TAXREP 6/01

FINANCE BILL OF SPRING 2001

Memorandum submitted in April 2001 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Chancellor of the Exchequer

CONTENTS

	Paragraph
WHO WE ARE	1
GENERAL COMMENTS	2-13
PART II: AGGREGATES LEVY	14-20
PART III: INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX	21-80
PART IV: OTHER TAXES	81-84

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WHO WE ARE

1. The Tax Faculty represents the 119,000 members of the Institute of Chartered Accountants in England and Wales (ICAEW) on tax matters. 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.

GENERAL COMMENTS

2. We set out below our detailed comments on the clauses in the Finance Bill 2001. However, we would particularly like to stress the following key areas of the Bill.

3. Most of the major measures in the Bill result from prior consultation and the relatively limited number of our detailed comments undoubtedly reflects the success of the consultation process. The Budget introduced a number of novel ideas for future consultation. We welcome the Government's readiness to examine revolutionary concepts by means of consultation and look forward to taking full part in such consultations.

4. We are, however, still concerned about the shortcomings of much of the consultation that is undertaken. This Bill demonstrates both sorts of consultation. The changes to the double taxation relief (DTR) rules in order to correct major defects in last year's legislation emphasise the dangers of inadequately-focused consultation. In contrast, the fact that we have no technical points on the self assessment machinery changes reflects the detailed consultation that has taken place. We have made the point on a number of occasions that for consultation to be effective there should be feedback and ideally further discussion on areas where the Government feels unable to adopt suggestions that the consultation process has thrown up.

5. Whilst in general we welcome the Government's commitment to consultation, we are disappointed that there is to be yet another round of consultation on intellectual property and on capital gains tax deferral for substantial shareholdings. These two changes were promised by the Government as part of a package of changes including double tax relief. In the circumstances we think it unreasonable that the Government should have enacted and brought into force from April 2000 the part of the package that increases the tax burden on industry whereas a year later we still await the enactment of the deregulatory part of the package.

6. We would hope that Parliament does not intend to restrict its consideration of this 290-page Finance Bill. If most of the clauses fall, because the Bill is truncated as a result of the likelihood of a general election in June, and a new Finance Bill is introduced in the summer by the incoming Government, we hope that space will be found in that Bill for those two very important measures.

7. We are disappointed that unlike in the last two years the Bill contains nothing significant to relieve the burdens on employers and small businesses. We have previously expressed concern about the tax system being used to deliver what are in effect social security benefits. There is growing evidence that the use of the phrase 'tax credit' for both Working Families' Tax Credit (WFTC), which is a social security benefit whose

collection is administered by the Revenue, and Children's Tax Credit (CTC), which is a traditional tax allowance, is causing confusion amongst employers. It is also disappointing to find that in many cases the effect of the CTC is to reduce the amount of WFTC due to the claimant. If employers are to be expected to undertake the heavy burden of administering such reliefs we would have hoped that the interrelation between the two might have operated more efficiently rather that the introduction of CTC necessitating alterations to payrolls to reduce the amounts of WFTC payments.

8. Whilst we give a muted welcome to the taper relief changes we think the time has come for a radical rethink of capital gains tax especially as it affects individuals. We believe that less than 100,000 people pay capital gains tax and yet this is undoubtedly the most complicated part of the personal tax return. The Government's efforts to encourage wider share ownership especially by employees means that many more people are having to try to understand the very complex capital gains tax rules.

9. We think that capital gains tax ought to be rebased to 5 April 1998 so that citizens do not have to retain details of purchases for very many years and grapple with calculations of gains that combine both indexation and taper relief.

10. Rebasing, whilst reducing the complications, is, however, only part of the answer. We question whether the complexity of both taper relief for individuals and indexation relief for corporates is the appropriate way to reflect the concept that capital gains ought to be taxed less heavily than income to reflect the generally longer period over which the gain arises. It may be that both reliefs should be abandoned in favour of simply a lower rate of tax on capital gains. We hope that the next Government will look hard at this area.

11. We welcome the relaxation of the rules on Enterprise Management Incentives (EMI) and the clarification of the rules on employee share ownership. However, the EMI changes mean that the disparity between those who are and who are not eligible is growing. The difference is reflected in the effective rates of tax on gains of 10% and 40%. Whilst this disparity is no doubt intended, we wonder whether part of the intended target is being missed. The enterprise management incentives appear to be aimed at new companies; we feel that the Government needs to consider an incentive for companies that have reached the stage where they need to expand.

12. We particularly welcome Clauses 75 (notional transfers within a group), 77 (de-grouping charge) and 78 (attribution of gains of non-resident companies). We also welcome the increase in the use of drafting adopting the Tax Law Rewrite style.

13. We are, however, disappointed with the length of the Bill. Whilst we accept that it is significantly shorter than those of recent years, we do not believe that so many changes are needed to be made to the tax system each year and consider that Parliament should question the need for changes where Finance Bills exceed 100 pages. Much of the reason for the length of the Bill is the complexity of many of the provisions. In particular, we are disappointed to see that the new aggregates levy requires 34 Clauses and seven Schedules; a total of 71 pages or almost one quarter of the total Bill. And a small measure such as VAT on certain residential conversions takes up over seven pages.

PART II

AGGREGATES LEVY

Charging provisions

Clauses 16 to 49 and Schedules 4 to 10: Aggregates levy

General points

14. The product end-user suffers double taxation as operators are required to charge VAT on the price including aggregates levy. We understand that a typical selling price of aggregates may be about £10 per tonne. With the levy set at £1.60 per tonne this results in a total increase in costs of £1.88 per tonne, i.e. a 18.8% increase in business costs.

15. The levy is not properly targeted to achieve the desired environmental improvements. Aggregates levy is the same rate for all business operators whether they conduct their business in an environmentally-sensitive manner or not. This contrasts with Climate Change Levy where more efficient energy use reduces company costs and where there is now the incentive of first year allowances at 100% on energy-efficient equipment.

16. We understand that during the consultations with industry, it was suggested that, in a similar manner to Landfill Tax, an amount of up to 10% of the levy could instead be paid to certain environmental bodies. However, the proposed legislation does not appear to provide for this.

17. We appreciate that the Government's stance is that the introduction of the levy and the associated National Insurance Contributions reduction will be revenue neutral. However, the introduction of the levy will create additional compliance and administrative burdens and will therefore increase the costs of quarry operators and ultimately of businesses in general.

Clause 16: Charge to aggregates levy

18. The amount of the levy is set at £1.60 per tonne but this does not recognise that low grade bi-products from quarrying operations may sell at only £1 per tonne. In this event the levy exceeds the commercial value of the product with the result that product may become unsaleable and therefore create unnecessary stockpiles.

19. We understand that imported aggregates are subject to the levy on the basis that they are subjected to commercial exploitation in the UK. However, imported finished products containing aggregate (for example, concrete blocks and pipes) will not be subject to the levy, thus giving a competitive advantage to non-UK source products which include aggregates.

Clause 19: Commercial exploitation

20. The levy is not exclusively a sales-based tax and this may result in compliance burdens and also a tax charge arising before the aggregate has been sold. An example is where

aggregates are delivered by a group company to a company in the same group which uses the aggregate to make, say, concrete blocks. The use of the aggregate in this way means that it has been commercially exploited (Clause 19(1)(d)) and the levy is triggered. However, the block may remain in stock for several months before it is sold to a third party.

PART III

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER II

OTHER PROVISIONS

Employment

Clause 57 and Schedule 12: Mileage allowances: exemptions and reliefs

21. In section 57(1), in new section 197AE(1), there appears to be a drafting error in that the last word in (a) should be 'or', not 'and'. As it is, new section 197AE can never apply because it only applies if 197AD(2) applies AND it is a company vehicle. But new section 197AD cannot apply to company vehicles because 197AD(4) says so.

22. We would also welcome clarification of why an individual is taxed on the passenger payment if he does not receive a mileage allowance payment from the company.

Clause 59: Employees' vehicles: withdrawal of capital allowances

23. Under Clause 59(4) a balancing adjustment will arise in respect of a privately owned car that has been the subject of a capital allowances claim. This will be in point in any case where the drop in value is less than the fall in written down value. Whilst this is most likely to occur where the vehicle is a classic car, this will happen in a large number of other cases. We suggest that where a balancing charge arises, the payment of tax on this should be deferred until the car is disposed of.

Clause 61 and Schedule 13: Employee share ownership plans

24. We welcome the more generous relief in Schedule 13. However, we consider that as most share plans run for five years, there should be a further year's extension for existing profit sharing schemes so that they can run their course to obviate the need for employers to set up new schemes before the normal expiry of the scheme term. We would mention that the average set up costs for a small scheme of this type is estimated to be in the region of £10,000.

Enterprise incentives

Clause 64 and Schedule 16: Venture capital

25. In new paragraph 6(1) of Schedule 28B, ICTA 1988, it appears surprising that for the first 12 months the company can intend to use up 20% of the money for purposes other than the trade without needing an intention to use it for the purposes of the trade until after that 12 months has expired.

26. The 80% threshold should in any event be qualified by the words 'at least'. This will avoid ambiguity and be consistent with, for example, the test in paragraph 5, inserting new sub-paragraph 36 (1) into Schedule 15.

27. In paragraph 6(5) of Schedule 16, the substituted wording for paragraph 54(4) appears to need as the opening words 'the amount of the replacement value is'.

Capital Allowances

Clause 65 and Schedule 17: Energy-saving plant and machinery

28. We have a number of concerns with this provision.

29. Generally, the conditions for plant to qualify for this new allowance are far too complicated and place an onerous compliance responsibility on taxpayers. Taxpayers have enough difficulty in practice identifying the capital allowances available in respect of, say, a new building project, and this new relief will make matters worse.

Paragraph 2

New section 45A

30. Whilst the energy-saving plant must be of a description specified in a Treasury Order (new section 45A(3)), in practice, the key condition will be whether the equipment is on the list issued by the Secretary of State (new section 45A(4)). It appears that this power has already been delegated to the Energy and Environment Best Practice Division of the Department of the Environment Transport and the Regions and the information on products is to be published on a stand-alone website and apparently nowhere else. This will not make it at all easy, particularly for smaller companies and their advisers, to identify which items of plant do qualify for the allowances in both when the purchasing decision comes to be made and when the time comes to prepare the tax computations. This could be up to two years after the date of purchase, and it may be difficult or impossible to track changes that have been made to the list in the meantime.

New section 45B

31. A particular concern is that under new section 45B(4) approval can be withdrawn retrospectively in cases where a certificate of energy efficiency is required. It appears that such a certificate will not be granted to the taxpayer but rather to the manufacturer of the equipment. It is unreasonable that the first year allowance should be retrospectively withdrawn if the certificate is revoked particularly as the taxpayer may will have purchased that equipment solely because it was certificated and he has no control over the revocation.

32. If the machinery is specially designed for the taxpayer, we would accept that retrospective withdrawal might sometimes be reasonable if the taxpayer modifies the equipment so as to reduce its energy efficiency. However, we consider that this is likely to be very rare in practice.

33. If relief is to be conditional on the existence of a certificate of energy efficiency then there ought to be a requirement on the vendor to provide the taxpayer with a copy of the certificate so that he knows whether or not he is entitled to claim the relief.

34. We would welcome confirmation that if a taxpayer replaces a component on qualifying equipment that will not of itself be something that will call into question the energy-efficiency certificate. We would welcome clarification of what happens if standard equipment which carries an energy-efficiency certificate is modified, for example to fit into the taxpayer's premises or production processes. Does the certificate hold good provided that the modification do not affect the energy efficiency or would a fresh certificate need to be obtained?

New section 45C

35. The operation of new section 45C is unclear. Where plant includes a mixture of approved and non-approved equipment, then the amount of the cost for the approved component can be limited to an amount specified in the Treasury Order, whereas there appears to be no such restriction if only an approved item is purchased.

36. Presumably it is also possible that the plant will include both approved and non-approved equipment with no monetary amount having been specified by Treasury Order in respect of the former. In that event we would expect the normal apportionment rule in section 562(3), Capital Allowances Act 2001 would need to apply. However, new section 45C(5) excludes the operation of section 562(3) in all cases where there are both approved and non-approved components.

37. It is also of course possible for equipment to be purchased with other items, for example it might be included in a new building. We would have expected section 562(3) to be needed in such circumstances, albeit with the amount that is apportioned to the energy-saving equipment limited to the amount specified in the order.

Clause 66 and Schedule 18: Fixtures provided in connection with energy management services

Paragraph 2

38. New section 175A, Capital Allowances Act 2001 appears to be drafted such that in order to qualify, the agreement must include all of the items (a) to (d), i.e. it requires the energy services provider to design, as well as provide and operate, the energy-saving plant or system. This appears to exclude the use of a system which is available 'off the peg', or perhaps re-uses a design produced for another client. This appears unnecessarily restrictive, since the energy saving is the same whether the system is bespoke or off the peg, and it could also raise difficult boundary issues of exactly how much 'design' work the provider has to do in order to qualify for the allowances.

Clause 67 and Schedule 19: Conversion of parts of business premises into flats

39. We are disappointed that this limited provision requires ten pages of legislation. It is an example of what happens when the Government tries to push taxpayers in a narrowly-targeted direction. Complexity is the natural result of such targeting. In spite of this length, we are concerned that the Treasury has the power (in paragraph 393C(5)) to change the rules as to what is, or is not, a qualifying building. Whilst we do not object to the Treasury or the revenue departments being given administrative powers, or power, for example, to update monetary amounts, we think it wrong that the revenue

departments be given the power to increase the burden on taxpayers. We believe that this is something that should be the prerogative of Parliament.

New section 393C

40. We are unclear why relief will not be available if a building originally contained shops on the ground floor and on the first floor, and residential accommodation on the second and the third. Such buildings do exist (although we appreciate they are not very common) and we see no reason why relief should not be available in these circumstances. In any event, we would welcome clarification of the exact situation intended when the storeys above the ground floor were for use ‘primarily as one or more dwellings’ (section 393C(1)(b)). For example, is it intended to allow part of the first floor to be used as storage and if so how much non-residential use is envisaged? We would welcome confirmation that if the first floor is retail and the second and third floors are retail the relief applies as the majority of the space is residential.

41. This new allowance, unlike most other capital allowances, is given only to the person who actually incurs the qualifying expenditure. There is no provision for allowances to be transferred to a subsequent purchaser, by reference either to the price which he pays or to the unrelieved residue of the vendor's expenditure.

42. Whilst this will encourage the long-term property investor, it will distort the market in converted properties by introducing a strong disincentive to sell before the end of the seven year period. It will also have a particularly capricious effect if the taxpayer dies soon after completing the conversion.

43. It may be that this is intended as a quid pro quo for the simplicity of there being no clawback on a disposal after seven years. If so, we feel that an exception should be made for the situation where a shop owner who owns the building disposes of his entire business within the seven-year period. To in effect require him to retain a lease of the residential premises would distort the normal commercial transaction.

44. Clause 393C(1)(a) requires the identification of the ‘ground floor’ and Clause 393C(3) refer to the ‘attic storey’. These areas are often not easy to identify. For example, many older buildings contain a floor part of which is below ground and part of which is above ground and in some cases a roof space is used for storage although it would be unsuitable for residential use. The legislation should make it clear how such areas are to be dealt with.

New sections 393I, 393M and 393R

45. In the case of the renovation of an existing flat, we feel that the references in new sections 393I(4), 393M(4) and 393R(1) should be to either the time when the flat was first suitable for letting as a dwelling or the renovation was completed, as in many cases the flat will have been owned for some time prior to the renovation.

New sections 393O and 393S

46. A flat may cease to be a qualifying building as a result of some catastrophic event such as a fire that renders the flat unfit for letting as a dwelling, but falls short of actual destruction. New section 393O should provide that in such a case the deemed

proceeds would be the market value of the flat in the condition that exists after the event in question. New section 393S should also be amended so that in such a case, if the flat is then demolished, allowance is made for the demolition costs notwithstanding that the flat is no longer a qualifying one at the time of demolition.

Clause 68 and Schedule 20: Decommissioning of offshore oil infrastructure

Paragraph 5

47. New section 161C, Capital Allowances Act 2001 fails to say that the decommissioning expenditure is to be treated as qualifying expenditure. Normally only qualifying expenditure (as defined) can qualify for capital allowances, or be allocated to a pool, under Part 2 of the 2001 Act. It is, therefore, questionable whether the direction in section 161C to allocate the decommissioning expenditure to a pool is sufficient in itself to achieve the intended effect; and even if it is effective, it is highly undesirable to cut across the painstakingly rewritten structure of the 2001 Act in this way.

Other relieving provisions

Clause 70 and Schedule 22: Relief for expenditure on remediation of contaminated land

48. This relief should be available to all taxpayers rather than being restricted to companies.

49. The relief applies only if the land is in a contaminated state at the time of acquisition. Whilst we appreciate contamination of land should not be encouraged, in many cases the contamination would have happened many years ago as a result of industrial practices which were generally considered acceptable at the time. It may not even be possible to establish whether the contamination occurred under the present owner of the land or under a previous owner. There seems no policy reason why relief under these rules could not be given in such cases to the present owner, without requiring him to show that the contamination existed when he acquired the land and did not result from anything done by him. This should encourage the owner of a long-standing contaminated industrial site to remediate the land and use it for the construction of new plant rather than, for example, developing a greenfield site in preference. It is in the public interest that an industrial company that shuts down a site should be encouraged to develop it to provide alternative employment for its former staff.

50. Part I of Schedule 22 appears on its face to apply only to trades, while Parts II and III apply to trades and Schedule A businesses. In fact, Part I does also extend to Schedule A businesses, by virtue of the new section 21A(5), ICTA 1988 introduced by Schedule 23. However we find the presence of an explicit reference to Schedule A businesses in one place but not in the other confusing, particularly as this legislation is evidently intended to be drafted in the clearer 'tax law rewrite style'. We consider that an explicit reference should be made to Schedule A businesses in Part I.

Paragraph 4

51. The effect of paragraph 4(5) of Schedule 22 is that preparatory activity does not qualify for a deduction unless the company also undertakes actual remediation works.

Further, one interpretation of this rule is that it requires the company to be undertaking such works (presumably on adjacent land) at the time when the preparatory activity is carried out. It should be extended to cover any preparatory activity which is likely to lead to the company undertaking remediation works if the assessment shows such works to be necessary.

Paragraph 5

52. The 80/20 test set out in paragraph 5(3) appears to be based on a similar test which is used for the purpose of the research and development (R&D) tax credit, but the two cases are not entirely similar. R&D will usually be carried out in a structured and systematic way and it would usually not be too difficult to estimate what proportion of his time an individual spends on R&D. However, remediation work is likely to be project based, so if a test of this sort is to be used it is necessary to identify the period over which it is to be applied. Logically the test should be based on the period of the project. However we accept that this is probably not practicable because of need to submit the corporation tax return to a strict timetable. We feel that the practical answer would be to measure the proportion of time spent on remediation in the chargeable period in question, but if the company is not engaged in remediation activities for the whole of the chargeable period to take into account only the part of the period when it is so engaged.

Paragraph 10

53. As drafted, paragraph 10(b)(ii) would require the whole of the sub-contractor payment and of the relevant expenditure to be recognised in the sub-contractor's accounts for a single relevant period. That is unreasonable, and presumably unintended, since a very common pattern would be for the work to span a year-end, so that income and expenditure are recognised partly in one period and partly in the next. At the least, therefore, 'a relevant period' should be amended to read 'one or more relevant periods'.

54. However, that would still leave a problem if part of the work is delayed, perhaps for reasons beyond the control of the parties, beyond the end of the last relevant period. As drafted, it would seem that no relief is available for any of the sub-contractor payment if part of the sub-contractor's expenditure, however small, is deferred until after the last relevant period. This is clearly unfair, and the existence of an apportionment provision in paragraph 10(4) suggests that it may also be unintended. What is needed is to refer in paragraph 10(b)(i) not to the whole but to any part of the sub-contractor payment and in paragraph 10(b)(ii) to the amount of the sub-contractor's relevant expenditure attributable to that part.

Paragraph 11

55. Paragraph 11 appears to apply in a case where the company and the sub-contractor are connected persons but the test in paragraph 10(1)(b) is not satisfied. Presumably this is not intended.

Clause 71 and Schedule 24: Creative artists: relief for fluctuating profits

Paragraph 1

New paragraph 2

56. New paragraph 2 of Schedule 4A requires the profits of the trade or profession to derive wholly or mainly from qualifying creative works. Very often an artiste carries on a mixed trade so cannot meet this test. Take for example a singer/songwriter. The songwriter is a qualifying creative work but the singing is not, at least where it is at live performances (as that is not a work). We would welcome clarification of whether singing in a recording studio is to be treated as a creative work. Even if it is, is it a musical work created by the taxpayer personally as it is created jointly by the taxpayer and the backing musicians? And what if the songwriter is not the lead artiste but simply one member of a band?

57. We would also welcome clarification in the case of authors, where a similar problem arises. The author probably derives income from literacy readings and possibly from personal appearances as well as his book royalties. The existence of such income which is not an integral receipt of the profession can prevent the wholly or mainly test from being met.

58. We would also welcome clarification of whether it is intended that the averaging relief does not extend to a Case V activity. Sections 534 and 535, ICTA 1988 (copyright and public lending right), section 537A, ICTA 1988 (designs) and section 538, ICTA 1988 (artists' receipts) are not restricted to Cases I and II activities.

New paragraph 11

59. We would welcome clarification of new paragraph 11(1). Our reading of the provision is that the idea is simply that profits from the trade are to be struck before any offset of losses brought forward. However, suppose a singer songwriter receives a £100,000 publishing advance in his year to 31 March 2002 and the only other thing he does in that year besides song writing is to gig in pubs to showcase his songs from which he generates £1,000 but has expenses of £1,500. The profits of the trade are £99,500 but it is arguable that the profits for averaging are £100,000, i.e. before making deductions for the £500 loss on gigs, although we suspect that is not the intention.

Chargeable gains

Clause 76 and Schedule 25: Taper relief: assets qualifying as business assets

60. Whilst we welcome the extension in new paragraph 6 of business asset taper relief to employees of non-trading companies, we consider that widening the scope of the relief is a poor substitute for a workable statutory definition of a qualifying company. We still feel that the definition of a trading company should be amended to a wholly or mainly test which would create much less uncertainty for shareholders than the present test.

61. There are anomalies arising out of the provisions in this year's Bill. In addition, the anomalies that we have raised in the past arising out of the distinction between business and other assets will become of application to even more cases than hitherto. We would welcome confirmation that the anomalies that we list below are intended, and if they are, clarification of the policy reasons for them.

62.An anomaly arising from the new provisions is that employees who dispose of their shares whilst they are employees will have a smaller amount chargeable to capital gains tax than former employees who dispose of their shares after leaving the employment, even though they may have held their shares for longer. For example, an individual who sells his shares after four years and is an employee will be taxed at an effective rate of 10% whereas if the same individual leaves the employment and sells the shares after eight years he will taxed at an effective rate of 19% (half x 25% + half x 70% = 47.5 @ 40% tax rate). We would welcome clarification of the logic behind this. We suggest that business asset taper relief should attach to shares acquired whilst the individual is an employee until the time of disposal rather than until the individual leaves the employment.

63.Points outstanding that we have raised on previous occasions include:

- employees who acquired shares after 5 April 2000 will pay less capital gains tax than those who acquired shares on or before that date. The calculation is also complicated. This arises from the business asset taper relief not being in point for the earlier period: we suggest that it should be;
- when a former trading company is treated as ceasing to trade on the appointment of the liquidator, business asset taper ceases to run. We suggest that where liquidation or receivership is in point, then business asset taper relief should continue to apply.

International matters

Clause 79 and Schedule 26: Double taxation relief

General comment

1.We welcome the changes set out in the Finance Bill. However, the double taxation relief (DTR) rules as amended by these provisions are still restrictive and do not cover all of the anomalies and problems that arise. Also, these provisions still do not remove the issue of tainting altogether, which we consider is regrettable and open to challenge under EU law.

Specific comments

Paragraph 2

Revised mixer cap formula

2.Paragraph 2 substitutes a new section 799(1A) which substitutes a revised mixer cap formula in place of that set out currently set out in section 799(1A). New section 799(1B) allows a company to make a claim to exclude amounts of underlying tax. However, where a company makes a claim under new section 799(1B), then it appears that such amounts are left out of account for the purposes of the revised mixer cap formula set out in new section 799(1A). This leads to an unexpected result which we believe is not intended.

3.For example, a UK company A owns a Dutch company B which owns a third company C which has a profit of £1,000 and suffers local tax of £400. So as to avoid the dividend paid up from C to B from being tainted, a disclaimer is made under new section 799(1B) in respect of the excess foreign tax, i.e. £400 - £300 = £100. This should give the result that A receives a dividend of £1,000 which has suffered overseas tax of £300 with the result that the UK tax liability is fully covered by DTR. However, if the amount disclaimed has to be left out of the mixer cap formula, then the mixer cap becomes £(600 + 300) x 30% = £270. In this case, the UK corporation tax is £300 and the DTR is only £270, leaving a residual UK liability of £30.

4.We understood that this was not the intention and that in the above example the overseas dividend would be fully covered by DTR.

5.A further problem arises with this formula in that the mixer cap is reduced so that, in the above example, it becomes £270. The result is that the dividend is tainted. In the above example, it would be necessary to disclaim £600 x 3/7 = £143 rather than £100, and this increases the UK corporation tax to £43.

Paragraph 5

Revised section 806B(4)

6.It is not clear from the wording of paragraphs (a) and (b) of the revised section 806B(4) whether it is necessary to consider whether the mixer cap has applied at any point which ultimately results in the Schedule D Case V dividend. We believe that the section should be read as applying only in respect of the Schedule D Case V dividend and not to dividends further down the chain but we would welcome clarification that this is how the provision operates.

Revised section 806B(4)(a)

7.The calculation of the upper rate amount would appear to include underlying tax attributable to lower level dividends rather than just the dividend payable by the intermediary which is subject to Schedule D Case V. Sections 801(2) and (3) deem underlying tax paid by a lower tier company to be underlying tax of the intermediate company. Section 806B(4) does not appear to exclude this from the upper rate amount, with the result that underlying tax of lower tier dividends will be double counted in the calculation of eligible unrelieved foreign tax (EUFT).

8.We think that this provision needs to be amended to exclude underlying tax attributable to lower tier dividends.

Withholding tax and reduction in Case B EUFT

9.Where dividends are paid up from lower tier subsidiaries which are subject to withholding tax, the application of the mixer cap formula results in a significant reduction or elimination of Case B EUFT even though the overall underlying rate may be lower than 45% and which therefore one would expect to be relievable in full.

10.For example, let us assume that the dividend from company C to B above suffered withholding tax at 5%. The actual dividend received would therefore be £570 (ie. £600 - (£600 x 5%). In this example, one would expect that the DTR would be £300 and that EUFT would be £130 (i.e. £100 underlying tax plus £30 of withholding tax).

As these would be less than 45% in total, one would expect that the whole amount of the EUFT of £130 to be relievable. However, it appears that the upper rate amount will be restricted to 45% of the withholding tax of £30, i.e. £13.5, and that EUFT will be restricted to £113.5 rather than £130.

11. The calculation of the upper rate amount should be amended to ensure that any withholding tax suffered on dividends at a lower tier does not restrict the availability of Case B EUFT where the overall underlying rate is less than 45%.

Miscellaneous

Clause 83: Deductions of tax: payments between companies etc.

12. This provision is introduced following earlier consultation. Our earlier response was published as TAXREP 38/00. We welcome the proposal in principle, but are disappointed that a taxpayer who conscientiously checks the status of his payee in accordance with the published Revenue guidelines will be liable for the payee's tax if it subsequently transpires that contrary to all appearances the payee is not within the charge to corporation tax. We stated in our earlier representation:

13. 'The payer will never know for sure that the payee is within the charge to UK tax: only the Revenue will know this. Therefore, there needs to be a method whereby the payer can obtain sufficient assurance to make payments gross without the risk of recourse. We think it reasonable that if the payer complies with certain specified compliance procedures before the payment is made, then the payer should be able to pay gross without risk of comeback. In order for the payer to be protected, it will be necessary to set out a detailed definition of what the payer has to do before payment can be made.'

14. We still feel very strongly that it is unreasonable that the payer will remain on risk in such circumstances. Whilst we support deregulation, replacing one deregulatory measure with a burden which places an increased risk on the payer is hardly deregulatory.

15. We should be grateful for an explanation of why it is felt appropriate for a conscientious taxpayer rather than the state to have to shoulder the risk that an arm's length non-UK resident might default on his tax obligations.

16. We also consider that this provision should be extended to payments made to tax-exempt UK bodies, as suggested in Budget Notice BN 13. Payment of interest to an approved pension scheme by its sponsoring company is a particular case where the requirement to withhold and subsequently recover income tax is an unnecessary administrative burden.

17. Section 349C appears to give the Revenue an unrestricted power to disapply section 349A whenever they like. We think that it should be qualified by the addition of the following words at the beginning of sub-paragraph (1): 'If the Board reasonably believes that neither of the conditions set out in section 349B is satisfied'.

PART IV

OTHER TAXES

Value added tax

Clause 95: VAT: residential conversions and renovations

18.In order to obtain the benefit of the 5% VAT rate on residential conversions, the flat will need to have been unoccupied for three years. This is inconsistent with the information technology relief in new section 393B, ICTA 1988 inserted by Part I of Schedule 19 of this Bill where the premises need to have been unused or used only for storage in the12 months before renovations commence. We would have thought it reasonable to reduce the three-year period to one year, thus making the reliefs consistent.

19.Much of Clause 95 is based on Group 5 of Schedule 8, Value Added Tax Act 1994. We would welcome clarification of why paragraph 16(1)(a) which refers to carrying out 'works to the fabric of the building' differs from Group 5 which covers all 'services relating to the construction' or 'conversion'.

20.The expression 'lived in' in paragraph 19(2) seems to embrace transitory occupation such as by squatters. It is unreasonable that temporary occupation by squatters should deny the relief.

21.Paragraph 19(2)(e) requires the works to be 'carried out' within one year of acquisition. Many conversions take more than a year to execute. We feel that the works should 'have to commence' rather than have to be carried out during the one year period.

14-4-62
PCB
19.4.01