

TAXREP 40/08

Finance Bill 2008: Committee Stage Briefing on Clause 55, UK residents and foreign partnerships

Parliamentary Briefing submitted on 18 May 2008 by the ICAEW setting out our concerns and a suggested amendment over the retrospective nature of the proposed changes to the residence rules for partnerships.

Contents	Page
The issue	2
background	2
Suggested amendment	4

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FINANCE BILL 2008: COMMITTEE STAGE BRIEFING ON CLAUSE 55, UK RESIDENTS AND FOREIGN PARTNERSHIPS

The issue

The ICAEW accepts the need for the Government to legislate against tax avoidance. We appreciate that this provision is designed to prevent tax avoidance by UK taxpayers on income from foreign partnerships using Isle of Man/Channel islands partnerships, this planning being based upon an interpretation of the 1987 rule that was introduced following the *Padmore* case.

We support the Government's efforts to address tax avoidance, but believe that in principle tax changes should apply prospectively and not retrospectively as with this measure. We are concerned particularly by the effect of sub-section (4) of clause 55, which seeks to treat the new provisions 'as always having had effect'. The result of this change is that established tax law that has been in the statute books since 1970 has been rewritten. We do not think that the rewriting of legislation in this way meets the legitimate expectation test and it sends out a very damaging signal about the stability of the UK tax system, whereby business transactions made under one set of laws can become subject to a different tax outcome at a later date due to a retrospective change in the rules. We would therefore like the clause to be amended to apply to only current and future transactions.

Background

Although we understand that the clause is directed primarily at transactions involving Isle of Man or Channel Isles partnerships, we believe the EU law principle of legitimate expectation needs to be respected so that taxpayers are entitled to understand the implications of any transaction that they enter into. We believe that treating this provision as 'always having had effect' runs contrary to Parliament's intent over the past 30 years to lay down rules whereby the tax effect of particular transactions can be 'changed' or advance warning is given of a change in tax treatment in identified circumstances.

One of the earliest attempts to set out rules that ought to apply in such situations was made by Peter Rees (now Lord Rees) in the Standing Committee debates on what became the 1978 Finance Act: these have since been known as the 'Rees rules'. The proposals put forward by Lord Rees were in the context of anti avoidance provisions and the time from which they should have effect. The Rees rules laid down that if some form of anti avoidance provisions were to be legislated then there should be a clear warning in the House of Commons that that was intended, if possible a draft clause should be published as soon as possible which would give effect to the proposal and the clause should be incorporated in the next available Finance Bill/Act. The practical effect of the Rees rules was that they laid the ground rule for retroaction, i.e. the law when it was finally enacted could not have effect earlier than the House of Commons announcement of the upcoming anti-avoidance change.

Another approach was adopted in the late 1980s to counter a legal decision that had gone against the Inland Revenue and which the government wished to 'reverse'. In that case although the new law was stated to have always had effect this did not influence any judicial decisions made before the new law was announced.

So, for example, s 62 of Finance Act 1987 (which was the original amending legislation to the overseas partnership provisions in ICTA 1970 that has given rise to this latest amendment) was introduced to reverse the decision in *Padmore v IRC* [1987 STC 36]. The amendment to s 153 ICTA 1970 (as it then was) was deemed always to have had effect, except in relation to any judicial decision before 17 March 1987, the date when the amending legislation was announced, or to any appeal therefrom. In other words the High Court decision in *Padmore* was not retrospectively declared to be wrong and the old law was not treated as amended for the purpose of any appeal by the Inland Revenue against the High Court's decision. The appellant in *Padmore* won his case but no other taxpayer was expressly protected by the terms of the legislation. The justification for this approach was that the 1987 amendment 'restored the general understanding of the law to the position before *Padmore*', although this approach predated the more recent emphasis on the need to respect the EU doctrine of legitimate expectation.

A more recent approach was the statement of the Paymaster General on 2 December 2004 to the effect that legislation would be introduced in the future, effective from 2 December 2004, in relation to:

what the Government considers to be unreasonable tax avoidance schemes involving employment income.

We wrote to the Paymaster General in February 2005 and in our letter we noted that the Treasury Select Committee had stated in a written report that:

'The Inland Revenue should, without jeopardising their position, publish a paper setting out their thinking on the principles which will guide the way they implement [the Paymaster General's] announcement.'

Such a paper has never been published but we believe that the philosophy underlying retrospective or retroactive legislation should now be examined in conjunction with the current move to introduce purposive, or principles based, legislation.

If the underlying purpose behind any piece of legislation, or any area of tax law, is clearly articulated then any taxpayer who respects that purpose should have certainty as to the (tax) outcome of their particular transaction. If the underlying policy is to be changed then any change should, in our view, only have effect in relation to future transactions.

In summary, the application of the legitimate expectation test to this provision should be that any amendment only applies from the date that this change was announced, namely Budget Day 2008. In respect of periods before that date, if HMRC believes that these interpretations are based on a wrong view of the law then they should be challenged through the courts.

We recommend that an appropriate *modus operandi* ought to be agreed by HM Treasury, HM Revenue & Customs and Representative Bodies and then published for the benefit of all taxpayers.

Suggested amendment

- 'In Clause 55, subsection (4), pg 27, line 31, remove from 'always' to 'effect' and insert 'having effect from the 12 March 2008'

Further information

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18 May 2008