

TAXREP 9/99

FINANCE BILL OF SPRING 1999

Memorandum submitted in May 1999 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Chancellor of the Exchequer

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INTRODUCTION

General comments

1. We welcome the fact that this year's Finance Bill is significantly briefer than in previous years. However, we cannot describe 169 pages as short. In our view the Bill contains far too many unnecessary anti-avoidance provisions and needlessly complex rules. Consequently its length could have been considerably reduced without detracting from the policy objectives which it enacts.
2. We are concerned at the number of the comments in the Budget Day press releases and the Explanatory Notes that appear to us to give a gloss that masks the intention of and reasons for the proposals. This form of 'spin' detracts from the usefulness of the press release in providing much needed clarification and does not aid interpretation. It also means that in future years it will be more difficult to determine the exact intention of the legislation.
3. This issue has become more important since the decision in *Pepper v Hart* [1992] STC 898 which stated that Hansard could be consulted as an aid to interpretation where the law is unclear. Clear press releases will assist in clear interpretation by those who help formulate the law. For example, we were surprised to see that the Budget Day press release IR32, which sets out the proposed changes to the taxation of reverse premiums, stated that the change did no more than clarify the law. The experience of our members is that the Inland Revenue has long accepted that such payments are not liable to tax because they do not have an income nature and do not derive from the disposal of an asset. Similarly Clause 92 (gifts with reservation: interest in land) does not in our view restore a generally held view: it reverses the House of Lords decision in the *Lady Ingram* case [1999] STC 37, which approved earlier decisions of the House of Lords relating to gifts with reservation.
4. We are also dismayed that it appears to be becoming habitual for a Finance Bill to contain some provisions correcting legislation introduced in the previous Finance Act. We believe that this reflects the speed with which Finance Bills seem to be rushed through the Parliamentary process without adequate time being allowed either for external organisations, such as ourselves, or Members of Parliament, to understand fully and comment on the implications of proposals which are often very complex.
5. We are concerned at an increasing tendency for very wide provisions which go far beyond the scope of the problem with which they seek to deal, which necessitate assurances by the tax authorities that they will apply the legislation only in very limited circumstances. One example is the VAT grouping provisions in Schedule 2 of the Finance Bill: Customs in Budget Notice 56/99 have indicated that they will restrict the use of the powers being given to them by the legislation.
6. We think it is important that legislation is precisely targeted. Widely-drawn legislation creates uncertainty. In the context of self assessment it is particularly unreasonable to impose a legislative requirement on taxpayers in the expectation that they will be aware that they can ignore that requirement on the basis of a Revenue press release which purports to limit its scope. Particular examples of this relate to the taxation of reverse premiums and the corporation tax quarterly payment system. As expressed by Mr Justice Walton

in the Vestey case [1977] STC 414, and famously approved by Lord Wilberforce in the House of Lords judgment in that case [1980] STC 10, a taxpayer is entitled to be taxed by law and not untaxed by concession.

7. Another worry is the semi-retrospective nature of many of the provisions. We accept that the Government has not sought to introduce legislation which clearly has retrospective effect. However, where provisions are introduced which change the tax treatment of existing contractual obligations, taxpayers are frequently unable to alter those existing arrangements, with the result that they suffer an unexpected tax charge which could not have been anticipated when the arrangements were entered into. In the past it has been normal to exclude from new legislation income flows and payments under contractual arrangements in existence at the time of the Budget. We believe it is a retrograde step not to continue with such a practice. This new departure creates unfairness within the tax system.
8. A good example is Clause 33, which removes tax relief for maintenance payments under pre-1988 arrangements. This will provide a windfall to recipients of such payments who had entered into agreements on the assumption that the receipt would be taxable. We accept that as the provision does not take effect until 6 April 2000, there is an opportunity to apply to the courts to vary existing arrangements. However, we believe it is unreasonable that individuals should have to incur substantial legal costs in order to seek to preserve the overall effect of arrangements which were entered into many years ago, particularly when it is uncertain whether they will be successful.

Complexity

9. We believe that many of the provisions are unnecessarily complex. This creates significant practical problems in the context of self assessment. We are already very concerned about the burden placed upon individuals by this regime and the difficulties many people find in completing their tax return forms and in understanding all the surrounding documentation relating to self assessment (in particular the Taxpayer's Statement). Complex legislation introducing minor exceptions to basic tax rules needlessly complicates the tax return form.
10. In this context, whilst we welcome the 10% starting rate for income tax, we are concerned about the proliferation of personal tax rates. This makes it extremely difficult for the average citizen to understand his tax liability with the result that it undermines the integrity of the tax system.
11. Most citizens will not readily understand a system under which their first slice of taxable income is taxed at 10% if it happens to be earned income or a pension, but will be taxed at 20% if it is investment income. They will be more confused to learn that the next slice is then taxed at 23% if it happens to be earned income, but again at only 20% if it happens to be investment income, although for a basic rate taxpayer the effective tax rate is nil % if it is a UK dividend.
12. Complexity is increased by the introduction of anti-avoidance rules covering situations where very little tax is at stake. For example, is it really necessary to provide that no tax charge will arise on an employee simply because his employer subsidises a local bus service but that common-sense exclusion is lost if some of the employees happen to use the bus service concerned in their day-to-day social life? Similarly, we find it hard to believe that it is really necessary that, if an employer provides fluorescent safety strips for the clothing of employees to cycle to work safely, the employer must retain

ownership to avoid a benefit falling on the employee. Or, if he provides an employee with a bicycle, the exemption from a benefit charge will be lost if the employer does not devise a system to ensure that the employee does not use the bicycle on cycling holidays. We find it hard to believe that a page of anti-avoidance rules, as is included in Clause 35, is required to stop people prepaying mortgage interest where the maximum result of prepayment is to top up the current year's relief from its existing level by a few hundred pounds.

13. As we suggested in our Finance Bill representations last year (published as TAX 13/98), it is vital that Parliament should appoint somebody with specific responsibility for reviewing a Finance Bill and considering whether the changes proposed are consistent with both an easily-understandable tax code and the desirability of taxpayers being able to complete their own tax returns correctly. We appreciate that much complication is prompted by an understandable desire to prevent avoidance. However, we believe that a balance needs to be struck between simplicity and anti-avoidance rules. In many cases, it would be in the public interest to tolerate a small degree of avoidance around the fringes in order to achieve the objective of making the legislation readily understandable. We remain firmly of this opinion.

Consultation

14. We very much welcome the policy of the Government to consult on proposed legislation where this is practical. However, in this context we are surprised that there was no consultation in relation to the changes on reverse premiums (Clause 50).
15. Although there was consultation last year on the rules on company cars (see Revenue Budget Day press release IR 6 issued 17 March 1998), that consultation proposed that the existing rules should be replaced by a new method based on a discount for driving fewer private miles. It is therefore surprising, and disappointing, that a decision has been made to move to an entirely different test based on carbon emissions, which was not envisaged in the consultation. It may well be that the new concept was put forward by consultees. However, we think it is important that where there is a major shift in Government thinking following a consultation process, the new ideas (and the detailed reasoning behind them) should themselves be exposed for consultation before being adopted.
16. We are particularly concerned about the lack of consultation on the introduction of tax changes for personal service companies. The Revenue Budget Day press release (IR 35) was very imprecise and has created great confusion and consternation to those in existing arrangements. We had assumed that there would be consultation on this area between now and the next Finance Bill which would have included the provision of draft Clauses. However, it now appears that consultation will be limited to helping the Revenue to produce guidance on the practical application of proposals which are not themselves open for discussion and which still have not yet been published. It is particularly ironic that these proposals have created considerable worry for sub-contractors within the computer industry at a time when the Government is seeking to encourage greater use of computers and increase awareness of the need to review computer systems before the new Millennium. Announcements which encourage a highly mobile programming workforce to look for work overseas rather than in the UK are not conducive to these aims.
17. We welcome the Government's decision not to proceed with a General Anti-Avoidance Rule ('GAAR') or with the proposed Mini-GAAR on VAT and construction services. These

decisions reflect the advantages of consultation in identifying potential problem areas of proposals. We are grateful that the concerns expressed by ourselves and other bodies have been listened to.

18. We would however point out that the consultation period on the Mini-GAAR expired on 1 March 1999, 8 days before the decision not to proceed with it was announced. The consultation raised complex and wide-ranging technical issues and our own response (TAXREP 8/99) extended to some 17 pages with an enclosure of 32 pages. We understand that Customs received around 65 other responses which would have also entailed many hours of work and careful thought. We do not believe the full impact of these representations could have been considered fully in that 8 day period.
19. We suspect that the decision not to proceed with this proposal was based on the informal consultation with us and other bodies during the consultation period and that the decision had been made to abandon the proposals some time prior to 1 March 1999. It would have been helpful if this had been announced when the decision was taken rather than have people waste time and resources in formulating detailed responses. Unfortunately, as a result, many people now regard the consultation as having been a sham and will be reluctant to devote time in the future to assisting the Government in refining its legislation. Obviously that is not in anyone's interest.
20. Many of the issues addressed in the detailed responses went well beyond the question of whether or not to have a Mini-GAAR. There is a concern that, the decision having been taken not to proceed with the legislation, the written submissions will simply be filed and the additional points raised in the responses overlooked. We think it would allay many concerns if the Government were to make clear that these responses will be reviewed in detail to pick up all areas where improvements to the legislation might be introduced and that a detailed response will be published.
21. We are puzzled at the inclusion of Clause 17 which we had understood had been included to reflect the European Court of Justice decision in *Commission v Italian Republic* (Case C-45/95). Customs have recently issued for consultation a technical note on this decision. The deadline for responses is 21 May 1999. We find it hard to see how the requisite legislation can be drafted satisfactorily in advance of considering the responses to the consultation. This calls into question the genuine nature of the consultation.

Statutory Instruments

22. As we have stated many times in the past, we are concerned at the widespread use of regulations to amend VAT law. In recent years this has extended to amend substantive statutory provisions, such as the exemption and zero rating Schedules in the Value Added Tax Act 1994. Because of the different Parliamentary procedure for Statutory Instruments these generally receive far less scrutiny than primary legislation. This makes consultation on draft Statutory Instruments exceedingly important. We are concerned about the number of Statutory Instruments which were introduced without consultation with effect from Budget Day. We accept that an advantage of Regulations is that deficiencies in the drafting can readily be rectified by an amending Regulation. However, we think that it is important that the Government makes clear that where there is no prior consultation, it is nevertheless prepared to consider taxpayers' concerns after a new Regulation is introduced. In view of the importance of consultation on Statutory Instruments, we have set out in Annex A our comments on the Statutory Instruments issued at the time of the Budget.

23. PART II

VALUE ADDED TAX

General

24. We have set out below our comments on the Clauses set out in the Finance Bill. This should be read in conjunction with Annex A, which sets out our comments on the Statutory Instruments issued at the time of the Budget.

Clause 13 and Schedule 2 - Groups of companies

25. We are very concerned with the appeal procedure as set out in proposed section 84(4C) which is found in paragraph 4 of Schedule 2. This limits the Tribunal's role to a supervisory one. It enables Customs and Excise to reserve discretionary powers to themselves to be the sole interpreters of what they meant in the first place. We believe this is best left to an independent arbiter. For Customs to exclude a company from a group after it has entered into commercial arrangements, and perhaps made VAT returns, is likely to give rise to considerable commercial problems as well as administrative difficulties. In such circumstances we believe it is important that the Tribunal should be able to consider what is fair to both Customs and the taxpayer. The Tribunal should not be limited to merely considering whether Customs acted unreasonably in the light of what may well have been limited information available to them at the time the decision was taken. We appreciate that Customs consider the protection of the revenue to be part of their care and management role. However, where it is necessary to undermine contractual commercial arrangements to achieve such protection, we believe it important that the VAT Tribunal should be able to look at the whole situation afresh.
26. Section 84(2), VATA 1994 provides that a VAT appeal cannot normally be entertained unless all returns and all VAT payments per those returns have been made. This is unlikely to be practical in many cases involving group applications. Furthermore, the requirement to pay over VAT on 'group' supplies could cause considerable hardship, thus deterring an appeal. We therefore think it important that section 84(2), VATA 1994 be amended in relation to appeals under the proposed section 83(k), VATA 1994 to allay such concerns by not requiring returns and payments to be made until the outcome of the appeal is known.

PART III

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

Income tax rates and charge etc.

Clause 19 - Starting rate

27. We are concerned that the rules on the new 10% rate do not deal with the effect on charitable deeds of covenant. We imagine that, as happened when the 20% savings rate was introduced, the Inland Revenue will not in practice seek to raise assessments to collect the difference between the 10% and 23% rate where the amounts involved are small. However, in view of the fact that the difference between the rates is now 13% as against 3%, the amount of tax is now much more likely to be significant. The law requires a taxpayer who is not issued with a tax return but has a tax liability to give notice of chargeability to the Inland Revenue. Accordingly without some legislative protection, it appears to us that millions of taxpayers who are currently treated as having no further tax liability will have an obligation to give notice of chargeability, complete self assessment tax returns and pay the tax due.
28. We would welcome clarification of the effect of Clause 19(8) (substitution of starting rate for lower rate in the taxation of gains from life assurance policies). We are concerned that this could be read as imposing tax on the difference between the 40% rate and 10% rates, although we understand that this is not the intention.
29. We note that the starting rate does not apply to investment income. This has opened up a potential unfairness between those who receive investment income as against employment income. For example, a pensioner with the State Pension and a little savings income will pay no tax on the pension, as this will be covered by the personal allowance, but will pay tax at 20% on the first slice of savings income.

Income tax reductions

Clause 27 - Children's tax credit

30. This Clause changes fundamentally the operation of the personal tax system in that in order to make a valid claim, a taxpayer will need to know about the tax affairs of another person. This is a retrograde step and undermines the principle of independent taxation established in 1988. Whilst some taxpayers may be willing to divulge this information to another taxpayer, it places many taxpayers in a difficult position, for example, in a year when a couple separates.
31. We are concerned with the complexity of this provision, which requires five pages of legislation. It appears to us that the majority of taxpayers will have to become familiar with the detailed provisions of Schedule 3. In view of the problems already experienced in the changeover to self assessment, this is expecting too much of taxpayers.
32. Not only is the provision very complex; it appears to operate unfairly. For example, under paragraph 6 of Schedule 3, in the case where a child lives with parents who do not live together, or with a same sex couple, they are able to allocate the allowance in whatever way that they choose, and if there is more than one child they can each make a claim.

In contrast where a couple are living together they are far more restricted in how the relief can be split.

33. It appears that having formulated rules for couples living together, the draftsman realised they did not work in other circumstance and therefore had to devise a different set of rules. The result is to provide couples who live together other than as man and wife with an unfair advantage. We think it would simplify greatly the legislation without leading to a significant loss of tax to drop paragraphs 1 to 5 and allow paragraph 6 to apply generally.
34. The provisions regarding married couples lead to a lack of horizontal equity across couples with children, and a marginal tax rate of 46 2/3% on income in the marginal zone. This can be illustrated by the following example. A couple with a qualifying child consists of one working partner earning £40,000 and one non-working partner. No child tax credit relief will be available. However, for a similar couple, one of whom earns £30,000 whereas the other has (say) investment income of £30,000, the relief will be available in full. This is unjust. The difference in treatment will encourage some couples not to marry and to establish relationships in such a way as to avoid being deemed to live together as husband and wife.
35. We are also concerned at the lack of precision in some of the definitions. For example, the definition of 'a man and woman living together as man and wife' is likely to lead to many problems of classification and necessitate the exercise of a considerable amount of discretion on the part of the Revenue.
36. New paragraph 6(1)(c) of Schedule 13B, as introduced by Schedule 3 of the Finance Bill, seems to imply that the child could be the parent. We presume that this intended to mean that 'he is not the relevant child for the purposes of paragraphs 2 to 5 above', such terminology being used in paragraph 7.
37. In the context of self assessment it is disappointing that the Married Couples Allowance ('MCA') is being withdrawn at the end of the current year and the new child tax credit will not be introduced until the year beginning 6 April 2001. This requires taxpayers to grapple with changes to the tax return in two successive years whereas only one amendment to the return would be needed if the changes took place simultaneously.
38. In the light of the above deficiencies we consider that Clause 27 and Schedule 3 should be deleted. The withdrawal of the MCA should be deferred until April 2001 to allow for consultation and a revised provision introduced in April 2001 as planned. In order that the new code is easy to follow it should be rewritten using the techniques learned in the Tax Law Rewrite Project.

Clause 28 - Restriction of MCA to those reaching 65 before 2000-01

39. We are concerned that this provision will operate unfairly on those taxpayers who are near retirement age many of whom may be unable to generate sufficient additional savings income to meet this unexpected extra tax burden before they reach the age 65. For example, under the current system, a married person reaching age 65 on 6 April 2000 would have expected an allowance of £3,305, relief on which at 15% gives a tax reduction of £495 in a year. For a taxpayer with income of, say, £10,000 a year, this represents almost 5% of total income **before** tax, a significant burden for those retiring on low incomes. We suggest a transitional relief to give taxpayers born before, say, 6

April 1945, the right to the allowance. This leaves younger taxpayers a reasonable period in which to reorganise their investment strategy to boost their income levels.

Clause 30 - Abolition of existing relief in respect of children

40. This relief is available for those who are supporting children but who may not be married, and is of maximum benefit to those on relatively low incomes. As with the MCA, we believe that this relief should not be withdrawn until such time as the new children's tax credit is introduced.

Clause 33 - Maintenance payments

41. We are unclear why the withdrawal of tax relief for maintenance payments should be thought to be closely linked to the MCA, as stated at paragraph 2 of the Treasury Notes. This Clause is in effect retrospective and is unfair, as it alters the basis on which maintenance arrangements set up before 15 March 1988 were agreed over ten years ago. Such legal arrangements can not be reorganised easily, and, indeed, may be impossible to change. Taxpayers will need to seek variation of existing court orders to take account of the new circumstances. Furthermore we believe that where an agreement relates to both maintenance and child support, the variation of the child support element will require the intervention of the Child Support Agency. It is our view that this Clause should be withdrawn.

Employee benefits etc.

Clause 39 - Conditional acquisition of shares

42. It appears that this Clause makes amendments to rules introduced in the 1998 Finance Act in order to remove a potential double charge to tax in certain circumstances. We would have thought it reasonable that the change is backdated to apply from the introduction of the rules last year.

Clause 41 - Exemption for mobile telephones

43. In principle, we welcome this change as a simplification to the burden on businesses. We would welcome clarification that the exemption covers all private use of the phone and extends to the line rental.

Clause 42 - Limited exemption for computer equipment

44. We support the desire to encourage computer literacy, which we believe would also encourage home working and reduce dependence on the car. However, if this measure is to achieve that objective we believe it should be as flexible as possible, not limited by unnecessary restrictions.
45. We are concerned at the restrictive nature of new section 156A(2). Whilst we can see why preferential treatment for directors should exclude the director concerned from relief, we are unclear why such provision should impose a benefit charge on all the rest of the employees concerned.
46. We also think it unfair that directors of a small company which has no employees should be excluded from the relief entirely whilst the director of a large company who is supplied with a computer of a higher value would be relieved from benefit. It appears from sub-

section 2(b) that if a company introduces a scheme under which all employees with some business use of the computer, or all employees earning above a certain level, are provided with one model of computer and other employees with a cheaper model, that is acceptable. However, if a director participates, he must be provided with the cheaper model even though providing him with the more expensive one simply puts him on a par with the category of employee into which he falls. We cannot see the logic of such a restriction.

47. We would welcome clarification of why sub-section 5(b) should exclude from benefit Internet access charges but not the telephone line which is needed to access the Internet. We think that exposure to the Internet is important and that it would be reasonable at least to exempt from tax a dedicated telephone line used exclusively for the computer. In any event, with the increasing availability of free service providers, it appears that it is inevitable that this benefit will be provided, and we think that the rules should recognise this from the outset.

48. If the Government wishes to encourage computer literacy, we believe that a similar relief ought to be introduced for the self employed to remove the current restriction that applies to the private use of a computer provided for business purposes.

Clause 44 - Cars available for private use

49. We are puzzled by this provision as it seems to penalise those who are obliged to travel extensively in the course of their work. For example, in Scotland a farm or forestry manager may need to cover extensive distances on a regular basis and will have no alternative public transport option available. Further, it does not reduce the incentive to drive unnecessary business miles. As a major reform of company car taxation is proposed we question the justification for such non-targeted changes with such a short life. We are also concerned that the suggestion made in last year's Budget that the existing system should be replaced with one which gives discounts for private mileage appears to have been abandoned.

Clause 45 - Provision and support of bus services

50. Proposed section 197AA appears to be aimed entirely at big businesses with many employees, as the limit of 17 people will exclude many small businesses. Although in theory small businesses can club together to provide transport, in practice it is very difficult to do this. Further, it offers a clear incentive to use a larger vehicle than may be required, thus negating, at least in part, the purpose behind the Clause. We believe that a more sensible limit is nine people, which we believe is the level beyond which a Public Service Vehicle licence is needed. We understand the concern that this could be abused by the use of 'people mover' vehicles, but think this could be overcome by the use of a definition which excluded a vehicle normally used privately.

51. It is unclear what is meant by the requirement in new section 197AA(4) that the service must be available generally to the employees of the employer. For example, if a company has a factory outside Norwich and a small office in London, it might well wish to provide a works bus to the factory but this would not be available to the London employees. We doubt that it is intended that the proposed exemption is not available such circumstances but would be grateful for clarification.

52. We are concerned with the substantial compliance test (see new section 197AA(5)). If, for example, the bus was also used to transport children to a workplace nursery (something

which we believe the Government is keen to encourage), then this would mean that this test would not be met. It also appears to exclude relief where, for example, a company allows sub-contractors to travel on its works bus to its premises. There may also be a problem where some of the workers at a company's premises are out-sourced from a specialist supplier. For example, a facilities management company may employ and supervise payroll staff of its client company. In such circumstances, the works bus of Factory A would clearly not be available to those employees of the facilities company who happen to work at the client company's premises.

53. New section 197AB(4) appears to make the provision wholly unworkable. If a company subsidises a public bus service, which by definition must be available to all passengers at all times, it is unreasonable that the use of the bus by an employee outside of travel to and from work should cause the relief to be withdrawn. We cannot see how this provision can be effectively monitored. Further, we believe that use of the bus outside work will at least encourage fewer car journeys.

Clause 46 - Provision of motor cycle and cycle parking facilities

54. As a general rule, we believe that tax legislation should be self-contained, and that cross references to completely unrelated Acts should be avoided. It is unrealistic to have to search further to find the definition of motor cycle and cycle. As the relevant definitions set out in the Road Traffic Act 1988 are both short, and we suspect are unlikely to change materially in the medium term, we believe that they should be set out in full in this clause.

Clause 47 - Cycles and cyclist's safety equipment

55. In view of the limited likely benefit of this Clause to a taxpayer, it appears far too complicated, and appears to reflect an obsession with avoidance which we believe is not justified. We fail to see why new section 197AC(4) is necessary. It is unclear what is meant by 'substantial compliance'. It is an imprecise term which could impose unnecessary restrictions on the relief. On the basis that bikes do not normally have milometers, we do not see how this test can be policed effectively. Further, if an employee used his bike at weekends, this would again achieve the objective of reducing the potential number of cars on the road. We suggest that this Clause could be simplified by exempting the provision of a bike up to a monetary limit, with perhaps the use of a 'wholly or mainly' test.

Reverse premiums

Clause 50 and Schedule 6- Reverse premiums

56. We are concerned about the reference to 'other benefit by way of inducement' in paragraph 1(1)(a) of Schedule 6 and in particular the treatment of a rent-free period. Even the Treasury's Explanatory Notes contain contradictory statements as to whether this gives rise to a taxable imputed benefit or not. We have received a letter from the Revenue's Business Tax Division which states that the legislation does not in fact impose a charge where, for example, the inducement takes the form of a rent free period under a lease, and more generally that 'other benefit' does not extend to any notional consideration foregone or deferred. While this statement is welcome, we regard it as wholly unsatisfactory that a fundamental defect in the drafting of the legislation should be dealt with by means of an extra-statutory clarification, which appears to be unsupported by the actual wording. More generally, we regard it as essential,

particularly in the context of self assessment, that the limits of the legislation should be entirely clear and that the same difficulties should not arise, as have become familiar in the VAT field, in drawing the line between an inducement to enter into a lease and a term of the lease itself.

57. This distinction is also important in relation to fitting out costs. The Revenue's letter says (again without any clear support in the legislation as currently drafted) that a contribution to fitting out costs is regarded as an inducement if it relates to expenditure incurred by the tenant on tenant's fixtures, and not if it relates to expenditure incurred by the tenant on works which would normally be the responsibility of the developer. This seems reasonable so far as it goes, but it leaves a grey area between the two extremes, and it also fails to deal with expenditure incurred directly by the lessor.
58. We suggest that for clarity and consistency the question of fitting out costs should be dealt with in the same terms as in section 51, CAA 1990, i.e. that there is an inducement if and only if the lessor incurs expenditure (either directly or by reimbursing the lessee) on items which do not in law become part of the land. Where the landlord does bear the cost of tenant's fixtures there should be no charge on the deemed reverse premium if the assets in question would have qualified for a capital allowance but this is denied under section 153, CAA 1990. Otherwise the tenant is effectively being taxed twice.
59. We are concerned about the lack of symmetry in that the proposed legislation imposes a tax charge on the lessee, on deemed income, but gives no corresponding relief to the lessor. Contrary to the implication given by the Budget Day press release, most transactions of this sort will be on capital account for the lessor, so the reverse premium could only qualify for relief under the capital gains code, that is as enhancement expenditure in the event of a future disposal of the lessor's interest; in most cases we think it unlikely that it would actually qualify even on that basis. We think this is unreasonable, considering that the reverse premium represents part of the commercial cost of earning taxable rental income. The lessor should therefore be allowed a deduction for deemed trading or Schedule A expenditure corresponding to the deemed income which is taxed on the lessee. There is a precedent for this approach in the treatment of normal premiums under sections 37 and 87, ICTA 1988.
60. Two points of detail also arise in Schedule 6. First the word 'sale' in the second line of paragraph 6 is presumably used in an extended sense equivalent to 'transfer', as defined in section 779(3), ICTA 1988. This factor needs to be made clear. Secondly, the 'period' referred to in the third line of paragraph 7(1) needs to be defined.

Charities

Clause 51 - Gifts to charities.

61. The proposed section 83A(5) appears to us to be a deterrent to the giving of, say, surplus stock, (for example, unsold food to the Salvation Army), because in order to qualify a claim is required specifying the items concerned. Further, the short time period appears to us to be too restrictive. It is important to remember that, in any event, the stock usually has little or no value to the company concerned, or else it would not be donated to the charity, and therefore any tax charge is not likely to be material.

62. We would also like clarification that section 83A(2) will include scraps and offcuts, in addition to the manufactured articles themselves.

Enterprise investment scheme

Clause 65 and Schedule 7 - Deferred gains and application of taper relief

63. We mentioned in our representations last year that we were opposed to the introduction of taper relief, as it introduced further complexities into an already complicated system. Our concern at the time was that the anomalies produced by taper would require further complicated rules and our concerns are now being brought out by the highly technical and complicated rules introduced by this clause. Entrepreneurs need encouragement and simple straight-forward tax rules which encourage investment for growing companies as opposed to complicated legislation which is full of pitfalls and traps and where frequently it is impossible to identify whether the relief is available.

Capital allowances

Clause 69 - First-year allowances for small businesses etc.

64. Once again, we are disappointed that the first year allowances are extended for only one year. We find this surprising, given the Government's commitment to the long term importance of such companies to the success of the UK economy. We stated this in our representations last year (TAX 13/98) and we believe that the points we made then are still valid. In our view, such short term measures do not encourage additional investment: they merely bring forward investment that is already planned. It would be far more satisfactory if this Clause granted the allowances for a minimum of five years so as to allow businesses adequate time to plan new expenditure.

Advance pricing agreements and CFCs

Clauses 76 -78 - Advance pricing agreements (APA)

65. We have commented already on the draft legislation. Whilst we note that our point in relation to fraudulent or negligent conduct was taken (see Clause 77(5)(b)), we are disappointed to see that the other points were not taken. We believe that most of these points are still relevant, and we have set out in Annex B a copy of earlier representation (TAXREP 4/99) updated to reflect the Finance Bill proposals. We remain concerned that the APA system as set out in this clause and the accompanying draft statement of practice are not sufficiently attractive to encourage taxpayers to make an application.
66. In view of the increased emphasis on simplification, we are disappointed to note that the APA rules are not written back into Schedule 28AA. In order to understand the transfer pricing rules introduced last year, a taxpayer now has to look in three places, sections 110 and 111 FA, 1998, Schedule 28AA (as introduced by Schedule 16, FA 1998), and now clauses 76 to 78 of the Finance Bill 1999. If the Government is serious about simplification, we think it makes sense that all the rules relating to transfer pricing should be written back at one place, in this case Schedule 28AA, ICTA 1988.

Management and enforcement

Clause 80 - Corporation tax: due and payable date

67. Although this appears innocuous, our members are much concerned about the burden which the quarterly payment regime will impose on companies in estimating their tax liabilities at such an early stage, and particularly about the prospect of Revenue officers trying to impose their own views of what budgetary procedures a company should operate. They also are concerned that the new information powers relating to quarterly payments could be misused by Revenue officers trying to use them to obtain information for other purposes. These anxieties are heightened by the provision for penalties to be charged for failure to provide information, which possibly may not even exist.
68. We understand that the Revenue is intending to issue a statement of practice indicating that these powers will only be used where the Revenue already has reason to suspect that the company has deliberately or recklessly failed to comply with its payment obligations. We think it is important that a clear statement is published to that effect, and that any actual use of these powers is closely monitored. In view of the concerns on this area, we think it would be better to have a separate provision limited to a deliberate or reckless action rather than simply add the regulations to existing more generalised legislation.

Clause 83 - Group relief - consequential amendments

69. As this effectively rewrites existing legislation, we feel that the opportunity should be taken to limit its application to its intended target, namely where the second company benefits from group relief as a result of the withdrawal of the surrender to the first one. As drafted new paragraph 75A of Schedule 18, FA 1998 appears to have the effect that, in any case where a consent to surrender group relief to one company is reduced or withdrawn, the Revenue can collect any unpaid tax which results from any other member (or former member) of the group which has claimed group relief from the same surrendering company for the same accounting period. This is excessively wide, since it is not limited to cases where the second company has received benefit as a result of the withdrawal of the surrender to the first company. It would for example cover the common situation where all the group's claims and surrenders are made at the same time, but one of them later has to be withdrawn simply because the aggregate losses available for relief turn out to be insufficient.

PART V
INHERITANCE TAX

Clause 92 - Gifts

70. We would appreciate confirmation that these provisions do not apply where the disposal is other than by way of gift, for example by the termination of an interest in possession or where there exists an undivided interest in land, such as tenants in common meeting all outgoings.

Clause 93 - Delivery of accounts

71. This provision imposes an onerous and imprecise obligation upon personal trustees. We are unsure as to what is meant by fullest enquiries, as ordinarily this would depend upon the nature of the estate. Secondly, the use of the term 'exact value' appears to us to be unrealistic. We think that the requirement on personal representatives should be limited to making such reasonable enquires as are appropriate in the circumstances in order to ascertain the true value.

PART VI

STAMP DUTY AND STAMP DUTY RESERVE TAX

Stamp duty

Clause 97 - Interest and penalties on late stamping

72. We are concerned about the introduction of interest for late stamping documents executed overseas. This proposal will lead to an unexpected impost arising in straightforward commercial arrangements which had nothing to do with the UK. Consider the case of a foreign parent company which owns a foreign subsidiary. The subsidiary takes out a UK and Irish copyright. At a later date this copyright is assigned to an independent foreign company for consideration. Some years later an infringement of the copyright takes place in the UK. In order to pursue its case in the UK courts the company will need to have the assignment stamped, which will result in a charge to interest. It does not seem reasonable that the foreign assignee company should have to pay interest in the UK. We suspect that this is only one of many typical examples, and believe that this provision should be limited to cases where one of the parties to a transaction is UK resident.

14-4-60
FCL/FJH/PCB/AM
4.5.99

VAT STATUTORY INSTRUMENTS

Comments on Statutory Instruments laid around Budget Day

Election to waive exemption (*SI 1999 No 593*)

1. We do not oppose this anti-avoidance legislation, but there may be isolated cases of innocent transaction caught by the new provisions which can apply to contracts and commercial agreements entered into prior to 10th March 1999. We would welcome clarification of how Customs propose to deal with such instances.
2. An example of such a case would be where a developer entered into a contract to develop a site which was going to be occupied by a bank which was going to finance the development. If this took place on, say, 1 January 1999 it would have been possible for the developer to waive exemption, because the site would not be a capital item. The letting agreement on the same day, say, would have assumed that the developer charged VAT on the rent and recovered VAT on the development.
3. The new provisions severely disrupt such arrangements leaving the developers out of pocket to the extent of the VAT on the entire development costs. The bank would gain by not having to pay VAT on the rent. There is no provision to force the parties to re-negotiate their contract to reflect the new situation. This is clearly unfair.
4. We are aware that Customs do not favour a motive test in targeted VAT anti-avoidance legislation. This makes it more difficult to exclude commercial transactions where there was no tax avoidance motive. Concessionary treatment is a less certain and less consistent than statutory rules. Also in the case of land, it is problematic to allow a rent to be taxed by concession rather than allowing the anti-avoidance legislation apply to exempt it. We would welcome discussions on devising a suitable motive test that can be used in future targeted anti-avoidance legislation.

Financial services (*SI 1999 No 594*)

5. This Statutory Instrument amending Group 5 of Schedule 9, VATA 1994 was in flagrant breach of best practice on VAT changes. Traders were expected to charge tax from 10 March 1999, nearly a week before HMSO could produce the Statutory Instrument.
6. Considerable disruption and uncertainty was created because the new provisions are poorly drafted and introduce terms not used in the real world of the financial sector. That uncertainty will continue as a number of firms possibly affected by the changes have announced their intention to litigate.
7. It appears likely that any additional revenue will be marginal as traders seek to enforce their rights to the exemption under the EC Sixth VAT Directive.
8. What is particularly surprising here is that many people in the financial sector would not object to a revision of UK law on financial services to bring national law closer in line with Community law. Few would complain about the main objective of getting rid of the

term ‘the making of arrangements’. Proper consultation could have produced new provisions carrying the broad support of the financial sector.

9. It is not too late. The courts are not the best way of resolving this problem. We suggest that a thorough review of Group 5 is required. The financial sector has advised us that it will co-operate to produce sensible legislation.
10. We have already made clear to Customs our detailed objections to SI 1999 No 594. There are two main problems. First, the statutory instrument introduces a new definition of ‘the management of credit’ which the market would not recognise as such a service. The second problem is how the term ‘negotiation’ (of a financial service) is defined in UK national law.

Partial exemption (*SI 1999 No 599*)

11. We note the change made to the partial exemption rules by the abolition, for tax years beginning after 10 March 1999, of the simplification in Regulation 105 of the VAT Regulations 1995 effected by the VAT (Amendment) (No 2) Regulations 1999 (SI 1999/599). We appreciate there may have been an unfair advantage gained by some larger businesses as suggested in Budget Note 17/99. However, we are concerned that the result may be to prejudice the many other traders for whom this rule was important.
12. In particular, we are concerned at the possible impact this change may have on the treatment of the assignment of trade debts. We believe that, in the context of the standard method in Regulation 101, such supplies by the assignor are incidental for the purposes of the residual input tax calculation in Regulation 101(2)(d) (see Regulation 101(3)). We also believe that none of the taxable charges made to the trader by an assignee, such as a factoring company, would be specifically attributable to the exempt supply of the debt under Regulation 101(2)(b). We would welcome assurance that this is the case. More generally on the same point, we would welcome confirmation that, for traders using a special partial exemption method, the policy of the Commissioners will be to look through any such exempt supplies of trade debts and judge the recovery of input tax by reference to the underlying goods and services those debts represent.

ADVANCE PRICING AGREEMENTS (APAs)

Extract of a letter submitted to the Revenue in January 1999 in response to a consultation paper issued in December 1998 (TAXREP 4/99) updated to reflect the Finance Bill proposals

CONTENTS

	Paragraph
Clause 76	2 - 8
Clause 77	9 - 13
Clause 78	14 - 15

Clause 76 - Scope of APAs

- 2 We believe that the scope of APAs should be extended to include, in particular, the following situations:
- * [we are content not to take the point concerning thin capitalisation].
 - * the ‘special relationship’ circumstances contemplated by section 788(3)(c)(ii). There are two points which need to be made. Firstly, we believe that an APA should cover the relatively few cases where there may be a special relationship within section 788(3)(c)(ii) even though there is not the necessary degree of connection to bring Schedule 28AA into play. Secondly, where Schedule 28AA does apply but has been covered by an APA, we believe that the Revenue should not have the power to invoke section 788(3)(c)(ii) to override the APA.
- 3 We believe that consideration should also be given to APAs in relation to matters which may give rise to chargeable gains and capital allowances.

Clause 76 (2)(b) - Definition of ‘permanent establishment’

- 4 It is unclear whether the reference in this clause to a ‘permanent establishment’ is a reference to an ‘establishment’ as defined in section 788(3)(c)(i), ICTA 1988. We believe the problem could be resolved by the deletion of the word ‘permanent’.

Clause 76 (4)

- 5 This clause makes it clear that new clauses 76 (2)(d) and (e) are specifically related to schedule 28AA (transfer pricing rules). However, we believe that the other parts of new clause 76 (2) (i.e. (a), (b) & (c)) should refer to sections 11(2) and 788(3)(c), ICTA 1988 and section 126(2), FA 1995.

Clause 76 (5)(a)

- 6 We are confused by this sub-clause, and various opinions have been expressed as to what it is meant to say. One view is that the clause appears to suggest that the scope of an APA

might vary the normal legal/tax consequences of a transaction. This is not what we understand to be the purpose of APAs. Their purpose is simply to agree what is essentially a matter of quantification, and should not give an administrative power to the Revenue to change the rules on a case by case basis. We suspect that this is not the intention of the clause.

- 7 Another, more likely, view is that a taxpayer is being asked to venture an opinion on what would be the outcome without an APA, when the whole point is that the taxpayer has applied for an APA to resolve an area of doubt and uncertainty. This appears to put the taxpayer in an impossible position which, on the face of it, might prejudice his APA application. We believe that a taxpayer can only reasonably be expected to put forward his APA proposal, disclosing fully the circumstances, terms and nature of the transactions, with the objective of reaching agreement with the Revenue.
- 8 We would be grateful for an explanation as to what this sub-clause is designed to achieve. We suspect that it will need to be redrafted to make its intentions clearer, but our preference is for it to be deleted.

Clause 77(2) - Revocation

- 9 Taxpayers should be able to rely on an APA where they have complied with the terms of the agreement. If a binding agreement is made on the basis of proper disclosure, we are concerned that there should be no general power of revocation by the Revenue until the facts change. It is, of course, likely that changes in the facts will be identified by the periodic monitoring information which will need to be supplied by the taxpayer under the terms of the agreement.
- 10 Although we are opposed to a general power of revocation, in any event the question of revocation should be capable of appeal to the Special Commissioners, including where the points referred to in clauses 77 (2) and 2(5) are in issue. Although such disputes would essentially be contractual in nature, an appeal to the Special Commissioners would provide a suitable forum for review which is relatively inexpensive and which would avoid the necessity for the taxpayer applying for a judicial review. For the avoidance of doubt, we believe that this is a separate issue from the normal rights of appeal referred to in paragraph 44 of the draft Statement of Practice.

Clause 77(4) - Information requirements

- 11 We understand that the information requirements set out in this clause mirror the corresponding rules in the US tax code. However, the requirements do not fit easily with self assessment for companies. In principle, the normal rules should apply so that taxpayers with APAs should self-assess their liability. If any ongoing information is required, beyond the normal self assessment information, then this should be specified clearly at the outset in the APA and there should be no general power given to the Revenue. Therefore, we are of the view that the words 'or by virtue of any request made by an officer of the Board in accordance with the terms of the agreement.' should be deleted.
- 12 If the taxpayer does not comply with the APA and/or does not make suitable disclosure, then we would have thought that the taxpayer will face penalty consequences in the normal way. We would be grateful for clarification of the penalty position as it is intended to apply to APAs.

Clause 77(5) - False and misleading information

- 13 [This point has been addressed by the inclusion of the words fraudulently or negligently].

Clause 78(1) - Effect of APAs on non-parties

- 14 Clause 78(1) appears to permit agreements which are at variance with the arms length rule in Schedule 28AA, ICTA 1988. We believe that the section should provide that a question determined in accordance with the agreement is deemed to be in accordance with paragraph 1 of Schedule 28AA or any other applicable statutory provision. Accordingly, we do not think that it should disapply any part of that schedule.

Clause 78(2)

- 15 We believe that it is wrong in principle that an APA between the Revenue and, say, Company A can effectively bind Company B, even though Companies A & B will be connected within the expanded definition of Schedule 28AA. This contrasts with, for example, the position under paragraph 12(4) of Schedule 28AA, where Company B is entitled to be heard in Company A's appeal. The logical outcome is to exclude any transactions with UK counterparties or to include those counterparties in a tripartite agreement (as contemplated by clause 78(4)).