Tax Representation

ICAEW TAX FACULTY

TAXREP 31/08

FINANCE BILL 2008

Memorandum on the Finance Bill 2008 submitted in May 2008 to Government by the Tax Faculty of the Institute of Chartered Accountants in England and Wales

Contents

	Paragraph(s)
Introduction	1 – 5
Executive summary	6 – 42
General comments	43 – 64
Detailed comments on the Finance Bill	65 – 351
Other points relevant to the Bill	352 – 356
Detailed comments on Clause 23, Schedule 7, Remittance basis	Appendix 1
Updated TAXREP 67/07 – Clause 42, Homes outside the UK owned through a company	Appendix 2
The Tax Faculty's Ten Tenets for a Better Tax System	Appendix 3
Who We Are: the Tax Faculty and the ICAEW	Appendix 4

ICAEW Tax Faculty, Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ www.icaew.com/taxfac	T F E	+44 (0)20 7920 8646 +44 (0)20 7920 8780 tdtf@icaew.com

FINANCE BILL 2008

INTRODUCTION

1 We are writing to provide our comments on the provisions contained in the Finance Bill 2008.

2 We have already issued a summary of key issues in a briefing paper for MPs (published as TAXREP 27/08, see http://www.icaew.com/index.cfm?route=156884) and have also issued a separate committee stage briefing paper on CGT and Entrepreneurs' relief. We will continue to issue briefing papers on certain key clauses as the Finance Bill progresses through Standing Committee.

3 The purpose of this paper is to bring together in one place our comments on the Finance Bill, including our general comments on the overarching themes in the Bill. The comments in this paper are consistent with our earlier briefing papers.

4 As in previous years, we have judged the Finance Bill 2008 by reference to our 'Ten Tenets for a Better Tax System'. These are the ten key principles that we believe should underpin a good tax system and they are set out in Appendix 3.

5 Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Appendix 4.

EXECUTIVE SUMMARY

(References to paragraph numbers in this summary are to the paragraph numbers in this document which set out our detailed comments, which begin from paragraph 43 onwards)

General comments

Tax policy formulation (paras 43 to 50)

6 There is a pressing need to improve tax policy formulation. Government must undertake consultation before making policy decisions, and both external stakeholders and HMRC must have a greater input at the earliest possible stage.

The need for reasonable transitional rules (paras 51 to 53)

7 Changes to the tax system need to respect taxpayers' legitimate expectations and we are concerned that many of the changes made in the Bill do not have adequate transitional provisions, in particular the reform of CGT and the residence and domicile changes.

Retroactive legislation (para 54)

8 We are opposed to retroactive legislation and in particular clause 55, which seeks to rewrite the residence of partnership rules introduced in 1987 as if they had always had that effect.

Simplification (paras 55 to 58)

9 We welcome the Government's commitment to simplification. We believe that the tax simplification agenda would be improved by strategic guidance and input from

simplification committees comprised of HMRC/HM Treasury and the professions that are dedicated to specific areas of tax.

Drafting and the use of regulations (paras 59 to 61)

10 We remain concerned about the considerable amount of tax rules that is left to be determined by way of regulations. We believe it is wrong in principle to delegate substantive tax provisions to regulations, particularly where the relevant regulations that have not yet been published and thus Parliament is forced to scrutinise legislation without seeing the detail which will be in regulations.

Small business taxation (paras 62 to 64)

11 We welcome the Budget announcement to defer the implementation of the income shifting proposals and the opportunity for further consultation on this issue. We think that the small business tax review needs to be reactivated.

Detailed comments on the Finance Bill

Clause 6 and Schedule 2 (paras 69 to 80)

12 We welcome the proposed simplification of CGT but are concerned that this is the third CGT regime in ten years and question whether the changes will prove to be sustainable. We believe that the reform would have been much improved by better transitional rules, either by grandfathering existing reliefs and/or providing taxpayers with a longer period to reorganise their affairs.

Clause 7 and Schedule 3, Entrepreneurs' relief (paras 81 to 109)

13 The new entrepreneurs' relief rules are based on the old retirement relief rules, with various simplifications. Those rules were not without problems and many of the uncertainties have been re-enacted in the new relief. We recommend that:

- the £1m limit should be indexed in line with inflation;
- the £1m limit should be kept under review to see if it discourages serial entrepreneurs;
- the detailed conditions that need to be met should be reconsidered in the light of developments in business structures such as limited liability partnerships;
- a number of detailed amendments are made to the associated disposal rules so that they operate fairly.

Clause 22, Periods of residence (paras 117 to 124)

14 In the interests of certainty and competitiveness, the UK now needs a statutory residence test.

Clause 23 and Schedule 7, Remittance basis (paras 125 to 139 and Appendix 1

15 We have a number of major concerns with these provisions:

- there should be a detailed economic justification for change;
- the £2,000 de minimis should be increased to ease the compliance burden;
- much of the legislation is incomprehensible, unworkable and likely to be undermined by poor compliance; and
- a significant part of the legislation remained unfinished even as it came into effect on 6 April 2008.

16 We have set out in Appendix 1 a detailed note of our concerns and what amendments should be made to these rules. We remain of the view that the detailed remittance rules should be deferred by a year or that they should apply only to remittances on or after Royal Assent.

Clause 25, Companies in difficulty: SME R&D relief and vaccine research relief (paras 140 to 142)

17 Relief should be restricted to companies which are not insolvent or in liquidation – the VAT Regulations could form a suitable model.

Clause 28, Enterprise investment scheme: increase in amount of relief (paras 144 and 145)

18 We welcome the increase in the investment limit but are concerned that the FA 2006 changes have reduced considerably the attractiveness of the EIS scheme. There is a need to review the cost effectiveness of EIS as a way of attracting venture capital funding and we think that HMRC should publish statistics on the number of investments made, and their value, both before and after the FA 2006 changes.

Clause 31 and Schedule 12, Tax credits for certain foreign distributions (paras 150 to 152)

19 We question why the relief has been restricted to shareholdings of less than 10% when the *Lasertec* judgment (C-492/04) would suggest that the limit should be up to 25%.

Clause 32, Small companies' relief: associated companies (para 153)

20 We welcome the amendments to simplify the operation of these rules but think that they would benefit from further simplification and suggest this should follow the approach used for related companies claiming the new annual investment allowance.

Clause 34 and Schedule 15, Trade profits: changes in trading stock (paras 154 to 157)

21 We are concerned that this runs counter to the move to align tax and accounting profits and recommend that appropriations to stock should follow the existing VAT treatment under which VAT is due on the cost price of goods applied to private use.

Clauses 38 and 39, Tax treatment of participants in offshore funds and regulations under section 38: supplementary (paras 158 to 167)

22 We are concerned that where an offshore fund manager has not applied to HMRC for Reporting Fund status, there are no provisions for investors to ask HMRC to grant Reporting Fund status. We have a number of recommendations to improve the situation.

Clause 42, Homes outside UK owned through company etc (paras 168 to 172 and Appendix 2)

23 We welcome this in principle but are concerned that the clause is defective and appears little changed from the draft published for comments in 2007. We recommend that further amendments are made so that the provision achieves its objective.

Clause 54, Double taxation relief (paras 173 and 174)

24 We accept the need to include provisions to ensure that relief for foreign tax is given only once but the Bill should include an equivalent provision to ensure that UK businesses do not suffer economic double taxation.

Clause 55, UK residents and foreign partnerships (paras 175 to 186)

25 We are concerned that this amendment seeks to amend rules introduced in 1987 and treat them 'as always having had effect'. We believe that this is contrary to the EU law principle of legitimate expectation and that any change should only have effect from the date that it was announced (Budget day 2008).

Clause 64, Income of beneficiaries under settlor-interested trusts (paras 187 to 191)

26 Whilst we welcome this clause as addressing one anomaly, it does not address the problem that including the payment in the net income of the non-settlor beneficiary will adversely affect his or her entitlement to age allowance, thereby resulting in effective double taxation.

Capital allowances (paras 192 and 193)

27 Whilst we welcome some aspects of the new regime, we remain concerned about the lack of prior consultation on these proposals, in particular the withdrawal of industrial and agricultural buildings allowances for existing investments.

Clause 71 and Schedule 24, Annual investment allowance (paras 195 to 197)

28 The new Annual Investment Allowance is only available to individuals, companies and 'any partnership consisting of individuals', denying relief to partnerships that include companies and trustees. The provision should be amended so that relief is available in circumstances where there is no intention to avoid tax.

Clause 76, First-year tax credits (para 198)

29 First-year credits are only available to companies and we think that the provision should be extended so that the credit is available to all businesses.

Clause 77, Main rate of writing down allowance (para 199)

30 We are disappointed that the reduction in rate from 25% to 20% applies to expenditure that was incurred before the announcement was made.

Clauses 81 and 82, Abolition of allowances and phasing out of allowances before abolition (para 201)

31 We continue to disagree strongly with the decision to withdraw, without any consultation, Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (ABAs) for past expenditure. We think that abolition of these allowances should only apply for expenditure incurred on or after the 2007 Budget, with the consequence that the phasing out provisions should be withdrawn.

Stamp duty land tax

Clause 93, Withdrawal of group relief (paras 203 to 211)

32 We would welcome clarification of why SDLT group relief will be clawed back in circumstances where there is no disposal of a property holding company by a group.

Clause 94 and Schedule 31, Transfers of interests in property-investment partnerships (paras 212 to 214)

33 This clause seeks to address certain concerns arising from the FA 2007 changes but it does not address the uncertainties raised about the interpretation of the existing legislation in para 36 of Sch 15 FA 2003.

Clause 108 and Schedule 36, Information and inspection powers (paras 215 to 286)

34 These provisions make new powers to obtain information from taxpayers and third parties and for HMRC officers to inspect business premises. Although the provisions have been subject to consultation, we remain concerned about a number of aspects of these proposals. Our key concerns are that:

- Paragraph 21 of Schedule 36 enshrines protection from disclosure documents that are subject to legal professional privilege. The result is that taxpayers who seek tax advice from professionally qualified but non-legally qualified tax advisers are placed at a disadvantage.
- Inspections could be made at the premises of the taxpayer and also third parties. We are concerned that this power is much wider than we had expected from the consultation documents and that taxpayer safeguards are not sufficient.
- Taxpayers must have the right of appeal against any decision or action by HMRC where that power must be exercised 'reasonably'. It is not sufficient for HMRC to define what is reasonable in its own guidance and say that this will contain safeguards for the taxpayer, because such guidance has no legal force, is subject to change, and cannot be considered by the tribunal or court.
- We appreciate the need for a power to make checks before a return is due where fraud is suspected (for example in fighting MTIC fraud) but this provision is much wider than that, and allows HMRC in effect to mount 'fishing expeditions' with no right of objection by the taxpayer.
- The new powers should only be available in respect of enquiries opened on or after 1 April 2009 for corporation tax and on or after 6 April 2009 for income tax. Further, any transitional rules should be included in the Bill and not in regulations published by HMRC.

Clause 109, Computer records etc (paras 287 and 288)

35 This is a very wide-ranging provision that gives HMRC power to 'obtain access to' any computer. We request that the provision is clarified and that an authorised person should have to be an officer of HMRC and that a taxpayer should be able to check whether an HMRC employee is authorised.

Clause 110 and Schedule 37, Record-keeping (paras 289 to 299)

36 The Schedule seeks to align existing record-keeping requirements for the various taxes. The key change is that HMRC is given the power to specify by way of regulations what records should be kept and preserved and that some of these requirements will be set out in HMRC guidance. We think it is wrong for a taxpayer to have to refer to any HMRC guidance to identify any statutory requirements. Further, the concept of materiality should be applied in determining the degree of detail in which records should be kept for tax purposes.

Clause 113 and Schedule 39, Time limits for assessments, claims etc (paras 300 to 306)

37 We recognise that the proposals to standardise time limits have been subject to consultation, but we are concerned about the absence of reasonable transitional provisions. For example, the current time limits for error or mistake claims are five years and ten months for income tax (s 33 TMA 1970) and six years for companies (para 51 of Sch 18 FA 1998). These will be reduced to four years but there are no proposals for transitional arrangements. EU law is clear that legitimate expectations ought to be preserved and that a transitional period is required.

Clause 117 and Schedule 40, Penalties for errors (paras 308 to 317)

38 The new penalty provisions that were introduced in the FA 2007 for the purposes of income tax, corporation tax, CGT and VAT are extended to a further range of taxes, duties and levies, including inheritance tax, stamp duty land tax, stamp duty, petroleum revenue tax and insurance premium tax. We have a number of concerns with these proposals:

- The FA 2007 penalty provisions are far-reaching and have only just been introduced in April 2008. The provisions should be allowed to first bed down before consideration is given to extending them. There is as yet no evidence that they will encourage improved compliance.
- We are not convinced whether penalties based on underlying behaviour and which differentiate between prompted and unprompted disclosure are appropriate for one-off taxes such as inheritance tax and stamp duties.
- The rules conflict with the increase in the VAT de minimis limit for mandatory disclosure of VAT errors.

Clause 118 and Schedule 41, Penalties for failure to notify etc (paras 318 to 325)

39 We are concerned that the stepped percentages are too high and are therefore unlikely to encourage people to come out of the 'shadow economy' and regularise their tax position. We recommend that there should be a system of suspended penalties similar to the regime which has been included in Sch 24, FA 2007. There needs to be greater clarity about what a taxpayer is required to do to take reasonable care. The taxpayer should be entitled to rely on another person if that other person is professionally qualified.

Clauses 122 to 124 and Schedules 42 and 43 24, Taking control of goods etc (paras 326 to 333)

40 We are concerned that the provisions refer to procedures in Schedule 12 of the Tribunals, Courts and Enforcement Act 2007 (TCEA 2007) which will be introduced by regulations. As far as we are aware, none of these regulations have yet been published, thus making it impossible to determine whether these provisions are reasonable and appropriate in the circumstances. It is wholly unsatisfactory that such an important provision is introduced with such an unclear framework for enforcement and it is essential that the regulations under the TCEA 2007 are laid before these clauses are debated in Parliament so as to allow Parliament the opportunity for proper scrutiny of these provisions. In particular we do not know:

- What protections the taxpayer will have against the use of Sch 12 by HMRC;
- What will be HMRC's practice in not distraining on certain goods, such as those which are jointly owned or which are essential tools of the taxpayer's trade.
- Whether HMRC will continue to keep the goods seized for five days before selling them.

Clauses 125 and 126, Set off (paras 334 to 338)

41 We have a number of concerns with these proposals:

- The provisions only allow HMRC to apply set-off and not the taxpayer, when the right should be available to both parties.
- The provisions need to be amended to provide adequate safeguards for taxpayers. HMRC should be required to publish a Code of Conduct setting out the circumstances in which they will and will not exercise a set off.

- The rules are allowing the set off of pre-insolvency credits against post-insolvency debits appear to fly in the face of all the basic principles of insolvency and could be detrimental to creditors generally.

Clause 130, Fee for payment (paras 341 to 342)

42 This clause gives HMRC the power to introduce regulations to pass on any fees charged where tax debts are settled by way of a credit card transaction. However, it is very widely drawn and the scope of the clause should be restricted to credit card charges and similar costs on any transaction that HMRC are charged by a third party.

GENERAL COMMENTS

Tax policy formulation and effective consultation

43 We welcome the measures in the Budget designed to improve on the original proposals in the 2007 Pre-Budget Report.

44 A key lesson that must be taken from the reaction to the tax reform announcements made in the October 2007 Pre-Budget Report is that the government must improve its tax policy formation process. It is critical that tax policy formation – particularly where simplification is the objective – must follow effective consultation, whether open or informal. The ICAEW Tax Faculty remains committed to assisting the government in creating good tax policy. As a body we represent the largest group of qualified professionals who advise on tax in the UK and can offer a unique assessment of the likely behavioural impacts and unintended consequences that a particular policy approach is likely to create.

45 In our submission to the Chancellor ahead of the Budget (see TAXREP 16/08 http://www.icaew.com/index.cfm?route=154645), we expressed concern that the major reforms proposed to the existing tax system in the 2007 Pre-Budget Report (PBR), namely:

- income shifting;
- capital gains tax (CGT) reform; and
- residence and domicile

had been announced without prior consultation, with inadequate transitional provisions and with a lack of appreciation of the likely behavioural impacts and compliance costs that they would impose. Further, we were concerned that insufficient consideration had been given to the potential damage that the measures would inflict on the international reputation of the UK as a stable place to live, work and invest.

46 Since the PBR proposals we have worked closely with HM Treasury and HM Revenue & Customs to clarify the policy objectives of the Government and to suggest improvements to the original proposals. We are pleased to see that in the light of the representations of the ICAEW Tax Faculty, and other representative bodies, organisations and taxpayers, the following major changes have been made to the original PBR proposals:

- income shifting – the proposals have now been deferred until 2009;
- CGT reform – entrepreneurs' relief was announced in January 2008; and
- residence and domicile – a number of relaxations have been announced in the Budget.

47 Notwithstanding these welcome changes, we remain very seriously concerned about the approach to policy formulation as shown by these recent developments. This whole process has seriously undermined confidence in the UK as a place in which business can plan for the future with certainty. Whilst we have been working with HM Treasury and HM Revenue & Customs (HMRC) officials since the PBR to help improve these proposals, once Ministerial announcements have been made is far too late in the process.

48 There is a pressing need to build in adequate consultation at a much earlier stage. It is essential that the views of taxpayers and other stakeholders with relevant experience, for example the ICAEW, are sought when policy ideas are being formulated rather after the policy has been decided. If this had been done, we believe that policies in these areas could have been formulated that met not only the Government's needs but which also enjoyed the wide support of stakeholders.'

49 Further, we are not convinced that tax policy formulation is assisted by the apparent dichotomy between HMRC and HM Treasury and the latter taking a lead on policy formulation. It is essential that the likely operational and practical implications of tax policy are examined at an early stage and HMRC should have a key role in this process. We believe that HMRC may be best placed to take the lead on formulating tax policy.

50 We are disappointed that measures were announced in the Budget relating to the three consultations arising out of the Powers review. The consultation documents were published in January 2008 and the consultation period ended only six days before the Budget. We question whether this was sufficient time in which to have considered properly all the responses received and make a series of suitable recommendations. The hasty issue of these decisions shortly after the expiry of the consultation period does little to encourage the perception of the tax profession and taxpayers generally that there has been proper consultation; rather, it suggests that Government has already made its mind up and is merely going through the motions of consulting.

The need for reasonable transitional rules

51 We are concerned generally that many of the changes made in the Bill do not have adequate transitional provisions. We appreciate that transitional rules add to complexity and that this conflicts with the Chancellor's desire (which we share) to simplify the tax system. However, as we said in our representation on the CGT reform (TAXREP 69/07, see http://www.icaew.com/index.cfm?route=152088), simplification needs to be balanced against fairness and the need to respect taxpayers' legitimate expectations.

52 We think it is unreasonable to introduce changes to the tax system which result in the tax position depending upon events that happened in the past and which the taxpayer can no longer influence. This applies in particular to the CGT changes and Entrepreneurs Relief, to some of the domicile changes and to homes outside the UK owned through companies.

53 We remain concerned about the changes to the capital allowances rules, in particular the withdrawal of industrial buildings and agricultural buildings allowances and the reduction in the rate of writing down allowances on plant and machinery from 25% to 20%. These changes, particularly the withdrawal of IBAs and ABAs, in effect change the basis upon which prior investment decisions were made. This approach does not meet the legitimate expectations of taxpayers. Nor does not provide the necessary stability to allow businesses to plan, thus damaging confidence in the UK as a competitive place to invest and do business.

Retroactive legislation

54 We remain concerned at the use of retroactive taxation, which we think is wrong in principle, contrary to EU law and which goes against previous commitments given in Parliament. We do not think it is right that a provision can be included in this Bill

(clause 55) which seeks to amend legislation from 1987 and treating it as always having had effect. We appreciate the need to counter avoidance and that the Government rightly warned in 2004 that it would introduce retrospective legislation if necessary in a specific area of major revenue importance, namely income tax and NIC on remuneration, but clause 55 does not match this criterion.

Simplification

55 We welcome the Government's explicit commitment to a radical programme of simplification of the tax system.

56 However, we are concerned that the Government has 'dived into the detail' without first articulating an agreed tax simplification strategy. The present approach looks like a 'change agenda' with many different initiatives, but we remain concerned about the need for an overarching strategy and principles that we believe should underpin such a major work of simplification.

57 We believe that if simplification is to be successful, there also needs to be recognition that not only does it take time and thought if real progress is to be made but there should also be some formal structure to guide the process and make sure that simplification remains an ongoing commitment for Government.

58 We have previously recommended that the Government set up a Tax Simplification body, similar to the Steering Committee of the Tax Law Rewrite Project, to bring together representatives of Government, business including employers, taxpayers and the tax profession. This idea has not been taken up but we remain of the view that the tax simplification agenda would be improved by strategic guidance and input from simplification committees comprised of HMRC/HM Treasury and the professions that are dedicated to specific areas of tax.

Drafting and the use of regulations

59 We remain concerned about the considerable amount of tax rules that is left to be determined by way of Regulations. We have expressed concern about this development in the past and are disappointed that this trend continues. We do not think it is right in principle for Parliament to enact laws which are too vague such that MPs cannot be expected to understand what is really being proposed.

60 We have no objection to the use of secondary legislation to set out detailed administrative rules, or to deal with issues that are unlikely to arise often in practice, but it is an entirely different matter when substantive provisions are delegated to regulations. In the past, where Parliament gave regulatory powers, it spelt out in a fair amount of detail the issues that it intended such Regulations to cover. We are particularly disappointed to find that this Bill cross refers to Regulations made under the Tribunals and Courts Act 2007, when the relevant regulations have not yet been made. We do not see how the Bill can be debated properly by MPs when they do not know how substantive provisions will be applied because the relevant regulations have not been made.

61 If this approach is to continue, we think it is imperative that any relevant regulations that have substantive provisions are made available before the Bill is debated in Committee.

Small business taxation

62 We welcome the Budget announcement to defer the implementation of the income shifting proposals. The proposed income shifting rules bore all the hallmarks of other recent measures in this area, namely the IR35 rules and managed service companies, which are in the nature of 'sticking plaster' changes, in other words piecemeal changes being made in a reactive way that are merely papering over the perceived underlying problems rather than providing a comprehensive solution, and which are damaging confidence in a key growth sector of the economy. We think that the proposed legislation would have been largely ineffective but would have imposed considerable administrative burdens and costs on businesses, coupled with a high level of uncertainty as to whether taxpayers were caught by the new rules.

63 We welcome the opportunity for further consultation on this issue. This should give sufficient time for proper consultation and we believe that this is an opportune time for a considered review of the UK's small business taxation policy.

64 We still believe the solution to the problem found in these areas is by way of a reinvigoration of the small business tax review, launched in 2004. The only tangible outcome from this review that has been seen to date is to raise the small companies' rate of taxation. It could, however, be used as a constructive consultation process to identify some longer term answers to questions such as:

- how owner/managed businesses should be taxed;
- how this should interact with social security (including tax credits) provision for families;
- how this might be achieved in a way which is workable in practice by taxpayers who may not have a detailed understanding of tax rules nor the resources to seek expert help;

and framed in such a way that it is in accordance with our Ten Tenets for a Better Tax System (summarised in Appendix 3).

DETAILED COMMENTS ON THE FINANCE BILL

PART 1

CHARGES, RATES, ALLOWANCES, RELIEFS ETC

Income tax

Clause 1, Income tax – charge and main rates for 2008/09

65 The setting of tax rates is a policy decision for Government to decide. Nevertheless, we are concerned that the consequences of abolishing the 10% rate for non savings income was not properly thought through and that there was insufficient consultation about the proposal beforehand with representatives of taxpayers who would be most affected by this change.

Corporation tax

Clause 4, corporation tax - charge and main rates for financial year 2009

66 We would welcome clarification as to the state aid implications of the retained 30% corporation tax rate for the ring fence profits of oil companies when the profits of other companies are to be reduced to 28%. Our understanding of the state aid provisions is that it to not appropriate to tax a company differently simply on the grounds that it is an oil company.

Clause 5, small companies' rates

67 We remain concerned about the increase in the corporation tax rate for smaller companies (with a further rate rise of 1% to follow next year) and the extensive changes to capital allowances, although we recognise that smaller companies should benefit from the new annual investment allowance.

68 We remain concerned that there is a lack of a coherent strategic plan for small business tax policy; the perception is that Government is now anti small business. Small business tax policy needs a comprehensive review in consultation with stakeholders so that a clear strategic framework is established within which small businesses can plan and operate with certainty.

Capital gains tax

Clause 6 and Schedule 2, Rate etc

69 Clause 6 and Schedule 2 enact the Government's proposal, announced in the 2007 Pre Budget Report on 8 October 2007, to reform the CGT rules and introduce a new 18% flat rate of CGT.

70 We have welcomed in principle the Chancellor's move to make a significant simplification of the existing capital gains tax (CGT) regime but we remain concerned about a number of aspects.

CGT policy

71 This is the third CGT regime in the space of ten years. The flat rate marks a complete reversal of the taper relief rules, a regime that was introduced in 1998 and substantially amended in 2000 and 2002. Taper relief provided a favourable rate of CGT for disposals of business assets and in respect of non-business assets, and initially in respect of business assets, encouraged the holding of assets for the longer

term. In the space of ten years, the Government has moved from a CGT regime that favoured the long term holding of business assets to one that potentially encourages short-term speculation. Given that CGT is levied on assets which have often been held for the longer term, this chopping and changing in CGT policy does not provide taxpayers with much certainty as to CGT policy.

72 Whilst we appreciate that the Government is entitled to make major changes in tax policy, there was no substantive economic justification for this complete shift in thinking on CGT and why the two fundamental principles of taper relief (favourable treatment of business assets and longer-term holdings) were peremptorily abandoned in favour of a flat rate that applies to all assets no matter how long they have been held. We still think that the Government should have provided a substantive justification for these changes. We doubt that these changes will have put CGT 'on a sustainable footing' as quoted in the Budget Note and we suspect that there will be more changes to the rules, particularly if inflation begins to increase.

No prior consultation

73 The policy announcement was made with no prior consultation and, even now, we believe that some of the detailed impacts of the proposed legislation are not well understood.

The need for proper transitional provisions

74 We welcome the introduction of entrepreneurs' relief but are concerned that taxpayers should have been given more time to understand the implications of this new relief before it is implemented. The announcement of the new relief was not made until 24 January 2008, despite promises that this would be done before Christmas, and the delay meant that the draft legislation setting out the relief in sufficient detail to enable businessmen to decide what action to take was not finally available until 28 February 2008, when the new rules came into force on 6 April 2008.

The preservation of legitimate expectations

75 We believe that a fundamental principle of taxation is the preservation of legitimate expectations. We remain concerned that these changes have not respected that principle. For example, when taper relief was introduced, existing entitlement to indexation relief was preserved in the new regime. We think that that was the right approach to tax reform. However, in this latest reform, that existing entitlement has been lost.

76 We remain concerned in particular about the expectations of taxpayers who acquired bonds following a previous disposal of assets that would have qualified for business asset taper relief. The legitimate expectations of taxpayers were that they were deferring a 10% tax charge. We think it is unreasonable in such circumstances that the gain, which could have been several years ago, will now be taxed at 18% rather than 10%.

77 This is a particular concern where business assets were exchanged for non qualifying corporate bonds (non QCBs). Entrepreneurs' relief will only be available if throughout the period of one year leading up to the redemption of the non-QCBs:

- the company that issued the loan notes is a trading company or the holding company of a trading group;

- the taxpayer owns at least 5% of the ordinary share capital and that holding gives at least 5% of the voting rights in that company; and
- the taxpayer is an officer or employee of that company or, if it is a holding company, of a company in the same group as the holding company.

78 In practice, it is unlikely that these conditions will be satisfied. For disposals from 6 April 2008, taxpayers can elect to treat an exchange for non-QCBs as a disposal, thus potentially accessing Entrepreneurs' relief. It would be reasonable to allow taxpayers with non-QCBs to make a retrospective election where this is beneficial.

79 Where qualifying corporate bonds (QCBs) were acquired, the taxpayer may be able to obtain Entrepreneurs' relief under the transitional provisions in Schedule 3. Relief is available in these circumstances if the earlier disposal would itself have qualified for Entrepreneurs' Relief. This is a welcome provision but many taxpayers will still not qualify because on the original disposal they will not have satisfied the conditions for Entrepreneurs' relief.

80 We believe that the current reform of CGT would have been much improved by better transitional rules, either by grandfathering existing reliefs and/or providing taxpayers with a longer period to reorganise their affairs.

Clause 7 and Schedule 3, Entrepreneurs' relief

General comments

81 Clause 7 and Schedule 3 enact the new 'entrepreneurs' relief, which was announced on 24 January 2008. This relief, which is based upon the CGT retirement relief rules which were phased out beginning in 1999, provides that gains of up to £1million on the disposal of all or part of business are taxed at an effective rate of 10% rather than 18%.

82 The move to a flat rate CGT is a potentially welcome simplification but will create winners and losers. In particular, many employee shareholders who previously would have qualified for the 10% CGT rate as their shares qualified as business assets will not qualify for entrepreneur's relief and will therefore be faced with an 18% CGT rate. In the light of these changes we would welcome clarification of the direction of tax policy in relation to encouraging employee shareholders and the interaction of the new rules with existing reliefs to encourage employee share ownership such as the enterprise management incentives (EMI) scheme.

83 The new entrepreneurs' relief rules are based on the retirement relief rules as they existed before they were phased out in 1999. Whilst we appreciate that this new relief includes a number of welcome simplifications as compared to the old retirement relief rules, those rules were not without a number of problems and many of the retirement relief uncertainties have been re-enacted in the new relief.

84 The inherent problems with taper relief were recognised at the time when taper relief was introduced. The following comments on business asset taper relief as compared to retirement relief were made in Parliament on 8 May 1998 by the then Paymaster General (Geoffrey Robinson)

> *I might summarise the comparison of the two reliefs by saying that retirement relief is in many ways subjective, depending a great deal on the circumstances of the investor, whereas taper relief is a wholly objective relief,*

depending purely on the nature and length of holding of the investment. The taper will be a positive encouragement for all small and medium businesses to invest for the longer term and it will provide a real incentive for all businesses to grow. . . . Taper relief, by contrast with retirement relief, is wide ranging and certain.

85 Whilst we welcome Entrepreneurs' relief, it seems to us a retrograde step to reintroduce many of the problems that affected retirement relief.

86 The rules for partnerships and companies are not identical, with the latter being generally more restrictive in that the shareholder must be an officer or employee and own 5% or more of the voting rights. The business world has moved on since 1999 and there is now an alternative business structure, the limited liability partnership (LLP), which combines some of the flexibility of a partnership structure but with an element of limited liability. Whilst LLPs are treated as partnerships for tax purposes, we question whether the old retirement relief restrictions on personal holding companies are still appropriate given the advent of LLPs as an alternative business structure.

87 The legislation reintroduces the 'whole or part of the business' test that was such a problem for retirement relief for unincorporated businesses. This contrasts with the position for shares and securities, where it seems that any disposal, however small, can qualify. Further, on one reading of the legislation it would appear that a partner can qualify for entrepreneurs' relief, however small the disposal of his interest in the partnership. If this understanding of this provision is correct, it would appear that this particular problem would then apply only to sole traders. We would welcome clarification of this point and whether this is the consequence of the provisions. If only sole traders are affected, it appears harsh and we request that the policy is reconsidered.

88 The new entrepreneurs' relief will be a very useful and valuable relief for gains up to the £1m limit. We recognise that the £1m limit is a policy decision and understand the rationale for it. However, given our understanding that the new relief is aimed at entrepreneurs rather than business people looking to retire, we are concerned that the £1m limit will not necessarily encourage 'serial' entrepreneurs to reinvest in new businesses.

89 We think that the limit should be indexed in line with inflation and to simplify matters suggest that there is logic in aligning it with the pensions lifetime limit.

90 The limit should in any event be kept under review to see whether it discourages investment by serial entrepreneurs.

Detailed comments on Schedule 3

Length of ownership

91 We welcome the 12 month ownership period set out in new s 169I (in para 2 of Sch 7), which compares favourably with the ten year ownership period for retirement relief. Nevertheless, since retirement relief was withdrawn we believe it would make more sense and provide a welcome simplification if the condition is aligned with rules for the substantial shareholding exemption. This allows for any 12 month period within the previous 24 months and would allow more flexibility where a taxpayer is in the process of extracting himself from a business.

Associated Disposals

92 The legislation in respect of associated disposals in new s169K and new s169P (in para 2 of Sch 7) is poorly drafted and needs to be clarified.

93 New s169K lays down three conditions, of which condition A is that there is a main disposal qualifying for Entrepreneurs' Relief and condition C is that the property has been in use for the purpose of the business for a 12 month period. However, Condition B is loosely drafted and refers to the associated disposal being 'part of the withdrawal of the individual from participation in the business carried on by the partnership or by the company'. It is not entirely clear what this relates to and it seems to be a retirement requirement of sorts, as well as conflicting with the main drafting of the requirements for a disposal. Its meaning should be clarified.

94 New s 169P is meant to deal with the restriction of the relief where the associated asset is not used entirely for the purposes of the business throughout the period of the ownership, or only partly used, or more controversially where the relief is based on the payment of rent. However, we think that the provision needs to be amended so as to ensure that relief is not denied unreasonably.

95 As drafted currently, the restriction on the relief will operate by reference to the time since the asset was first acquired. New section 169P(4) reads as follows:

The conditions referred to in sub section (1) are –

> *a) that the assets which (or interest in which) are disposed of, are in use for the purposes of the business* ***for only part of the period in which they are in the ownership of the individual****;*
>
> *b) that only part of the assets which (or interests in which) are disposed of, are in use for the purposes of the business* ***for that period****;*
>
> *c) that the individual is concerned in carrying on the business (whether personally, as a member of a partnership or as an officer or employee of a company which is the individual's personal company) for only part of the period in which the assets which (or interests in which) are disposed of are in use for the purposes of the business, and;*
>
> *d) that, for the whole or any part of the period for which the assets which (or interest in which) are disposed of, are in use for the purposes of the business, their availability is dependent upon the payment of rent.*

96 Sub-sections (a) and (b) are defined both by reference to the period of the usage of the asset in the business and by the period of ownership by the individual. We have put in bold the references to ownership by the individual. However, sub-sections (c) and (d) include no reference to the ownership period by the individual and are only defined by reference to the usage of the asset in the business.

97 Take, for example, a farming partnership started in 1960. The land has always been owned outside the partnership but a new partner acquires land in 2000. The land is sold in 2010. Our understanding of the provisions is that the relief will be restricted to 10 years out of a total of 50. Please confirm whether our understanding of the provision is correct.

98 This section has been taken from para 10 of Schedule 6 to the TCGA 1992 but seems to have been reworded to an extent that is detrimental. Whilst we appreciate that new s 169P operates by reference to a just and reasonable apportionment and that there are further clarifications in sub-section (5), these do not appear sufficient to overcome the problem identified in the above example.

99 A similar issue arises in respect of let property and the payment of rent where, again, the rules will operate to deny relief in circumstances where we think it should be available. This is a particular problem in view of the fact that payment of rent did not matter for the purposes of business asset taper relief and roll-over relief. The point is best illustrated by using an example which was set out in a document which was published on Budget Day providing examples of how the new relief would work in practice.

> *Example*
> *Mr R has been a member of a trading partnership for several years. He leaves the partnership and disposes of his interest in partnership assets to the other partners, realising gains of £125,000, all of which qualify for entrepreneurs' relief. He also sells the partnership office building which he owned outright, but let to the partnership, realising a gain of £37,000. The disposal of the office building is 'associated' with Mr R's withdrawal from the partnership business, and the £37,000 gain therefore also qualifies for entrepreneurs' relief (assuming there is no restriction on the amount of the gain qualifying for relief as a result of non-qualifying use).*

100 Our understanding of the rules is that entrepreneurs' relief will only be available in relation to the office building if it was let 'rent-free' to the partnership for the whole of the period of ownership. We presume that the words in brackets at the end of the example are referring to this potential problem although the precise meaning of them is not clear, and we would welcome clarification.

101 Again, the problem is that even if rental arrangements are changed from 6 April 2008 and thereafter any property is let rent-free, the test of whether the asset was an investment is by reference to the complete period of ownership, which will include any period of ownership prior to 6 April 2008.

102 The rule also imposes a potentially onerous record keeping on the taxpayer for the whole period of ownership of the asset.

103 On the grounds of simplification, consistency and ensuring that taxpayers' legitimate expectations are preserved, we think that these conditions should be applied only be reference to periods of ownership after 6 April 2008 and that there is a reasonable time period for considering whether these conditions apply. We suggest that a reasonable time period would be that set out in new s 169K(4), although we appreciate that in policy terms a longer period may be preferred.

Guidance on just and reasonable

104 There needs to be guidance on how HMRC will approach the 'just and reasonable' amount of disapplication of the gain from entrepreneurs' relief in all of the circumstances covered in new s 169P(4).

Whole or part of a business

105 The legislation reintroduces the 'whole or part of the business' test that was such a problem for retirement relief for unincorporated businesses. This contrasts with the position for shares and securities, where it seems that any disposal, however small, can qualify. Further, it seems to us that a partner can qualify for entrepreneurs' relief, however small the disposal of his interest in the partnership. If our understanding of this provision is correct, it would appear that this particular problem applies only to sole traders. We would welcome clarification of this point and whether this is the consequence of the provisions. If so, it appears harsh and we request that the policy is reconsidered.

Personal company definition

106 The personal company definition in new s 169S(3) is different to that used for hold-over relief in s165(8) and for roll-over relief in s157. We cannot see the policy justification for this and especially given that the Government is seeking to simplify these rules. Why is the tighter definition required for Entrepreneurs' Relief? Given that the Government is seeking to simplify CGT, we request that consideration is given to adopting the same definition throughout.

107 We are particularly concerned that the entrepreneurs' relief legislation as drafted will have a detrimental impact on EMI option holders and are concerned that this reflects the change of view by the Government against supporting such initiatives. We believe that EMI option holders should continue to qualify for this new relief from the date that the option is granted.

Trust business assets – new section 169J

108 In relation to disposals by trustees, in order for the trustees to qualify for the relief, it is necessary for the company to be the qualifying beneficiary's personal company, ie the beneficiary needs to own 5% or more of the company. Whilst we recognise that this provision is similar to the old retirement relief code, we request that this requirement is reconsidered as it seems unduly restrictive given that the beneficiary may not own shares personally in the company. We think that the provision should be amended and that the ownership condition is applied by reference to the shares owned by the trustees.

109 We would welcome confirmation that an interest in possession otherwise than for a fixed term includes a defeasible life interest.

Inheritance tax

Clause 8 and Schedule 4, Transfer of unused nil-rate band etc

General comments

110 We welcome this provision, although the rules are very complex.

111 This extension of the existing rules calls into question the continuing policy purpose behind the monetary limit of £55,000 on the exemption for transfers of value to a spouse who is not domiciled in the UK. This limit dates back to 1983 at a time when the nil rate band was also £55,000. Since then, the nil rate band has risen continually and for 2008/09 is £312,000. The £55,000 limit needs to be reviewed and increased to a more realistic figure.

112 We question whether the restriction on transfers to non-domiciled spouses is in any event legal under the EU treaty in regard to a transfer to a spouse who is domiciled in another EU country.

Detailed comments on Schedule 4

Paragraph 8: amendment of TCGA 1992

113 Paragraph 8 makes an amendment to s 274 CGTA 1992. However, this amendment will compound an unfairness which arises when the value of an estate has not been ascertained for IHT. This is because when a value has not been ascertained, s 274 (which says that the value ascertained for IHT will be taken as the market value for CGT) cannot apply, which means that different valuations can be used for IHT and CGT.

114 For example, if the value of a property at the date of death was not ascertained because the estate was excepted and in a later disposal the CGT market value on death was determined by the District Valuer to be £280,000, this would not be amended if, for the purpose of establishing the available nil rate band when the second spouse dies, the value of the property is later determined to be £295,000. From the point of view of practical expediency we can understand why HMRC want this amendment (so old CGT computations do not have to be re-opened), but this should not be at the cost of fairness to taxpayers. It is unacceptable that the IHT and CGT valuations of the same asset on the same day give rise here to a difference of £15,000 on which IHT and CGT may be chargeable.

115 The problem with para 8 is that it does not allow a later determination of the value of the property (for the purpose of establishing how much of the nil rate band has been utilised) to impact on any CGT calculation.

116 We therefore suggest that para 8 should amend s 274 to provide that the value used for any IHT purpose shall also be used for CGT, even if it means reopening old CGT computations. Failing that, we suggest that the amendment in para 8 be dropped in recognition of the unfairness to taxpayers, pending consultation with a view to legislating in Finance Bill 2009.

PART 2

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX – GENERAL

Residence and domicile

Clause 22, Periods of residence

117 The clause amends the legislation relating to the taxation of foreign income where the individual is in the UK for a temporary purpose. It amends the way in which days of presence are counted for determining the amount of time spent in the UK.

The need for a statutory residence test

118 This appears a very narrow amendment but the issues it raises are of considerable importance to UK plc. Given the fundamental importance of establishing whether a person is resident in the UK for tax purposes, this change highlights the fact that the existing residence test, which is based primarily on old case law and HMRC practice, no longer provides a satisfactory basis for establishing liability to UK tax.

119 As the Explanatory Notes acknowledge, the issue of whether one is or is not resident in the UK is fundamental to the application of the rest of the UK tax system. Current HMRC practice in this area is unclear, frequently ambiguous and highly uncertain in application. The result is that individuals can be present in the UK without knowing whether they are or are not tax resident. The lack of certainty puts the UK at a disadvantage as compared to our competitors.

120 The Explanatory Notes state that the Finance Bill change was introduced because 'the UK was out of step with … its international partners.' However, the more important reason the UK is out of step is because it is one of very few developed countries that does not have a statutory test. In our view, this absence of a statutory test is the issue that needs to be addressed.

121 We believe that there are suitable models of statutory residence tests that the UK could use to develop its own rule. A suitable example is the Irish statutory residence rule, which was first introduced in 1994 (subsequently consolidated in 1997) and which we understand works well although we recognise that it is (by UK standards) quite generous. An alternative less generous model is the US residence test. It would be for ministers to decide where they wished to draw the boundary but we would be happy to assist in the drafting of a suitable residence rule.

122 The Explanatory Notes indicate that HMRC practice will be amended to reflect the new legislation. The amendment will therefore perpetuate an existing unsatisfactory situation that needs to be addressed properly, not least to ensure that the UK maintains an internationally competitive tax system. It is a particular concern that the existing guidance in HMRC's booklet IR20 was withdrawn and that it was not intended to republish it until autumn 2008. However, we note that an electronic version of IR20 was posted to HMRC's website on 6 May 2008. Whilst we welcome its publication, we cannot see that the guidance reflects the proposed Finance Bill changes (both in respect of clause 22 and 23) although an Appendix has been added which sets out HMRC's interpretation of the *Gaines-Cooper* case (SpC 568). We request that IR20 is updated to reflect the Finance Bill changes as a matter of urgency.

123 So far as the clause as drafted is concerned there are no references to the present concessions relating to days on which the individual is detained in the UK by circumstances out of his control – such as illness or terrorism. We should be grateful for confirmation that the existing practices will continue.

124 The examples in the explanatory notes go some way towards explaining the thinking behind the transit rules but we would suggest that examples referring to the use of electronic media would be useful. The existing rules for incidental duties in the UK are different from the proposals in the Bill which may lead to confusion and uncertainty. We believe this reinforces our call for a statutory test.

Clause 23 and Schedule 7, Remittance basis

General comments

The drafting of the legislation

125 We welcome the changes that have been made in the Finance Bill to the draft legislation that was published on 18 January 2008. We are however concerned that a significant part of the legislation remained unfinished even as it came into effect on 6

April 2008. We understand that this is to enable the final legislation to be comprehensive and workable but are surprised that it was thought appropriate to lay before Parliament legislation that is admitted to be 'incomplete'.

126 HM Treasury confirmed to us in a meeting in February 2008 that the overwhelming message from the representations that they had received had recommended deferring the more complex measures to enable workable legislation to be drafted. There can have been little doubt that there was simply not enough time to complete satisfactorily that task. We were surprised to learn, given there are more than 50 pages of legislation, in addition to 160 pages of explanatory notes, that there are only 12 lines in the Lobby Notes briefing MPs on the measures and the delays in drafting the legislation. We remain strongly of the view that that it is unfair to the taxpayer not to have deferred the implementation of these aspects of the legislation until 5 April 2009.

127 The rules when they are finally determined will apply from 6 April 2008 but no-one knows at this juncture what they are as they are subject to further changes. This is unreasonable and damaging to investment in the UK. It is likely to result in widespread confusion and non-compliance. Many taxpayers will be making remittances not knowing their effect and this could turn out to be expensive if they have made the wrong choice. If the Government is not willing to postpone the remittance rules until 6 April 2009, we think that at the very least these new rules should only apply from the date of Royal Assent, and remittances before then would be ignored.

128 We appreciate the complexity of the legislation, the extreme time pressures imposed on HMRC staff and the efforts that they have made. We will continue to work with HMRC to try and improve the legislation but we fear there is insufficient time to make the necessary amendments so the legislation is fit for purpose. You will see from our detailed comments, however, that as regards the legislation that we do have there are a number of areas where we continue to have concerns.

129 In particular on the source ceasing provisions and the lack of a time limit we are of the view that not only is the legislation retrospective but that it may be impossible for a taxpayer to submit a correct Tax Return. If that is the case the culture of good tax compliance that is fundamental to the UK system is undermined. Furthermore some of the legislation, for example on mixed funds (new s809P) and on the order of remittances (new s809I), is so complicated that we fear it will be incomprehensible to the unrepresented taxpayer. We seek clear statements from HMRC as to how they are planning to assist the taxpayer rather than allow the institutionalisation of non-compliance to develop because the legislation is unworkable or incomprehensible.

130 The legislation is far from simple. We found it difficult to correlate the background notes with the legislation and would ask that in future statutory references be included. In our representation on the draft legislation (TAXREP 19/08, see http://www.icaew.com/index.cfm?route=155094) we noted at paragraph 9 that the commencement provisions for many of the sections were unclear. We found it particularly unhelpful for the commencement provisions to be sited at the end of the legislation in Schedule 7 Part 1. We would suggest that the general commencement provisions should be at the beginning of the Schedule and the 'transitional provisions' after the relevant paragraphs. We are also concerned that a number of the FAQs on the HMRC website relating to this legislation are incorrect, and/or incomplete, and/or confusing.

The economic justification for change

131 Whilst we appreciate the Government's need to make changes to the rules, we remain concerned that the changes will result in a net loss of revenue to the UK. Whilst the Budget Red Book predicts that the changes will increase revenue, we remain concerned that no economic and sensitivity analyses have been prepared to support the claimed quantum of change and that behavioural impacts will result in the opposite effect to that intended. We remain of the view that there is a need for a detailed economic justification of the changes.

The £30,000 levy

132 As far as we know, the £30,000 levy to access the remittance basis has no international precedent and there remain concerns about whether the levy will be creditable in other jurisdictions for double tax relief purposes. The Budget Notes included a helpful opinion from a firm of US lawyers that the levy would be creditable for US tax purposes but we would welcome clarification about the position of any negotiations on this issue with the tax authorities of other treaty countries.

The impact of the changes on 'ordinary' non-domiciles

133 While there is a perception that the changes will ensure that the 'super rich' pay more tax, the likelihood is that they will pay their £30,000 annual fee and continue largely as before. The people most affected by the changes will be the far larger number of people who have been here for over seven years and cannot afford to pay the £30,000 and those who have been here less than seven years and who are expected to grapple with the new, impractical rules on what constitutes a remittance. Many of these are unlikely to be able to afford professional advice, such as migrant workers. Further, many will not know that they face an increased tax bill in the UK.

The increased administration burdens

134 In addition to the increased tax charges, the changes will also impose significantly higher administrative burdens and associated costs on many non-domiciles. This is because they will now need to take advice on their UK tax position and they may now need to complete a UK tax return whereas currently many non-domiciles do not need to do so. The raising of the de minimis limit from £1,000 to £2,000 announced in the Budget was a welcome announcement and this will help to alleviate some of the compliance burdens that this change introduces, but we remain of the view that the de minimis should be set at a higher level.

135 We remain concerned that HMRC will also need extra resources to implement and monitor these changes and that the strains on an already creaking service that will be imposed could be considerable at a time when HMRC's budget is being cut in real terms over a three-year period.

The letter dated 12 February 2008 from the Acting Chairman of HMRC

136 Given the many concerns and confusion about the scope of the new rules, we welcome the publication by HMRC of a letter dated 12 February 2008 from the Acting Chairman (see http://www.hmrc.gov.uk/news/residence-domicile.pdf) which at least sought to address some of the key concerns about the proposals. The need to publish the letter reflected the widespread concerns and confusion about the proposed changes to the rules and demonstrates the need to improve tax policy formulation in conjunction with stakeholders, an issue which we have mentioned earlier.

137 Whilst we appreciate the unequivocal reassurances in the letter, we are not convinced that they are fully reflected in the Finance Bill, as follows:

a) *'Those using the remittance basis will not be required to make any additional disclosures about their income and gains arising abroad'.* HMRC have subsequently said that such individuals will be required to make additional disclosures if HMRC enquire into their return. Furthermore, they will be required to make additional disclosures in relation to their first £68,000 of income or £167,000 of chargeable gains even if they do not get an enquiry. They will also be required to make a disclosure of the source of payment of the £30,000, as this will only be disregarded if it comes direct from a disclosed overseas source.

b) *'There will be no retrospection in the treatment of trusts and the tax charges will not apply to gains accrued or realised prior to the changes coming into effect'.* Accrued gains will be excluded from tax only if the trustees, over whom the taxpayer has no control and who may well not wish to have any involvement with a foreign tax authority, so elect and they are prepared to forego future tax relief on accrued losses (which the trustees may feel is not for the benefit of the beneficiaries as a whole). The tax changes will also apply to gains accrued prior to the changes coming into effect if the gains arise in an overseas company and the shares in that company are held by an individual.

c) *'Money brought into the UK to pay the £30,000 charge will not itself be taxable'.* A remittance to pay the charge only ceases to be a remittance if it is paid directly to HMRC from an overseas account, which appears in breach of the assurance given in a) above. The additional disclosure assurance is further breached by the requirement that long-term residents paying the charge are required to 'nominate' income or chargeable gains upon which the charge is paid, despite the letter clearly stating '[S]o long as they [those using the remittance basis] declare their remittances to the UK and pay UK tax on them, they will not be required to disclose information on the source of the remittances'.

d) *'It will continue to be possible to bring art works into the UK for public display without incurring a charge to tax'.* The exemption only applies where the public display is at an 'approved museum, gallery or other institution. Therefore, a non-domiciliary cannot bring his work of art into the UK and arrange his own public exhibition without triggering a possible charge.

138 We trust that the assurances given in the letter of 12 February 2008 will be honoured in full in the amendments that are to be made to the legislation.

Detailed comments on Schedule 7

139 We have set out in Appendix 1 our detailed comments on these proposals. We indicate in our detailed comments the areas where there are consequences that have perhaps not been foreseen and we ask that these areas be reconsidered. In this context an immediate policy suggestion is that the acquisition of UK sited assets simply as an investment should not be a remittance under any circumstances as regards close companies, individuals or trustees – simply because it discourages investment in the UK. This will not preclude tax being due where UK assets are sold

depending on the nature of the entity/person owning the assets – which would mean no immediate charge to tax where trusts or foreign 'close' companies are involved. This of course presupposes that the proposed s.14A is revised to take this into account.

Research and development

Clause 25 and Schedule 9, Companies in difficulty, SME R&D relief and vaccine research relief

140 We have a number of concerns about the proposals in this clause. There is a general difficulty for these companies in knowing whether or not they are going to succeed – this being the nature of R&D. If the company had a legitimate expectation of succeeding why deny the relief? In any case there are already rules which make directors personally liable if the company is trading while insolvent.

141 Further, start up companies will not necessarily have the latest accounts. Companies in difficulty or with issues they do not wish to publicise will seek to delay publishing accounts. This new requirement places a greater burden on the auditor's liability. Further, many smaller companies will not have an audit report.

142 Relief should be restricted to companies which are not insolvent or in liquidation – the VAT Regulations could form a model for determining this. The restriction on loss relief should not be retrospective but only in respect of future relief.

Clause 26 and Schedule 10, Cap on R&D aid

143 We would welcome confirmation that this provision has been introduced to accommodate the state aid rules, failing which we would welcome clarification of the purpose behind this clause.

Venture capital schemes etc

Clause 28, Enterprise investment scheme: increase in amount of relief

144 We welcome the proposed increase in income tax relief on Enterprise Investment Scheme (EIS) shares from £400,000 to £500,000, which comes after a doubling of the income tax relief from £200,000 to £400,000 in the 2006 Finance Act.

145 We are concerned that the FA 2006 changes (in particular the reduction in the limits of the gross assets test to comply with state aid rules) have reduced considerably the attractiveness of the EIS scheme. There is a need to review the cost effectiveness of EIS as a way of attracting venture capital funding and we think that HMRC should publish statistics on the number of investments made, and their value, both before and after the FA 2006 changes. Please confirm whether there is an intention to monitor the take up of the further increase in the relief to £500,000?

Clause 30, Enterprise management incentives: qualifying companies

146 Please confirm whether it is contractual or actual hours worked which determine how long an employee works for the purposes of calculating 'full-time equivalent'

147 We request that HMRC publishes further guidance on the distinction between full/part time work and the 'just and reasonable' test.

148 As employees on maternity/paternity leave are excluded from the calculation, for consistency we believe that clause should be amended to also exclude employees on adoption leave.

149 We are concerned that for companies which are very near the 250 employee threshold, it may not be easy to monitor the situation to determine whether the 250 limit has been breached at the time the share options are granted (the appropriate time). We request that HMRC adopt a 'light touch' where a company may have breached the rule when it took reasonable steps to comply.

Other business and investment measures

Clause 31 and Schedule 12, Tax credits for certain foreign distributions

150 We welcome this statutory provision which gives statutory effect to the decision of the European Court of Justice in *Manninen* (C-319/02).

151 Please clarify why the relief has been restricted to shareholdings of less than 10% when the *Lasertec* judgment (C-492/04) would suggest that the limit should be up to 25%. We recognise that the Explanatory Notes, published alongside the Finance Bill, indicate that 'The Government intends to bring forward legislation in Finance Bill 2009 to deal with the situation of individuals who own 10% or more of the shares in a non-UK resident company' but would welcome confirmation of the rationale for the two stage approach.

152 We are concerned by evidence from our members that HMRC is resisting claims for the *Manninen* decision to be given effect even before the enactment of clause 31 as the ECJ judgment does not have any temporal limitation. We understand that HMRC is seeking to draw distinctions, which we do not believe are valid, between the individual cases concerned and the facts of the *Manninen* case. We believe that such distinctions are in almost all cases likely to be unreasonable. We would welcome clarification as to HMRC policy in relation to past claims to benefit from the judgment in *Manninen.*

Clause 32, Small companies' relief: associated companies

153 We have expressed concerns about the operation of these rules in the past and we therefore welcome these provisions. However, the amendments do not address all of the anomalies with these rules and we think that the rules still need to be simplified further. In this respect, we note the new 'light touch' approach to related companies claiming the new annual investment allowance and think that the approach set out in new s 51J (as inserted by para 3 of Schedule 24 to this Bill) is a suitable model which could be adopted for the associated company provisions, resulting in consistency and a further welcome simplification.

Clause 34 and Schedule 15, Trade profits: changes in trading stock

154 The proposal is that trading stock appropriated or otherwise 'used' by the trader for his own benefit should be treated as sold at market value. This treatment is contrary to the treatment under UK GAAP under which the transaction should be accounted for at either the cost price of the stock or at the price actually paid on the disposal. FA 1998 section 42 states that taxable profits must be computed in accordance with GAAP unless an adjustment is required or authorised by law. This opens up a further difference between GAAP and tax law and runs entirely counter to the Government's aim to simplify the tax system. Determining the market value of stock may also be difficult, particularly if the stock is in an unfinished state.

155 Whilst we appreciate that this proposal seeks to legislate the rule that HMRC has sought to apply since the case of *Sharkey v Wernher,* that decision in 1955 has long been felt by many to reflect the particular circumstances of that case and that it had no general relevance. It was certainly not applied in all cases and it is not true, as Budget Note BN 19 and the FB 2008 Explanatory Notes seek to suggest, that in this area the GAAP treatment is overridden. (For a detailed exposition of the technical position, and the earlier attempt to change the law as part of the Tax Law Rewrite project, see the article by Roger Kerridge published in *British Tax Review [2005] BTR 287 et seq.)*

156 We believe that this proposed 'rewriting' of the existing law will cause considerable administrative inconvenience to business and that, although it is intended as a revenue raising measure, in practice it is unlikely to do so. It will also put proprietors in a worse position than employees, as in the latter case any transfer is at cost to the employer.

157 We recommend that the treatment of stock appropriation in the circumstances envisaged in the Finance Bill should follow the existing VAT treatment under which VAT is due on the cost price of goods applied to private use (article 74 of Council Directive 2006/112/EC of 28 November 2006).

Offshore funds

Clauses 38 and 39, Tax treatment of participants in offshore funds and Regulations under section 38: supplementary

158 Clause 38(1) states that it is intended to make regulations about 'the treatment of *participants*' in offshore funds. Conversely, clause 39(1)(a) states that Regulations will *only* permit that treatment to be addressed at the level of the '*offshore fund, or a trustee or officer'* of such fund. Effectively the tax treatment for an investor in an offshore fund will thus be entirely governed by whether the fund managers have chosen to elect to meet the proposed changes to the offshore funds regime. This is not what clause 38(1) says is intended, nor is it is fair given that an investor in a Non-Reporting Fund might lose the benefit of the 18% CGT rate merely perhaps because of actions of simple oversight by a fund management house.

159 We are concerned that where an offshore fund manager has not applied to HMRC for Reporting Fund status, there are no provisions for investors to unilaterally ask HMRC to grant Reporting Fund status. We therefore recommend that consideration should be given to allowing that UK resident investors:

a) either can apply to HMRC on behalf of the fund for the fund that they have invested in to be granted Reporting Fund status, as can be done presently under paras 17–18 & 20, Sch 27, ICTA 1988; or,

b) if an equivalent to the Sch 27 procedure is not going to be retained, then as an alternative and more simply, can self assess on their tax returns that their gains were not in a fund that was chosen mainly to gain tax advantages, so that they will be liable to tax on the same basis as investors in funds that have been granted Reporting Fund status; or

c) the explanatory notes state that it is intended to consult further on the definition of offshore funds. If the definition is drafted sufficiently widely to exclude funds that are patently not offshore, than the mischief for which the offshore funds regime was introduced would quite simply not apply in most cases except those that are clearly designed to roll-up income into gains; or

d) more radically, have the option of an annual income tax on an assumed distribution equivalent to say the official interest rate, with the amount brought into charge constituting allowable expenditure for eventual capital gains tax.

160 While the proposals clearly have merit for the promoters of offshore funds marketed in the UK, they do nothing to address the concerns of many who invest in offshore funds that are established by residents in other countries perhaps many years before coming to the UK, and so become incapable of obtaining Reporting Status.

161 For example, as proposed currently, a UK resident with an investment in a US domestic mutual fund acquired while overseas will be subject to income tax on any surplus on disposal even if the mutual fund actually distributes all its income. The new proposals would not change this, as Clause 39(1)(a) still only permits the fund managers to take action to elect to be a Reporting Fund. This is inconsistent with treating taxpayers equally and we would welcome confirmation that this is not the aim of the legislation.

162 Thus the proposed legislation, like the existing provisions, ignores the position of those who have made their investment while overseas, and also ignore the growth of enthusiasm on the part of UK residents about funds based in places other than the Channel Islands, the Isle of Man and such UK-oriented territories. Those funds ignored include those in other member states of the EU, who also may not be minded to incur the cost of establishing and maintaining themselves as Reporting Funds with the UK HMRC. In connection with this, we recommend that regard be had to whether any proposed differences in the treatment of funds based in other EU Member States from those based in the UK offend against any EU Treaty obligations, for example covering freedom of establishment.

163 This legislation thus presents considerable difficulties for many tens of thousands of non-UK nationals living in the UK and holding investments acquired before arriving in the UK, as well as British nationals returning to the UK holding investments purchased whilst abroad.

164 The effects of this problem will be significantly increased because large numbers of non-UK domiciled residents will need to report worldwide income and gains from 6 April 2008 as a result of the proposed changes in the remittance basis of taxation.

165 The solution is to enable the UK resident investor to be able to apply for recognition of any particular investment vehicle as a Reporting Fund, where the fund managers have not so elected. Furthermore, the legislation should only require that the status of the fund be established for years in which the investor is a UK resident.

166 There is an existing procedure enabling investors to do this, in paragraphs 17, 18 and 20, Sch 27, ICTA 1988. The absence in the proposed legislation of a proposal for a similar procedure for a revamped offshore funds tax regime is a retrograde step.

167 Alternatively, and arguably more simply, the investor should be able to self assess on his tax return that his gains were not in a fund that was chosen mainly to gain tax advantages. Such a proposal would be fair and straightforward to administer with little possibility of loss of revenue to the UK exchequer, and it would serve to prevent the inequities that both the present legislation and the proposed new system incorporate.

Employment matters

Clause 42, Homes outside UK owned through company etc

168 We welcome in principle the policy purpose behind clause 42. However, we are concerned that the clause as drafted is defective and appears little changed from the draft published for comments in 2007 and upon which we submitted detailed comments. Key issues are set out below but we have also updated our earlier representation (TAXREP 67/07) which is attached as Appendix 2.

169 The new s 100A refers to a company. It is desirable that it be made clear that this expression covers any structure adopted overseas that HMRC regard as 'opaque', such as the French SCI and the US LLC. Furthermore, the reference to 'issued share capital' needs to be expanded to cover the equivalent in such other overseas structures.

170 The provision as drafted would not apply where the shares are owned by trustees for the benefit of individuals who include 'D' (as defined in new s 100A(1)). There seems no reason not to include such cases, perhaps confined to trusts where the only beneficiaries are D and other individuals, apart from charities (which are often included as 'fail-safe' or default beneficiaries in family trusts).

171 The new 100A also refers to 'living accommodation' without linking this phrase to 'the property' subsequently mentioned.

172 New s 100A(2)(c) refers to activities incidental to the ownership of the relevant interest in the property. If, as is believed, this is intended to include deriving rental income from letting to 'non-owners', the wording could be clearer or more specific. The word 'incidental' has been the subject of much debate, mostly underlining its ambiguity.

Double taxation arrangements

Clause 54, Double taxation relief

173 We accept the need to include provisions to ensure that relief for foreign tax is given once and once only. But the necessary corollary to this is that the Bill should include an equivalent provision to ensure that UK businesses do not suffer economic double taxation, as set out in the example below.

174 If a UK business has an interest in a US LLC and the LLC is subject to a CFC charge, there would be no double taxation relief (DTR) under the CFC provisions which give DTR where a dividend is paid up from a CFC (because there is no dividend), yet there would be an immediate US tax charge (on the stockholder of the LLC) and also an immediate UK charge, resulting in economic double taxation. We

would be grateful for confirmation of how it is proposed to ensure that a double charge does not arise.

Clause 55, UK residents and foreign partnerships

175 We are concerned by the effect of sub-section (4) which seeks to treat the new provisions 'as always having had effect'.

176 Although we understand that the clause is directed primarily at situations 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.

177 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.

178 One of the earliest attempts to set out some 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.

179 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.

180 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.

181 So, for instance, s 62 of Finance Act 1987 was introduced to reverse the decision in *Padmore v IRC* and the amendment to section 153 ICTA 1970 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* kept the fruits of his appeal, but no other taxpayer was expressly protected by the terms of the legislation.

182 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.*

183 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.'*

184 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.

185 If the underlying purpose behind any piece or 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.

186 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.

Miscellaneous

Clause 64, Income of beneficiaries under settlor-interested trusts

187 Whilst we welcome the fact that clause 64 seeks to rectify one of the two anomalies that we raised in meetings with HM Treasury and HMRC whereby the receipt of a discretionary payment by a non-settlor beneficiary from a settlor-interested trust may push the beneficiary's savings and or dividend income into higher rates of tax and recognises the unfairness by backdating the change to when the FA 2006 changes came into effect, we are concerned that it does not correct the second anomaly that we raised.

188 The anomaly that clause 64 does not address is that including the payment in the net income of the non-settlor beneficiary will adversely affect his entitlement to age allowance. Where including the payment in the income of the non-settlor beneficiary restricts his age allowance, the payment will effectively be taxed twice, once in the hands of the settlor as intended, and again in the hands of the non-settlor beneficiary.

189 On the assumption that this double taxation in the hands of both the settlor and non-settlor beneficiaries is not intended, we suggest that instead of the wording in clause 64, a better way of rectifying both anomalies would be in s 685A(5) of ITTOIA 2005 to delete the words: 'If the recipient of the annual payment is a settlor in relation to the settlement' and replace 'his income' with 'the income of the recipient' so that it applies equally to settlor and non-settlor recipients.

190 An alternative way of addressing the age allowance anomaly would be to both enact clause 64 and insert in s 58, ITA 2007 an additional Step to deduct the amount of the payment when calculating 'net income'.

191 Such income is also taken into account when assessing the beneficiary's entitlement to tax credits and pension credits. On the assumption that this too is unintended, we recommend that appropriate amendments be made to the tax credit and pensions credits legislation so that the income received by the non-settlor beneficiary from the trust is disregarded.

PART 3

CAPITAL ALLOWANCES

General comments

192 Whilst we welcome some aspects of the new regime, we remain disappointed with the way that these proposals were introduced. In particular, we remain concerned about the lack of prior consultation on certain key proposals, in particular the retroactive nature of the withdrawal of industrial and agricultural buildings allowances.

193 We responded in February 2008 to the two technical notes *Business tax reform: capital allowances changes: technical note'* and *'Payable enhanced capital allowances: technical note'* (TAXREP 18/08). We are disappointed that most of our recommendations have not been addressed. Our comments below reflect our earlier comments in TAXREP 18/08 that have not been addressed.

Plant and machinery: qualifying expenditure

Clause 70, Integral fixtures

194 We think that this clause should be amended to allow Integral Fixtures Allowances to be pooled by building. This will help to alleviate the problem of determining the value of fixtures on the sale of a building.

Plant and machinery: annual investment allowance

Clause 71 and Schedule 24, Annual investment allowance

195 The new Annual Investment Allowance is to be available to individuals, companies and 'any partnership consisting of individuals'. The allowance will therefore not be available if a partnership includes a trust or company as one of the partners. We appreciate that this provision is probably included to counter possible avoidance but in practice we cannot see that this is likely to be an issue.

196 We appreciate that a partnership of companies, or one with a corporate partner, might be viewed with suspicion, but it is quite common for partnerships to include a trust or company; such situations are common in, for example, the farming sector. There seems to be no good reason to bar such a partnership in the way described.

197 We recommend that this provision is amended so that relief is available in bon fide circumstances where there is no intention to avoid tax.

Plant and machinery: first year allowances

Clause 76, First-year tax credits

198 Restricting the payable enhanced capital allowance to companies would appear counter to the stated objective to 'maintain fairness of the tax system by ensuring that

people engaged in similar economic activities pay broadly the same overall level of tax regardless of the legal form they choose for their business'. We think that the provision should be amended so that the credit is available to all businesses.

Plant and machinery: writing-down allowances and pools

Clause 77, Main rate of writing down allowance

199 We do not think that the reduction in the rate of writing down allowance from 25% to 20% more accurately reflects the economic life of those assets. For the reasons given above, we are disappointed that this reduction in rate applies to expenditure incurred before the announcement was made.

Clause 78, Small pools

200 We welcome this provision which reflects a recommendation that we made.

Industrial and agricultural buildings allowance

Clauses 81 and 82, Abolition of allowances and phasing out of allowances before abolition

201 We continue to disagree strongly with the decision to withdraw, without any consultation, Industrial Buildings Allowances (IBAs) and Agricultural Buildings Allowances (ABAs) for past expenditure. We believe that this decision is wrong in principle because it does not provide certainty for businesses to plan and it also does not meet taxpayers' legitimate expectations. We think that these provisions should be amended so that abolition of the allowances only applies to expenditure incurred on or after the 2007 Budget, with the consequence that the phasing out provisions should be withdrawn.

PART 5

STAMP TAXES

Stamp duty land tax

Clause 90, Zero-carbon homes

202 Please clarify whether there are any zero-carbon homes that are able to take advantage of this section or the likely date when such homes will be available.

Clause 93, Withdrawal of group relief

203 We would welcome clarification of why HMRC seek a clawback of SDLT group relief in circumstances where there is no disposal of a property holding company by a group.

204 This is particularly onerous given the retrospective nature of the change.

205 The new clause imposes a clawback of SDLT group relief where:

(a) there is an intra group transfer of property;
(b) the vendor company is then disposed of; and
(c) there is subsequently a change of control over the purchaser company within 3 years of the transfer.

206 There is therefore a clawback of group relief in many circumstances where a sub-group is to be sold, but prior to that a property needs to be transferred out of that sub-group, to be retained by the group.

207 If there is subsequently a change of control, either by way of:

- a sale of the entire group; or
- placing a new holding company at the top of the group,

there will be clawback of SDLT group relief.

208 In effect this means that 0.5% stamp duty is payable on the purchase of shares in a parent company but if there happens to have been an intra-group transfer within that group there will be a clawback of SDLT group relief as well.

209 Quite apart from the fact that such a charge would be anomalous, this raises difficult due diligence issues for parties acquiring a 'vendor' company. Indemnities will need to be sought in respect of any SDLT clawback charges arising on a subsequent change of control over the group.

210 In our view, there are adequate existing anti-avoidance provisions to deny SDLT group relief where:

- there are arrangements for there to be a change of control over the purchaser (para 2(1) of Sch 7 FA 2003), or

- artificial arrangements are entered into for the avoidance of SDLT (para 2(4A) of Sch 7 FA 2003.

211 Please clarify what this further provision will achieve that cannot be achieved by HMRC enforcing these existing provisions.

Clause 94 and Schedule 31, Transfers of interests in property-investment partnerships

212 We welcome the fact that this clause is intended to address certain concerns arising from the FA 2007 changes but we consider that this clause does not address the uncertainties raised about the interpretation of the existing legislation in para 36 of Sch 15 FA 2003.

213 Para 36 of Sch 15 FA 2003 was amended in 2007 to define a 'transfer of an interest in a partnership' to include any transaction whereby 'a person acquires or increases a partnership share'. We understand that practitioners have questioned whether there is a deemed transfer where:

- a partnership share increases by the passage of time (eg a partner's share is 20% increasing to 30% from a certain date);
- a partnership share increases on a certain contingent event (a partner's share is 20% increasing to 30% after completion of a particular development project);
- a partnership share varies according to a formula so could vary from year to year (eg a partner is entitled to 20% of profits up to £X million and 30% of profits after that threshold. This means his share could be 20% in year 1, 28% in year 2, 21% in year 3 etc.

214 The proposed clause represents an extremely complex approach to dealing with this issue and yet does not answer the fundamental question raised – viz, do the above scenarios represent transfers of partnership interests? Accordingly, we would welcome clarification of whether the three examples cited are within para 36 of Sch 15 FA 2003.

PART 7

ADMINISTRATION

CHAPTER 1

INFORMATION ETC

New information etc powers

Clause 108 and Schedule 36, Information and inspection powers

General comments

215 These provisions make new powers for:

- the provision of information from taxpayers and third parties; and
- new powers for HMRC officers to inspect business premises.

216 The provisions follow a consultation process on aligning the powers of the former HM Customs & Excise and the former Inland Revenue. Following their merger in 2005, it was announced that there would be a review of the existing powers and how they might be aligned in the new department (the Powers review). A consultation forum was established with external stakeholders in 2005 and there has been a series of public consultation documents.

217 These clauses relate to the reform of powers for compliance checks, on which a first consultation document was published in May 2007, followed by a further consultation document and draft legislation which was published in January 2008. Some changes to the draft legislation have been made as a result of the comments received.

218 Although the provisions have been subject to consultation, we remain concerned about a number of aspects of these proposals. The consultation period ended on 6 March 2008 but the detail of the proposed changes was announced in the Budget on 12 March 2008. This has called into question whether all of the concerns expressed by stakeholders have been considered in the provisions set out in Schedule 36.

219 These provisions contain formal powers which HMRC will be able to use if necessary. We assume that HMRC will continue its current practice, which is to start by seeking information on an informal and voluntary basis. Please confirm that HMRC will continue to adopt this approach.

Legal professional privilege

220 Paragraph 21 of Schedule 36 enshrines protection from disclosure documents that are subject to legal professional privilege. Whilst we appreciate that this seeks to re-

enact provisions which are similar (although by no means identical) to existing rules, the lack of protection for papers produced by a non-legally qualified tax adviser is an issue of national importance. It reinforces the different treatment given to advice given by a legally qualified tax adviser and by a non-legally qualified but professionally qualified tax adviser, as decided in the *Morgan Grenfell* case, and therefore the lack of equality of treatment between the advice given by those two types of adviser.

221 In the draft legislation, the equivalent paragraph was merely a re-run of the existing provision in s 20B(8) TMA 1970, which provided protection for documents in the hands of lawyers. Under the new paragraph 21, a legally privileged document is protected from disclosure to HMRC, whether in the hands of the client or the lawyer. Paragraphs 23–25 are a re-run of s 20B(9) et seq TMA 1970, and tax advice documents in the hands of a tax adviser continue to be protected but there is no parallel protection for tax advice in a taxpayer's hands.

222 The result is that taxpayers who seek tax advice from professionally qualified but non-legally qualified tax advisers are, in effect, being placed at a disadvantage for tax purposes. We think that this is wrong in principle. Further, it runs completely contrary to the recent changes to the money laundering reporting rules, where a qualified accountant is placed on a similar footing to legally qualified advisers as regards disclosure.

223 The problem is compounded by the fact that these measures also provide for a considerable increase in HMRC's powers to visit the client's business premises and inspect and take copies of documents. However, these powers are again restricted in the case of privileged documents (paragraph 26 of Schedule 36) and HMRC cannot inspect a document that it could not require a person to provide by way of an information notice.

224 All taxpayers should be treated alike and it is wrong in principle that taxpayers seeking advice from legally qualified tax advisers are in a more favourable position than those who seek advice from non-legally qualified professionally qualified tax advisers. All taxpayers who seek tax advice from professionally qualified tax advisers should be in the same position, whether or not their advisers are legally qualified.

Right of appeal

225 Taxpayers must have the right of appeal against any decision or action by HMRC where that power must be exercised 'reasonably'. It is not sufficient for HMRC to define what is reasonable in its own guidance and say that this will contain safeguards for the taxpayer, because such guidance has no legal force, is subject to change, and cannot be considered by the tribunal or court. Taxpayers should have the right to ask a tribunal to determine whether HMRC's exercise of its powers is reasonable.

226 There should be a right of appeal against HMRC's use of the power to see statutory records. Whilst we appreciate that taxpayers can appeal against a penalty for non-production, we do not think that this is satisfactory protection. The taxpayer may dispute whether the particular document is part of the statutory records under para 60 of Schedule 36, so it is essential that the taxpayer is able to appeal this point to the tribunal for their decision. The absence of an appeal right also puts unfair pressure on the taxpayer to produce records even if he believes they are not relevant.

227 There should be a right of appeal against the power to inspect assets and premises. The use of any statutory power to visit business premises ought to be a last resort and only where the taxpayer has refused to make his records available at some other place, where fraud is suspected or where a visit to the premises is the only realistic way to carry out the check that the officer perceives is necessary.

Pre-return checking

228 We appreciate the need for this power in cases of suspected fraud (for example in fighting MTIC fraud) but we do not think that the power should be wider than necessary to achieve that objective. The provision is drafted much wider than that, and allows HMRC in effect to mount 'fishing expeditions' with no right of objection by the taxpayer.

229 We think the use of this power in cases other than suspected fraud is unreasonable. It must be appreciated that when preparing a return, accountants frequently have to adjust the raw data received from the client. Therefore, the raw data by itself may not provide useful information about the accuracy of the return that will subsequently be made. If HMRC undertake pre-return checking, we think it will lead to wasted time and costs for both taxpayers and for HMRC. The provision should be amended to ensure that HMRC can only undertake pre-return checking in cases of suspected fraud.

Timing and the effect of repealing the existing legislation

230 The expectation is that these powers will have effect from 1 April 2009, and at that date the existing rules on HMRC's powers relating to enquires will be superseded. Therefore, if a taxpayer's affairs are currently under enquiry today, for example a long-running transfer pricing enquiry, the taxpayer could suddenly find that its books and documents are open to inspection however long the enquiry has been running. We think that any new powers should only be available in respect of enquiries opened on or after 1 April 2009 for corporation tax and on or after 6 April 2009 for income tax.

Inspection power

231 Paragraph 10 of Schedule 36 enables HMRC to carry out an inspection at '**any** business premises and inspect ... for the purpose of checking the tax position of **any person**'. This wording includes the premises of the taxpayer and also third parties, this interpretation being supported by paragraphs 26 and 28 which make no sense otherwise. We are concerned that this power is much wider than we had expected from the consultation documents, where HMRC indicated that it wanted to inspect business records at the business's premises in order to better understand the way the business is operated. A power to inspect a third party's premises is clearly not going to achieve that.

232 The business documents that may be inspected include documents 'that relate to the carrying on of any business'. Para 10 is not delimited by reference to there being a return being in respect of which there is any enquiry notice and what this means for corporation, income and capital gains taxes is that HMRC will have powers to:

- access records before returns are filed;
- in certain circumstances turn up unannounced to check the records;
- routinely have access to business premises and assets;
- have the right to copy or remove documents; and

- the records and documents that HMRC will be able to access are very widely defined.

233 One significant point to note from the Summary of Responses to the January 2008 consultation published on 27 March 2008 is that HMRC is determined to have a power that enables records to be inspected before a return is filed despite the fact that the majority of business and professional organisations who responded to HMRC's Consultation Document objected to this proposal. In the January 2008 consultation at paragraph 5.25 HMRC had commented that one of the situations where it would exercise a power that enables it to check pre-return would be 'to check current actions which are relevant to a tax avoidance scheme'. We do not think that that is sufficient reason to check a taxpayer who has yet to submit a return for the period concerned.

234 It is not sufficient argument for HMRC to say that inspections pre-return already happen for PAYE and VAT, because in reality returns under PAYE and VAT are submitted regularly and these can therefore be checked. Similarly, HMRC does not need a law to discuss matters before a return is submitted where a taxpayer is prepared to do this by agreement.

Transitional provisions

235 Clause 108(3) enables details of transitional provisions to be made by Order. We are concerned that such details should be left to secondary legislation, to be drafted by HMRC. The provisions should be included in primary legislation so that Parliament can decide on them. They should also be subject to proper consultation.

Detailed comments on Schedule 36

Para 1 (and throughout)

236 We have a general concern at the use of the term 'officer of Revenue & Customs', which includes any employee of HMRC. These new compliance powers should only be exercised by officers who are competent to do, ie with suitable training and authority. We should like this made clear in legislation. We would also like HMRC to clarify how they will ensure that the use of these powers is limited to officers competent to use them.

Para 2(1)

237 The requirement to provide information or produce a document should not in our view mean that a third party should have to produce something that does not exist. We therefore think that para 16 should be amended so that in respect of third party notices the requirement to produce information is limited to documents in that person's possession.

Para 2(1)

238 This extends s 20 TMA 1970 powers by including the requirement to provide information as well as documents.

Para 3

239 This paragraph envisages an ex parte hearing application for a third party notice. In our view both the taxpayer and third party should be entitled to attend.

Para 3(3)(d)

240 It is not acceptable that the tribunal should just have a summary of the third party's representations – which summary will presumably be prepared by HMRC. The tribunal should be given the representations themselves.

Para 5

241 As in para 4, the person intended to receive the notice should be entitled to object and attend the hearing in person.

Para 5(4)(d)

242 Who is to determine whether the information is readily from another source?

Para 7(2)

243 We are very concerned about the provisions about where the information etc should be provided, as follows:

- The first criterion should be that it is provided at a place which the taxpayer reasonably proposes – and if it is reasonable, HMRC must agree to it.
- HMRC should only be able to specify the place if the first condition in para 7(2)(a) cannot be met.

Para 10

244 We should like a definition of what 'inspect' means, ie to look at but not search (the explanatory notes say it means 'examine' but that could include opening things etc as well as looking at them).

Para 10(3)(a)

245 For inspections where the taxpayer is to be given notice in advance, 24 hours' notice is inadequate and unrealistic.

Para 10(3)(b)

246 Where no notice is given, the inspection has to be done by or with the agreement of an authorised HMRC officer. We do not see why HMRC needs this much power. The definition of authorised officer is too unclear to provide protection. There should be third party authorisation of an unannounced inspection.

Para 10(4)(c)

247 We strongly disagree that just leaving a notice somewhere prominent is good enough.

Para 10(4)

248 When the officer provided the notice, the officer must also be required to make clear to the taxpayer/recipient what is in it and what are his or her rights.

Para 10(5)

249 We strongly object to the wording 'obstructing the officer' if the notice is not complied with. It implies that the taxpayer is being difficult and unhelpful when he may actually just be asserting his rights, eg the taxpayer may not agree that the inspection is reasonably required or that the other conditions in para 10 are being complied with. The officer is entitled to enter the premises for purposes of his inspection – but he does not have a right of entry per se, so the taxpayer could legitimately refuse entry.

Para 10(7)

250 The definition of business documents is wide enough to include statutory records relating to the non-business affairs of the proprietor of the business, which could allow ‘fishing’ into private bank accounts etc. The definition should be amended to exclude such non-business records.

Para 14

251 The explanatory notes say that this does not amount to a power to seize documents but, to all intents and purposes, that is exactly what it is. Please explain the difference.

Para 14(2)(b)

252 It is not acceptable that the taxpayer should be able to get a copy of his own documents only when ‘reasonably required’. They are his documents and if he needs them he should be able to have a copy without justifying it.

Para 14(4)

253 Compensation for expenses is not enough. HMRC should also be obliged to pay for consequential losses, eg where they lose an original document which prejudices a business transaction.

Para 15

254 HMRC must exercise the power to mark assets in a responsible manner which does not cause damage.

Para 18

255 We are concerned by the power to request documents from more than six years’ ago if an authorised officer is involved. A person may have validly destroyed such documents but it might be in their power to get replacements. Effectively this removes any time limits.

Para 19(2)

256 Some words are missing at the end – presumably it should say ‘in relation to the chargeable period’.

Para 19(6)

257 If all the officer needs is ‘reason to suspect’, he can effectively go back to earlier periods to look for information to support a hunch that there is something to discover. The criterion should be that the officer’s suspicion is based on actual evidence.

Para 19(6)

258 The taxpayer should have the right of appeal.

Para 21(3)

259 It should be up to the tribunals not HMRC to make these rules.

Paras 27–31

260 As noted above, there need to be rights of appeal against all HMRC decisions and actions.

Para 30(1)(c)

261 We see no need for the appeal to be made to a specific officer. Anyway appeals are to be made to the tribunal not to HMRC.

Para 30(4)(a)

262 The specified period should not be less than 30 days.

Para 32

263 It is not sufficiently clear that this applies only to VAT.

Para 33

264 A third party may not be in a position to know what companies may or may not be in a group, where they are dealing with only one or some of the companies. HMRC must specify the relevant companies in the notice.

Para 37

265 We note that the penalties have increased compared to the current ones.

Para 41

266 This provision should be deleted. It is not reasonable to expect someone to keep something because HMRC tells him it might be the subject of a future notice. HMRC should either issue the notice to get the document, or the taxpayer should be able to destroy it under the usual rules.

Para 42

267 The tribunal should also have power to allow further time.

Para 43(2)(b)

268 The first person also needs to know that the other person has failed to do the thing.

Para 45

269 If a taxpayer appeals against a penalty under para 37, HMRC should not be permitted to impose daily penalties until the matter has been considered by the tribunal.

Para 46(1)(c)

270 The appeal must be to the tribunal not to HMRC.

Para 48(4)

271 The taxpayer should have the right to attend or at least make representations.

Para 49(1)

272 Given delays between dates on notices/correspondence and receipt, the penalty should be due not 30 days from the date of issue of the notice but from when it is received.

Para 55

273 We object to Regulations that limit the rights of taxpayers. Parliament itself ought to decide what taxpayers should be obliged to do – particularly in circumstances like this where it is apparently deciding that a citizen should be sent to prison for not complying with the regulations (see for example para 53(b)).

Para 56

274 The definition of ‘checking’ is far too wide. At a minimum it ought to be limited to carrying out an investigation or enquiry in respect of which a notice has been given under para 1 or 2 of Sch 36.

Para 57

275 The definition of an authorised officer is inadequate and needs to be clarified. It is essentially says: an authorised officer is one who is authorised. This does not provide sufficient clarity or taxpayer protection. If a citizen is to be required to produce information to an authorised officer, there ought to be some way of knowing whether or not an HMRC officer who seeks information is authorised. The obvious solution is to require HMRC to list on their website which officers are authorised so that the taxpayer can check before providing confidential information to a person who claims to be authorised.

276 We also think that HMRC ought to make public the level of training that an officer has been given before he is authorised. Ideally such authority ought to be limited to an Inspector of Taxes working within SCI or CIF.

Para 58(3)

277 We are unclear what this paragraph is intended to deal with. We think it unreasonable that HMRC should have power to move a taxpayer from a non-business status (where his obligations are much lower) to a business status (which opens him two years' imprisonment). This ought to be a matter reserved to Parliament to decide.

Para 60

278 On the basis that it is not intended that the records that a person is required to keep should be prescribed in detail – which we fully support as the appropriate records for a business to keep ought to depend on the individual needs of that business – a person cannot be certain as to what records he is 'required to keep'.

279 Accordingly, although this provision appears designed to expand on the meaning of statutory records, we do not understand what it means and doubt that taxpayers will understand it either. We think it wrong in principle for Parliament to pass laws that it knows will not be understood by the citizen who is required to obey them.

280 We do not understand what is meant by records which a person is required to keep 'by virtue of' the Taxes Acts'. This phrase is obviously something different from 'under' the Taxes Acts, but we are unclear what else is intended and would welcome clarification.

281 We would appreciate confirmation of the meaning of para 60(2). We assume that this is trying to say that HMRC cannot look at personal records during the course of a tax year but must wait until the year expires but we would welcome confirmation that this is intended.

Para 62

282 We do not understand what is meant by a person's 'position' as regards any tax. We have looked up the word in the *Concise Oxford Dictionary* but none of the definitions there make any sense in such a context and we would welcome clarification of what is meant.

283 It seems particularly unreasonable to talk of 'the person's position … as regards … any future liability to pay any tax'. It is impossible for anyone to know what the tax laws may be in the future. History has shown that they change at least once a year, and in the last ten years or so twice a year. It is unreasonable to impose obligations

on a citizen that he is clearly unable to be sure of complying with as they depend on future legislative changes outside his control.

284 We are also concerned about the reference to a person's 'past' tax position. For some citizens that could require the person to produce information about what happened 80 years ago and a penalty or imprisonment if he has not kept the information. That is unreasonable. As the normal assessing period is four years, the taxpayer should not be expected to produce information earlier than that.

285 It is particularly unreasonable that para 62(2) seems to expect a company to produce PAYE information from 1945 when PAYE was introduced.

Para 62(1)(a)

286 We have the same concern about the reference to 'future liability' as under para 62(b).

Clause 109, Computer records etc

287 This is a very wide-ranging provision, in particular clause 109(3). We are unclear what is meant by 'obtain access to' any computer and request that the provision is clarified. Many businesses have very secure computer systems to ensure that the introduction of an unauthorised disk cannot infect the system with a virus. It is unreasonable to allow HMRC to breach that security, particularly as, for obvious reasons, many people have strong reservations about HMRC's perception of computer security.

288 An authorised person should have to be an officer of HMRC. HMRC officers have a statutory duty to protect confidentiality that would not apply to an outside contractor. As stated under para 57 of Sch 36 (clause 108), we also believe that there needs to be an easy way to check whether or not a person who seeks access to a computer is an authorised person.

Other measures

Clause 110 and Schedule 37, Record-keeping

General comments

289 The Schedule seeks to align existing record-keeping requirements for the various taxes and also arises out of the Powers review of compliance checks (see comments under clause 108 and Sch 36 above in relation to information powers). The Schedule amends the existing record-keeping requirements set out in s 12B, TMA 1970 and the corresponding rules for corporation tax (Sch 18 to FA 1998) and VAT (Sch 11 to VATA 1994).

290 The key change is that the amended provisions give HMRC the power to specify by way of regulations what records should be kept and preserved. For these purposes, the records extend to include supporting documents such as vouchers and receipts. Further, the regulations may make further reference to items specified in any notice published by HMRC.

291 As far as we are aware the current requirements in s 12B, TMA 1970 (and the corresponding provisions for corporation tax found in para 21 of Sch 18, FA 1998) which require a taxpayer to keep the records needed to make a correct and complete

return, are readily understood and we believe constitute a reasonable generic statutory requirement and we are concerned about a blanket power given to HMRC to prescribe what record should be kept.

292 We would be grateful for clarification as to what is proposed for secondary legislation. We would expect that such provisions would not seek to expand generally on the generic requirement but will be limited to specific areas such as the existing additional record-keeping requirements targeted at MTIC fraud.

293 We understand that record-keeping requirements will be set out not just in legislation but also in HMRC guidance. We think it is unreasonable for a taxpayer to also have to refer to any HMRC guidance in case it might contain statutory requirements somewhere among the guidance. If guidance is intermingled with statutory requirements, taxpayers are likely to be uncertain as to where the guidance ends and the obligations begin.

294 The concept of materiality should be applied in determining the degree of detail in which records should be kept for tax purposes.

Detailed comments on Schedule 37

Para 2(4)

295 We feel that this is too wide. The power to make regulations should be limited to those under specific provisions imposed by Parliament, such as paras 2(3A) and (3B) of Sch 11, VATA 1994 which Parliament decided should require enhanced record keeping requirements in limited circumstances to seek to combat MTIC fraud. This is a recurring theme throughout this Schedule.

Para 2(5)

296 The Explanatory Notes state that this is restating existing law. We cannot readily identify the existing legislation and would appreciate knowing what this is. As also stated in the explanatory notes, this paragraph also includes a new power for HMRC to specify conditions and exceptions to the general rule. Please clarify why this power is considered necessary. Both of these points are recurring themes throughout this Schedule.

Para 2(7)

297 We believe it fundamentally wrong to impose obligations on taxpayers by way of tertiary legislation. A taxpayer is expected to know the law. We think it unreasonable to expect someone to read many pages of HMRC guidance booklets in case there is a statutory obligation hidden somewhere amongst them.

Para 3(3)

298 We believe that this provision should be limited to things specified in writing in relation to an individual taxpayer. The paragraph seems to give HMRC a wide ranging power to create statutory conditions by means of, for example, a press release of which it is unlikely most taxpayers will be aware.

Para 8(3)

299 We are unclear why a limitation to six years should apply for corporation tax but not, as far as we can see, for income tax and capital gains tax.

CHAPTER 2

TIME LIMITS FOR CLAIMS AND ASSESSMENTS ETC

General

Clause 113 and Schedule 39, Time limits for assessments, claims etc

General comments

300 We recognise that the proposals to standardise time limits has been subject to consultation, but we concerned about the absence of reasonable transitional provisions. For example, the current time limit for error or mistake provisions are five years and ten months for income tax (s 33 TMA 1970) and six years for companies (para 51 of Sch 18 FA 1998). These will be reduced to four years but there are no proposals for transitional arrangements.

301 It is unreasonable that a person who believes that he has 5 years 10 months to make an existing claim and decides not to do so until the end of that period because he cannot foresee whether his circumstances may change may now find himself time-barred. Indeed it appears that circumstances can arise where a person might be required to make a claim for 2009/10 before he is required to make a corresponding claim for 2008/09. This is a particular issue where claims may be made under these provisions as a result of EU law developments.

302 EU law is clear that legitimate expectations ought to be preserved and that a transitional period is required. We therefore think that the clause 113 should be amended to require the Treasury to bring the Schedule into effect only in relation to claims in respect of fiscal years after that specified by the order. As we assume that the intention is to bring the Schedule into effect from 6 April 2009, we suggest that the new time limits apply only in respect of periods beginning after 5 April 2009.

Detailed comments on Schedule 39

Para 9(2)

303 We think it unreasonable for the new para (1A)(b) in conjunction with (1B) to extend the period for assessing from 4 to 20 years where a loss of tax is brought about by an agent or other third party, unless the taxpayer is himself complicit in the action.

Para 15

304 We are unclear as to the meaning of a person ‘bringing about a situation’ in new s 118(5) and would be grateful for clarification. What is this intended to embrace? We note that the explanatory notes put the expression in inverted commas, as if it has a special meaning, but do not explain what that meaning is.

305 New s 118(6) should apply only where the information is discovered at a time when HMRC are in time to assess the undercharge. It is unreasonable that a person who discovers a 10-year old mistake should be required to shoulder the burden of telling HMRC, knowing that HMRC can do nothing with the information, but that if he decides that it is pointless to do so HMRC become entitled to assess the item back 20 years.

306 It also appears that such a failure to notify can enable HMRC to assess under the current legislation. We think it unreasonable that the new code should have such a retrospective effect.

Income tax and corporation tax

Clause 114, Correction and amendment of tax returns

307 Currently, para 77 of Sch 18, FA1998 allows one company in a group to submit a joint return. In clause 114(6), it is unclear whether the reference to 'other company returns' is intended to apply to returns by the same company for other years, or returns for other group companies, or both. We think this should be clarified. We also do not believe that new para 34(2A) should apply where the officer has been notified that the company in question is no longer a member of the group.

CHAPTER 3

PENALTIES

Clause 117 and Schedule 40, Penalties for errors

308 These provisions also arise out of the Powers review. The Schedule extends the new penalty provisions that were introduced in Schedule 24 of the FA 2007 for the purposes of income tax, corporation tax, CGT and VAT to a further range of taxes, duties and levies, including inheritance tax, stamp duty land tax, stamp duty, petroleum revenue tax, insurance premium tax and a wide range of duties.

309 We are disappointed that the penalty provisions are being extended in this way when the FA 2007 measures have only recently come into force. The FA 2007 penalty provisions are far-reaching and we think it is right that these provisions should be introduced and bedded down before consideration is given to extending them further. We think it is wrong in principle to extend provisions that have only just been introduced and where there is as yet no evidence that they will work or encourage good compliance.

310 Further, while we favour alignment where this can be sensibly done, we do not agree with alignment for the sake of alignment, particularly if it gives rise to other problems. We are sceptical whether penalties based on underlying behaviour and which differentiate between prompted and unprompted disclosure are appropriate for one-off taxes such as inheritance tax and stamp duties.

311 In relation to inheritance tax, we think that they are inappropriate for personal representatives who are often unpaid laymen and who may have to try to piece together historical information from inadequate records which the deceased had responsibility for creating. In such circumstances the penalty will not necessarily reflect the behaviour of the personal representatives – and may not even reflect that of the deceased, as records might exist of which the personal representatives are unaware.

312 In clause 117(3), it will be very confusing to taxpayers if new obligations are imposed on them piecemeal. The whole Schedule ought to be brought into effect on a single date.

313 In clause 117(4), we think that an order should require a positive resolution of Parliament. The provisions can fundamentally affect the penalties for which a person

is liable and it should be for Parliament, not HM Treasury, to deprive a citizen of his possessions. Likewise, in clause 117(8), it should be for Parliament, not for HM Treasury, to decide what transitional provisions are appropriate.

314 In para 3 of Schedule 40, new paragraph 1A(1)(c) should only apply where the inaccuracy was attributable to T 'knowingly' supplying false information. This appears to be what was envisaged by HMRC, as the explanatory notes refer to the information being 'deliberately' supplied.

315 We are concerned about the amendments to the FA 2007 provisions in para 9 of Schedule 40 in relation to the disclosure of VAT errors. Whilst we welcome the Government's decision to increase the VAT de minimis limit for mandatory disclosure of VAT errors under Regulation 34(3) of the VAT Regulations 1995 from £2,000 to £10,000 as a significant deregulatory measure, we believe that the new penalty rules introduced in FA 2007 will deter most taxpayers from taking advantage of this deregulation.

316 We do not believe that Government would introduce a deregulatory measure that might trap taxpayers into paying additional penalties. We would have expected that amending an error on a tax return in accordance with this deregulatory provision would be regarded as disclosing the error to HMRC and thus attract the reduction in penalty provided for by para 9 of Sch 24, FA 2007.

317 However, we understand that HMRC's view is that correcting an error under that statutory mechanism cannot be regarded as a disclosure as it does not satisfy the requirements of para 9(1)(b) and (c). In order to make the deregulatory relaxation effective, para 9(3) of Schedule 40 ought also to provide that an amendment to a return in accordance with Regulation 34(3) constitutes a disclosure, provided that should HMRC subsequently wish to enquire into the adjustment the person then complies with para 9(1) (b) and (c).

Clause 118 and Schedule 41, Penalties for failure to notify etc

General comments

318 Again this provision arises out of the Powers review and provides a comprehensive framework for penalties. These follow a similar format to those in Schedule 24 FA 2007 referred to above and provide for stepped penalties based on the level of tax lost and the taxpayer's behaviour. Penalties range from 100% of the tax lost for deliberate or concealed failure to 30% for non-deliberate and non-concealed failures with further reductions depending upon whether the taxpayer made a prompted or unprompted disclosure about the failure.

319 We do not think that these proposals will encourage a situation in which the deliberate non-complier can become compliant.

320 We are concerned that the stepped percentages are too high and are therefore unlikely to encourage people to come out of the 'shadow economy' and regularise their tax position. Paying the tax plus interest plus a penalty may be just too much for some taxpayers who would otherwise come forward.

321 In order to encourage non-compliant taxpayers to come forward and put their tax affairs in order, we recommend that there should be a system of suspended penalties

similar to the regime which has been included in Sch 24, FA 2007. These provisions allow for a penalty to be suspended for up to two years subject to the taxpayer complying with any conditions. This system looks equally applicable to non-deliberate failure to notify cases and would allow HMRC to monitor future behaviour, such as whether the taxpayer submits returns on time and otherwise complies with his or her obligations, after the notification has been dealt with.

Detailed comments on Schedule 41

Para 17

322 We think that the taxpayer either should have a right of appeal against the notice under para 16, not against the decision, or that the time limit for an appeal should run from the date of the receipt of the notice. The legislation clearly envisages that the decision should precede the notice, but does not limit the time that can elapse between the two. Accordingly it is possible for the time limit for the appeal to have expired before the taxpayer has even received the notice of the penalty.

Para 20(2)

323 The provision needs to be clarified as to what events are outside a taxpayer's control. The taxpayer should be entitled to certainty before becoming liable to a penalty.

324 The provision also should be clarified as to what a taxpayer is required to do to take reasonable care. We think that the legislation should entitle him to rely on another person if that other person is professionally qualified in the area concerned and the taxpayer has no reason to believe that what he relies on that person to do is outside his area of expenditure.

Para 24(3)

325 We are unclear why 'tax' should include 'duty' but not a levy such as climate change levy. We would have thought it sensible to define 'tax' as including anything within the first column in para 1.

CHAPTER 5

PAYMENT AND ENFORCEMENT

Taking control of goods etc

Clauses 122 to 124 and Schedules 42 and 43, Taking control of goods etc

326 Again these provisions arise out of the Powers review and provide for an officer of HMRC to make a single action (clause 122 relates to England and Wales and clause 123 to Scotland) to seize goods to recover a tax debt.

327 We are concerned that the provision in clause 122 refers to procedures in Schedule 12 of the Tribunals, Courts and Enforcement Act 2007 (TCEA 2007). Schedule 12 sets out procedures and powers for taking control of goods but these rules are subject to a number of areas where the precise procedures and powers are subject to regulations, for example what form of notice must be given to the debtor, the time when control of goods can be taken and what powers of entry and force may be used. As far as we are aware, none of these regulations have yet been published, thus making it impossible to determine whether these provisions are reasonable and appropriate in the circumstances.

328 We still have the concerns that we expressed in TAXREP 22/08 (submitted on 11 March 2008 to HMRC, see http://www.icaew.com/index.cfm?route=155211) as it will be the regulations that tell us how Schedule 12, Tribunals, Courts and Enforcement Act 2007, which will cover the enforcement of tax debts by taking control of goods, will operate. In particular, we do not yet know what protections the taxpayer will have against the use of Sch 12, TCA 2007 by HMRC. Schedule 12 provides for goods to be taken unless they are exempt, and the exemptions are to be specified by regulation. At the moment HMRC follows a practice of not distraining on certain goods, such as those which are jointly owned or which are essential tools of the taxpayer's trade.

329 We should like reassurances that the existing safeguards for the taxpayers which HMRC observes in distraint proceedings will be preserved. Section 61(3), TMA 1970 requires HMRC to keep the goods seized for five days before selling them. This should be preserved in any new rules. Para 39 of Sch 12 TCE 2007 provides for a minimum period, to be specified by regulation – and again we do not know what that will be.

330 Under the present legislation, HMRC has power to distrain, but cannot insist on entry to premises in order to distrain goods unless it obtains a court warrant (s 61(2) TMA 1970). Under para 14, Sch 12, TCE 2007, an enforcement agent 'may' enter relevant premises without a warrant. This appears to give HMRC wider powers than at present. We think that the current requirement to obtain a warrant before insisting on entry should be preserved. In TAXREP 22/08 we expressed concern at the proposal (clause 122(1)) to extend HMRC's right to proceed against goods to amounts due under a contract settlement. Similar issues with contract settlements also arise in clauses 131 and 132 – see comments in para 283 below.

331 It is wholly unsatisfactory that such an important provision is introduced with such an unclear framework for enforcement. It is essential that the regulations under the TCEA 2007 are laid before these clauses are debated in Parliament so as to allow Parliament the opportunity for proper scrutiny of these provisions.

332 We also think it important that a taxpayer should be able easily to understand his rights and relegating safeguards and detailed provisions to secondary legislation will make it difficult for a person to do so. We strongly believe that if statutory powers are to be subject to limits or conditions, then these safeguards should also be spelled out in statute.

333 We do not believe that the powers that are appropriate to the collection of tax should extend to civil debts that happen to be due to HMRC. A contract settlement is a civil agreement to accept a sum of money in lieu of tax. It is deliberately framed by HMRC as a civil contract. Accordingly HMRC should use the normal enforcement powers that relate to civil contracts to enforce such debts.

Set off

Clauses 125 and 126, Set off

334 These provisions also arise out of the powers review and provide a statutory basis to allow HMRC to set-off sums payable to the taxpayer against sums owed to HMRC by the same taxpayer.

335 We are very concerned that the use of a right of set off can be very damaging to a business and in some circumstances could force it into insolvency. It can equally be damaging to individuals and could cause extreme financial hardship. It is clearly difficult to try to define the circumstances in which the right ought not to be used. We feel however that HMRC should be required to publish a Code of Conduct setting out the circumstances in which they will and will not exercise a set off and that such a Code should be exposed in draft for public comment before it is brought into effect and before HMRC seek to use the right of set off.

336 We are concerned that clause 125(2) only allows the Commissioners to apply set-off and not the taxpayer. The right to claim set-off ought in equity to be available to both parties.

337 The provision needs to be amended to provide adequate safeguards to taxpayers. Currently, they are inadequate because:

- There is no right of appeal against HMRC's decision.
- The taxpayer does not have the right to opt for set-off himself.
- There are wide powers in the draft legislation, and few safeguards.
- Safeguards solely in the form of HMRC's operational guidance are not adequate.
- Set-off should not be used for liabilities which are the subject of a formal complaint which is being investigated.
- The order of set-off may make a considerable difference to taxpayers in terms of interest, surcharges, etc. The legislation should be amended to ensure that HMRC should be required to set-off debits and credits in whatever way is most favourable for the taxpayer.
- We understand that tax credits will not be used to reduce a tax debt. However, this is not stated specifically stated in the legislation. We also believe that tax credit overpayments should be excluded from any set-off.
- We assume that child benefit will also be excluded from set-off but again think that this needs to be set out in statute.

338 We are concerned that by specifically excluding from set off in clause 126(2) post-insolvency credits against pre-insolvency debits, the rules are implicitly (or perhaps even explicitly) allowing the set off of pre-insolvency credits against post-insolvency debits. While this may not be particularly important in many corporate insolvencies there will be many cases (and all cases of personal insolvency) where such a set-off would be detrimental to the creditors generally and fly in the face of all the basic principles of insolvency.

Other measures

Clause 129, Interest on unpaid tax in case of disaster etc of national significance

339 We welcome this clause, which gives HM Treasury power to make regulations when necessary to allow deferred payment so that interest and surcharges can be waived where people have problems paying tax in cases of national disaster or emergency.

340 This follows on from the widely welcomed approach adopted by HMRC in response to the foot and mouth crisis and last year's flooding.

Clause 130, Fee for payment

341 This clause gives HMRC the power to introduce regulations to pass on any fees charged where tax debts are settled by way of a credit card transaction. HMRC should not be entitled to charge a taxpayer for the normal banking costs that apply to any bank account and we would welcome confirmation that this will not occur.

342 The clause is very widely drawn and it would appear that HMRC could use the provision to pass on other costs, for example cash or cheque handling, processing or banking charges etc. We think that the scope of the clause should be restricted to credit card charges and similar costs and that HMRC should be empowered only to pass on transaction costs in excess of the costs it is itself charged by the third party provider. The clause should either be amended or HMRC should provide an assurance to the same effect.

Clause 131, County Court proceedings

343 Clause 131 enables HMRC to take one court action for several debts. We do not object to the principle. The change is made by taking the provisions about civil proceedings out of the relevant acts on specific taxes and putting one power into CRCA 2005 (the Commissioners of Revenue and Customs Act).

Clause 132 and Schedule 44, Certificates of debt

344 As far as we are aware this is clause that has not hitherto been exposed for comment although the Explanatory Notes say it has been subject to consultation. It adds a new section to the CRCA 2005 and is concerned with certificates of debt, which are what HMRC need before they can commence civil recovery procedures for tax debts.

345 It should be made clear in the legislation that the certificate is not intended to be conclusive evidence but is rebuttable.

346 Amounts due under contract settlements are specifically included. In our TAXREP 22/08 (submitted on 11 March 2008 to HMRC, see http://www.icaew.com/index.cfm?route=155211) we said:

> *'We are also concerned at the proposal … to extend HMRC's right to proceed against goods to amounts due under a contract settlement. There is no such right under current law and HMRC has not indicated why it believes that powers which apply to tax should be extended to purely civil debts. We believe that HMRC ought to rely on contract law to enforce contracts in the same way as other parties to a contract. We also believe that the definition of a contract settlement could give rise to arguments. For example, a taxpayer sometimes includes in an offer liabilities that are out of time for assessment and we doubt that such an amount can be said to be 'in connection with any person's liabilities'. An offer is also sometimes made as a pragmatic way to resolve a dispute albeit that the taxpayer does not believe that any tax is due.*

We also doubt that such an offer is in connection with a liability. We do not think that taking goods is an appropriate remedy where there is a possibility of a dispute.'

347 There is doubt as to whether certificates apply to tax credits and we would welcome clarification of the position.

Supplementary

Clause 133, Interpretation of chapter

348 A contract settlement is not an agreement in connection with a person's liability under an enactment. On the contrary it is a civil agreement under which, in consideration of a person making a payment, HMRC undertake not to seek to enforce a person's liability to tax.

PART 8

MISCELLANEOUS

Inheritance tax

Clause 134, Charge on termination of interest in possession where new interest acquired

349 We welcome this clarification, which responds positively to our request in our letter to the Financial Secretary to the Treasury dated 14 February 2008 (TAXREP 15/08, see http://www.icaew.com/index.cfm?route=154518) and, prior to that, meetings with HM Treasury and HMRC.

350 In correspondence in 2007, HMRC took the view that where an existing interest in possession (IIP) at 22 March 2006 was altered, this could create a new IIP even for the same beneficiary which under existing s 53(2A) IHTA was not eligible for relief under s 53(2). Thus in HMRC's view there was an immediately chargeable transfer on such a charge. We would welcome confirmation that the effect of clause 134(2) is that the HMRC view cannot be applied to transactions before 12 March 2008.

Clause 135, Interest in possession settlements: extension of transitional period

351 We welcome the extension to the transitional period, which, albeit not as long as we requested in our letter to the Financial Secretary to the Treasury dated 14 February 2008 (TAXREP 15/08, see http://www.icaew.com/index.cfm?route=154518) and, prior to that, meetings with HM Treasury and HMRC, does go some way to compensate for the uncertainty arising from HMRC's statements in the latter part of 2007 as to how the law that is now being clarified in clause 134 should be applied.

OTHER POINTS RELEVANT TO THE BILL

Repeals

352 The Bill does not contain the customary repeals schedule. We note from the Bill that a number of measures are repealed within the relevant sections, which suggests that the approach adopted has changed to one of a 'repeal as you go' rather than 'repeal at the end'. We would welcome confirmation of the approach adopted this year and whether this will be future policy.

VAT staff hire concession

353 The withdrawal of this long-standing concession from 1 April 2009 will mean that the whole of the charge for the staff will then be subject to VAT, rather than, as at present, just the agency margin. It will involve be a very significant VAT increase for many businesses. As HMRC have said:

> *'The customer sectors that will be most affected will be those sectors unable to recover VAT in full: the financial services sector (e.g. banking and insurance), private healthcare providers, private care homes, private and voluntary aided schools, higher education establishments (e.g. universities), other partly or fully exempt businesses, charities and some parts of the public sector.'*

354 *'Some parts of the public sector'* include the NHS when they hire in agency staff. In addition, private individuals will be affected when they buy in support care from local authorities or privately.

355 HMRC has stated that announcing the withdrawal a year in advance will 'give those affected by the change in VAT treatment time to plan for its withdrawal'. This is welcome but we think that the costs will still be considerable for many businesses and healthcare, welfare and educational bodies.

356 We recommend that a further review should be undertaken on the withdrawal of the concession and the impact that it will have on costs in the welfare and education sectors. The review should consider the possible introduction of a special low rate of VAT to supplies in these sectors, an approach which is permissible under EC Law.

FJH
9 May 2008

Appendix 1

DETAILED COMMENTS ON SCHEDULE 7, REMITTANCE BASIS

Section 809B Claim for remittance basis to apply

A1 We believe it is unnecessary for taxpayers to be forced to nominate a source of income or gains. We suggest that this is an option available but that taxpayers should be able to simply assert that they wish to pay the remittance basis charge (RBC) without a nomination but recognising that they will have no future credit for this sum in the UK. This refers back to our earlier points about disclosure and also to the costs of compliance which would be generated for no particular purpose. We find the comment at paragraph 15 in the explanatory notes glib and unhelpful. Our proposals would pass the burden of choice to the taxpayer and put paragraph 15 into context.

A2 We should be grateful for explicit confirmation that the normal time limit of 5 years and 10 months from 31 January following the end of the relevant tax year under s43 TMA 1970 will apply.

A3 It is unclear whether the RBC will form part of the payments on account system. The explanatory notes at para 17 appear to contradict previously published guidance and the FAQs. If the payment on account system is to be used, this is inconsistent with chargeable gains legislation. We suggest that the RBC should be paid as part of the balancing payment whether it relates to nominated foreign income or gains.

A4 If it is decided that the RBC will form part of the payment on account system we seek confirmation that the charge could be postponed without later interest charges or penalties if the taxpayer subsequently decided to pay the RBC.

A5 May we also have confirmation that relief for repayments of special withholding tax under ss108–109 FA2004 will apply?

A6 The explanatory notes and FAQs refer to Gift Aid donations, We should be grateful for clarification of the mechanism for such relief and similar tax reducers including EIS etc.

A7 Finally may we observe that it would be helpful if the entire explanatory notes and FAQs could refer to a single abbreviation for the charge.

Sections 809C and 809D Application of remittance basis without claim

A8 We have indicated previously, and maintain, that £2,000 is inadequate to avoid inadvertent non-compliance and is too low to justify the additional costs to both HMRC and taxpayers of making additional tax returns that are presently not required. We have seen no evidence that this threshold has been thought through on any statistical basis. We propose that the level of personal allowances is a useful measure since one function of personal allowances is to minimise inefficiencies.

A9 It is not clear how the £2,000 limit operates in a split year of arrival or departure. An employee from abroad may derive overseas earnings substantially in excess of £2,000 in the non-resident part of the year. The definitions in s809Z suggest that only income which is UK chargeable if remitted (e.g. relevant foreign earnings and relevant foreign income) will count towards the £2,000 limit.

A10 The position needs to be clarified where the employee is treaty resident abroad during the non-resident part of the year. Both the explanatory notes and the FAQs fail to mention the assurance given by HMRC on 28 February 2008 at the Joint Forum on Expatriates Tax and NICs where the minutes on HMRC's website read: 'HMRC confirmed that Treaty residence should be regarded as integral to the yearly accounting test for the purposes of determining whether or not the £30,000 charge is appropriate.

A11 Similarly clarification is needed if he is resident for the whole year because he exceeds 183 days but comes from, or returns to, a non-treaty country. The same concerns arise in relation to s809D where an individual arrives in the UK part way through the tax year and has made transfers prior to becoming UK resident subsequently.

A12 We welcome the introduction of s809D but query whether the requirement at (1)(c) that the individual has no UK income or gains for that year may limit its usefulness. It is probable that a non-working, non-domiciled spouse or civil partner, the individual most likely to fall within the ambit of this section, will have a modest level of UK income, say from a joint bank account. We would suggest that a de minimis provision be included in this section.

A13 We suggest also that there should be a provision to allow a foreign domiciliary to opt out of the remittance basis of taxation. A foreign domiciliary who just has a foreign dividend which has been paid straight into a UK account would want to be taxed on the arising basis to benefit from the 32.5% tax rate. We recognise that it is possible to ensure that £2,000 or more of the dividend income is retained offshore but it should not be necessary to have to go to those lengths.

A14 We understand that legal opinion advises that the denial of the dividend rate to those who claim the remittance basis is discriminatory. We assume that the Government will seek their own advice on this matter, but if the Government accept this to be the case and amends as appropriate then our comments in the previous paragraph will no longer apply.

Section 809F Claim for remittance basis: effect on allowances etc.

A15 We remain unclear as to why it is considered necessary, or justifiable, to remove personal allowances for those claiming the remittance basis. It is our understanding that the personal allowance exists to recognise that until a taxpayer has a certain amount of income they have no taxable capacity, whether this basic level of income is satisfied by UK or foreign sources is irrelevant to the underlying principle.

A16 As regards capital gains tax we consider it unfair that a resident, UK domiciled individual who is not ordinarily resident and who pays tax on their world-wide gains can be refused the annual exempt amount (AEA). An example of such a taxpayer would be an employee of UK origin working abroad in a permanent overseas employment but who is seconded to work in the UK for a limited period. This individual may be resident but not ordinarily resident, and entitled to claim the remittance basis on their foreign income. If they do so, and their non-UK income exceeds £2,000, it is difficult to see why they should also forfeit the capital gains tax annual exempt amount. Accordingly, the clause should be revised to exclude this unfairness.

A17 The reporting requirements for capital gains tax are currently linked to the AEA. If this is reduced to zero there will be a disproportionate increase in the administrative burden on both HMRC and the taxpayer. As an example, if a relevant taxpayer with £2,001 of overseas income realises a currency gain of £5 on their return to the UK they would – strictly – be required to complete the capital gains tax pages of the tax return and pay the maximum of 90 pence capital gain.

Section 809G Claim for remittance basis by long-term UK resident: charge

A18 It appears from the recently published FAQs issued by HMRC that all years of actual residence in the UK will count towards the seven out of ten years test. This will be the case even if for some, or all, of those years the taxpayer was treated as 'treaty resident' in another country for the purposes of a DTA tie-breaker. It is not clear why this should be so, especially for years throughout which the individual is treaty resident in a country from which he derives the whole of his remittance-basis income and gains. In such a year there is no advantage at all in being non-domiciled or not ordinarily resident, and it is difficult to see why it should count towards the seven year total.

A19 We are concerned that there are a considerable number of individuals in this position. They are perhaps unlikely to pay the RBC since the treaty will almost always give primary taxing rights to their home country. However there will be a disproportionate impact in relation to any income they receive from a third country and – again – a tax return with all the associated costs will be required for little tangible benefit to the UK Exchequer.

Sections 809H and 809I Remittance basis charge: income and gains treated as remitted and order of remittances

A20 It is beyond our comprehension as to why these two sections have to be so complicated. We are extremely concerned about the extent of record keeping and tracing pre-supposed by these sections as drafted. In our experience it is the unrepresented taxpayer who is unlikely to have the records necessary to comply with these sections and those with representation will incur significantly higher costs. There is no apparent logic behind these rules which are only designed to maximise revenue. This is short-sighted and completely contrary to the fundamentals of the self assessment system. Taxpayers must be able to understand and apply the rules to their own circumstances if they are to be able to comply with their obligations. HMRC will find it virtually impossible to police these proposals in anything other than a draconian way.

A21 S809I only applies for the purposes of section 809H. This needs to be made clear and must be specified in the body of the text. It is totally inadequate to have to include the section headings to be able to interpret the legislation.

Section 809K Meaning of 'remitted to the United Kingdom'

A22 We remain confused by the policy intention behind the alienation provisions and seek clarity on this aspect. If the intention is to catch a benefit arising to the donor then this could be simply done by substituting 'taxpayer' for 'relevant person'. The section then becomes workable.

A23 If there is to be no limitation then we would ask that where the donee is UK resident that an election can be made whereby the donee elects to pay the tax on the remittance rather than the donor.

A24 Paragraph 2 (b) would, in our view, benefit from a definition or clarification of what is meant by the word 'service'.

A25 There is inconsistent language used. Condition A refers to 'the benefit of a relevant person' whereas Conditions C and D refer to 'enjoyed by a relevant person'. What is the difference between these concepts? If there is a distinction it should be specified, and if not consistent wording is preferable.

A26 The wording in Condition B (3)(a) and sub-section (9) is, as written, nonsense. What does 'if the service is … the income' mean? If there is a deeming here then could this be clarified?

A27 The reference to gifts needs a limitation on definition by time and knowledge and control. As the legislation stands the section is not possible to comply with and not possible to police or enforce. As an example, it would require an individual who had given funds to his adult child outside the UK to report a remittance if that adult child provided a benefit to their own minor child in the UK out of those funds, such as purchasing a railway ticket for them. To enact legislation that a taxpayer cannot comply with, through no fault of their own, undermines the whole system.

A28 We assume that settling a debt offshore, which is not a relevant debt, would not constitute a remittance if subsequently remitted to the UK, provided a relevant person does not benefit in any way. We are thinking specifically of debts that might be imposed by the UK courts in divorce cases, for example. A husband may make offshore payments to his ex-wife. If she brings those payments into the UK she will not be a relevant person and the ex-husband will not benefit in any way at the time of the remittance. If, however, the ex-wife has custody of the minor children she may use those funds to benefit them. The ex-wife could of course pay for the children's' maintenance separately from UK funds but the husband would have no way of knowing whether his ex-wife has kept the monies separate so will not be able to prepare his return with confidence.

A29 We assume that the purpose of sub-section 6 is to prevent a multiple charge, as is s809O(12). We understood that at one point there was an intention of introducing an overarching provision that would only allow one tax charge on one individual with respect to the remittance of foreign income or foreign gains (and would cover the offshore trust anti-avoidance provisions as well). We ask if this is still the intention?

A30 We are aware that the intention of sub-section 8 is to ensure that interest payments with respect to an offshore mortgage are to be classified as remittances from 6 April 2008. We are not certain that the wording 'debt for interest' puts this beyond doubt, it could be argued that interest paid as it falls due is not a 'debt for interest'. Whilst we would presume that, given the transitional provisions later in the legislation, a court would go for a purposive interpretation we would suggest that the wording is revised to put the matter beyond doubt.

A31 We understand from HMRC that the 'alienation' clauses remain a work in progress. As amendments are made throughout the progress of the legislation we should be grateful if those changes could be highlighted, in particular in the FAQs on the HMRC website. At the moment the FAQs on this subject are ambiguous and there are two different commencement provisions. The alienation rules of Grimm v Newman have simply been ignored.

Section 809L Section 809K: relevant persons

A32 The definition of relevant persons under this legislation differs from those originally proposed. The scope has been restricted in some respects, and made much wider in others. In particular there are three areas where further change is thought necessary.

Grandchildren

A33 A grandchild under the age of 18 is a relevant person (2)(d). As is shown by the example above on s809K the rules do not work effectively making it very difficult, if not impossible, for a grandparent to complete a correct self-assessment tax return.

A34 We suggest that this category should be removed from the definition of a 'relevant person' on practical grounds. It might be reasonable for an individual to be aware of whether steps have been taken which might cause a remittance to have taken place in relation to their immediate family, the same cannot be said in respect of a grandchild, save where the grandparent is acting *in loco parentis*.

Close company

A35 Sub-section (2)(f) added a new category of relevant person, a close company in which a relevant person is a participator. This appears to be aimed at foreign close companies, so that it becomes a relevant person if, broadly speaking, a relevant person owns shares in it. The concern here is that a UK resident, non-UK domiciled individual may use foreign gains to capitalise their shares in the company, and the moment the company acquires UK sited assets with such funds there will be a remittance. It is unclear why the government wishes the legislation to penalise investment in the UK economy in this way.

Trustees

A36 Sub-section (2)(g) added a further new category of relevant person, the trustees of a settlement of which a person falling within the other categories of relevant person is a settlor or beneficiary. This provision will cause particular problems in respect of charitable trusts established by non-domiciled but UK resident settlors. It will deter the trustees of such a charity from investing in UK assets so as not to give rise to a remittance for the settlor. From a practical point of view the settlor is in an invidious position. He could never be in a position to complete his self assessment return without having detailed information as regards the investment activities of any trusts that he has established since 5 April 2008 and where he has used foreign unremitted income or gains to do so.

Section 809N Section 809K: dealings where there is a connected operation

A37 We note the extremely wide terms used to define a ‘connected operation’ and what amounts to a ‘qualifying disposition’. We assume this section is aimed at channelling operations, but should be grateful if you would provide us with some practical examples to illustrate where the section will be relevant.

Section 809P Sections 809K and 809O: transfers from mixed funds

A38 The proposals for dealing with remittances from mixed accounts remain essentially unchanged compared with the draft legislative proposals released in January. This is disappointing. The new rules overturn the previous practice as set out in SP5/84, a change that has been inadequately highlighted in the Explanatory notes.

A39 The proposals are overly complex and are a particular problem for the unrepresented taxpayer as they tax previously untaxed income before income that has already suffered tax. We think there is a risk that such taxpayers will not be able to understand and properly apply the rules. We should be interested to learn how HMRC plan to assist these taxpayers.

A40 The rules still fail to address how overseas expenditure or gifts made overseas from the mixed fund are to be treated.

Section 809Q Section 809P: composition of mixed fund

A41 Sub-section 4 needs to be amended to take into account the more detailed breakdown of income and capital in s809P than there was in the draft legislation.

Section 809R Sections 809K to 809Q: foreign chargeable gains accruing on disposal made other than for full consideration

A42 There has been a lot of concern about whether deemed gains that arose when assets were settled on offshore trusts by non-UK domiciliaries before 6 April 2008 could somehow be revived and become attached to payments made to settlors after

5 April 2008. We understand that this is not intended but the provision does not include a suitable transitional provision. The provision should be amended so that s 809R(1)(a) cannot apply in relation to gains arising prior to 6 April 2008.

Section 809S Money paid to the Commissioners

A43 We have already commented that in our view the requirement that a remittance to pay the £30,000 charge will only cease to be a remittance if it is paid directly to the Commissioners is in breach of the assurance given by the Acting Chairman of HMRC.

A44 We also consider that it is unacceptable that under subsection (2|) any subsequent repayment of this amount becomes a taxable remittance. HMRC should simply make the repayment back to its original source.

A45 As regards this section we fail to see why the principle it embodies, that direct payment of tax to HMRC out of overseas income or gains is not a remittance, should not be extended to other payments of tax on remitted income.

Sections 809T to 809Y: Exempt property

A46 These sections broadly exempt certain property from the remittance provisions. We have a number of concerns on the interaction of these sections, particularly in the case of property brought into the UK for personal use. Our overriding concern, however, is that, other than for property brought in for public display, the exemptions only apply if the property derives from relevant foreign income. We are unable to understand the logic of such a restriction that, in our view, complicates the law unnecessarily, particularly for the unrepresented taxpayer who may well not appreciate the distinction. In order that a long and detailed calculation need not be undertaken every time, for example, a Polish builder flies into the UK with a newspaper bought at Warsaw airport, we suggest that the exemptions at s 809T(4) and (5) be extended to apply to property derived from all foreign income and gains.

A47 As currently drafted the provisions on exempt property are complicated to such a degree as to be almost incomprehensible and unworkable. The next two paragraphs illustrate just some of the anomalies that arise on an item of ‘personal use’ property.

A48 An item of ‘personal use’ property (defined as clothing, footwear, jewellery and watches) that costs under £1,000 is exempted under both s 809T(4) and s 809T(5)(a). As such if the item is sold whilst in the UK there is a remittance of the original cost at the time of sale, even if the item is sold at a car boot sale for £1 (s 809U(3)). Yet if the item is taken overseas and sold in the UK, whilst still physically overseas, there is no remittance. If the item is scrapped or gifted in the UK there is no remittance, neither is there a remittance if the item is stolen. This remains the case even if the item is insured and monies are received in settlement of a policy claim.

A49 An item of ‘personal use’ property that costs over £1,000 is only exempt under s 809T(4). As such if it is gifted whilst in the UK to anyone other than a relevant individual, even to a charity shop, the cost of the item becomes a remittance at that date under s 809U(4), although there is no remittance if the item is gifted to an overseas charity shop whilst abroad. The same provisions mean that if such an item is scrapped or stolen whilst in the UK there is a remittance of the cost of the item, although this is not the case if the item is scrapped or stolen overseas. If however the item has been in the UK for less than 275 days and the non-domiciled individual can show that the item was taken overseas after it was stolen, for example, then there will not be a remittance. If a gift is made of the item by the non-domiciled individual to their infant child there is no remittance as the property continues to meet the personal use rule (s 809W(2)). When that child reaches their 18^{th} birthday, however, a remittance will arise if the property is in the UK, although not if the property is overseas on that day even if it is brought back to the UK the following day.

A50 We would suggest that these provisions be redrafted to make them comprehensible and accessible to the taxpayer.

A51 We are unable to understand the need for the restriction in s 809V(5)(a) and why it is necessary to mirror the VAT provisions in this respect.

Paragraphs 2–40

A52 We have not commented on these as we understand they are to be withdrawn and rewritten in entirety. If this is not so we would welcome urgent confirmation of the position.

Paragraph 49

A53 The paragraph substitutes a revised s 832 (and ss 832A and 832B) into ITTOIA 2005 to disapply the previous rule that an amount of income could not be taxed in the UK if the source of that income did not exist in the year of remittance. This is simple anti-avoidance legislation with which there is little dispute. There is, however, a significant practical problem with the clause as currently drafted. HMRC had long recognised and accepted the previous position which means it was used by a large number of taxpayers on many occasions over many years. The problem is therefore one of identification. As drafted any sum which was, for example, income when it arose will be taxed as income in the year it is remitted. It will be impossible to correctly and accurately identify these sums as they have been treated as capitalised and assimilated into other funds or reinvested in other assets.

A54 There was no requirement to keep records at the time of the transaction and it will not be possible to comply with the provision as drafted and correctly complete a self assessment return. The legislation needs to contain some delimitation. We propose that the legislation is amended to reflect the fact that s 832(3) ITA 2007 should read '… whether or not the source … exists when the income is remitted *where the source ceased after 5 April 2007'..*The italics are our words.

Section 832B Section 832: deductions from remitted income

A55 The FAQs suggest that the provisions apply to a deemed trade such as furnished holidays lettings but the wording of the legislation does not support that interpretation. We assume this is an oversight and the appropriate amendment will be made. Please confirm.

Paragraphs 51– 52 (Removal of annual exempt amount)

A56 As suggested earlier we propose that a de minimis of at least £1,000 is applied to these provisions to obviate the need for tax returns in cases such as small currency gains etc.

Paragraph 56

A57 It seems that the interaction of the general commencement provision (paragraph 77 stating that all provisions have effect with respect to 2008/09 and later years) with the specific commencement provision (paragraph 80) is such that a remittance after 6 April 2008 of an asset disposed of prior to that date would be treated under the new s 12 TCGA 1992 rules (that is the gain is deemed to be remitted first).

A58 We are unclear whether this is what was intended but cannot see any commencement provision with respect to paragraph 56 which disapplies the new s 12 TCGA where the gain arose prior to 6 April 2008. We note this is in contrast to paragraph 85 which does this with respect to the mixed funds provisions of ss 809P and Q.

Paragraph 58 (Foreign losses on disposals of assets)

A59 We think that these rules should apply automatically but the taxpayer should be able to elect out of them if they are not beneficial. As the time limit for the election is linked to the commencement of the remittance basis rather than when a loss is realised, then the unrepresented taxpayer is very unlikely to appreciate that any action should have been taken and could be severely disadvantaged. We suggest that if taxpayers wish to make the election then the time limit for opting out could be five years and ten months after the first tax year with respect to which the 16ZC provisions apply and a loss accrues

A60 We are also concerned as to whether s 16ZD(3) actually does what is intended. It does not appear to be is linked to either s 16ZB(1)(c) or s 12 TCGA. The aim is to provide that the set off under s 16ZC(3)(b) will apply going forward. However, s 16ZB is the section that deals with what is chargeable in a tax year. It is s 16ZB(3)(b) that deals with remitted gains and this is defined by s 16ZB(1)(c) which is linked to TCGA 12 with no tie in, as far as we see, to 16ZD(3). Please clarify that the provision works as intended.

Paragraph 59 (Amendments to s 33 TMA 1970 – error or mistake claim)

A61 It would seem appropriate for it to be set down in the legislation that, if an individual pays the £30,000 under s 809H and it is established that he was not foreign domiciled, that the £30,000 will be available as a credit against any additional tax liability resulting from being taxed on the worldwide arising basis.

Transitional provisions
Paragraphs 82 & 83

A62 We think there are several incorrect references in paragraphs 82 & 83 where it refers to section s 809L rather than s 809K.

A63 In paragraph 82(2) does the word ‘property’ include cash? We suggest that chattels would be a more appropriate word since otherwise 82(3) and (4) could include cash, which is presumably not the intention.

Paragraph 86

A64 We fail to understand why relief is not allowed under the transitional provisions for interest paid overseas from foreign earnings and capital gains. Under the old rules both could be used to pay interest on an offshore mortgage secured on UK property without that resulting in a remittance.

A65 In addition, we suggest that transitional relief should be extended where land is not subject to a direct charge. The provision in paragraph 86(1)(c)(iii) that the debt is secured on the interest in the property is very restrictive. In practice many offshore lenders prefer to have security over assets under management with them. Nevertheless, the loan can be demonstrated as being for the purpose of purchasing the interest in the land that was acquired.

A66 We are concerned that the provisions as currently drafted do not allow any transitional relief where part of the borrowings has been used to pay for renovations.

A67 Paragraph 86(3)(c) seems particularly harsh as this was not announced on Budget Day.

PART 2
NON-RESDIDENT COMPANIES AND TRUSTS

Paragraphs 92–94 Attribution of gains to members of non-resident companies

Application of the remittance basis

A68 The part of the gain chargeable on a participator under s 13 TCGA 1992 (the ‘deemed chargeable gain’) is treated as being a ‘foreign chargeable gain’ for the purposes of charging tax on the remittance basis. However, this only applies to that part of the gain that is attributable to gains arising in respect of chargeable foreign sited assets. Gains in respect of UK sited assets are taxed on the arising basis. This contrasts unfavourably with the position where a non-UK resident trust is involved, and the remittance basis is applied in respect of gains arising under s 87 TCGA 1992. These changes will act as a major disincentive to investment in the UK. It is difficult to understand why the provisions with respect to offshore trust gains were amended such that foreign domiciliaries would be taxed on ALL gains on the remittance basis and yet no similar amendments have been made with respect to offshore companies not held within trust structures. We seek clarification of the policy rationale. It is unclear to us why the Treasury would want to penalise those investing in the UK.

Rebasing

A69 The current proposals do not include an option for non-UK domiciliaries to benefit from a rebasing election in the way that non-UK resident beneficiaries are eligible to do so under paragraph 112(1)(2). It is hard to follow the logic of allowing a wholesale rebasing of assets within an offshore trust structure (including assets owned by an underlying company) when there are no provisions to allow for a rebasing with respect to assets owned by an offshore company where the interest in the share capital is owned directly by a foreign domiciliary.

A70 We consider that such an option should be made available where non-UK domiciliaries hold shares in non-UK companies that would be close were they to be UK resident. If it can be done to benefit non-UK domiciled beneficiaries in relation to offshore trusts, it would seem possible in the context of holdings owned individually and we cannot understand why a distinction is being made in such cases.

Paragraph 100 Transfers between settlements: s 90 TCGA 1992

A71 Section 90(4) defines the ‘the relevant proportion’ as being the market value of the property transferred, divided by the total market value of the property in the transferor settlement prior to the transfer. This approach could produce distortions where the transferor fund is indebted, or where property is transferred subject to debt charged upon it. A fairer approach might be to calculate the relevant proportion taking into account net values.

A72 The term ‘transfer’ used on s 90(9) is a general word of wide application; it would seem to include both interest free and interest bearing loans. Generally the consideration for receiving a loan is the covenant to pay interest (where interest is payable) and the covenant for repayment of the capital due under the loan. This would seem to suggest that a commercially structured loan from one trust to another will have a nil value for the purposes of s 90, as would an interest free loan which was repayable on demand. However, the position might be different where a loan was at a reduced rate of interest and for a fixed term.

A73 We would welcome clarification of the position generally where loans are made between trusts in such circumstances.

Paragraph 111

A74 The examples in the Budget documentation indicated that where (i) a rebasing election has been made by the trustees and (ii) excess capital payments were made prior to 12 March 2008, the excess capital payments will be matched first to gains treated (by virtue of the deemed split between pre 6 April 2008 and post 5 April 2008 gains resulting from the rebasing election provisions) as accruing before 6 April 2008.

A75 This provision does not appear within the legislation. Please clarify that this proposal has been dropped.

Paragraph 112 Rebasing election

A76 This paragraph gives effect to the statutory provisions relating to the rebasing election for trustees both in relation to assets held by them as at 5 April 2008 and by a foreign company in which they were a participator within the ambit of s13 TCGA 1992.

A77 There is currently considerable confusion within the profession on this aspect of the legislation, particularly as it differs from the documentation that accompanied the Budget. The explanatory notes indicate that changes will be made which serves only to exacerbate this confusion. We need to know what these changes are and to be provided at the earliest opportunity with complex worked examples, with narrative explanation, so we can be sure that we understand how the legislation is supposed to work and are also able to advise our clients.

A78 Paragraph 112(2) states that the time limits for triggering an election will commence (beginning with the tax year 2008/09) where either there has been a capital payment or a transfer to another settlement within s 90 TCGA 1992. However, the position is unclear where a settlor becomes resident in the UK after this date and where the triggering event has already taken place.

A79 We suggest that this situation is addressed, in order to ensure that the availability of the election is not lost.

A80 Paragraph 112(9) defines a 'relevant asset'. The FB 2008 provisions refer in a number of cases to 'the asset'. It is not clear how this provision is to be interpreted where the asset concerned is for example swapped for another. We would suggest that there is a need for there to be some statutory rules that trace through to the asset in question.

A81 For example, where there has been a share for share exchange, the composite new holding rule in s 130 TCGA 1992 might apply. But what happens where those rules are not triggered, for example where shares are sold for a qualifying corporate bond? Or where a business held as at 6 April 2008 is subsequently incorporated? Or the business asset sold and the proceeds reinvested in a replacement? We suggest that amendments need to be introduced to deal with all these situations.

A82 Paragraph 112(9)(c) provides one of the conditions that has to be satisfied before an asset can be a 'relevant asset'. The Explanatory Notes at para 509 state that the rule will not be satisfied if, at any time from 6 April 2008 to the date of disposal or deemed disposal, the trustees would have been entitled to a higher proportion of the gain than the proportion they were entitled at the time of the disposal made by the close company. This is apparently to guard against the trustees reducing their interest in the company. If this is the objective, we think that the wording used at paragraph 112(9)(c) does not clearly convey this meaning. We should be grateful if the position could be clarified.

A83 Paragraph 113 makes provision to apply the effects of an election under paragraph 112 made by the trustees of a settlement who subsequently transfer all or part of the settled property to the trustees of another settlement where s 90 applies to the transfer. Under paragraph 112, one of the two occasions that allow an election to be made is where the trustees transfer part, but not all, of the settled property to the trustees of another settlement and s 90 TCGA 1992 applies to the transfer. It is not clear how paragraphs 112 and 113 interact where the transferor trustees make a transfer of all of the property concerned. We would welcome clarification on this aspect. It also appears to us that this section may be incomplete.

Appendix 2

Updated TAXREP 67/07

CLAUSE 42: HOMES OUTSIDE THE UK OWNED THROUGH A COMPANY

FOREWORD

1. The comments below update those made in our representation TAXREP 66/07 in which we commented on draft legislation published by HMRC on 17 July 2007 which we submitted to HMRC on 5 October 2007, receipt of which was not acknowledged and which has not been taken into account in formulating the legislation in the Finance Bill. The updating consists of renumbering the clause subsections to fit in with the numbering in the Finance Bill.

KEY POINT SUMMARY

2. Whilst we welcome the objectives, the draft legislation is unlikely to be sufficient to achieve all that is intended.

3. First, it limits the relief to properties owned directly by an individual through a single company whereas many properties abroad are held by a company the shares in which are held in a trust or by another company.

4. Secondly, it may miss the stated objectives owing to the approach adopted of leaving the property potentially within the benefit in kind charge and carving out a very limited exception. A better way to achieve what we assume was intended would be simply to disapply section 97(2), ITEPA 2003 in relation to living accommodation where, although a person is the director of a company, he is:

   - unpaid;
   - does not perform significant duties for the company;
   - is entitled to occupy the property in the normal course of his domestic, family or personal relationships; and
   - the property was acquired by the company either solely for the purpose of such occupation or primarily for that purpose but also with the purpose of being let when not required for such occupation.

5. Finally, as the intention is that no benefit in kind charge applies for as long as the property has been held, we would welcome confirmation that well-advised and honest taxpayers who have declared a benefit on their returns in the past will be able to claim a tax refund.

GENERAL COMMENTS

6. We are disappointed with the draft clauses and suggest that they be rewritten. The 2007 Budget Note BN50 said that Government would bring forward legislation ‘which will ensure that individuals who have bought or will buy a home abroad, will not face benefit in kind tax charge for any private use of the property if purchased through a company’. We do not think that the clauses achieve this in very many cases. They seem simply to enact the very temporary and limited measures that were introduced at the 2006 Budget. We expected consultation on what form permanent measures should take and are disappointed that this has not happened.

7. The exclusion from the benefit in kind charge extends only to foreign properties owned by a company owned directly by individuals (excluding any holdings by trustees or partnerships) – and the company must do nothing more than hold the property and do things which are incidental to its ownership. Whilst this is undoubtedly helpful to some people, there are a great many more whose properties are held by a company the shares in which are held in a trust or another company and these are unaffected by this legislation.

8. We therefore question whether the limitation to properties owned directly through a single company is sufficient to achieve the policy objective. Many properties in Spain and Portugal are typically owned by a local domestic company which itself is owned via an offshore company. The property is used in exactly the same way as a directly-owned property and the UK tax effects are the same for the shadow directors, but they appear to be outside the new relief. Was this deliberate, and if so, what is the justification for the different treatment?

9. The real problem is of course that there is no rational reason why a benefit in kind charge should arise where a holiday home is purchased through a company. This has accidentally got caught up in the benefit in kind legislation because of the deeming that a benefit provided by a person's employer must be treated as provided by reason of the employment. This deeming conflicts with facts in relation to holiday homes, where the person might be a director or shadow director by virtue of the fact that the company has acquired the property as his holiday home, not that the property is available for his use by virtue of the fact that he is a director or shadow director.

10. Accordingly we think it fundamentally wrong to enact legislation to leave the property within the scope of the benefit in kind rules and then carve out an exception. It would be far more logical to disapply section 97(2), ITEPA 2003 in relation to living accommodation where, although a person is the director of a company, he is:

- Unpaid;
- does not perform significant duties for the company;
- is entitled to occupy the property in the normal course of his domestic, family or personal relationships; and
- the property was acquired by the company either solely for the purpose of such occupation or primarily for that purpose but also with the purpose of being let when not required for such occupation.

We accept that there would be a need to exclude a company which is a subsidiary of another company and possibly one in which another company has interest.

11. The approach of leaving the property potentially within the charge and carving out a very limited exception is that the exception does not cover many of the circumstances that in fact exist – we suspect because it is very difficult to identify all such circumstances unless and until they come to light. We accordingly think that the approach adopted will lead to many hard cases that create unfairness.

12. A point on retrospection is that the draft legislation, assuming the conditions are met, seems to exempt holiday homes from the ITEPA 2003 Part 3 Chapter 5 charge for as long as the property has been held, without qualification as to length of time. We would welcome confirmation that well-advised and honest taxpayers who have

declared a benefit on their returns in the past will be able to claim a refund. Error or mistake claims are presumably precluded because the tax will have been paid in accordance with a current practice or understanding of the law, underpinned by the judgment in *R v Allen*.

DETAILED COMMENTS

13. Our comments on the … clauses are as follows.

14. **100A(1)(a)** Why should it be necessary for all of the company's shares to be owned by individuals? Where a property is bought for use by the family it is surely not unreasonable for the shares in the company that owns it to be owned by a family settlement or for the company to be owned jointly by two generations of the family and the shares owned by infant children to be held via a family settlement. No one in their right mind would advise that shares in the company should be held direct by an infant because of the difficulty that it would create in selling the company.

15. **100A(1)(b)** We are unhappy with the expression 'the holding company' as this has a well known meaning which is different to the meaning in the section. This is a recipe for confusion. Why not simply say, 'The company falls within subsection 2 below at all times after the relevant time'? Indeed why not simply say the company has owned a relevant interest in the property at all times since it first owned such an interest and the conditions in subsection 2 below have been met throughout that period?

16. **100A(2)(b)** What is meant by main or only asset? Main normally means over 50%. Is this the proposed test? If so, we have no problem with it. If not, it can create problems because sometimes in order to borrow at arm's length to acquire the property the lender requires the company to hold a certain amount of cash to partly secure the borrowing. Furthermore the company may be expected to have an overseas bank account out of which to pay the running expenses of the company and into which rents can be banked. The existence of such a bank account ought not to prevent the property being the main or only asset of the company.

17. **100A(2)(c)** What is meant by 'incidental activities'? If a company acquires a property for use by the family and instructs a local estate agent to try to let it out at times when the family is not using the property, that letting seems to us to be incidental. Conversely if the family acquires the property with the intention of using it at Christmas, Easter and for six weeks during the summer, and asks the local agent to try to let the property during the remainder of the year, we very much doubt that such letting is 'incidental'. If the property is situated in a location where the prime letting season is, say, June to September and the family ask a local estate agent to try to let it during that period and undertakes that the family will not itself use it during that time, we also doubt that the letting is incidental to the ownership.

18. As this is a relief that in reality only applies to those who are badly advised – as a well advised person will not be a director of the company and is likely to take precautions to ensure that he is not a shadow director either – it seems wholly wrong to use vague expressions so that a lay taxpayer is likely to have difficulty in interpreting the rules

19. **100A(3)** What is so wicked about someone buying an overseas property jointly with a friend or neighbour so that his company only has a half interest in the property

and accordingly the right to possession is jointly with the similar right of the other joint owner?

20. Also what is wrong with an offshore company acquiring an overseas timeshare interest? After all, the reason that an individual has to hold the interest in the company may well be to avoid overseas enforced inheritance rules and an individual will be equally anxious to avoid these if he buys a timeshare as if he buys a villa.

21. **100A(5)** The relevant time ought not to include any time before D first owned an interest in the company. It is not uncommon for a person to acquire a holiday home by means of acquiring an existing company which owns it. Why should he be denied relief because of something that a previous owner may have done, particularly where that previous owner has never been resident or domiciled in the UK and therefore cannot be expected to have any knowledge of UK tax?

22. We also think that the relevant time ought not to include any time before say 6 April 2009 so as to allow individuals who do not meet the very restrictive tests of the section a little time in which to rearrange their affairs in order to come within its terms. For example, if 10% of the shares are held by somebody other than an individual, D ought to be able to purchase those shares so as to himself come within section 100A for the future, rather than having to set up a new company with qualifying shareholdings and transfer the property to that new company, which might trigger potential tax charges.

23. **100B(2)** If an individual owns his holiday home in France through a French company that also operates the French branch of the individual's business and he decides that the company should sell the property to a parallel company that will meet the conditions of 100A(1)(a) but the price at which he transfers the property turns out to incorporate a small undervalue, why should the individual lose the relief entirely for all future years? After all he would have been taxed on that undervalue under section 13, TCGA 1992 and will also have suffered a benefit in kind charge under section 97, ITEPA 2003 on the undervalue. Again this impacts mainly on the self-advised as the well advised will include a price adjustment clause in the purchase agreement in case the price is challenged by either the local or UK tax authorities. If HMRC have a good reason for this restriction then it ought to be possible for the individual to escape the restriction for future years by making good the undervalue to the vendor company.

24. **100B(3)(a)** We are unclear what this covers. Suppose for example that an individual has a Spanish building company, which refurbishes his Spanish villa, and the villa owning company pays the market rate for the work. It seems to us that expenditure in respect of the property has been incurred by the building company as it bought the building materials and paid its staff. However it seems irrational for the relief not to apply in such circumstances.

25. Similarly suppose one of the individual's accounts staff makes a mistake and accidentally draws a cheque on his UK company for work on the villa and the individual notices this a month later when he goes through the bank statements and immediately draws a cheque from the villa company to reimburse the trading company. It seems to us unreasonable that this should deny the individual the relief for all future years whilst the villa company owns the property.

26. **100B(3)(b)** It seems equally silly that if, in order to secure the property, an individual pays the deposit from his trading company and repays the deposit to it once he has secured long term finance that section 100B should not apply if he deposits before completion (because that is a time before the individual's villa company owns a relevant interest) but the restriction should apply forever more in the far more common case where the individual repays the deposit when he gets the long term mortgage (which clearly must be after completion as the lender wants the property as security).

27. Also, what is meant by an indirect borrowing? Suppose an individual borrows from the bankers to his trading company but they are only prepared to lend it to the individual if the trading company reduces its borrowing facility with the bank. Has the individual indirectly borrowed from his trading company?

28. **100B(4)** Do HMRC have something in mind? We find it hard to see how an individual can be trying to avoid tax if he meets all the other restrictive tests that the provision requires him to make. We would have thought that if someone was trying to avoid tax in factual terms his occupation of the property would not be by virtue of his relationship with the property owning company but rather by virtue of his employment or directorship with some other company. Section 100A would not take someone out of the benefit in kind rules where the benefit arises by virtue of employment with a different company.

29. We are particularly concerned about the position of a non-UK domiciled individual who comes to the UK and puts his previous home into an offshore company because he intends to let it out temporarily whilst he is living in the UK but also uses it for visits home and will resume occupation when he returns to the UK. Is the fact that the rents would have been taxed in the UK had he used a UK company regarded as avoidance of tax?

30. It appears that the intention of Ministers to remove a relatively tiny anomaly from the tax system is being thwarted by HMRC who are trying as hard as possible to severely restrict the number of cases in which that intention will be achieved by inventing fears of tax avoidance that are highly unlikely to arise in practice

31. **100B(9)** We assume that a company is connected with D only if section 839(6) applies, i.e. D and persons connected with D together control the company. This seems to follow from Schedule 1, ITEPA 2003. However as 100A(1)(a) will allow an individual to buy the holiday home in a company jointly owned with his neighbour (albeit that it will not allow them to have separate companies to hold their individual interests) it appears that in such circumstances the individual can ignore section 100B completely though his own wholly owned company lends funds to the property-owning company to cover his share of expenditure.

32. We would welcome clarification of the logic behind this.

Appendix 3

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.

4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see www.icaew.co.uk/index.cfm?route=128518.

Appendix 4

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.

4. To find our more about the Tax Faculty and ICAEW including how to become a member, please call us on +44 (0)20 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.