on the estate rather than on the recipient. The inheritance tax, as you may remember, Sir Roger, became the capital transfer tax and then went back to being inheritance tax again, which is where we are now—although they are commonly called death duties. The tax payable back then was calculated on the value of the estate and the thresholds, allowances and so on relating to that. These clauses change that—perhaps the change was made in the past and I am not aware of it, which I readily concede might be the case—and tax payable will now be calculated on the tax rate of the individual beneficiary or recipient.

Secondly, this is money that has been taxed at 45%. It is a windfall. It is money that had tax relief when paid into the pension scheme and it had tax relief while that pension scheme was accumulating its funds. It now gets not tax relief, but a lowered tax rate than has hitherto been the case, dropping from 45% to 20% or 40% due to these two clauses. I am uneasy about that. My fears may be allayed if the Minister or his colleagues can clarify the matter further, but it may be that I will ask my hon. Friends to vote against these two clauses.

Mr Gauke: I am sorry that we seem to have hit the buffers quite so quickly when things were so consensual. First, there is a well-established distinction between the inheritance tax regime and the treatment of lump-sum death benefits. For example, if a spouse dies and leaves his or her estate to the surviving spouse, there is an

[Mr Gauke]

exemption and no tax is paid. There is no equivalent provision in terms of the tax on lump-sum death benefits. I take the hon. Gentleman's point, but I disagree with it. His argument does not go very far in terms of a direct analogy between the inheritance tax regime and lump-sum death benefits.

The hon. Gentleman argues that pensions are taxed on the basis of what tax professionals describe as EET—that is, exempt, exempt and then taxed. It is worth pointing out that under this regime, although pension savings are still taxed at the final stage, they are taxed at the marginal rate of the recipient. That does not mean that these sums essentially go completely untaxed—which I think is at the heart of the hon. Gentleman's concern. More fundamentally, however, I would argue that we want a savings regime that encourages people to save for their pensions and a regime with a charge of 55%—as it was not that long ago—could be seen as punitive. In the circumstances that apply in this case, it is not unreasonable that there should be consistency in the tax treatment of these pension funds, regardless of whether payments are made as a lump sum or a stream of income.

I do not know whether I have succeeded in persuading the hon. Gentleman of the case for this, but I would argue that these provisions make our tax system fairer. They ensure that individuals receiving taxable pension death benefits are taxed in the same way, regardless of whether they receive the funds as a lump sum or as a stream of income. I therefore hope that clauses 21 and 22 can stand part of the Bill.

Amendment 13 agreed to.

Clause 21, as amended, ordered to stand part of the Bill.

Clause 22 ordered to stand part of the Bill.

Clause 23

PENSIONS: ANNUAL ALLOWANCE

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

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

Government amendments 14 to 21.

That schedule 4 be the Fourth schedule to the Bill.

Mr Gauke: Clause 23 and schedule 4 ensure that the cost of pensions tax relief is fair, manageable and affordable. These changes will restrict the benefits of pensions tax relief for the highest earners by tapering away the annual allowance for those with an income, including pension contributions, of more than £150,000. Amendments 14 to 21 were drafted in response to industry feedback on the legislation for this schedule, which was published before the recess. They will ensure that an aspect of the transitional legislation providing an administrative easement for defined benefit schemes works as intended.

Pensions tax is one of the Government's most expensive reliefs. In 2013-14, the cost to the Exchequer of income tax relief for pensions was more than £34 billion. This has increased from £17.6 billion in 2001. About two-thirds of pensions tax relief currently goes to higher and additional rate taxpayers, and around 15% of the tax relief in 2013-14 went to those with an income of more than £100,000. In the last Parliament we took steps to control that cost and ensure that pensions tax relief is appropriately targeted. These provisions take further steps to achieve that. They are focused on the wealthiest pension savers, to ensure that the benefit they receive is not disproportionate to that of other pension savers.

The annual allowance is the limit placed on the amount of tax-relieved pension saving that can be made by an individual each year. It is currently set at £40,000. The clause introduces a tapered reduction in the amount of the annual allowance for individuals with an income, including the value of any pension contributions, of more than £150,000. The taper, which will have effect from 6 April 2016, will be at the rate of £1 for every £2 of income that exceeds the £150,000 threshold, down to a minimum of a £10,000 annual allowance. To provide further certainty about who is affected by the change, the clause also provides that those who have incomes excluding pension contributions of £110,000 and below are not affected by the reduced annual allowance.

10 am

Finally, schedule 4 introduces changes to ensure that individuals and the industry can adjust easily to the tapered reduction. Part 1 aligns pension input periods—the periods over which pension savings are measured for the purposes of the annual allowance—with the tax year. Parts 2, 3 and 5 contain transitional rules to protect savers who might otherwise be adversely affected by the alignment of their pension input periods. That will also simplify the process for scheme administrators to calculate pension savings for the transitional year.

In response to industry feedback on the legislation, the Government have tabled amendments 14 to 21. These are minor amendments to ensure that the transitional easement works as intended for deferred members. The changes made by the clause will potentially affect just 1% of taxpayers who save into a pension and even fewer will have to change their pension-saving behaviour or face an allowance charge. We expect only about 150,000 individuals in total to be directly affected by the clause.

The clause will ensure that the cost of pension tax relief is controlled. It introduces a tapered reduction in the annual allowance and implements that change in as fair a way as possible. It will save about £1.3 billion a year by 2020 and more than £4 billion over the next five years.

Rob Marris: I regard the amendments as technical changes that smooth the transition periods for the input year and tax year. I have to say that I am delighted by the clause. Many years ago, I was a lone voice in Parliament calling for a restriction of tax relief on pension contributions. As the Minister quite rightly said, it cost almost £18 billion a year in 2001 and that figure has shot up.

When I asked the Department for Work and Pensions—in 2003 or 2004—what evidence there was that tax relief on pension contributions encouraged people to save for a pension, the DWP had no such evidence. To me, that was shocking for a tax relief that

then cost £18 billion a year. In a sense, the Government were spending, through forgone income, to encourage a pattern of behaviour when there was no evidence that they were encouraging such behaviour. I salute this Government for grasping that nettle.

The other reason I oppose pension tax relief—the Minister generously adverted to this today and clarified for the Committee—is that it has hitherto been incredibly regressive. When I raised this matter 10 or 12 years ago, it was even more regressive. The proportion being claimed by higher and additional rate taxpayers is now down to two thirds; it used to be about 90%. It was astounding to me that a Labour Government—a socialist Government in name—would continue with a tax measure that did not do what it was designed to do and which favoured the very well-to-do. We then had my hon. Friend Ruth Kelly, then Member for Bolton and, I think, Financial Secretary to the Treasury, introducing the nonsense of the annual allowance. It was completely bodged, as the Finance Bill Committee at the time, on which I sat, pointed out to her.

I still think there is a question mark over the whole concept of pension tax relief system for pension contributions, but this measure is progressive and, I have to say, it is somewhat to my surprise that the Government and their predecessor have now grasped the nettle twice. I urge my hon. Friends enthusiastically to support the clause.

Question put and agreed to.

Clause 23 accordingly ordered to stand part of the Bill.

Schedule 4

PENSIONS: ANNUAL ALLOWANCE

Amendments made: 14, in schedule 4, page 99, line 43, leave out "227B(2)" and insert "227B(1)(b) and (2)".

Amendment 15, in schedule 4, page 100, line 10, leave out "section 227ZA(1)(b)" and insert

"each of sections 227ZA(1)(b) and 227B(1)(b)".

Amendment 16, in schedule 4, page 100, line 14, leave out "section 227ZA(1)(b)" and insert

"each of sections 227ZA(1)(b) and 227B(1)(b)".

Amendment 17, in schedule 4, page 103, line 3, at end insert—

"Exceptions in certain cases where individual is deferred member of scheme

(6A) Subsections (3) to (5) do not apply, and subsections (6B) and (6C) apply instead, if—

(a) because of section 238ZA(2), a pension input period for the arrangement ends with 8 July 2015,

(b) another pension input period for the arrangement ends with a day ("the unchanged last day") after 5 April 2015 but before 8 July 2015, and

(c) section 230(5B) or 234(5B), when applied separately to each of—

(i) the pension input period for the arrangement ending with 8 July 2015, and

(ii) the pension input period for the arrangement ending with 5 April 2016,

gives the result that the pension input amount in respect of the arrangement for each of those periods is nil.

(6B) The pension input amount in respect of the arrangement for the post-alignment tax year is nil.

(6C) The pension input amount in respect of the arrangement for the pre-alignment tax year is the amount which would be the pension input amount in respect of the arrangement for the pre-alignment tax year if—

(a) the pension input period ending with the unchanged last day were the only pension input period for the arrangement ending in the pre-alignment tax year, and

(b) subsections (3) to (5) were ignored."

Amendment 18, in schedule 4, page 103, line 4, after "Modifications", insert "in some other cases".

Amendment 19, in schedule 4, page 103, line 44, at end insert—

"Modification where last input period ends before 9 July 2015

(11A) If the last pension input period for the arrangement ends after 5 April 2015 but before 9 July 2015—

(a) the time-apportioned percentage for the post-alignment tax year is treated as being nil, and

(b) the time-apportioned percentage for the pre-alignment tax year is treated as being 100."

Amendment 20, in schedule 4, page 103, line 46, at end insert—

"() subsections (6B) and (6C) do not apply,".

Amendment 21, in schedule 4, page 104, line 7, after "period", insert

"(for this purpose treating that remainder as a single pension input period if not otherwise the case)"—*(Mr Gauke.)*

Schedule 4, as amended, agreed to.

Clause 24

RELIEF FOR FINANCE COSTS RELATED TO RESIDENTIAL PROPERTY BUSINESSES

Mr Gauke: I beg to move amendment 22, in clause 24, page 36, line 23, leave out

"a property business carried on by a company"

and insert

"calculating the profits of a property business for the purposes of charging a company to income tax on so much of those profits as accrue to it".

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

Government amendments 23 to 26.

Clause stand part.

Mr Gauke: Clause 24 makes changes to ensure that all individual residential landlords get the same rate of tax relief on their property finance costs. This change will make the tax system fairer. Landlords with the largest incomes will no longer receive a more generous tax treatment. The distortion between property investment and investment in other assets will be reduced, and the advantage landlords may have over those who work hard to save for a deposit in order to own their own home will be minimised.

Let me begin by setting out the problem that the clause remedies. Landlords are able to offset their finance costs, such as mortgage interest, from property income when calculating their taxable income, reducing their tax liability. At present, the relief they receive from this is at the marginal rate of tax. That means that landlords with the largest incomes benefit the most from the relief, receiving relief at the higher or additional rates of

[Mr Gauke]

income tax—40% or 45%—whereas landlords with lower incomes are able to benefit from relief only at the basic rate of income tax, which is 20%. In contrast, owner-occupiers of properties do not get any tax relief on their mortgage costs, and finance cost relief is also not available to individuals investing in other assets, such as shares in public companies. That creates a distortion between property investment and investment in other assets.

Clause 24 will reduce the inequity by restricting finance cost relief to the basic rate of income tax—20%—for all individual landlords of residential property. It will unify the tax treatment of finance costs for such landlords, including individual partners of partnerships and trusts. The change will ensure that landlords with the largest incomes no longer benefit from more generous rates of relief.

The Government recognise that many hard-working people who have saved and invested in property depend on the rental income they get, so the clause is being introduced in a proportionate and gradual way. The restriction will be phased in over four years from April 2017, ensuring landlords have time to plan for the change.

The Government have tabled five amendments to the clause. Amendment 22 ensures that all companies are excluded from the restriction, even when carrying on a property business in partnership. Amendments 23 to 26 ensure that where a trustee's finance cost deduction is restricted, basic rate relief is available to trustees with accumulated or discretionary income.

Only one in five individual landlords are expected to pay more tax as a result of this measure. The Government do not expect the change to have a large impact on either house prices or rent levels due to the small overall proportion of the housing market affected. The Office of Budget Responsibility has endorsed this assessment. It believes that the impact on the housing market will be small and, taking account of the other measures in the Budget, has not adjusted its forecast for house prices. By April 2020, only 10% of individual landlords will see a tax bill increase greater than £500.

The clause will make the tax system fairer. It will restrict the amount of tax relief landlords can claim on property finance costs to the basic rate of tax, thus ensuring that landlords with the largest incomes no longer receive the most generous tax treatment. It will also reduce the distorting effect that tax treatment of property has on investment and the advantage landlords may have in the property market over owner-occupiers.

Rob Marris: The amendments, as far as I can tell, are technical measures to smooth things out. As ever, these things come out in the wash, whether it is Mrs Gauke or someone else who spots them.

It is likely that I will ask my hon. Friends to support the clause but I want to probe the Government on it. As the Minister knows, this is one of the higher profile clauses in the Bill and has attracted a rather large postbag. Some landlords—not all—are concerned.

I appreciate that any landlord among the one in five paying more tax under the provision has almost two years from 8 July to April 2017 to sell the property if they wish to do so, so that they are not boxed in with de facto retrospective action, which can happen if there is only three months in which to sell. I salute the Government for giving that transition time.

I am surprised to hear that only one in five landlords will be affected, but the Government and the OBR have done their research. I am concerned that the measure will do nothing for house prices, which is perhaps a debate for another day. Would that it would bring down house prices, which are far too high around the country. Those prices might well get higher when pensioners, under the Government's freedoms, buy not Lamborghinis but houses with the money freed from their pension funds.

Mark Garnier: I have a small amount of sympathy with the view that house prices are too high, but is the hon. Gentleman genuinely advocating that the principal method of saving for most people in this country should be reduced in value? The effect on households would be astronomically catastrophic if one were to start reducing house prices. Is that part of his policy?

Rob Marris: Yes, I would like house prices to come down; they are far too high. For most people, property is not an asset that is any good to them until they die—in which case, of course, it is no good to them. The house I live in is worth roughly eight times what we paid for it 30 years ago. That is almost entirely a windfall, though some of it is due to improvements we have made. I will not take long on this, Sir Roger, because I know you do not want us to be too diverted, but were my wife and I to move, we would have to pay an equivalent sum for something else. Yes, house prices are far too high but they will come down when the Government do their bit by increasing the supply of houses.

Meanwhile, returning to clause 24, this is the issue on which I wish to probe the Minister. I may have misunderstood these technical matters because I am not an accountant, but I believe the buy-to-let income accruing to the landlord is counted as income for income tax purposes. There will therefore be some landlords—perhaps the Government have figures—who, before this change, when their non-buy-to-let income, perhaps from a job, was added to their buy-to-let income were standard rate taxpayers, but who will become higher rate taxpayers after the change is made. Therefore, that group may end up paying considerably more tax.

It is not simply a question of landlords who are already 40% taxpayers because of other income being levelled, as it were, to 20%, which is what I understand the clause is designed to do. That is understandable. However, it would actually be promoting people—pushing them into a higher rate tax bracket—and therefore they would be losers. Does the Minister have any figures on that "in between" group—a rather maladroit phrase, but the Minister will understand what I mean—who will be pushed up. I hope that, now he has the piece of paper, he will be able to elucidate that point for the Committee. As I say, my inclination is to support the measure, but I am concerned about that cohort who may be suddenly treated in a slightly different way, which may mean that the figure of one in five the Minister quoted is somewhat low.

10.15 am

Mr Gauke: I hope I will be able to welcome the support of the Opposition for the clauses in full, although the hon. Gentleman is quite right to ask scrutinising questions.

We are not making any claims about the effect on house prices. The OBR's assessment is that the impact on the housing market will be small and it has not adjusted its forecast for house prices. The answer to the issue of house prices is improvement in supply—I suspect the hon. Gentleman would agree—so it is worth pointing out that housing starts are at a seven-year high. However, the Government remain focused on putting the right conditions in place so that we build more houses and more people have the opportunity to own their own home.

Christian Matheson (City of Chester) (Lab): The hon. Member for Wyre Forest made the interesting point that home ownership is the principal form of saving for most people in this country—I hope I am not misrepresenting him, Sir Roger. Do the Government share that view?

Mr Gauke: It is up to individuals to decide how they wish to save. We are determined to ensure that the opportunity to own one's own home is available to as many people as possible. That requires us to increase the supply of homes in this country, and that is a Government priority. We are moving in the right direction, but, as we set out during the Conservative party conference last week, we want to do more to put in place the conditions wherein more people will have that opportunity.

On the impact of the changes, there was a question about whether the measures might move a basic rate taxpayer into the higher tax band. We expect that around 94% of landlords who will have to pay more tax will have a total taxable income of over £35,000. On average, landlords own 2.7 properties. Those currently with taxable income under £35,000 who will have to pay more tax have, on average, larger rental incomes and larger property portfolios; they have an average pre-tax rental income of more than £64,000, and own six properties. It is true that basic rate taxpayers could be affected by the measures, but often—not in every case, but overwhelmingly—those people will have quite large portfolios and may have leveraged up to a greater extent than the typical buy-to-let landlord.

I hope that clarification has been helpful to the Committee, and that the measures will have the Committee's support.

George Kerevan *rose—*

The Chair: Order. I will make an exception in this case, but, as a matter of form, ordinarily when I call the Minister to wind up the debate, that is it. If the hon. Gentleman wishes to intervene, he needs to be a little more spritely in leaping to his feet.

George Kerevan: Forgive me, Sir Roger. I am concerned about a sub-class of property owners in rural areas who might have unincorporated businesses on farms. They often rely on rented accommodation as part of the diversification of their business. I am concerned that one of these changes will make that more difficult for them, as they will be penalised, albeit unintentionally, with regard to investing in their property as part of a farm business. They might also be penalised with regard to their ability to make relevant commercial deductions for investment loans. In rural areas, property is quite often mortgaged less as part of a buy-to-let and more as part of the general farm business. Will the Minister comment on that?

Mr Gauke: The same principles apply to rural landlords as apply across the board. We want to ensure fairness in how interest deductibility applies: the same rate should apply across the board. In terms of whether businesses will be able to secure loans against property for business development, the measure will apply to restrict relief for borrowings used for the purpose of residential property businesses, not to borrowings secured against residential properties that are used for the development of other business. I hope that that reassures the hon. Gentleman and, again, I commend the clause to the Committee.

Amendment 22 agreed to.

Amendments made: 23, in clause 24, page 37, line 18, leave out "finance costs" and insert

"costs of a dwelling-related loan"

Amendment 24, in clause 24, page 37, line 19, leave out

"non-deductible costs of a dwelling-related loan"

and insert "individuals"

Amendment 25, in clause 24, page 38, line 26, at end insert—

"274B Tax reduction for accumulated or discretionary trust income

(1) Subsections (2) to (4) apply if—

(a) an amount ("A") would be deductible in calculating the profits for income tax purposes of a property business for a tax year but for section 272A,

(b) the trustees of a particular settlement are liable for income tax on N% of those profits, where N is a number—

(i) greater than 0, and

(ii) less than or equal to 100, and

(c) in relation to those trustees, that N% of those profits is accumulated or discretionary income.

(2) The trustees of the settlement are entitled to relief under this section for the tax year in respect of an amount ("the relievable amount") equal to N% of A.

(3) The amount of the relief is given by—

BR × L

where BR is the basic rate of income tax for the year, and L is the lower of—

(a) the total of—

(i) the relievable amount, and

(ii) any difference available in relation to the trustees of the settlement and the property business for carry-forward to the year under subsection (4), and

(b) the profits for income tax purposes of the property business for the year after any deduction under section 118 of ITA 2007 ("the adjusted profits") or, if less, the share of the adjusted profits—

(i) on which the trustees of the settlement are liable to income tax, and

(ii) which, in relation to the trustees of the settlement, is accumulated or discretionary income.

(4) Where the amount ("AY") of the relief under this section for the year in respect of the relievable amount is less than—

BR × T

where BR is the basic rate of income tax for the year and T is the total found at subsection (3)(a), the difference between—

[Mr Gauke]

(a) T, and

(b) AY divided by BR (with BR expressed as a fraction for this purpose),

is available in relation to the trustees of the settlement and the property business for carry-forward to the following tax year.

(5) In this section "accumulated or discretionary income" has the meaning given by section 480 of ITA 2007."

Amendment 26, in clause 24, page 40, line 3, at end insert—

'( ) In section 26(2) of ITA 2007 (tax reductions deductible at Step 6 of the calculation in section 23 of ITA 2007 in the case of taxpayer who is not an individual), before the "and" at the end of paragraph (a) insert—

"(aa) section 274B of ITTOIA 2005 (trusts with accumulated or discretionary income derived from property business: relief for non-deductible costs of dwelling-related loans),".—*(Mr Gauke.)*

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

Clause 25

ENTERPRISE INVESTMENT SCHEME

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

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

That schedule 5 be the Fifth schedule to the Bill.

Clause 26 stand part.

That schedule 6 be the Sixth schedule to the Bill.

Clause 27 stand part.

Mr Gauke: These clauses and schedules will make changes to the rules for the enterprise investment scheme and venture capital trusts. I will discuss clause 27 after dealing with the rest of the group.

The changes will ensure that the schemes are brought into line with new state aid rules, which came into force in January 2015. They will ensure that the schemes continue to be well targeted towards companies that need investment to develop and grow, and they will provide for greater levels of support for innovative, knowledge-intensive companies, which play a key part in economic growth.

The UK has put forward a very strong case for schemes that go beyond the general block exemption regulations, and to support that we commissioned independent academic research into the UK equity gap. I am pleased to be able to announce that the Commission has now given its approval for the schemes. The UK is the first member state to negotiate an approval beyond the basic EU rules. That secures the long-term future of the schemes and will mean that they continue to support companies that need funding to develop and grow.

EIS and VCT have been supporting small companies to access finance for more than 20 years. The schemes provide generous tax incentives to encourage private individuals to invest in higher risk small and growing companies that would otherwise struggle to access finance from the market. The changes made by clauses 25 and 26 and schedules 5 and 6 will ensure that the schemes are state aid compliant and that they offer support in line with the latest evidence of market failure. They will mean that additional support is provided for knowledge-intensive companies that are particularly likely to struggle to access finance.

The changes include the following provisions. Knowledge-intensive companies will need to have received their first investment through the schemes no later than 10 years after their first commercial sale, and may receive up to £20 million of tax-advantaged risk finance investment. Other qualifying companies must receive their first investment through the schemes no later than seven years after their first commercial sale, and may receive up to £12 million of tax-advantaged risk finance investment. The age limits will not apply where the investment represents more than 50% of turnover averaged over the previous five years, or where follow-on funding is being raised.

Companies will no longer be able to use money raised through EIS and VCT to acquire existing businesses, whether through asset purchase or share purchase, building on rule changes introduced in 2012 to prevent the use of EIS and VCT money to acquire other companies through a share purchase. The rules will also apply to non-qualifying VCT holdings, as well as investments by VCTs of funds raised before 2012. The employee limit for knowledge-intensive companies will be increased to 500, providing further support to innovative firms. All EIS investors will be required to be independent from the company unless the shares they already hold are founders' shares. The requirement that 70% of seed enterprise investment scheme money must be spent before EIS or VCT funding can be raised will be removed, smoothing the interaction between the schemes. It will also be required that all investments be made with the intention to grow and develop a business.

The Government have been consulting on the majority of the rule changes since last year. A consultation was held last summer to explore how the schemes were working in practice and to gather evidence. The Government are grateful to everyone who provided evidence. Many examples were used in the state aid discussions with the European Commission. Draft legislation, based on discussions with the European Commission up to that point, was published in March for a technical consultation. A response to last summer's consultation was published at the summer Budget. Throughout, my officials have been working closely with members of the industry and their representatives, including through a legislative working group. Many of the changes to the draft legislation first published in March, including amendments to be introduced on Report, arise from those discussions. We are grateful for the industry's support, which it is continuing to give, including on developing the guidance in due course.

The Government will be tabling a number of amendments on Report to cover a number of areas. Most of the amendments are technical in nature and will ensure that the detailed rules work as intended, and that the new rules work correctly with the existing provisions. I would like to use this opportunity to address a point that has been raised with me by EIS and VCT investors and managers concerning the use of the schemes for replacement capital. Replacement capital is the purchase of shares from existing shareholders and is not currently allowed within the schemes. The Government are keen to provide increased flexibility when the amount

invested in newly issued shares is at least equal to the amount invested in secondary shares. The change will be introduced through secondary legislation at a later date, subject to state aid approval.

The Government are securing the long-term future of the schemes by making these changes, which will also ensure that the schemes remain well targeted and provide value for money for the taxpayer. I understand the impact that these changes will have on the way that some VCTs and EIS investors operate. Those that have specialised in investing in older, more established companies, often through management buy-outs, will be affected in particular. The Government expect that fundraising will be reduced in the 2015-16 tax year owing to the adjustment to the new rules, but also that it will recover as existing VCTs adapt and new VCTs enter the market. The Government are encouraged by recent reports from industry commentators that the industry is confident the changes can be managed and that they may help new VCTs focused on early stage businesses to enter the market.

Based on current trends, over 90% of companies seeking investment through the schemes will be unaffected by the changes to the scheme limits. Any start-up or early stage company seeking finance to grow that already meets the current rules will not be affected by the changes. Of course, EIS and VCT are only two of the many schemes that the Government provide to support small businesses. The Government also provide support through other schemes such as the angel co-investment fund, enterprise capital funds, the venture capital catalyst fund and the business growth fund to help businesses to access the finance that they need to develop and grow.

Clause 27 corrects a technical flaw that allows farming activities outside the UK to qualify for tax relief under the venture capital schemes and for enterprise management incentives. The venture capital schemes in question are the enterprise investment and seed enterprise investment schemes, and venture capital trusts. Farming activities have always been excluded from the scope of the venture capital schemes and EMI. Indeed, farming activities were excluded from the business expansion scheme that preceded the enterprise investment scheme from 1984.

10.30 am

Farming benefits from subsidies under the common agricultural policy. It would be unreasonable to provide extra Government subsidies under the venture capital schemes and EMI. The Income Tax Act 2007 defines farming for the purposes of the venture capital schemes and EMI in relation to activities carried out in the UK only. The provision had no effect when it was introduced. At that time, all activities under those schemes had to be carried out wholly or mainly in the UK. However, in 2010 the rules for the venture capital schemes and EMI were changed to take account of state aid rules. The changes allowed activities to be carried on outside the UK, subject to the company having a permanent establishment in the UK, but the definition of farming in the Income Tax Act 2007 was not changed to align with the new rules. The effect is that farming activities carried on outside the UK have qualified for tax relief under the venture capital schemes and EMI since 2010. That is clearly an oversight; it recently came to light and we are now correcting it.

Clause 27 will repeal a restriction on the definition of farming as an activity carried on within the UK. The restriction applies only to the venture capital schemes and EMI. The definition of farming will become the same for all income tax purposes and there will be no geographic boundaries. The effect of the change will be to stop farming activities carried on outside the UK qualifying for relief under the venture capital schemes and EMI. Farming will be an excluded activity wherever it is carried on. This was an obscure provision that interacted with the main scheme rules. In practice, only a handful of non-UK farming cases benefited from the reliefs and the costs have been negligible. Clearly it was never intended that farming should be a qualifying activity for venture capital schemes or EMI, and I hope that the clause will be a welcome correction.

The Government's priority throughout has been to ensure the long-term future and sustainability of EIS and VCTs. The schedules make changes to ensure that they can continue to support small and growing companies to get access to the finance they need to develop and grow. The schemes will continue to be well targeted, effective and in line with state aid rules and the latest evidence on the equity gap. As I mentioned earlier, the Government will table amendments on Report to ensure the rules work smoothly, and there will be a further opportunity for debate.

Rob Marris: I welcome the continuation of a Labour scheme from 2007 in clauses 25 and 26, and the refinement of the scheme. I congratulate the Government on securing approval from the European Commission, which has been in question for some time. That is also a replay—we will get on to this—of what happened in 2010 with farming.

I am pleased that the employee limit will be raised—to 500, I think the Minister said. That is helpful. I thank the Minister for the teaser he gave us on two occasions for the amendments to be tabled on Report, which we look forward to with excitement. I am pleased that the EIS and VCT schemes are not to be used to take over existing businesses, because that would undercut their whole raison d'être. However, in the light of that, I am a little concerned about what the Minister said about using the schemes for replacement capital. Prima facie, that is not what the schemes are intended to do, which is to kick-start and help to grow knowledge-based, innovative industries—hence the exclusion, for example, of farming. That replacement capital, of course, would keep such a business going, but in a sense it is not new money, because it is, as its title suggests, replacement capital. I am concerned about that point. We must focus on the tax relief and why it is being given.

I am pleased about clause 27. It concerns a scheme brought in by the last Labour Government—and happily continued by the coalition Government and, now, the current Government—to encourage investment in cases of market failure, and it shows that people will look for loopholes. The Minister adverted to market failure, which is also helpfully mentioned in the explanatory notes. Indeed, let me take this opportunity to pay tribute to those who compile the explanatory notes. I am sure it is a big team and they do an excellent job; the notes are very helpful. [Hon. Members: "Hear, hear!"] Would that this Government and their predecessors were a little more alert to market failure on a broader

[Rob Marris]

canvas—for example, in the energy industry. That is one of the things my party is very keen on: using the levers of the state to address market failure.

This small scheme, which is being continued from the Labour scheme in 2007, is of course to do with market failure, but when it comes to farming, it shows just how cunning these tax accountants are at coming up with loopholes. As I understand it, there was no loophole for the three years before 2010. Then the European Union made a ruling on certain aspects of state aid, which meant that a company could not be wholly or mainly a UK company in terms of its operations. Lo and behold, we have a few companies—I think that the Minister's noun was "handful"—who exploit this to carry on farming activities outside the UK, claiming tax reliefs through EIS and VCT. Had they been carrying out farming activities within the UK from the inception of the scheme in 2007, they could not have claimed that tax relief. Wow, are they cunning! They have been getting with away with it, doing something quite legitimate and lawful, as I understand it—it is avoidance, not evasion—for five years.

Of course, some aspects of farming are very knowledge-based and innovative, but that is not what these schemes are focused on, and this example underlines how vigilant we all need to be as parliamentarians about these cunning tax avoiders. The Minister and his colleagues spent years in opposition decrying my Government for an increasingly long tax code, as shadow Ministers used to call it—although that is an Americanisation, just as they pronounce leverage the American way, rather than using the proper English pronunciation. We will come to the issue of our tax legislation being so long and complicated later, but this is just one minor example of where we have to introduce anti-avoidance provisions because these experts are so cunning with their tax avoidance. I am therefore very pleased about clause 27.

Mr Gauke: I thank the hon. Gentleman for his support for these clauses. He essentially raised two points. First, he raised his concern about whether replacement capital was consistent with the rationale behind these schemes. Let me provide what I hope is some reassurance. The intention is for replacement capital to be available only where there is significant new investment in the company. That will be subject to state aid approval, but there are circumstances where it may be necessary as part of any new investment for there to be some re-organisation of capital. That is what we are getting at in this clause. Our intention is to come forward with secondary legislation on this point, and I look forward to the opportunity to debate this with the hon. Gentleman in detail when we do so.

I welcome the hon. Gentleman's support for clause 27. It is always disappointing when a technical flaw is found in legislation, especially after a few years. It came to light only recently and we are correcting it as quickly as we can. It arises from a fairly obscure interaction between the main scheme rules and the definition elsewhere in the Taxes Act. Very few cases of farming outside the UK have received tax reliefs under the schemes.

On that point, the most information I can provide to the Committee is this. HMRC does not keep a record of tax reliefs by reference to the activities of the company. However, HMRC's operational staff can recall seeing no more than half a dozen or so applications a year, most of which were rejected because the company failed to meet all the requirements. The number of cases that have received relief is small, as I said earlier. Given those points of clarification, I hope the Committee is happy with these measures, and I hope they stand part of the Bill.

Question put and agreed to.

Clause 25 accordingly ordered to stand part of the Bill.

Schedule 5 agreed to.

Clause 26 ordered to stand part of the Bill.

Schedule 6 agreed to.

Clause 27 ordered to stand part of the Bill.

Clause 28

Travel expenses of members of local authorities etc

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

Mr Gauke: The clause makes changes to allow tax relief for councillors on expenses paid by a local authority for home-to-work travel. Councillors perform an important constitutional role in representing communities across the United Kingdom. They carry out their role in their own time, often in addition to other professional and personal commitments, and most receive no payment other than allowances in recognition of the time and expenses they incur. The current rules enable councillors to claim tax relief for business journeys. Where councillors routinely see their constituents at the councillor's home, tax relief is also due for travel between their home and council offices. However, changes in working practices mean that fewer councillors now see constituents at home, so most are no longer eligible to relief for home-to-work journeys. The Government do not think that is fair. We want to ensure that no one is discouraged from undertaking a role as a councillor due to the tax treatment of their travel expenses. Clause 28 will achieve that aim by introducing a clear, statutory exemption.

The changes made by the clause will exempt travel expenses paid to councillors from income tax, including journeys between a councillor's home and permanent workplace, where the councillor lives in the local authority area or within 20 miles of its boundary. Secondary legislation will be used to introduce a matching disregard for national insurance contributions. The exemption will apply only where qualifying payments are made by a local authority for travel expenses incurred either on public transport or where a councillor uses their own vehicle for travel.

To ensure that councillors do not benefit from an unlimited tax relief, the exemption will be limited to the statutory approved rates where qualifying payments are made to a councillor for travel in their own vehicle. This will make the rules clearer and more consistent for local authorities and councillors. The measure will affect only the tax liability of elected or appointed councillors who currently receive taxable home-to-work travel expenses.

Wes Streeting (Ilford North) (Lab): How many councillors does the Minister anticipate will benefit from these changes?

Mr Gauke: I think the numbers are difficult to calculate because they will depend on the particular arrangements that councillors wish to pursue and whether they claim or not. We received representations from a large number of councils—particularly county councils—that said the change would be welcomed.

Wes Streeting: I should have said that I am still an elected member of the Redbridge London Borough Council, albeit an unpaid one. The reason I ask is that, although I agree with the Minister's case about fairness to local councillors, I wonder how he squares that with, for example, the changes the Government made to local government pensions, which meant that such people—in particular, leaders, mayors and cabinet members, who often give up their full-time work—are no longer eligible for the local government pension scheme. Surely these changes, which I do not think will apply to many authorities because many do not reimburse councillors for any journeys, are pretty small beer compared with the previous Government's changes.

10.45 am

Mr Gauke: I do not know if the hon. Gentleman is advocating reversal of the changes made in the previous Parliament to pensions for councillors. I would argue that there is a degree of consistency with those changes. Councillors do not perform a job in the normal sense of most people in employment, so we argued in the previous Parliament that for them to have the same pension provision as most employees would not be appropriate. It is right to have a special regime that is not the same as that applied to people in employment with regard to travel expenses, and that is why we have brought in this measure.

Simon Hoare (North Dorset) (Con): Following on from the intervention by the hon. Member for Ilford North, I spent 11 years as a district councillor and several of those in cabinet. There always seemed an anomaly to me. I never joined the local government pension scheme and I always thought it was rather incorrect for councillors to be allowed to do so, because it equated their position with that of local government staff, rather than elected volunteers. The Government are to be congratulated. There were many in local government—possibly the silent majority—who welcomed that decision and had been rather embarrassed by being allowed to be members of that pension fund.

Mr Gauke: My hon. Friend makes a good point. It is not my purpose to reopen the debate on pensions and local councillors, however tempting that might be, but I am grateful for my hon. Friend's intervention.

The clause will support councillors in the vital constitutional role they perform by exempting travel expenses paid by their local authorities from liability to income tax, and I hope it will stand part of the Bill.

Rob Marris: I do not propose to spend a long time on this. I have never been a councillor but it would be seen as navel gazing for us as elected representatives to spend a long time on this clause. The Opposition support the clause because we want to encourage democracy and so that democratic parties can get the best candidates, and this measure is all part of that spectrum.

I would like the Minister to clarify one point. He referred to journeys by public transport. I apologise that I was not concentrating enough when he made that reference. My understanding from the Chartered Institute of Taxation is that this change would not cover travel by public transport. If public transport travel is not covered, will the Minister please explain why? Will he also say whether, for example, a mayor who travelled by bicycle might claim these expenses?

Mr Gauke: I am grateful to the hon. Gentleman for his support for the clause. It is always good to see a consensus on supporting democracy. As I said earlier, the provision does apply to public transport, so the hon. Gentleman can be reassured that there is nothing that would discourage people using public transport. The provision will apply to public transport or where a councillor uses their own vehicle.

Rob Marris: Bicycle?

Mr Gauke: I am afraid that I do not think that the travel expenses regime will apply to bicycling. I sense that the hon. Gentleman has his first campaigning issue to get his teeth into as a Front Bencher.

Question put and agreed to.

Clause 28 accordingly ordered to stand part of the Bill.

Clause 29

London Anniversary Games

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

Mr Gauke: The clause makes changes to ensure that sports people who visited the UK to compete in the London Anniversary games are exempt from tax on any income received as a result of their performance at the games.

As hon. Members will know, the London 2012 Olympic and Paralympic games were an extraordinary success, with stunning wins for British athletes, beautiful stadiums and an unforgettable atmosphere. For the Olympics, the Government provided an exemption from income tax for non-resident sportspersons. That was a condition of the bid to host an internationally mobile, world-class event.

The success of the 2012 Olympics and Paralympics did not end there: we have now created a legacy programme that has delivered urban regeneration and engagement in sporting activities. The prestigious 2015 London Anniversary games were an important part of that legacy, attracting icons that hon. Members will remember from 2012.

The clause applies the same exemption policy that the Government provided in 2012. It benefits athletes who reside overseas and visited the UK to participate in the London Anniversary games, which were held in July. Importantly, this tax exemption encouraged more world-class international athletes to compete in the event. Following the announcement in the Budget, Usain Bolt

[Mr Gauke]

confirmed that he would compete and he went on to win the 100-metre race, which drew a much wider audience's attention to the success of the Olympics and London. The exemption was granted on an exceptional basis owing to the opportunity the event provided to build on the legacy of the 2012 games.

Christian Matheson: The London Anniversary games were specifically related to the Olympics, which were a great success for London and the whole of the nation. I have to say that a feeling remains in other parts of the UK that London, notwithstanding its success, does seem to get more than the lion's share of sporting events. Is there a view in government that specific provisions such as this, which help to attract world-class athletes such as Usain Bolt, might be extended on individual bases to other great events that take place outside London, so that they too might benefit from the attendance of such athletes?

Mr Gauke: I can give one good example: we applied the same exemption for the Glasgow 2014 Commonwealth games. That is an example of the Government's willingness to do that. Again, that was part of maintaining the Olympic legacy and ensuring that we could get top athletes to compete in the Commonwealth games. The hon. Gentleman raises a fair point and I hope he accepts that I have given a fair answer to it. I hope the Committee agrees that the clause should stand part of the Bill.

Rob Marris: My hon. Friend the Member for City of Chester raised a point that I wished to raise. The Minister's reply was not entirely clear. My hon. Friend's question, as I understood it, was whether such ad hoc arrangements would continue to be ad hoc, or whether they would be systematised into our tax rules on a general basis, so that we can continue to attract world-class athletes and other competitors, indeed to other parts of the country as well as London.

I echo what my hon. Friend said. As I am sure all hon. Members know, the Olympic games were revived in Much Wenlock, just down the road from Wolverhampton South West, in the late 19th century. We want to encourage such events and we want more to be held outside London, so it seems logical for the Government to look at systematising the tax relief, rather than giving it on an ad hoc basis, with the uncertainty that that brings. Do the Government have any plans to investigate whether there should be—or indeed should not be—such a permanent tax relief?

Mr Gauke: I hope to provide a little more clarity. In my previous answer, I wanted to make the point that we are not London-centric in granting relief. Indeed, as I said, we granted relief for the Glasgow Commonwealth games.

As for providing an overall exemption, we allow tax exemptions for sporting events only if they are a condition of a bid to host an international mobile and major world-class sporting event. We see the clause as part of the legacy of the Olympics, which is why we have made this decision. Any potential exceptions to the rule will be considered on a case-by-case basis and we will continue to take that approach, but we are of course determined to ensure that we attract major sporting events to this country. We are currently hosting the rugby world cup, although unfortunately England are no longer participating in it, and there will be major football finals in Cardiff in forthcoming years. We believe that the current policy of providing exemptions when world-class events request them as part of the bid conditions is the right approach, and we intend to continue with it.

Question put and agreed to.

Clause 29 accordingly ordered to stand part of the Bill.

Clause 30

R&D expenditure credits: ineligible companies

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

Mr Gauke: Clause 30 makes changes to correct an anomaly in research and development tax credits legislation by ensuring that universities and charities are unable to claim the new above-the-line expenditure credit, in line with the original intention of the policy. The change will ensure that R&D tax credits remain targeted at business R&D investment. The Government remain committed to supporting university research, and in 2015-16 will provide £4.6 billion of support through science resource funding.

The above-the-line credit was introduced in 2013. It was never intended that universities and charities would be able to claim it, and they were unable to do so under the previous large company scheme. However, HMRC has now received a number of claims from charities, mostly universities. Clause 30 amends the legislation so that it meets the original policy intention.

The Government are committed to supporting university research, which is funded by higher education funding bodies and research councils. Those organisations are better targeted to the research universities undertake, and the change maintains the focus on them as routes to funding research excellence in universities.

The clause amends the qualifying conditions for the above-the-line credit so that an institution of higher education or a charity will be ineligible to make a claim in relation to any expenditure incurred on or after 1 August 2015. The measure will impact only on universities and charities currently carrying out qualifying R&D activities. It is estimated that it will affect fewer than 50 universities and charities that were claiming under the previous rules, and will protect £150 million of revenue for the Exchequer each year. The change only applies to universities and charities in the way they are prescribed by law and does not impact on spin-outs—separate commercial entities of universities that transform university research into commercial products. They are fully liable for corporation tax and were always intended to be able to claim R&D tax credits.

R&D tax credits remain an effective mechanism for supporting business investment. A recent study conducted by HMRC found that each £1 of tax forgone stimulated between £1.53 and £2.35 of additional R&D investment. The clause will ensure that R&D tax credits remain effective and targeted towards business R&D investment.

Rob Marris: The research and development tax credit scheme has been successful. It was, of course, introduced under a Labour Government. The coalition Government's decision in 2013 to extend research and development tax relief to large companies was welcome. Historically, probably since the turn of the last century more than 100 years ago, this country has not invested enough in research and development. That is one reason why we have poor productivity—another is Government policy, of course. That trend needs to be reversed.

11 am

When it was introduced, the R&D tax credit was not intended to apply to universities and charities; it was for commercial organisations. It is arguably a loophole, which has now been discovered. I am interested to note the Minister's figure that the changes in clause 30 will protect £150 million per year of Exchequer revenue, which contrasts with the interesting figure he gave of £4.6 billion of government subventions for university research and development. I think that that £4.6 billion was for universities alone. Will the Minister give us some comparative figures on whether that £4.6 billion has been going up or down in the past five years and whether it is projected to go up or down in the next five years? I am not suggesting that the Minister gives us the figures for all ten years—although he is of course welcome to do so, at your discretion, Sir Roger—but it would be helpful to have the trend on that in order to put the £150 million into context.

I am pleased that these changes will not adversely affect spin-out companies—I did not expect them to, but it was a helpful clarification from the Minister—because these have had success in certain parts of the country. One thinks of Cambridge in particular, where spin off has been very helpful not only to the local economy but to the national economy and to exports. Will the Minister elucidate with some trend figures on Government support for university research and development? It might allay the fears of some in the university sector observing this debate, perhaps not in real time, who are concerned that this will be a major blow to university-sponsored research.

Christian Matheson: Will the Minister clarify one small area I am unsure of, which comes from my experience serving as Member for City of Chester? When Shell decided to close its research and technology area at Thornton in my constituency, which contains a large petrochemicals sector, it gave the Thornton research centre over to the University of Chester, which is growing in size, in stature and in academic reputation. Thornton science park has since become a very successful seedbed for growing companies as well as for academic research. My hon. Friend the Member for Wolverhampton South West talked about spin-off companies, and I am looking for clarification from the Minister on a similar issue. Some joint venture companies comprise higher education institutions, such as the University of Chester, and companies from the private sector that are engaged in research that may well bring economic development into an area or into the nation, and may lead to new technologies being developed in the area. Will the participation of a higher education institution preclude a company from receiving such grants? Is this an area on which the Government are not yet quite clear?

Mr Gauke: Again, I am grateful for the support of the hon. Member for Wolverhampton South West for the clause. I reiterate that the move towards above-the-line credit has been a success. Since 2013 it has ensured that the benefits of R&D relief are more visible and has provided greater financial and cash-flow support to companies, regardless of their corporation tax liability. The aim of the credit is the same as that of the previous large company scheme—to incentivise additional R&D investment—but it uses a completely different design. Teething problems can occur, and claims from universities and charities were not anticipated when the scheme was designed. HMRC monitors the use of reliefs to check that they are being used as intended, and occasionally it is necessary to clarify the law to support the original policy intention. This is one of those occasions.

On the question raised by the hon. Member for City of Chester about whether the change will discourage businesses from collaborating with universities and their R&D activities, no, we do not believe that it will. This change will prevent universities and charities from claiming above-the-line credit for their individual R&D. Firms are already able to claim R&D tax credits for qualifying R&D projects that are subcontracted to universities, and that will remain the case. The Government remain committed to promoting business collaboration with universities. Innovate UK schemes provide support for firms collaborating with academia. That includes catapult centres, which are a series of physical centres comprising the very best of the UK's businesses, scientists and engineers working side by side on late-stage R&D, transforming high-potential ideas into new products and services to generate economic growth. I hope that the hon. Gentleman is reassured by that.

The hon. Member for Wolverhampton South West asked about funding for science research. Science resource funding was protected through the ring-fencing of £4.6 billion per year. The Government are committed to £1.12 billion per year on capital spend until 2021, rising with inflation. I hope that that provides some reassurance to the Committee. With those points, I hope that the clause can stand part of the Bill.

Question put and agreed to.

Clause 30 accordingly ordered to stand part of the Bill.

Clause 31

Loan relationships and derivative contracts

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

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

Clause 33 stand part.

Government amendments 8 to 10.

That schedule 7 be the Seventh schedule to the Bill.

Mr Gauke: The clauses and the schedule make wide-ranging changes to the corporation tax rules for company debt—referred to as loan relationships in the statute—and derivatives. These changes bring the rules up to date, making them simpler and easier for companies to use and at the same harder to misuse or manipulate.

[Mr Gauke]

It may help the Committee if, before I explain the changes in detail, I provide some background. The rules on loan relationships are almost 20 years old. They are based on the straightforward idea of taxing company debt on the basis of commercial accounts. The rules operate without difficulty for many, particularly for smaller companies with simple financing arrangements, but they also have to cater for commercial situations that can be highly complicated. The Government have frequently received comments on the complexity of the rules. At the same time, the loan relationships and derivatives regimes have frequently been targeted by tax avoiders. Often, the reaction to those attempts at avoidance has been to close loopholes by very specific, narrowly focused changes to the law. That approach has generally been successful, but it has not deterred avoiders from finding new ways to get round the rules or abuse them. It has also added to their complexity. In addition, over the years there have been changes to the accounting standards that underlie the tax rules, and further significant changes are being made at the moment.

Those factors mean that the time is ripe for a general review of this part of the tax code. Indeed, an article in *Tax Journal* in December 2014 noted that such a review was "long overdue and necessary". At Budget 2013, the Government announced a consultation on a package of proposals to modernise the legislation. The clauses and schedule before the Committee today are the outcome of that consultation.

We are making extensive changes. I will explain briefly the most significant elements of the package. First, we are aligning taxable amounts more closely with commercial accounting profits, so taxation of loans and derivatives will now be based on amounts recognised in accounts as profits or losses, similar to the way trading profits are calculated. In contrast, up to now the tax rules for loans and derivatives have looked at amounts recognised anywhere in accounts—in equity or reserves, for example. A transitional rule will ensure that this change is broadly tax-neutral and that nothing is taxed twice or not at all. A recent article in *Tax Journal* described the change as "a hugely welcome simplification". Alongside it, we are making further changes that will reduce the occasions when taxation does not follow the accounting treatment.

We are introducing new corporate rescue provisions, which will benefit companies that are in genuine financial difficulty and looking to restructure their loans to avoid insolvency. The rules will make it easier for such companies to agree arrangements with creditors without incurring a tax charge. The change has been warmly welcomed and will help companies to stay in business, to continue contributing to the UK economy and to preserve jobs. For example, in its February 2015 client newsletter, Allen & Overy noted:

"These exemptions received a uniformly positive welcome."

I described how, although they effectively close down avoidance schemes as they come to light, the existing narrowly focused rules have not stopped attempts to target or use company loans and derivatives in tax avoidance arrangements. Because of that, we are strengthening the protection for the Exchequer by introducing new regime-wide anti-avoidance rules, which will deter and block arrangements of any kind that are entered into with the intention of obtaining a tax advantage by way of the loan relationships or derivatives rules. Unlike many existing anti-avoidance provisions, the new rules do not focus narrowly on specific situations or types of avoidance, so it will be harder to sidestep them.

It is important that the rules do not interfere with genuine commercial activity, so we have worked closely with interested parties to ensure that they will prevent avoidance without affecting legitimate business transactions. A number of existing anti-avoidance rules will now be redundant, so we are repealing them, which will be a welcome simplification.

Consultation has continued since the Bill was introduced and has identified the need for Government amendments to schedule 7 to deal with a potential unintended outcome. The amendments do not represent any substantive change of policy, but simply bring forward the date at which the corporate rescue reliefs that I described a few moments ago become available. The Bill currently provides for those reliefs to be available from the date of Royal Assent, but we have recently been made aware in consultation that a small number of companies have entered into transactions on the basis that retrospective relief would be available from 1 January 2015, as was envisaged in earlier draft legislation published in December 2014. As a result, they would not qualify for relief and so would be in danger of becoming insolvent, with possible loss of jobs.

As a rule, the Government do not legislate to take account of the fact that taxpayers have acted on the basis of unenacted legislation, but I am mindful that in this case the whole purpose of the corporate rescue reliefs is to avoid unnecessary insolvencies and preserve businesses and jobs, so the amendments reset the commencement date to 1 January 2015.

In conclusion, the provisions support the Government's aim of promoting a tax system that is efficient, competitive, predictable, simple and fair. They bring the tax system for corporate debt and derivative contracts up to date and make it simpler. They make it easier for companies to restructure debt to avoid insolvency and they make it harder for tax avoiders to get around or take advantage of the rules. I therefore commend clauses 31 and 33 and schedule 7 to the Committee.

Rob Marris: These are welcome anti-avoidance measures, although I must say that they are of such complexity that I do not understand them and, with respect to my hon. Friends, I suspect that few of them do either. I am pleased that the Government have listened to the consultation and changed the commencement date to 1 January 2015, which was something on which I was lobbied.

The provisions indicate how difficult it is to simplify our tax regime—something with which the Minister will have struggled in the past five and a half years since he got into government. It is easy to argue from the Opposition Benches for a simplified tax regime, and of course I would argue for that as well. Clause 31 looks simple: it is 11 words long—now that is nice and simple. However, those 11 words incorporate schedule 7, which is, at 43 pages, the longest schedule I can recall seeing appended to any Bill. I would like some further reassurance from the Minister, if he is in a position to give it, that a 43-page schedule simplifies our tax regime.

11.15 am

Mr Gauke: I would probably pray in aid the various remarks in the articles I quoted earlier. We consulted extensively with industry and tax professionals to ensure that the changes we are making are balanced and fair, and that they fulfil the aims of the review, which include making the rules as simple as possible to understand and use. The rules are straightforward for the great majority of companies with ordinary loans, which means that the great majority of small companies will experience simplification. However, the measure must also cater for highly complex commercial situations and financial instruments, so it can never be entirely simple.

Key simplifications that we are making include aligning tax and commercial accounting profits more closely. As I said, the 30 July article in *Tax Journal*, which I suspect the hon. Gentleman will read assiduously from now on, described the measure as "a hugely welcome simplification". The changes include the repeal of about 26 pages of primary legislation with more than seven pages of anti-avoidance rules. There is a net increase of 18 pages, but I think it is fair to say that, as the Office of Tax Simplification has pointed out, the number of pages of legislation is not always the best measure of complexity.

I note that by and large there is consensus between us on the measures, although not about the pronunciation of "schedule".

Question put and agreed to.

Clause 31 accordingly ordered to stand part of the Bill.

Clause 33 ordered to stand part of the Bill.

Schedule 7

Loan relationships and derivative contracts

Amendments made: 8, in schedule 7, page 179, line 6 leave out "and 33(2)"

Amendment 9, in schedule 7, page 179, line 8, leave out

"the day on which this Act is passed" and insert "1 January 2015"

Amendment 10, in schedule 7, page 179, line 8, at end insert—

107A Paragraph 33(2) has effect in relation to the release of a debtor relationship of a company on or after the day on which this Act is passed."—*(Mr Gauke.)*

Schedule 7, as amended, agreed to.

Clause 32

Intangible fixed assets: goodwill etc

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

Mr Gauke: The clause removes corporation tax relief in relation to purchased goodwill and certain other customer-related intangible assets. The changes ensure that companies will no longer be able to reduce their corporation tax profits by claiming relief for the cost of purchased goodwill written off in the company accounts. Clause 32 applies to all acquisitions made on or after 8 July 2015. Companies that have completed acquisitions before 8 July 2015 will not be affected.

In accounting terms, purchased goodwill is the balancing figure between the purchase price of a business and the net value of the assets acquired. Goodwill can therefore be thought of as representing the value of a business's reputation and customer relationships. Customer-related intangible assets include the types of assets associated with the goodwill of the business or the business's reputation, such as customer lists, customer information and unprotected trading names or marks.

The Finance Act 2002 introduced a new tax regime for companies' intangible fixed assets commencing on 1 April 2002. The treatment of intangible assets generally follows the accounting treatment set out in the legislation, which treats goodwill like any other type of intellectual property such as a trademark, patent, design right or copyright. However, in reality goodwill is simply the difference between the purchase price of a business and the business's net asset value. It represents the premium a buyer will often pay to acquire an established business, compared with buying business assets and commencing a new business. It is therefore different from other, separable, intangible assets such as websites and patents.

The existing rules allow the buyer to claim annual corporation tax relief for the cost of the goodwill. That relief reduces corporation tax profits, as the cost of the purchased goodwill is written down in the company accounts or is given on a fixed-rate basis of 4% per annum. That advantage is not generally available to companies that undertake mergers and acquisitions by purchasing the shares of the target company, nor is it available to new start-up businesses or to businesses that grow organically. The current rules can therefore distort commercial practices and lead to manipulation and avoidance. For example, relieving the cost of a business acquisition can affect the price payable in anticipation of the available tax relief.

The changes made by clause 32 will withdraw amortisation and fixed-rate relief for all goodwill and customer-related intangible asset acquisitions that occur on or after 8 July 2015. Instead, relief will be given if and when those assets are subsequently sold or otherwise disposed of. The clause will treat any loss arising on such a disposal as a non-trading loss. That is to limit how such losses can be relieved. Existing cases—companies that acquired goodwill or other relevant assets before 8 July 2015—will not be affected.

In conclusion, clause 32 removes the financial advantage for structuring a merger or business acquisition so that goodwill can be recognised by the buyer. It levels the playing field for mergers and acquisitions, and brings the UK in line with international standards. I hope the Committee will agree to its standing part of the Bill.

Rob Marris: This seems to be a sensible measure to level the playing field, although it may have an effect on businesses that are not incorporated and where there could be no question of shares being substituted. The change builds on the excellent 2002 legislation on the taxation of intangible assets, and Opposition Members should support it.

Question put and agreed to.

Clause 32 accordingly ordered to stand part of the Bill.

Clause 34

Group relief

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

Mr Gauke: Clause 34 makes the tax system simpler by removing differences in the treatment of consortium link companies based in the UK and other jurisdictions. The current rules state that, for corporation tax group relief to be available between a group and a consortium, the company that links the two must be located in the UK or the European economic area. Where the link company is in the EEA but not the UK, there are other requirements.

The changes made by clause 34 remove all requirements relating to the location of the link company so that relief may be given regardless of where it is based. The change simplifies the tax system by putting consortium relief on the same footing as normal group relief. That supports the Government's ambition to continually improve the UK's international ranking as a place to do business.

Rob Marris: With due respect to the Minister, I would like a little more clarification, because I do not think this is simply a simplifying measure. I may be wrong, but it appears to change the nature of the game. As I understand it, it removes the requirement for all link companies to be either in the UK or the EEA; a link company could therefore be in Canada, Hong Kong or Indonesia, for example. That seems quite a big change and more than merely a simplification.

Will the Minister explain a little more—touching on more than just simplification—why it is desirable for the tax regime of UK plc to be so flexible about the headquarters and location of link companies, when most, if not all, hon. Members present would recognise to a greater or lesser extent that the UK has a particular problem with companies disappearing to, or setting up in, tax havens overseas. I am concerned that the clause, if implemented, would increase opportunities for companies and groups of companies to take advantage of tax havens, to the disadvantage of UK plc, those we represent and companies that are playing morally by the rules, as opposed to companies such as Facebook, which, we heard this week, appears to be adhering to UK legislative rules, but to its considerable financial advantage. That suggests that the UK legislative rules adhered to by the Facebooks, Starbucks and Googles of this world are not sufficiently tight. I am concerned that clause 24 goes in the wrong direction on that issue.

Ordered, That the debate be now adjourned.—*(Mel Stride.)*

11.24 am

Adjourned till this day at Two o'clock.