TAXREP 17/02

FINANCE BILL OF SPRING 2002

Memorandum submitted in May 2002 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Chancellor of the Exchequer

CONTENTS

FINANCE BILL OF SPRING 2002

WHO WE ARE

1. The Tax Faculty is the focus within the Institute of Chartered Accountants in England and Wales for those Chartered Accountants working in the area of tax. It is a centre of excellence and the authoritative voice for the 119,000 members of the Institute on taxation matters. The Tax Faculty makes representations to Government and other authorities, and public pronouncements on major tax issues. Chartered Accountants are advisers to all of the top 100 FTSE companies and our members include those in tax practices and in businesses ranging from the largest to the smallest concerns.

INTRODUCTION

2. We set out in this memorandum our detailed comments on the clauses in the Finance Bill 2002. However there are some general comments that we feel we should make first.

Size and complexity

3. We are concerned at the length of the Bill, which totals 488 pages. We had hoped that last year's Finance Bill had marked a recognition that the volume of tax legislation had got out of control.

4. We appreciate that the move towards a more modern form of drafting initiated by the Tax Law Rewrite project, which we fully support, inevitably results in an increase in the volume of legislation. We agree with the Tax Law Rewrite concept that it is worth sacrificing brevity for clarity. Nevertheless, we doubt that a great deal of the size of the Bill, which is roughly 50% longer than last year's, can be attributed to an increase in the use of the rewrite style of drafting. Whilst we appreciate the Government's desire to modernise many areas of the tax legislation, it is important that users of the legislation, both within the tax authorities and taxpayers and their advisers, are able to assimilate the new legislation.

5. If there is such a volume of new legislation that advisers cannot be confident that they understand its intricacies that dulls the effect of the incentives that the Government are seeking to introduce. Uncertainty is a very significant deterrent to commercial transactions.

6. We are particularly concerned about the size of the Bill this year because the Budget was a month later than normal and it appears that the timetable for consideration of the Bill has been compressed to allow it to be enacted as normal in July. We think it important that new legislation is properly considered before it is enacted. This requires time for professional bodies and other interested parties to assimilate the Bill and identify problem areas, so that these can be reconsidered and hopefully amended before the legislation is enacted.

7. The compressed timetable has allowed only three weeks between publication of the Bill and the start of its consideration in Standing Committee. This gives little time for

bodies such as the Tax Faculty to solicit views from members around the country, collate them and consider which are of sufficient importance that we feel that we need to make representations on them. The compressed timetable is also likely to limit the time for Parliamentary scrutiny.

8. Whilst we acknowledge that the Finance Bill Standing Committee is not composed of tax experts, we do think that Parliamentary scrutiny is of importance, not only because it provides an opportunity to seek to persuade Members to take up issues about which taxpayers and representative bodies feel strongly but have been unable to convince the Inland Revenue of the merits of their case, but because it also gives the opportunity for the reasons for some of the changes to be probed. The longer the Bill the less time that the Standing Committee is likely to be able to spend on considering individual issues. Indeed we suspect that with a Bill of this magnitude large parts of it will receive no parliamentary scrutiny at all.

9. We think this bad not only because if a Standing Committee is unable to perform its traditional role of scrutinizing and improving the Bill this will result in poorer quality legislation, but also because we do think it is important that taxation is imposed by Parliament and if Parliament is not able even to briefly consider large parts of the legislation the reality becomes that the tax imposed by those parts is imposed by the Executive and rubber stamped by Parliament.

10. We are particularly concerned about the fact that much of the legislation is relegated to Schedules, which make up over 60% of the Bill. Whilst we accept that there is merit in relegating details of the legislation to Schedules to avoid the details obscuring the primary thrust of a particular provision, it is inevitable that long Schedules receive less scrutiny than actual sections of an Act.

11. We find it particularly frustrating given that the rewrite of the Capital Allowances Act, the first fruits of the Tax Law Rewrite project, managed to dispense almost entirely with Schedules. We do not think that this was an accident but rather a deliberate recognition that it is far easier to understand legislation where it is set out in a logical way in the body of an Act. We find it hard to believe that a Bill of 140 clauses should require 39 Schedules to supplement those clauses.

Consultation

12. We acknowledge that most of the major areas in the Bill have already been the subject of consultation. We welcome the trend towards increased consultation. However, even where consultation results in the publication of draft legislation so that there is an opportunity prior to the publication of the Finance Bill to consider comments on that part of the legislation the Finance Bill itself does not highlight the changes that have been made in response to the consultation, so whilst it does not need to be looked at afresh the relevant provisions do at least have to be studied to identify where changes have been made.

13. If the Government's desire for change makes long Finance Bills inevitable, it would be helpful if a way could at least be found, either in the Bill itself or an accompanying document, to highlight how the legislation has changed as compared with the draft that was previously published.

Statutory Instruments

14. There are a number of areas in the Bill that leave the details to be fleshed out by statutory instrument. As we have stated many times in the past, we believe that substantive legislation ought to be contained in Acts of Parliament where they can be readily found by taxpayers.

15. We accept that the use of Regulations is sensible to deal with administrative rules, and possibly fairly esoteric specialist areas which are likely to affect a comparatively small number of taxpayers. However, we feel that, in general, recourse to statutory instruments ought to be discouraged. Not only do Regulations in practice receive little parliamentary scrutiny but it is very difficult to comment on the enabling legislation contained in a Bill without a draft of the statutory instrument being available, as the reader is left to guess at what the Government actually intends should happen.

Guidance

16. We welcome the detailed guidance that both the Inland Revenue and Customs & Excise give on the interpretation of new legislation. It is however important that such guidance is available well before legislation takes effect, particularly where this is prior to the enactment of the Finance Bill. We appreciate that this may cause extra work for the tax authorities as the guidance would need to be revised if the Bill is altered during its passage through Parliament.

17. The VAT Flat Rate Scheme is a good example of the problem. There are significant changes between the legislation and the consultation document issued last year. We are obviously very pleased that Customs listened to representations and made these changes. However, the Budget day press release did not highlight these changes and neither did VAT Information Sheet 2/2002. The full details of the scheme were not available until the publication of VAT Notice 733, which was published on Customs' internet site on 25 April.

18. As the scheme operated from 25 April this effectively meant that very few people could adopt the scheme from that date as clause 23 of the Bill gives no details of what is proposed and the Regulations, which will contain the bulk of the legislation, had not been published – and presumably will not be until the Bill has received Royal assent. Accordingly, nobody was in a position to decide whether or not to adopt the Flat Rate Scheme prior to the issue of Notice 733. We think that it would have been sensible to issue that notice on Budget day so that people could consider it and decide what to do prior to 25 April.

What is Government tax policy?

19. We are concerned at the increasing divergence between high and increasing tax rates on small unincorporated businesses and a gradual reduction in the rates of tax of small companies. In some cases, albeit fairly rare, an individual may be taxed (including national insurance) at an effective rate of 48% (40% income tax plus 8% Class 4 national insurance) whereas the same profits earned by a company are taxed at

significantly less than 20%. The profits of the small unincorporated business with a profit of under £10,000 will normally be taxed at 30% (22% income tax plus 8% national insurance) whereas if the business is incorporated the overall rate of tax will be nil, irrespective of whether the profit is ploughed back into the business or is distributed by way of dividend to its shareholders.

20. We can no longer discern the policy of the Government towards small businesses. On the one hand the structure of the tax system seems increasingly to be encouraging such businesses to incorporate. On the other hand, where such businesses do incorporate, as happened in the IT industry where it became commercially impossible for a sole trader to obtain work, the Government seem to perceive incorporation as a form of tax avoidance.

21. Thirty years ago earnings were taxed less heavily than investment income and the tax system incorporated provisions (the shortfall rules) to, in effect, force small companies to pay a minimum amount of after-tax profits as dividend rather than allow surplus funds to accumulate within the company. Today, earnings are taxed more heavily than investment income and the tax system encourages the accumulation of surplus profits within companies. We are not economists. We accept that it is possible that there may be good economic reasons why investment income should be regarded as more beneficial to the economy than earnings or that surplus funds should remain within a company, usually on bank deposit, rather than being distributed and used either for spending or investment in other businesses. However, we suspect that most people would be surprised if that is the case.

22. The problem for the small business is that it cannot keep changing its form of organisation in line with changes in approach to tax policy. Indeed, we believe strongly that the form of organisation of a business should not be affected by the tax system. It should be determined solely by commercial considerations, including ease of administration.

23. We submitted last year to the Inland Revenue a paper suggesting a format for a common system of taxation for small businesses which we believe would largely eliminate the form of organisation of such business being dictated by the tax system that prevails at the time the business is set up and its remuneration and dividend policies being dependant on the attributes of the tax system that prevail from time to time. We think that this ought to be the Government's objective for small businesses.

24. Similar dilemmas arise in relation to tax and National Insurance contributions and tax and social security benefits. At times the policy seems to be for the two sets of systems to converge as far as possible yet there seems little inclination to adopt a common set of rules for basic concepts such as the measure of income.

General comments on the Bill

25. We welcome the positive response of the Revenue to our and others' representations and the fact that many issues that have been discussed are in the Finance Bill. We are disappointed that there are numerous other difficulties which remain unresolved or have been rejected.

26. In particular we welcome the changes to taper relief in Schedule 10. These result from consultation with ourselves and other professional bodies. We particularly welcome the openness and willingness to listen shown by the Revenue in the course of those consultations. We hope that these changes are a first instalment. There are a number of issues to which the Revenue have undertaken to give further consideration and we accordingly look forward to further changes next year.

27. We are obviously disappointed that the Government has announced that it has rejected a number of changes that we felt important. We hope that the door has not been firmly closed on at least the following item that we believe would significantly improve the operation of capital gains tax and remove inequities that damage the credibility of the system, namely, the apportionment of taper relief.

28. A large measure of unfairness and distortion, not to mention complexity when computing amounts chargeable to tax, arises when an asset changes its status, either owing to the change in the rules on 6 April 2000 or because of an event that disqualifies the asset from being a business asset. The first means that someone who after 5 April 2000 disposes of an asset which changed from a non-business to a business asset for taper relief purposes on 6 April 2000 has to take into account his ownership for a longer period, in some cases up to ten years, than someone who owned an asset for the same time but whose ownership does not straddle this date. Examples of the second are where a trading company is put into liquidation or an employee shareholder changes jobs. These instances lead one to surmise that the effect of business asset taper relief in reality is more to encourage people to contrive to hold the assets they have got as business assets rather than encourage investment.

Abbreviations

29. The following abbreviations apply:

FA	Finance Act
ICTA 1988	Income and Corporation Taxes Act 1988
TCGA 1992	Taxation of Chargeable Gains Act 1992
VATA 1994	Value Added Tax Act 1994

30. The male gender implies both the masculine and the feminine.

PART 1

EXCISE DUTIES

Hydrocarbon oil duties

Clause 6 and Schedule 3: Regulating trade in rebated heavy oil etc

31. This legislation provides that suppliers of rebated heavy oil will have to ask their purchasers to tell them to what use they will be putting the fuel that they are buying. The supplier will be obliged to exercise a duty of care (apparently including the monitoring of purchasing patterns); otherwise he will be liable for the duty in the event of unauthorised use by a customer. It is abhorrent that one group of traders may be penalised for the actions of others which are beyond their control.

PART 2

VALUE ADDED TAX

Clause 22: Disallowance of input tax where consideration not paid

32. We welcome the withdrawal of the requirement for a supplier claiming bad debt relief to notify the customer that the debt has been written off for VAT purposes, as this could lead the customer to believe that it was also written off or waived commercially.

33. We are however very concerned at the practical problems that new Section 26A (1) is likely to cause. It seems to require every single trader to review all of his unpaid bills every time that he prepares a VAT return and then to adjust the VAT on any that are more than 6 months old. There are many reasons why an invoice might be outstanding for more than 6 months. For example, the supplier may have agreed a trial period to ensure that a machine performs as promised before payment needs to be made, there may be a dispute over whether a particular invoice has been paid or not, where a person gets into financial difficulties he often makes general payments on account that will not relate to specific invoices so there would be a need to allocate such payments against invoices. There is also a problem with running accounts such as intercompany current accounts where the date of payment of any particular item is unclear and in many cases will not be until the customer has finalised and approved his annual accounts. We question whether the creation of such problems, which are wholly unrelated to bad debts, justifies the imposition of this clawback.

34. We trust that the compliance obligations that are prescribed will be implemented so as not to impose disproportionate burdens on traders. For example, we would not like to see routine requests for aged creditors listings so that Customs can check that all of the above possible adjustments have correctly been made.

35. We would welcome confirmation that the input tax claw-back will not apply to repayments of VAT to European Union and third country traders under Parts XX or XXI, VAT Regulations 1995. It seems to us that this is the position based on the words of the legislation and, indeed, that the relevant European legislation provides no power to impose such a claw-back, but it would be helpful to have a clear statement of the policy position adopted by the Commissioners.

Clause 23: Flat rate scheme

Sub-clause (2)

36. There are many provisions in this clause the application of which is mainly subjective. As such it is not appropriate that the final word on these should rest with the Commissioners (see comments below concerning the right of appeal). VAT is a self-assessed tax, and it is essential as a simple matter of fair play that the traders with primary responsibility for applying it should have a measure of certainty when carrying out this task on behalf of Government.

37. For example, determining the appropriate trade category is not always going to be straightforward, particularly for fledgling businesses. The trader must make an initial judgement based on expectations. It would be wrong for that initial judgement to be overturned purely with the benefit of hindsight (a distinction must be drawn between an initial categorisation which is plainly implausible and one which is reasonable but happens to differ from the actual results).

38. There is a need for rights of appeal in respect of new sub-sections 26B(4) and 26B(8)(b). In the light of the wide scope for subjective judgement, the VAT and Duties Tribunals need to be given unfettered jurisdiction (ideally, there should be a presumption in favour of the trader's initial judgement on such matters). The amendment to section 83 VATA 1994 in sub-clause (2) is not sufficient. Either section 83 needs to be widened to cover the various aspects of new clause 26B or preferably, reiterating our view expressed many times in the past, section 83 VATA 1994, which restricts the right of appeal by traders to a relatively limited list, should be replaced by a general right of appeal.

Sub-clause (3)

39. New sub-section 84(4ZA) VATA 1994 is yet another attempt to fetter the jurisdiction of the Tribunal. As indicated above, we consider this entirely inappropriate, particularly for a self-assessed tax. In many instances it has the effect of rendering the right of appeal merely illusory.

40. We also question whether such a restriction is permissible under EU law. Given that clause 23 purports to enact EU law, it seems essential that there should be a full right of appeal to the courts (i.e. independent of the Commissioners), and we therefore question whether the UK is entitled to impose a restriction of this sort on the right of appeal. It is incumbent on Government to give serious consideration to this question before enacting the legislation, especially as the traders affected by it are by definition smaller traders, who may not have the resources to pursue such matters to the European Court of Justice.

41. In addition, it seems possible that such restrictions on the jurisdiction of the tribunal (and hence the courts) may in some cases be incompatible with human rights legislation.

Secondary legislation (SI 2002/1142)

42. We would welcome clarification of 'associated' in regulation 55L(d)(iii).

43. Regulation 55P implies that Customs has the power to retrospectively remove a trader from the scheme. We would welcome confirmation that this is not so, or if it is, that there will be a right of appeal.

Guidance by Customs

44. As the provision is intended to be deregulatory and is aimed at the simplest of businesses, it is even more important than usual for Customs' guidance to be clear and helpful.

45. For example, the notice should emphasise the continuing need to keep records for direct tax purposes, in case the Inland Revenue selects the trader for an enquiry.

46. The trade categories set out in the Regulations are very broad and it is not easy to determine to which of these many trades belong. We suggest that Customs' guidance should include a comprehensive alphabetical list of trades showing into which statutory trade category Customs consider particular trades fall in order to help traders to identify the appropriate category.

Clause 24: Invoices

47. Paragraph23 of the information sheet gives an implementation date of 1 January 2004, whereas sub-clause 24(5) implies that there may be a variety of implementation dates. A single date will be better not only for traders but also for software designers. This is of particular importance to the very largest businesses operating throughout the EU and invoicing via Shared Service Centres, but is also of importance to many others.

48. As a related point, under Article 2.6 of the Invoicing Directive, all Member States have to issue VAT identification numbers, or a tax reference number, but not until 1 January 2004. If the UK jumps the gun, there could be problems if Customs have not checked first that all Member States have changed their systems and issued these numbers.

49. It appears that the UK will need to devise a scheme for the provision of tax reference numbers for UK businesses trading below the VAT registration threshold in order to deal with inward Article 9(2)(e), Sixth VAT Directive services.

PART 3

CHAPTER 2

OTHER PROVISIONS

Employment income and related matters

Clause 33: Employer-subsidised public transport bus services

Sub-section (4)

50. We believe that the relief ought to be extended to cover other public transport services such as trams and light railways. Whilst we doubt that an employer would want to subsidise the capital cost of such services, he may well be prepared, for example, to subsidise the cost of running additional trains during the rush hour.

Sub-section (5)

51. We are becoming concerned at the number of exceptions to section 141 ICTA that are scattered over the tax legislation. We think that it would be more sensible to amend section 141 to accommodate the change in sub-section (5) (and to bring together the similar changes made in earlier years) so that that section contains a complete list of exemptions rather than them being scattered about the legislation. The same comment applies to clause 36.

Clause 36: Exemption of minor benefits: application to non-cash vouchers

52. As indicated above under clause 33(5), we suggest that section 141 ICTA should be amended to accommodate the change in sub-section (1) so that that section contains a complete list of exemptions rather than their being scattered about the legislation.

Clause 37 and Schedule 6: Minor amendments to the Schedule E charge

Schedule 6

Paragraph 4

53. The major effect of the change to section 144A ICTA (payments etc received free of tax) seems to be to impose a charge to National Insurance in relation to tax paid by an employer that is referable to a non-cash payment to an employee and is not reimbursed by the employee within 30 days.

54. This 30 days time limit is very tight. Reimbursement one day late brings the provisions into effect. There are major practical difficulties in meeting this time limit, particularly where the employee is working outside the UK. The imposition of National Insurance clearly aggravates this problem. In these circumstances we believe that the 30-day period needs to be extended. We consider 90 days to be more appropriate.

Chargeable gains

Clause 43 and Schedule 8: Exemptions for disposals by companies with substantial shareholding

Schedule 8

Paragraph 1 (inserting new Schedule 7AC into TCGA 1992)

New paragraph 3(3)

55. We understand that the intention of this paragraph is to allow the conditions for exemption to be treated as satisfied for an additional two years where the disposal in question is made with a view to or in the course of a winding up. However we do not believe that it is effective to achieve that result. In such cases the reason for the failure to meet the requirement in new paragraph 18(1)(b) is not that company A has been wound up or dissolved, still less that it is going to be, but simply that it has disposed of a substantial part of its trading activities or trading subsidiaries.

New paragraph 4

56. The consequences of a transaction in which a company transfers a subsidiary to another company within the same group in exchange for an issue of new shares are unclear. We understand that the intended effect of new sub-paragraphs 4(1) and (3), read with new paragraph 6, is that the exemption under this Schedule does not apply, and the transaction is therefore treated exactly as it would have been before 1 April 2002. We can see how this conclusion can be reached. However in our view the complexity of the reasoning involved leaves at least as much scope for a court to come to an unexpected conclusion as there was in the case of Westcott v Woolcombers Ltd [1987] STC 600, and we consider that this type of transaction should be dealt with more explicitly.

New paragraph 5

57. This anti-avoidance provision is so widely drafted that it appears to catch almost any disposal. In particular, the provision is far too subjective and uncertain in its application, and these concerns will reduce substantially the effect of the new relief.

58. This is a key new relief and it is vital that it is not emasculated. We understand the Government's concern to prevent the new relief being abused, but we do not think that this paragraph is an appropriate response to the problem. The paragraph hands too much discretion to the Revenue to decide what transactions will qualify for the relief and what will not. Taxpayers are entitled to be taxed according to the law and not untaxed by Revenue practice. The provision should be withdrawn in favour of a properly targeted anti-avoidance provision. It is our understanding that the Government is concerned to prevent corporate taxpayers converting an ordinary investment return into a tax-free chargeable gain. We would have thought that it was

possible to draft a suitable anti-avoidance provision which would catch this type of arrangement.

59. We understand that the Inland Revenue is shortly to issue guidance on how it will apply this provision in practice. We welcome the publication of such guidance and hope that it will be published as soon as possible. However, we remain opposed to the approach adopted by this paragraph.

New paragraph 20: Meaning of "trading company"

60. We understand that 'substantial' in this context will be more than 20% and we would welcome clarification that that the corresponding taper relief rules will apply also for the purposes of this relief. In view of the increased importance of this test, however, it would be helpful if the Revenue published further guidance on how this test will be applied. In particular the existing guidance on taper relief fails to deal with the very important question of how one is to decide what is substantial when comparing an activity which may involve a large amount of money but little management time, such as investing surplus cash, with one where the converse applies.

New paragraphs 20 to 22

61. We understand that sub-paragraphs (2)(b), (c) and (d) in each of these paragraphs are intended to cover the case of a company which has sold a substantial trading activity or subsidiary and has temporarily invested the proceeds with a view to using it to acquire a new business. However we think it extremely doubtful whether the investment of cash, even in these circumstances, can strictly be said to be an activity carried on for the purpose of acquiring the new business. The investment of the cash might alternatively be regarded as not 'substantial', on the basis that it is qualitatively insignificant so long as the company's main concern is to find the new trade, but this too is uncertain as noted above. The point should at the least be explicitly covered in a new statement of practice.

Clause 44 and Schedule 9: Share exchanges and company reconstructions

Paragraph 1 (substituting new section 135 TCGA 1992)

62. We find it surprising that new sub-section 135(1) TCGA 1992 swaps round companies A and B as compared to the current section 135 TCGA 1992. This appears less intuitive and we prefer the legislation as drafted currently.

Paragraph 3 (inserting new Schedule 5AA TCGA 1992)

63. We welcome the new definition of 'scheme of reconstruction' found in new Schedule 5AA. In respect of the fourth condition set out in new paragraph 5 of Schedule 5AA, it is possible that the law of another country may not have a 'corresponding provision' but instead the same effect can be achieved in a different way. We would therefore prefer the wording to be amended so that it read 'provision to achieve an equivalent effect'.

64. There is a redundant comma at the end of line 20 on page 175.

Clause 45: Taper relief: holding period for business assets

65. Whilst we welcome the reduction of the holding period for business assets taper relief, we are concerned that this significantly widens the differential in treatment between business and non-business assets. Whilst we understand the desire to encourage investment in business assets, it needs to be appreciated that a single asset can very easily change its category from business to non-business during the course of an individual's period of ownership of the asset. Where this happens, the gain is apportioned over the period of the individual's ownership of the asset and the part attributed to the period when the asset not a business asset is taxed by reference to the non-business taper scale. Very often the non-business portion can be comparatively large.

66. For example, suppose an employee acquires shares in a property investment company for which he works for 2 years, is then made redundant, is required to sell his shares under the company's Articles and it takes 6 months to agree the sale price of his shares. He will find that 20% of his gain is treated as gain on a non-business asset. We are disappointed that the whole question of these apportionments has not been dealt with by, for example, introducing a de minimis period during which an asset retains its business status. The substantial increase in tax as a result of the need to make such calculations damages the incentive effect that the business taper relief seeks to achieve. It also creates a feeling of unfairness.

67. As we have previously said on numerous occasions, this sense of unfairness also applies to those who hold shares that were not business assets between 6 April 1998 and 5 April 2000 and became business assets on that date due to the change in definition of such asssets. We believe that both of these issues ought to be addressed.

Clause 46 and Schedule 10: Taper relief: minor amendments

Schedule 10

68. We welcome most of the amendments in this Schedule.

Paragraph 3 (inserting new para 11A, Schedule A1, TCGA 1992)

69. We believe that the new paragraph 11A is likely to create significant uncertainty. Whilst we realise that it is an anti-avoidance provision we are sceptical whether many people are likely to deliberately contrive the situation envisaged in the paragraph and would question whether the provision is justified in the light of the uncertainty it creates.

70. In particular it is unclear what paragraph 11A(2)(c) covers. We would welcome an explanation of the meaning of 'winding up the affairs of a business'. It appears to be no more than that the business is being closed down. If so, the use of the term 'winding up', which has a technical meaning under the Companies Acts, is unfortunate. It is also very difficult to determine when a trade is in the course of

being closed down and when it is merely being retrenched or temporarily suspended because of economic or other difficulties.

Paragraph 4(3)

71. We are unclear why the new definition should apply only to the period after 17 April 2002. We think that it would be better to apply it to all disposals on or after 17 April as if it had always had effect. Having to compute gains with reference to two sets of rules will create enormous compliance problems. It will also aggravate the apportionment problem referred to earlier as shares in companies affected will be business assets for part of the period and not for the remainder, even though there has been no change in what the company has done. The same comment applies to paragraphs 9, 10, 11 and 12.

Paragraph 5

72. We would welcome clarification of why this provision is being introduced. The expression "interest in shares" is used in a number of other places in the tax legislation. If there is felt to be a need to define the expression we would have thought it more logical to define it for all tax purposes and not merely for the purpose of Schedule A1,CGTA 1992.

Paragraph 9

73. New sub-paragraph 22A(3) is likely to create uncertainty. The expression 'reasonably practical in the circumstances' is very subjective and creates great scope for dispute. It seems to do no more than seek to emphasise that a trade genuinely needs to be in contemplation but that test already needs to be met before a transaction can fall within sub-paragraphs 2(c). The same comment applies to new paragraph 22B(3) introduced by paragraph 10.

74. See also comment under paragraph 4(3).

Paragraph 10

75. As mentioned above any company that passes the tests in sub-paragraphs 2(c) and (d) is likely to pass the test in sub-paragraph (3). We would therefore question whether both sub-paragraphs are necessary, particularly as the effect is to reduce clarity.

76. See also comment under paragraph 4(3).

Paragraphs 11 and 12

77. See comment under paragraph 4(3).

Clause 50 and Schedule 11: Deduction of personal losses from gains treated as accruing to settlors

Schedule 11

Paragraph 2(4)

78. New section 2(6) TCGA 1992 provides that personal capital gains tax losses must be deducted from personal gains in priority to attributed gains (under sections 77 and 86 TCGA 1992). Whilst we welcome such a relieving provision we note that personal losses are to be offset against personal gains in priority to attributed gains if that gives a worse taper relief position. We would welcome clarification of why the normal rule, whereby the taxpayer chooses, should not apply.

79. Similarly proposed new section 2(7) provides that where there is more than one attributed gain which qualifies at the same rate of taper relief (including nil) there has to be a proportionate deduction (assuming the losses are insufficient to reduce all gains to nil), rather than the taxpayer simply choosing how to allocate losses against gains (including attributed gains) on a trust-by-trust basis. We would welcome clarification of why this restriction has been included.

80. We think it unfair that the change does not extend to section 87 TCGA 1992 (apportionment to beneficiaries). We suspect that this has been omitted as the drafting needed might be very complex. However sections 92 and 93 TCGA 1992 already contain rules for matching gains against distributions and we would have thought that it would be possible to build a relief on the back of these existing rules. We do accept that the relief would be very complex to compute in some cases but doubt that this would be so in the majority of cases. It may be that this problem could be dealt with by allowing taxpayers to adopt the current system where they felt that the calculation under Schedule 11 would be too complex.

81. It does seem particularly unfair that a beneficiary, who is often an innocent bystander, should be taxed more heavily than a settlor, who is the person who may have sought to avoid tax by using the settlement.

Paragraph 8

82. Paragraph 8(4) explains that, if a person elects for the new rule to apply earlier than 2003/04 and the effect of the election is to increase the total amount of tax on attributed gains so that the taxpayer is entitled to recover the tax from the trustees, then the relevant trustees must be a party to the election. Although this is fair, we would welcome clarification of how a claim to offset a loss against an attributed trust gain can increase the tax payable in respect of that attributed trust gain.

New reliefs

Clause 52 and Schedule 12: Tax relief on research and development

Schedule 12

Paragraph 4

83. If R&D is contracted out to an independent research company, that company will not generally use the results of the work in its own trade. That being so, it seems very doubtful whether the R&D can be said to be 'related to' the research company's trade, or therefore to qualify as 'relevant research and development' in relation to that company for the purposes of paragraph 4(4). It would be better for this purpose to add an additional paragraph (c) to the definition imported from paragraph 4(1) of Schedule 20 FA 2000: 'or (c) which is undertaken for another company as part of a trade carried on by the company'.

Clause 57 and Schedule 18: Relief for community amateur sports clubs

84. We welcome these new reliefs and are pleased that the Government decided to proceed with them, as we recommended in our response to the earlier consultation (published as TAXREP 5/02). However, we note that these new reliefs do not put such clubs on a completely equal footing with charities. For example, the reliefs for donors set out in paragraph 9(3) of Schedule 18 do not apply to gifts of shares and securities set out in section 587B, ICTA 1988 (as extended by clause 96 of the Finance Bill 2002). We would welcome clarification as to why such reliefs have not been extended to community sports clubs.

85. We object to the the 'exit charge' set out in paragraph 10 of Schedule 18. The imposition of a deemed disposal at market value results in an immediate tax charge on an unrealised gain. We do not see the policy need for such a draconian provision and would welcome clarification as to why it is considered necessary. If the charge is to be retained, then we think it should be capable of being rolled-over until there is an actual disposal of the property.

86. On page 243, line 21, we presume that the reference should be to Schedule 18.

Loan relationships, foreign exchange gains and losses, currency, derivative contracts

Clauses 70 to 82 and Schedules 23 to 28: Loan relationships, foreign exchange gains and losses, currency, derivative contracts

General

87. We commented on the draft legislation published on 19 December 2001 in February 2002 as TAXREP 7/02. Some of the comments that we made then are still applicable and we set out below the relevant extracts from TAXREP 7/02.

Clauses 71 and 72: Convertible securities

Clauses 71(15) and 72(4)

88. We stated in TAXREP 7/02 (at paragraph 45) that:

> ‘The effect of clause [71(15)] and clause [72(4)] is that, where an existing security ceases to qualify under section 92 of the Finance Act 1996 as a result of the changes in the law effective from 26 July 2001, it is deemed to be

disposed of at market value immediately before that date and any gain or loss is held over under section 116(10), TCGA 1992. This means that the held-over gain or loss will crystallise when the security is converted, since it is disposed of at that time and section 116(10) contains no provision for a second rollover or hold-over. This is unreasonable. Under the existing law, any gain or loss on the security would be rolled over into the shares issued on conversion, and would crystallise only when those shares are sold. The new legislation should preserve that position in respect of gains or losses accrued before 26 July 2001. This requires that for this purpose, the "subsequent disposal" referred to in section 116(10)(b) should not include any transaction which would be treated by virtue of sections 127 to 130 as not being a disposal were it not for section 116 itself.'

89. We remain of this view.

Clause 78 and Schedule 23: Exchange gains and losses from loan relationships etc

Schedule 23

Paragraph 5: Convertible securities etc: exchange gains and losses

90. We expressed concern in our earlier representation that forex movements on convertible loan stock within section 92 FA 1996 were to be brought into the loan relationships regime (as per clause 7 in Appendix 5 of the July 2001 consultation document), although they are currently excluded from the Finance Act 1993 regime. The paragraph confirms that this treatment will apply.

91. We remain concerned at the approach adopted. We said in TAXREP 7/02 that:

'This appears to be a complete reversal of the accepted principle that all gains and losses on equity-type instruments held as investments should remain outside the income regime. This is one of the points listed in paragraph 8.17 as "the solutions". However, no reason is offered as to why this change in the tax treatment of the bona fide convertibles which will still remain within section 92 should be a necessary or appropriate part of "the solution" to the perceived problem that some artificially-devised instruments should not be within section 92 at all'.

92. So far as we are aware there has still been no adequate justification given for this fundamental change to the regime and we would welcome clarification.

Paragraph 6: Extension of s.100 to exchange gains and losses and to items other than money debts

93. It is not clear in new section 100(9)(c) whether the amounts referred to are confined to those which actually are disallowed as Case I deductions or expenses of management and we would welcome clarification. Further, the amount which is or is not deductible is not the money debt itself, but the expense to which it relates.

Clause 81 and Schedule 25: Loan relationships: general amendments

Schedule 25

Paragraph 23: Bad debts and consortium relief

94. It is not clear in new paragraph 5A(14) what is supposed to happen if a group relief claim is carried forward and there is a cumulative net amount of relevant net debits in a later period. If the intention is that the group relief claim is retrospectively reduced by new paragraph 5A(12) machinery seems to be needed to give effect to this. If so, there appears to be no time limit and we would have thought that either the normal six-year or the group relief time limits should apply. Alternatively, is the intention actually that the carried-forward group relief should be treated as a claim for the later period for the purposes of new sub-paragraph (6) rather than new sub-paragraph (12)?

95. In new paragraph 5A(15)(a), since paragraph 5(3) specifies circumstances in which amounts do *not* have to be brought into account, it seems that the reference should be to amounts brought into account despite, rather than under, that paragraph.

Paragraph 24: bad debts etc where parties have a connection

96. We request once again that consideration be given to backdating this provision because this change corrects a defect in the original rules. We said (at paragraphs 39 and 40 of TAXREP 7/02 that:

> 'We are, however, disappointed again that this provision has not been given retrospective effect because this change corrects a clear defect in the original rules which should have been addressed much earlier. We requested in our earlier representation that consideration be given to giving this provision retrospective effect and we remain firmly of that view.
>
> 'We do not see why this should not be possible, given that targeted anti-avoidance measures were introduced in the draft legislation published on 26 July 2001 and that these latter measures apply with effect from that date. As a minimum, it would seem reasonable to back-date this relieving provision also to 26 July 2001 but, ideally, we think the provision should be treated as having effect from the original introduction of the rules in 1996'.

Paragraph 26: Bad debts etc: companies becoming connected

97. We can see no justification for the extension of the 'no connection' rule in new paragraph 6B(6) to periods more than 12 months before the date of the acquisition. We said in paragraph 42 TAXREP 7/02 that:

> 'The possibility of manipulation of bad debt relief in such circumstances is remote in the extreme, and the rule will have capricious results if the continuing process of mergers and acquisitions brings together a debtor and a creditor which happened to be connected long before in entirely different circumstances'.

98. In paragraph 43 of TAXREP 7/02, we said that:

'Paragraph [6B] also needs to be extended to cover the case where the company in question acquires the impaired debt by an intra-group transfer from a company which itself acquired it in a transaction meeting the requirements of sub-paragraph [(6)(a)]. Otherwise the intra-group transfer, perhaps undertaken in the course of a group reconstruction some time after the original acquisition, will result in the transferee having to write the debt up to full face value for tax purposes. This is a particularly nasty trap, and one which is not justified by the criterion suggested in paragraph 5.5 of the consultative document, namely whether the group had the benefit of tax relief for the original loss'.

99. In our earlier representation, we suggested that the general rule on tax-neutrality for intra-group transfers of loan relationships may provide an answer to this problem, but we suggested that the Revenue clarifies the position. We reiterate our request for clarification of this point.

Paragraph 35: Partnerships involving companies (inserting new paragraph 19(8), Schedule 9, FA 1996)

100. We said (at paragraph 35 of TAXREP 7/02) that:

'We consider also that paragraph 19(8) is too wide, in that it would treat a connection as existing between the partners in question for the purposes of section 87(3)(a) generally. This would affect any loan relationship which happened to exist directly between them, quite independently of their participation in the partnership. Paragraph 19(8) should treat the connection as existing only for the purposes of section 87(3)(a) as it applies to the particular loan relationship referred to in sub-paragraph (7)'.

101. We request again that paragraph 19(8) be amended in this way.

Paragraph 57: change in ownership of investment company

102. The conjunction at the beginning of the new sub-paragraphs 7(1)(e)(iv) and 16(1)(e)(iv) of amended Schedule 28A ICTA 1988, as inserted by sub-paragraphs 57(4) and (9), should be 'or' rather than 'and'.

Clause 82 and Schedule 26: Derivative contracts

Paragraph 7: Qualified exclusion: guaranteed amount payable on maturity

103. In a case where there are associated transactions, sub-paragraphs (5)(b) and (6)(b) appear to apply the 80% limit by comparing the consideration paid for entering into any one of the transactions with the amount payable on maturity of either that transaction or any of the others. This is liable to produce anomalous results, for example, where one transaction is on a much larger scale than the other, and so is almost certain to yield more than 80% of the consideration paid for the other even without any special arrangements. The two sub-paragraphs need to be linked, so that one only has to compare the consideration paid for any particular transaction or set of transactions with the amount payable on maturity of the same transaction or set of transactions.

104. The drafting of sub-paragraphs (5) and (6) is also circular, since one cannot tell whether the contract, or the contract and associated transactions, are 'designed as described in sub-paragraph (3)(a) [or (b)]' until one has established 'the guaranteed amount' and 'the relevant amount payable'.

Paragraph 26: Transfers of value to connected companies

105. It seems illogical to bring into account as the 'appropriate amount' the amount paid by the transferor for the contract, rather than the amount of the value actually transferred to the connected company. This would have the capricious effect of, in effect, disallowing the whole of the premium paid if there is even a very much smaller transfer of value.

Paragraph 37: Contract which becomes a contract to which paragraph 36 applies

106. One would expect the notional CGT disposal taken into account under sub-paragraph (5) to be at market value, to match with the opening valuation taken into account under the income regime in the next accounting period. The Explanatory Notes seem to confirm that this is the intention, but sub-paragraph (5)(b) as drafted would seem to produce that result only if the company accounts for the contract on a mark-to-market basis.

Intangible fixed assets

Clause 83 and Schedules 29 and 30: Gains and losses from intangible fixed assets of a company

107. We welcome this new regime. Further, whilst the provisions are lengthy, they are set out logically and are relatively easy to follow.

General comment on controlled foreign companies (CFCs)

108. We understand that, since intangibles are being brought into an income regime, the intention is that the controlled foreign companies (CFC) rules should apply to them in exactly the same way as to any other type of income. The Revenue's view is that few adjustments are required to the CFC legislation. However, as we discussed in our earlier representation (TAXREP 4/02 at paragraph 16 et al), the intangibles legislation contains a number of features which are not present in the existing regime for taxation of income, and it is necessary to ensure that these are appropriately dealt with in the computation of chargeable profits for CFC purposes. One such feature is the rollover relief for intangibles, which is dealt with in the new rules. However, there are several others which are not, notably the tax-neutral treatment of intra-group transfers, the market-value rule in paragraph 9 and the various provisions for reconstructions in Part 11.

109. We reiterate our comments in paragraphs 18-21 of TAXREP 4/02 that:

> ‘We accept that transfers of intangibles within a non-resident group cannot be treated as tax-neutral in circumstances where this would allow an accrued

profit to be moved out of the CFC net. However such transfers should be treated as tax-neutral if the transferee is itself within the CFC regime. Paragraph 20(2) of Schedule 24 to ICTA 1988 provides a broadly similar rule for transfer pricing purposes and could be used as a model. We note that if the "group" were defined for this purpose to include just CFCs and UK-resident companies, the degrouping rule in [paragraph 58] would operate if the transferee subsequently ceased to be a CFC. This would prevent any unrealised gain from escaping the CFC net in those circumstances'.

'Similarly [paragraph 92] . . . should not impose a market value on a transfer of intangibles between two CFCs.

'Since the rules in [Part 11] are subject to a motive test, there is no reason why they should not be extended to apply for CFC purposes to reconstructions involving the CFC and another non-resident company. The reliefs in [paragraphs 84 and 86], at least, are potentially important and should be available to CFCs. Those in [paragraphs 85 and 87] are probably of less practical importance in relation to CFCs, but since they are derived from the EC Mergers Directive consideration should be given as to whether EC law requires them too to be implemented in this context.

'The amendments which we think are required to apply [paragraphs 84 and 86] are relatively minor. In [paragraph 84], as applied for CFC purposes, it will be necessary to deem the intangibles to be chargeable intangible assets in the hands of the transferee, even though it is non-UK resident. [Paragraph 86] seems to need no substantive adaptation, since it assumes a non-resident transferee in any case. Both paragraphs would however require machinery to allow the reliefs to be notionally claimed, and Revenue clearance given, for transactions which are not directly subject to UK tax'.

Schedule 29: Gains and losses of a company from intangible fixed assets

Paragraph 9: Writing down on accounting basis

110. We would prefer charges for amortisation etc. in the accounts to be referred to as 'accounting debits' rather than 'accounting losses'. The former is closer to normal usage, and 'losses' has an entirely different meaning.

Paragraph 19: Meaning of 'realisation'

111. The definition in sub-paragraph (1) needs to be extended to cover the case of a total loss of the asset. The total loss of an asset is not a 'transaction' in the normal sense of the word; nor is it an event giving rise to a gain.

Paragraph 58: Company ceasing to be member of a group ('degrouping')

112. Sub-paragraph (1)(c)(ii) has the effect of imposing a degrouping charge in cases where the transferee was not a member of the group at the time when the asset was transferred to it. We do not think that there should be a charge in such circumstances, since in such a case the asset could not have been transferred on a tax-

neutral basis, and the mischief at which the charge is aimed would not exist. The degrouping charge should only operate in cases where there has been a tax-neutral intra-group transfer.

Paragraph 73: Assets entirely excluded: rights over intangible assets

113. We would welcome clarification that the effect of paragraph 73(b) will not result in, for example, the exclusion of a master tape from the regime.

114. We are unclear as to how an interest in a partnership under sub-paragraph 76(1) interacts with sub-paragraph 76(3) and we would be grateful for clarification.

Paragraph 76: Assets entirely excluded: rights in companies, trusts etc

115. We do not find these provisions easy to understand. It appears that sub-paragraph (1) generally prevents an interest in a partnership or trust being treated as an intangible asset in itself. However this would be over-ridden by sub-paragraphs (2) and (3) if the interest in question is treated as an intangible in the investor's accounts and also, if the investor treats the trust or partnership as transparent, to the extent that the underlying assets are intangibles.

116. If that is correct, we are concerned that there is a possibility of double counting in the case of a trust, which is taxed as an entity in its own right, if the investor is also treated as itself being within the new regime in respect of its interest either in the trust as such or in the underlying assets. Even in the case of a partnership, although the partnership is not actually a taxable entity it is required to make a return of its own profits, which normally then flow through to the partners' self-assessment returns in the appropriate proportions without further adjustment. It is not entirely clear that the machinery exists to prevent a double charge in the case of a corporate partner which is accounting for its interest in the partnership as transparent. We note the suggestion in the Explanatory Notes that 'in practice' double counting will not arise, but no reason is given for this view.

Schedule 30

Paragraph 6

117. It is not clear what is meant by 'the asset' in each of the three paragraphs of new section 33A TCGA 1992. Since sections 30 to 33 refer at various points to disposal of 'an asset', of 'the asset with enhanced value', and of 'the underlying asset', there is nothing which can be identified unambiguously with 'the asset' as referred to in section 33A.

International matters

Clause 87: extension of powers to give effect to double taxation arrangements

118. Whilst we appreciate the reasons for this clause, the extension of section 788, ICTA 1988 to cover what is likely to be an isolated case does not appear to us to be justified. If the UK Government decides to enter into any such arrangements, we

would have thought it was more straightforward to implement the arrangement by way of including a clause and Schedule in the Finance Bill at that time.

Clause 88: Controlled foreign companies: territorial exclusions from s.748 exemptions

119. This clause is an inappropriate response to a particular problem and should be dropped from the Finance Bill. Whilst we understand that the UK Government hopes that it never has to invoke this section, that begs the question as to why it is considered necessary in the first place. The policy response to the problem looks to us flawed in that it penalises UK companies rather than the territory. We think that the appropriate policy response should be to put pressure on the territories concerned: for example, we understand that Jersey has recently agreed to enter into an exchange of information agreement and we question whether as a result this provision is now necessary.

120. We are concerned that the provision could in certain circumstances be illegal under EU law. We, along with the other representative bodies, expressed concern late last year that some or all of the CFC rules may be illegal under EU law. Further, it also appears to us that, despite the statement on the front of the Bill, the provision could fall foul of Article 14 of the European Convention on Human Rights.

121. We do not think it is appropriate that Parliament delegates this important law-making power to the Treasury; that right should remain with Parliament and not delegated to Regulations. Whilst we accept that the affirmative resolution procedure applies, there is nevertheless no debate. If such a provision is considered necessary, then it needs to be redrafted and extended so that the substantive provision is included in full in the Finance Bill. In particular, the provision should specify the purpose and scope of the provision.

122. Further, the provision should not apply to UK groups which have subsidiaries in the territories concerned which meet the exempt activities test set out in Part II of Schedule 25 to ICTA 1988 and also the acceptable distribution policy as set out in Part I of Schedule 25.

Clause 89: Controlled foreign companies and treaty non-resident companies

123. We have already made in the point in the Working Group discussions on the substantial shareholdings consultation that we do not think that this provision is necessary. We remain of that view and think that the clause should be deleted. It is anomalous that a company which has ceased to be resident in the UK and no longer within the scope to UK corporation tax could remain resident in the UK for this purpose. The CFC rules are designed to protect the UK tax base, but we do not see why a non-resident company should potentially be within the UK tax base.

124. Once again, we have some concerns whether this provision might be held to be illegal under EU law as a restriction on the freedom of establishment principle. We are aware of a German case (Uberseering) currently before the ECJ where a similar provision in German corporate law was held by the Advocate General to be contrary to the EU treaty.

125. Furthermore, the company concerned will always remain subject to the application of this provision. If the Government believes that such a provision is necessary, then there should be a time limit put on its application.

Supplementary charge in respect of ring fence trades

Clause 90: Supplementary charge in respect of ring fence trades

126. We are concerned that the press release and accompanying Budget Notes appear to be misleading. REV/C&E 1 states that 'companies producing oil and gas from the UK or UK Continental Shelf will pay a supplementary charge of 10 per cent in addition to the current 30 per cent corporation tax'. However, the Finance Bill provision applies the supplementary charge to all ring fence profits. We would have expected that the charge would be limited to oil extraction activities under section 482(1)(a) ICTA 1988.

Deduction of tax

Clause 95: Cross-border royalties

127. We welcome this provision, but for the reasons set out below believe that it should be extended to cover other payments such as annuities.

128. Our concern is that there will now be different deduction procedures set out in sections 349, 349A and 349E, ICTA 1988 according to whether the payments in question are royalties or other types of annual payment. The UK deduction rules are now highly complicated and there is no clear policy reason for applying different rules to different types of payment. The new section 349E should be extended to cover all payments within section 349.

Miscellaneous

Clause 96: Gifts of real property to charity

129. This clause allows income tax relief for gifts of real property. In view of the introduction of this relief, we suggest that it would be appropriate to abolish the rule in section 25(2)(f) FA 1990 under which a gift of cash to a charity is disallowed where it is associated with a transfer of property to the charity, for example where the donor sells the property to the charity and gifts the proceeds to the charity.

130. In subsection (2) we would welcome clarification of why the real property cannot be situated outside the United Kingdom.

131. We are unclear why a person should not be able to obtain relief on a gift of his interest in a jointly owned property but that all of the joint owners must gift the whole of their interest under new section 587C(3) before any can obtain relief. There is a particular anomaly where one of the joint owners is the charity itself and the owner of the other interest is willing to gift his interest to the charity, as it is clearly not possible for the charity to dispose of its interest to itself.

132. The requirement in new section 587C(5) to receive a certificate appears unnecessarily bureaucratic. We would welcome clarification of the reason for this provision.

Clause 97: Gift Aid: election to be treated as if gift made in previous tax year

133. We suggest that subsection (2)(a) should be omitted so that the date by which the election has to be made becomes 31 January following the end of the year of assessment. We realise that the intention is to discourage people reopening their tax returns but doubt that that is a valid reason for limiting the encouragement to give money to charity. It also creates a serious risk that tax payers will delay submitting their tax returns until the last minute in case they make a charity payment during the remainder of the year. We suspect that most people normally consider charitable donations around Christmas and again towards the end of the tax year. Such a bunching of returns would cause major problems in the processing of returns and goes counter to the Revenue's attempts over the last few years to persuade people to file returns early.

134. If a carry back relief is to be granted we think in fairness it needs to be capable of applying to all charitable donations, not merely those that a taxpayer decides to make at the time he completes his tax return.

135. The rule in subsection (3) about the amount allowable is inconsistent with the existing rule governing gift aid payments; we suggest that consistency would aid compliance.

Clause 104 – Valuation of trading stock on transfer of trade

136. We are concerned about the uncertainties that this provision will create on arm's length trade and asset deals.

137. The Revenue have the power to re-apportion the consideration paid for a 'bundle' of assets both for capital allowances and capital gains purposes (under section 562 CAA 2001 and section 52 TCGA 1992 respectively). Both these provisions were amended as a result of the introduction of self-assessment. Before then, these powers were only exercisable by the Revenue where it was *'necessary'* (emphasis added). Hence, it is our understanding that the Revenue would only invoke these existing provisions where there is blatantly artificial manipulation of sale prices amongst separate assets.

138. We feel that the fiscal requirement to account for stock and work in progress on a 'just and reasonable' basis (under the proposed section 100(3) ICTA 1988) imposes an unrealistic and unreasonable obligation on parties who are in fact at arm's length.

PART 4

STAMP DUTY

Clause 109 and Schedule 34: Withdrawal of group relief

Clause 109

139. In sub-clause (1)(b) we consider that two years is unreasonably long. If a transaction is carried out with a view to it being associated with a group reorganisation then no-one is going to wait for anything like that period. We feel that one year would be sufficient.

140. Sub-clause (2)(b) provides that the stamp duty is payable within 30 days of the transferor and transferee companies ceasing to be members of the same group whereas paragraph 4 of Schedule 34 provides that interest on late paid stamp duty runs from 30 days following the date that the relevant instrument was executed. We suggest that the dates of payment of the duty and the date from which interest runs should interrelate.

Clause 111: Withdrawal of relief for company acquisitions

141. Sub-clause (4)(b) states that control is to be construed in accordance with section 416 ICTA 1988. When someone dies, the personal representatives have control during their administration of the estate. We consider that the provisions of this clause should not be activated simply by the death of someone who controls the company.

Clause 112: Penalties for late stamping

142. Sub-clause (2) inserts the words 'relates' and 'relate' and sub-clause (3) inserts the word 'involves'. We would welcome clarification of wether a distinction is intended between the words 'relate(s)' and 'involves'.

Clause 113: Contracts for the sale of an estate or interest in land chargeable as conveyances

143. In sub-clause (1) we would welcome confirmation that where there is a series of transactions the provision will only apply to the transaction that brings the total above £10 million and to subsequent transactions.

144. We consider also that the disregard for intellectual property in paragraph 4, Schedule 40, FA 2000, the disregard for goodwill under paragraph 3(1) of Schedule 36 to the Bill and the disregard for chattels under paragraph 6(2), Schedule 13, FA 1999 should all apply for the purpose of clause 113 in the same way as they apply for the purpose of paragraph 4, Schedule 13, FA 1999.

145. Sub-clause (2) provides for a time limit of 90 days by which a contract or agreement has to be presented to the Revenue for stamping whereas paragraph 8(1),

Schedule 13, FA 1999 provides a time limit of six months in which contracts or agreements have to be stamped. We consider that consistency aids compliance and suggest that the clause 113 time limit should be brought into line with the paragraph 8 time limit. Failing that, we would welcome clarification of why the time limits are different.

PART 5

OTHER TAXES

Inheritance tax

Clause 116: IHT: powers over, or exercisable in relation to, settled property or a settlement

146. We are concerned that new section 55A is likely to create uncertainty in relation to many arrangements that are outside its target. For example, suppose that on a trust reorganisation, a person receives a power that he did not have before and at the same time existing powers are cut down, the second change might be interpreted as consideration of the first. As section 55A is intended to deal with a very unusual circumstance, we would question whether its introduction is justified in light of the uncertainties it is likely to create.

147. In new sub-section 55A(1)(d), we would welcome clarification of why the spouse, charity and other exemptions are excluded.

Clause 117: IHT: variation of dispositions taking place on death

148. The requirement under the new section 218A(1) to notify to the Revenue 'the amount of the additional tax' is too wide. It is frequently impossible to quantify the tax payable due to such factors as disputes with Revenue departments about valuations and absence of knowledge about other deeds of variation. We consider that the clause should be amended so that the obligation is to notify the Revenue of the additional amount to be brought into charge to IHT, rather than the amount of tax payable. Alternatively, the obligation should be limited by reference to the best of the relevant person's knowledge and belief.

PART 6

MISCELLANEOUS AND SUPPLEMENTARY PROVISIONS

Recovery of taxes etc due in other member states

Clause 131 and Schedule 38: recovery of taxes etc due in other member States.

149. Whilst we appreciate that this clause implements an EC Directive, we have a number of concerns with it. Firstly, under paragraph 6 of Schedule 38, the request by the other Member State is taken to be duly made unless the contrary is proved. The burden of proof should be the other way around. We think that this provision will create burdens of proof which are questionable on public policy grounds and may breach Article 6 of the European Convention on Human Rights. Not all of the other member States have an appeals system which is as fair and reasonable as the UK system, and we are concerned that member States with an unsatisfactory appeals system could use this provision to collect tax in a way that is contrary to UK public policy.

150. In view of the potentially far-reaching implications of this provision, we are very concerned that the UK Government signed up to this Directive with minimal publicity. It is very important that if the Government signs up to Directives, that fact (and its implications) should be given adequate publicity. This use of this provision needs to be monitored and steps taken to ensure that taxpayers' rights are adequately safeguarded.

151. The provision is also likely to cause practical problems. What, for example, would happen if a member State requested recovery of an amount of tax which was subsequently held by the European Court of Justice to have been illegally imposed? This is a highly likely situation, given that most tax cases that are heard by the ECJ are decided in favour of the taxpayer.

152. It is important that early publicity is given in future when such Directives are intially proposed.

Mandatory e-filing

Clause 132: Mandatory e-filing

153. We object to this clause in the strongest possible terms and believe that it should be withdrawn.

154. It needs to be appreciated that the obligation to apply PAYE is not limited to businesses. Many individuals engage nannies, gardeners and other helpers and have an obligation to deduct PAYE from the salaries of such people.

155. This clause has its origins in the Report prepared by Patrick Carter on Payroll Services. As set out in our representation at the time (TAXREP 6/02), we disagree with some of the conclusions reached in that report and, particularly that there should

be compulsory e-filing of payroll returns. We said in TAXREP 6/02 (at paragraphs 2 and 3) that:

> 'Whilst the future of efficient payroll management, both for employers and for the Inland Revenue lies in an electronic solution, we are concerned at the unrealistic time scales which have been proposed and the element of compulsion suggested. ... Problems within the current electronic solutions need to be resolved before consideration of whether electronic filing should be made compulsory. Such a decision should only be reached after further debate in the light of experience of the current electronic filing methods'.

156. We are aware that other representative bodies submitted similar representations and we are deeply disappointed to find that, not only has such a provision been included in the Finance Bill, but the proposed scope of the provision has now been extended to include compulsory e-filing generally. We question whether this clause is compatible with the European Convention on Human Rights.

157. The Government and the Revenue should be concentrating their efforts an ensuring that its e-filing systems are easy to use, robust and reliable and only then encouraging taxpayers to use the service. To date the experience of taxpayers and agents of e-filing is at best mixed. Iit is essential that the quality and reliability of, and therefore public confidence in, the e-filing service improves. This may well take some years to achieve. The introduction at this early stage of a wide-ranging provision to compel taxpayers to e-file, backed by penalties of up to £3,000, is not helpful. The clause if enacted as it stands will damage the credibility of doing business electronically with Government and undermine the Revenue's 'customer focussed' approach.

158. Whilst we appreciate that the clause is meant to be phased in over several years, this merely confirms our view that such measures, if they are needed, should not be introduced prematurely. They have no place in the current Finance Bill.

159. Whilst we believe strongly that this clause should be withdrawn a subsidiary point is that we believe that management provisions, such as are proposed by this clause, should be introduced by amending the Taxes Management Act 1970 or, in the cases of companies, Schedule 18 to the FA 1998.

14-4-63
PCB/FJH
20.5.02