

## **TAXREP 37/04**

### **RELIEF FOR INTEREST PAID: TAX LAW REWRITE: BILL 4**

*Memorandum submitted in August 2004 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in June 2004 by the Inland Revenue Tax Law Rewrite Team*

## **CONTENTS**

<b>Section</b>	<b>Paragraph</b>
<b>A GENERAL COMMENTS</b>	<b>1-7</b>
<b>B QUESTIONS</b>	<b>8-21</b>
<b>C SPECIFIC COMMENTS ON DRAFT CLAUSES</b>	<b>22-29</b>
<b>D DETAILED COMMENTS ON DRAFTING</b>	<b>30</b>

# Tax Representation

## RELIEF FOR INTEREST PAID: TAX LAW REWRITE: BILL 4

### A GENERAL COMMENTS

1. We welcome the opportunity to comment on Paper CC(04)09 (Bill 4: Relief for Interest paid) dated 30 June 2004 and published by the Revenue's Tax Law Rewrite team at <http://www.inlandrevenue.gov.uk/rewrite/exposure/menu.htm>.
2. We note that Part 1 is drafted on the basis that it deals with 'reliefs' whereas, in the context of the Appendix 1 terminology, it currently deals with 'deductions'. We appreciate from explanatory note 7 that clause 1 (Effect of reliefs under this Part) signposts the Part dealing with calculation of liability to tax in which it will be made clear that the relief is to be given by deduction (against income); but this results in some loss of clarity. For example, clause 2(3) is not as readily comprehensible as s 353(1B) ICTA with the latter's clear direction that the relief is to be a deduction or set-off from or against income. We nevertheless also appreciate the use, in the Part 1 rewrite, of the generic term 'reliefs' to cover deductions, allowances and tax reductions and it accordingly appears preferable to delay a review of the suitability of this terminology until a more complete Bill 4 Part 1 becomes available, when its appropriateness may become more apparent.
3. We also note that the Part relating to the calculation of liability to tax of an individual remains to be written; but the further developed illustrative sketch in Appendix 1 is at this stage helpful in indicating how the deduction for interest paid fits into this computation.
4. In explanatory notes paragraph 3 it is misleading to state that relief under s 365 is obsolescent. It will remain relevant for those taxpayers eligible for this relief on 9 March 1999, who would now be aged just over 70 and upwards (depending on the date when they took out their loan). There is no indication of how many such individuals still remain eligible; but, if significant in number, rather than being left in ICTA and cross-referred to, it is arguable that s 365 should be rewritten in Bill 4 Part 1, even if in a separate Chapter in view of the distinctive relief by deduction and retention from interest payments. In this context, it is also unclear why it would be necessary for the entire MIRAS provisions in ss 369 – 379 ICTA to be rewritten as necessary support. Would not a rewrite of the effect of s 353(1F) – (1H) only be sufficient?
5. Clauses 2 – 6, as introductory clauses, collect together various basic aspects regarding the deductibility of interest payments which are currently fragmented within ICTA Part IX (Annual Payments and Interest) and this is helpful to the reader.

# Tax Representation

6. The structure of the important clauses 7 – 23, setting out interest relief for various purposes, is helpfully standardised with the ‘eligibility requirements’ clauses closely following the main relief clauses. The rewrite is generally very light touch, with the text of the source legislation being readily apparent and often little changed apart from some minor rearrangement, but the end result nevertheless works effectively.
7. The general and supplementary provisions are appropriately located in clauses 24 – 30.

## **B QUESTIONS**

8. **Q1** We agree the proposal not to rewrite s 368(2) ICTA, for the reasons set out in Annex 1 Change {jc 415}.
9. **Q2** Clause 7(2)(a) is effectively now being rewritten to reflect existing Revenue practice, accordingly affording relief for interest paid concerning ordinary Schedule A businesses (ordinary property businesses) but not for interest paid concerning the other qualifying activities in s 15(1) CAA 2001.
10. With reference to the fifth paragraph of Change {jc 404} in Annex 1, it is questionable whether there was at any time an intent that s 359(2) ICTA should be of a narrower application than s 359(1), and the present uncertainty may simply arise from defective past drafting of the various changes to this legislation. The CAA 2001 amendment of s 359(1) ICTA did substitute a clear reference to s 264 CAA 2001, and that amendment (although a change in the law) is now enacted, despite a view now that it erroneously changed the law by extending the scope for relief. The remedy is to change the law, which is what Change {jc 404} seeks to do.
11. However, s 359(2) clearly relates to s 359(1) only, as the primary sub-clause, and it is difficult to see why it should now be regarded on the basis of the currently enacted s 359(1) ICTA as applicable to certain only of the s 264 CAA 2001 activities and not to all of them, regardless of Revenue practice. It would clearly be anomalous in part-usage circumstances to restrict the interest deduction in the case of trades, professions or vocations, but not in the case of the other s 15(1) CAA 2001 qualifying activities. The drafting of clause 7(2)(a) is correct only if it is accepted that the insertion of the reference to s 264 CAA 2001 in s 359(1) ICTA was in error of excessive scope. We think the better view is that this should be accepted. It follows that we agree the inclusion of ordinary Schedule A businesses within the qualifying partnership activities in clause 7, and that clause 7 should be rewritten to exclude its application to the other qualifying activities in s 15(1) CAA 2001.
12. **Q3** We agree the drafting of clause 7(3) (and of clause 9(3)) as ensuring that relief for loan interest is potentially available for so long as the asset purchased with the loan remains within the capital allowances regime, hence affording relief in a period of account when capital allowances or a balancing charge do not arise.

# Tax Representation

13. **Q4** We agree the inclusion of clause 12(4)(b)(ii), aligning the period over which the full-time working test is applied (where the material interest conditions are met) with the period (between the application of the loan and the payment of the interest) specified in clause 12(3)(b) rewriting s 360(3)(b) ICTA (where the full-time working conditions are met).
14. **Q5** We agree that it is unnecessary to rewrite the material in s 360A(3) ICTA, on the grounds that it is spent (as relating to shares held by the trustees of a s 187 ICTA approved profit-sharing scheme). However, is it certain that ss 360A(8) and (9) ICTA, relating to pre- 14 November 1986 loans, are also now wholly spent as s 360A(8), subject to s 360A(9), appears to have a wide application to trusts. Is it considered that pre- 14 November 1986 loans, to which it applies, are now unlikely to still exist? If so, can this be confidently assumed? We have, of course, no objection as a simplification to s 360A(8) and (9) ICTA not being rewritten if they are spent.
15. **Q6** We welcome the proposal to legislate Statement of Practice A33, in clause 18(4) (Eligibility requirements for interest on loans within section 17).
16. **Q7** We agree that s 364(1)(a) ICTA has been appropriately rewritten to refer to s 226(2) Inheritance Tax Act 1984.
17. **Q8** Agreed.
18. **Q9** S 364(4)(b) ICTA does make it quite clear that relief for interest cannot be refused because interest continues to run beyond the first anniversary of the loan; whereas clause 22, as now drafted, contrary to intention, could still be interpreted as meaning that the interest must be paid only in respect of a loan period which does not exceed 12 months. It would be clearer to draft clause 22 as giving relief for interest paid in respect of the first 12 months of a loan or, if the loan is repaid within that 12 months, in respect of the shorter period.
19. **Q10** It is appropriate to rewrite s 363(1) ICTA, in clause 24 (Effect of recovery of capital in the case of certain loans), so that it applies in all cases where capital is recovered and not only where the recovered capital was not applied in making a loan repayment.
20. **Q11** We welcome the proposal to legislate current practice and ESC A43, in clauses 27 (Business successions between partnerships) and 28 (Other business successions and reorganisations).
21. **Q12** We consider that clause 30 (Information) is appropriately rewritten as regards the provisions relating to information requirements in the self-assessment context. With reference to clause 30(3)(c) are the words 'by reference to' intended to include the lengthier s 366(1)(c) ICTA bracketed reference to the inclusion of the carry-back and carry-forward s 364(2) ICTA (Loan to pay inheritance tax) relief? If so, is this intention made sufficiently clear in the drafting of clause 30(3)(c), there being no reference to this aspect in the explanatory notes on clause 30?

# Tax Representation

## C SPECIFIC COMMENTS ON DRAFT CLAUSES

### **cl 5 Loans partly meeting requirements**

22. Clause 5 is drafted on an assumption that the entire loan is for a qualifying purpose, with sub-clauses 5(2) and 5(3) then restricting the actual interest amount deductible by reference to the qualifying part of the loan when applied. S 367(4) ICTA is instead based on the reality that only part of the loan is applied for a qualifying purpose, with deductible interest then being restricted to interest apportioned pro rata to the qualifying amount of the loan when applied. The interest deductible result is, of course, the same either way; but we do not readily see why it is necessary to change the s 367(4) ICTA basis to that now proposed in clause 5. As a change in the law, is a PRC also needed?

23. S 367 ICTA does not make any provision regarding the calculation of deductible interest after part of a partially-qualifying loan is repaid (nor does clause 5). We agree the reasonableness of the comments in the third sentence in Explanatory Notes paragraph 14, which presumably also reflect Inland Revenue practice; but it would appear preferable to provide in clause 5 itself for the apportionment of loan repayments on partial repayment of a loan, requiring an appropriate PRC.

### **cl 11 Loan to buy interest in close company**

24. In Explanatory Notes, paragraph 36, the second sentence is not strictly correct.

### **cl 12 Eligibility requirements for interest on loans within section 11**

25. **sc (4)(b)** The drafting of clause 12(4)(b) is not as clear as s 360(2)(c) and its proviso. The latter makes it more obvious that s 360(2)(c) (the residential property condition) does not apply if the individual works full-time in the company. It may be clearer to include the words 'even if the condition in subsection (4)(b)(i) is not met' before 'the condition in subsection (3)(b) is met' in clause 12(4)(b)(ii).

### **cl 19 Loan to buy interest in co-operative**

26. **sc (3)** It is unlikely that the Industrial Common Ownership Act 1976 will be readily to hand when the reader wishes to ascertain the definition of 'co-operative' and related 'subsidiary'. Is it possible to rewrite these definitions in clause 19 itself?

### **cl 20 Eligibility requirements for interest on loans within section 19**

27. We note that the s 361(2)(a) ICTA condition, that the loan was made after 10 March 1981, is not being rewritten. This extends the clause 19 relief to any such loans, and we have no objection to this if it is satisfactory to the Inland Revenue.

### **cl 21 Loans to pay inheritance tax**

28. The explanatory notes do not make any reference to the dropping of the references to capital transfer tax in the clause 21 rewrite of s 364 ICTA; but we agree that this is appropriate.

# Tax Representation

## **cl 26 Replacement loans**

29. How will this clause operate if the original loan is replaced more than once? It would appear to require some redrafting to cater for such a situation, perhaps also necessitating an appropriate definition of 'the original loan' in clause 26(5).

## **D DETAILED COMMENTS ON DRAFTING**

### **cl 9 Loan to buy plant or machinery for employment use**

30. **sc (4)(c)** The reference to 'Part 2 of that Act' should more clearly refer to CAA 2001.

14.13-36  
TJH/PCB  
18.8.04