TAXREP 17/00

FINANCE BILL OF SPRING 2000

Memorandum submitted in May 2000 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Chancellor of the Exchequer

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FINANCE BILL OF SPRING 2000

WHO WE ARE

1. The Tax Faculty represents the 116,000 members of the Institute of Chartered Accountants in England and Wales (ICAEW) on tax matters. Chartered Accountants are advisers to all of the top 100 FTSE companies and our members include those in tax practices and in businesses ranging from the largest to the smallest concerns.

GENERAL COMMENTS

2. There is some debate as to whether the Finance Bill 2000 is the largest Finance Bill ever. However, at 558 pages, 152 clauses and 40 Schedules, we believe it certainly is big enough. We are keen advocates for the need to have a structured and well-thought through process leading to tax legislation. We have published our views on this in our 'Towards a better tax system' discussion document (issued in October 1999 as TAXGUIDE 4/00 and augmented in May 2000 in TAXGUIDE 2/00) and we are concerned to see that the Finance Bill does not adhere to many of the basic principles we set out there.

3. Our general comments on the Bill are highlighted below. These are followed by detailed technical representations.

Complexity

4. We accept that to an extent use of a Tax Law Rewrite style of legislation in itself increases the size of a Bill as it tends to take more words to explain matters. We therefore would be less concerned if the length of the Finance Bill arose from it having been written in Tax Law Rewrite style and was therefore intelligible and clear. However, much of the legislation is obscure or is so needlessly complex that its effect is hard to discern.

5. The complexity of the Bill and its incomprehensibilty is compounded by the fact that the arrangement of clauses does not follow the traditional method of dealing with each tax in distinct parts or chapters. For example, the rules on corporate venturing, which run to nearly 50 pages, are badged as enterprise incentives and yet most of the pages are restrictive in nature. Whilst we understand that the Government wishes to emphasise particular incentives there are better ways to do this than in the order of clauses. Not only does this add to the difficulty in following this Bill but will make it difficult in future years to refer back to specific items.

Consultation

6. There has been a welcome increase in consultation over the past few years. However, with regard to certain measures in the Finance Bill, such as the double tax relief (DTR) measures and recovery of tax by non-resident companies, there was little or no consultation on the proposal actually adopted, even though these are not anti-avoidance rules where premature announcements might have created scope for forestalling. We are particularly concerned that during lengthy consultations in relation to DTR and controlled foreign companies (CFC), not only were many of the legislative proposals not included in the consultation process, but the Revenue made it plain on a number of occasions that they did not regard the use of 'mixer' companies as unacceptable tax avoidance - only for the Bill to then include severe restrictions on their use.

7. We acknowledge that large parts of the Bill were published in draft form prior to the Budget. We welcome this opportunity to consider the detailed points of the legislation in advance of the Bill being published. However, whilst we are pleased that changes were made in light of our representations, it would have been more helpful if the changes from the draft to the published Bill had been highlighted. This would have enabled attention to be focused more readily on the changes.

8. Whilst we appreciate the Government's wish to enact its legislative programme as swiftly as possible, a large Bill carries the risk of allowing inadequate time for the full implications of the legislation to be appreciated. We think it would have been better for the Government to have delayed some of the provisions so that the more important ones could have been more readily refined.

9. It is disappointing that where the results of consultation were published, these are cursory and do not comment on the reasons for not taking up specific suggestions. It is difficult to motivate people to volunteer time to consider in detail and comment constructively on draft legislation when there is no worthwhile feedback to reassure people that their comments have been taken seriously.

10. We know it is unrealistic to expect MPs on the Finance Bill Standing Committee to understand all the intricacies of such a large Bill. This makes it particularly important that adequate time is allowed for potential users of the legislation such as ourselves to scrutinise provisions in detail. Whilst we accept that the Parliamentary timetable needs to be flexible we believe that it would be sensible for the Government to announce at or before Budget Day a target date for the publication of the Finance Bill and of the start of the Standing Committee debates. This would enable outside bodies, who depend on volunteer support, to plan their workload more effectively. We hope that a way can be found to do this in future years. In the past, the timetable was wrapped in secrecy because of fears of forestalling. However, in these days of more open Government and the fact that much legislation is released in draft, the necessity for such secrecy is largely gone.

Simplicity

11. We expressed concern last year that the Budget Day press releases, which have traditionally provided technical explanations, were in many cases given a political slant which overshadowed or obscured the technical issues. We are concerned that this practice has not only continued but appears to have accelerated and been extended to even the numbering of the press releases and in the Treasury Explanatory Notes.

12. We are concerned that in many areas fundamental changes to existing provisions have not prompted a review of the principles underlying those rules. For example, the anomalies in the taper relief rules (as pointed out in our submission TAXREP 4/00) were always problematic even when there was less of a distinction between business and non-business assets. Now they have become even more serious when the difference for a higher rate taxpayer is between paying 10% tax after 4 years and 24% tax after 10 years.

Constant

13. There appears no consistency in the use of traditional and Tax Law Rewrite styles in the drafting of clauses. At times both approaches appear to have been adopted in the same provision, adding to confusion. We would have expected by now that Bills would be written wholly in the new style except where a provision amends the wording of ‘old-style’ legislation.

Properly-targeted legislation

14. We have previously commented on a number of occasions upon the uncertainty created by widely-drawn and badly-targeted legislation. The Finance Bill contains many prime examples of badly drafted provisions, such as the anti-avoidance rules on trusts, which appear to catch many transactions which are clearly innocent of tax avoidance, and the Stamp Duty provisions, which also stretch far beyond their necessary remit.

Regularly reviewed

15. We have made the point on many occasions that tax law should be subject to regular review and outdated or unnecessary provisions should be removed from the statute books. We are disappointed to note no ‘sun-setting’ provisions in the draft legislation that would ensure the Finance Bill proposals will be expunged when they have run their natural course.

Competitive

16. Several of the provisions are potentially damaging to the competitiveness of UK Plc. For example, the proposals on recovery of tax payable by non-resident companies (clause 97), chargeable gains by non-resident companies (clause 101), DTR (clause 102), CFCs (clause 103), general insurance reserves (clause 106) and international exchange of information all appear to be in serious danger of reducing the competitiveness of the UK and its attractiveness as a business location in relation to other countries.

Statutory

17. We have expressed our concern on other occasions about Parliament delegating legislative powers to the revenue authorities to make regulations that increase their rights or create or expand a tax charge. This Bill is no exception: the revenue departments can increase their right to information (clause 140) and charge tax, for example, climate change levy (clause 30) and Stamp Duty (clause 116).

Past representations

18. Certain of the provisions in the Bill have been the subject of prior consultation to which we have responded: where published, the technical release number is noted below.

	Technical release
Research and development	TAXREPs 6/99 & 20/99
Corporate venturing	TAXREPs 7/99, 17/99 & 8/00
Employee share plans	TAXREPs 10/99 & 2/00
Enterprise management incentives	TAXREPs 11/99 & 1/00
Personal service companies	TAXREPs 12/99 & 15/99
Climate change levy	TAXREPs 13/99 & 3/00
Company cars	TAXREP 14/99
Charitable giving	TAXREPs 24/99 & 13/00
Double tax relief	TAXREPs 26/99 & 14/00
Stakeholder pensions	TAXREPs 31/99 & 12/00
Capital gains tax taper relief	TAXREP 4/00
Serious tax fraud	TAXREP 5/00
Tonnage tax	TAXREP 9/00

Abbreviations

19. The following abbreviations are used in this memorandum:

FA	Finance Act
ICTA 1988	Income and Corporation Taxes Act 1988
TCGA 1992	Taxation of Chargeable Gains Act 1992
TMA 1970	Taxes Management Act 1970

PART II

CLIMATE CHANGE LEVY

Clause 30 and Schedule 6 - Climate change Levy

Schedule 6

Penalty regime: paragraphs 39 & 84

20. Whilst we welcome the fact the there is now no daily penalty in paragraph 39 for failing to make a return or pay the levy, which takes up a point in our representations on the draft legislation (TAXREP 3/00), the penalty regime is unnecessarily harsh.

21. Paragraph 84 provides that penalty interest on undeclared or unpaid levy or unpaid ordinary interest is calculated on a compound basis at the section 197, Finance Act 1996 rate plus 10%. The rate is disproportionate and we suggest that the rate be set at the default rate used by Customs for VAT.

22. Furthermore, calculating the interest on a compound basis is out of line with other taxes. Interest should be calculated on a simple interest basis.

23. Whilst the general theme of the tax is set out in the Finance Bill we are concerned that the bulk of the legislation is to be in the form of secondary and even tertiary legislation. We think this is wrong in principle. We are further concerned that the regulations will probably be available in the Autumn and the tertiary legislation in the form of Customs' leaflets are unlikely to be available before Christmas. It is the latter category that will provide businesses with the guidance that they require to put in place billing systems that accord with all the necessary requirements. Where an installation is subject to CCL at different rates, this will not be a straightforward task. The time available for businesses to reorganise their billing systems to accord with the new rules is extremely short.

24. In view of the limited time for implementing the systems once tertiary legislation is available, we would welcome a reassurance that the penalty regime will be administered with a light touch for the first year.

Energy intensive businesses: paragraph 49

25. Supplies to businesses which are within the table in paragraph 49 benefit from a 20% rate rather than the full rate. We understand that the table consists solely of industries within the Integrated Pollution Prevention and Control (IIPC) regime, which are by definition high-energy users. We question whether IPPC regime membership is the appropriate sole criterian.

26. First, if it is intended to mitigate the impact of CCL on high-energy users, then all high-energy users should be included. Not all high-energy businesses are within the table: for example, the water industry, which is the third highest energy-intensive industry in the UK, is conspicuous by its absence. Secondly, there are sectors included that one would not expect to see, for example battery farming (item 33).

27. We would welcome clarification of the effectiveness that inclusion of each sector in the table is anticipated to have in achieving CCL's stated objective of encouraging energy efficiency.

Subordinate legislation

28. There are many instances where the Treasury or Customs are empowered to make regulations. Examples include paragraph 15(2) (the setting of limits on the amount of electricity supplied by a combined heat and power station) and paragraph 20 (giving effect to exemptions). As noted above, it will take time to set in place appropriate systems to cater for the new levy and in order to provide certainty to businesses we suggest that pending the issue of regulations and leaflets an announcement covering such issues, for example, the limits in paragraph 15, be made at the time the Bill receives Royal Assent.

PART III

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER I

CHARGE AND RATES

Income tax

Clause 33 – Deduction of income tax from foreign dividends

29. We note that this section is deemed to have effect for the year 1999-2000. Any paying agents which followed the rules correctly at the time will have made an over-deduction of tax. We would welcome confirmation that taxpayers will now be able to make a claim for the excess tax paid.

CHAPTER II

OTHER PROVISIONS

Giving to charity

Clause 43 – Gifts of shares and securities to charities etc

30. We are pleased to see the introduction of this relief. We would hope that in the future consideration is given to extending this relief to other assets.

31. We also note that new section 83B, ICTA 1988 makes reference in sub-paragraph 11 to section 272(4) TCGA 1992. The definition of 'market value' is in fact found in section 272(5) of that Act.

Clause 45 – Loans to charities

32. We welcome the clarification provided by this provision even though in our view the legislation in Chapter 1A of Part XV of ICTA 1988 never applied to interest free etc loans to charities.

Employee share ownership

Clause 47 and Schedule 8 – Employee share ownership plans

33. We are pleased to see that many of the substantive comments made in our representations on this new plan have been accepted. However, we note that four points made in our representation TAXREP 2/00 have not been taken up and we remain of the view that they are worthwhile. For simplicity we note the points again below:

34. Paragraph 1(1) of Schedule 8 would appear not to be worded as intended. It takes the form of a definition of the phrase 'employee share ownership plan', such that any plan which provides for free shares and/or partnership shares (as defined) is an employee share ownership plan. This is regardless of whether it meets the other requirements of the draft legislative Schedule or has any intention of seeking tax-favoured status. We do not think that this was intended, since the phrase is clearly being used elsewhere in the Schedule to mean a plan which satisfies all the conditions for tax-favoured status, subject only to the requirement for approval by the Revenue. The various subsequent paragraphs to the effect that a plan may, or must, contain such and such a provision can only make sense on that basis. We believe this would be clarified by adding at the end of Clause 1(1) the words 'and which meets the requirements of this Schedule'.

35. Paragraph 33(1)(a) of Schedule 8 does not seem quite to cover the normal case of a takeover bid. In that case the new holding is equated with the old holding by reason of the bid being accepted by the necessary number of shareholders to become unconditional, not just by reason of acceptance of the offer for the free shares of the plan participant in question.

36. In paragraph 51(3), does the employee have to be informed only if the ratio changes before any shares are acquired under the agreement i.e. before the first such acquisition, or if it changes before any subsequent acquisition as well? The former seems to be the better reading of the words used, but we believe the latter is what one would expect.

37. Paragraph 113 should be refined to show that it is referring only to deductions arising after the time with effect from which the approval is withdrawn.

Clause 51 and Schedule 9 – Approved profit sharing scheme: other awards of shares

38. We believe the acquisition period of six months is too short for sensible reinvestment. We would suggest a period of twelve months, which would also bring it into line with other reliefs.

39. The requirement to reinvest the consideration less the gain is at odds with such reliefs as enterprise investment scheme (EIS) deferral relief. Unless this threshold is reached no relief is given at all. This can create absurd results that in some circumstances if two employees acquire shares at different times the one who has held the shares the longest will be in a worse position than the one who has held the shares for the shorter time. It would be better if the hurdle were deleted so that rollover becomes a pound for pound relief on reinvestment in every case.

40. The condition requiring the trust to hold 10% of the ordinary shares may have the effect of limiting the benefit of this relief to larger shareholdings. We would like clarification as to whether this is intentional. Why should the holder of a small minority be denied the favourable treatment of his gain on sale to a favoured trust? One solution would be for the limit to be 5%, to equate with a level many minority holdings still retain following the recent 'personal company' changes.

Other provisions about employment

Clause 56 and Schedule 10 – Benefits in kind: deregulatory amendments

41. We welcome the introduction of deregulatory amendments and would like to see a commitment to make regulatory changes of this kind on an annual basis. However, we are concerned about the new section 155ZB. ICTA 1988 found in paragraph 3 of Schedule 10. This gives a power to the Treasury to make more regulations, which may not be subject to much Parliamentary scrutiny. This is at odds with a better regulatory programme.

42. New section 155ZA in Schedule 10 exempts certain benefits where the private use is 'not significant'. We would like clarification on what this means in practice. It is presumably less than 'substantial' but 'significant' in relation to what? For example, a manager's flat in a 600 room hotel is not significant in relation to the hotel, but very significant when related to the manager; whereas a room in a pub provided for a pub employee working late (as in the case of a pub allowed to open 24 hours a day but closing when the last customers leave) may represent 25% of the pub but not really be a benefit to the employee who would prefer to go home. We would therefore welcome further guidance on this area.

43. We are also a little perplexed as to the intended meaning of new section 155ZA(6)(b) (as found in paragraph 2 of Schedule 10). The wording appears impenetrable and almost impossible to follow. We would appreciate some clarification on what it is attempting to explain. The work of the Tax Law Rewrite team should have been considered when drafting this provision.

Clause 57 – Education and training

44. The proposed new section 200F(5) ICTA 1988 lists a variety of 'training materials'. However, this list does not include such items as DVDs and will quickly be outdated as technology moves on. We suggest the section be changed to read training materials 'includes' rather than 'means'.

45. We are also unconvinced by the need for the proposed section 200G for excluding expenditure if contributions are not generally available to staff. We cannot perceive of many instances when this would be needed. For example, no one wants to send all their staff to business school but would want to send their 'high flyers'. We would welcome clarification as to its necessity.

Clause 58 – Cars available for private use

46. The proposals for a new method of taxing company cars removes the business mileage element that currently is in place. We would welcome details of any consideration that has been given to the possibility of a single rate encouraging the provision of perk cars, which would appear at odds with an environmentally-orientated tax.

Clause 59 and Schedule 12 - Provision of services through intermediary

47. We have attended numerous meetings and submitted a number of representations (TAXREPs 12/99 and 15/99) outlining our objections to the introduction of the new rules affecting personal service companies. We welcome many of the changes made but we remain concerned with many aspects of the new regime. We are also surprised

about the stance on this issue taken at the outset not to discuss or consider the policy underlying the decision to introduce these proposals.

48. A selection of the outstanding anomalies in relation to this provision are as follows:

49. We believe that there is a real problem in expecting deemed tax calculations to have been prepared by 19 April. The majority of intermediaries will engage small firms of professional advisers for whom the 19 April deadline already creates problems in assisting clients with completion of forms P35. Many of these advisers have a number of clients who are affected by the rule changes. In some cases the number of clients affected could be several hundred. It will therefore be difficult, if not impossible, for such persons to make even a reasonable estimate of any tax due by 19 April, and more time should be allowed, at least while the new culture is being absorbed, say 19 July 2001, 19 June 2002 and 19 May thereafter.

We note the Revenue's suggestion that an estimate will be acceptable by 19 April but if this estimate is not accurate interest will be due. Most taxpayers will not see interest as what is referred to by the Revenue as 'commercial restitution' and view it as an unacceptable 'penalty' which they will have to bear. Furthermore, the preparation of estimates and final computations will mean for many advisers double the work load at double the time-costs. This cost will either have to be passed onto the taxpayer or absorbed in part by the adviser.

50. We believe the 5% expense deduction found in Step One in paragraph 7 of Schedule 12 is inadequate. We believe consideration should be given to an additional allowance when the relevant income is less than, say, £40,000. Alternatively, consideration should be given to some form of de minimis level of, say, £1,000.

51. Step Five in paragraph 7 allows relief for contributions made under Chapters I or IV of Part XIV, ICTA 1988, that is to say, to retirement benefit schemes and post-July 1988 personal pension schemes. The step does not provide for relief for contributions to old-style retirement annuity contracts under Chapter II of the same Part. As many older partners are still contributing to retirement annuity contracts it is inconsistent not to include such schemes and we accordingly suggest that relief be extended for contributions to them.

52. Paragraph 8 of Schedule 12 has a damaging effect on sub-contractors as it affects their cashflow. Tax already deducted from the subcontractor is not taken into account when calculating the tax due on the Schedule E deemed payment. This can mean that a subcontractor could have both 18% deducted from his income before receipt under the Construction Industry Scheme and be required to pay both tax and NIC on the same income because of the personal service company rules. One solution would be to expand the use of in-year repayments which at present only seem possible if the basis period for accounts is closed. We hope that the Revenue will take the common sense approach used for Schedule D purposes, and operate their normal administrative arrangements which in practice frequently allows tax credits.

53. Paragraph 17(2) of Schedule 12 effectively over-rides the 9 month provisions by companies and their deduction for corporation tax payments. This causes difficult and complex timing problems. For example, if a company has a 31 March year end and makes a deemed payment at 5 April following its accounting period, it appears that a deduction will not be given for the deemed payment in its 31 March accounts even if the 'deemed salary' were then to be actually paid on, say, 30 April. We believe this is an unreasonable measure and feel strongly that an amendment should be introduced to rectify this problem.

54. Paragraph 21(4) of Schedule 12 is imprecise. When are a man and woman 'living together'? The wording in the Working Families' Tax Credit legislation is clearer and applies to same sex couples. Whilst we accept that the clause wording stems from social security legislation, it is very different for a tax authority to take a view as to whether a couple are living together as opposed to expecting taxpayers to self assess their position. It is therefore vital that guidance is given to taxpayers on this point and for the Revenue to clearly set out the criteria it will be using. We think it would be sensible for the Revenue to publish now the guidance that they will propose to include in the notes to the 2001 tax return.

Pension schemes

Clause 60 and Schedule 13 – Pension schemes

55. There needs to be greater flexibility to reflect the changing work patterns of individuals. For example, few people work in one business all their life. Most people will have 'lumpy' earnings, with high earning years and lower earning years. Whilst we welcome the ability to use the highest earnings in the last 5 years, this does not solve the problem of fluctuating earnings. We therefore remain convinced of the need to retain the carry forward rules, as we have outlined in our representations on this issue (TAXREP 31/99 and TAXREP 12/00).

Enterprise incentives

Clause 61 and Schedule 14 – Enterprise management incentives (EMI)

56. We note that the numbers of 'key employees' able to benefit under EMI has now risen to 15. However, we believe setting an arbitrary limit such as this is potentially divisive and remain unconvinced that the scheme needs to be restricted in such a way.

Clause 62 and Schedule 15 - Corporate venturing scheme

57. We have already submitted detailed representations on the proposed corporate venturing scheme (see TAXREP 8/00). We remain unconvinced that the scheme will provide sufficient incentive to stimulate corporate venturing investments on a significant scale. Whilst badged as an incentive, its usefulness is further reduced by the excessively complex and restrictive legislation. We also remain sceptical that the enterprise investment scheme (EIS) legislation should even have been the starting point for a scheme aimed at a quite different type of investment.

58. We would welcome confirmation that this proposed new corporate venturing relief will not:

- be regarded as discriminating against companies resident elsewhere in the EU;
- be viewed as harmful tax competition under the draft Code of Conduct; and
- be regarded as unlawful State Aid under EU rules.

Schedule 15

Paragraph 6(2)

59. The definition of 'a related company' in paragraph 6(2)(b) is so wide that it denies relief in circumstances which could not in any sense be said to be 'reciprocal arrangements', and which appear to be entirely unexceptionable. For example it would catch an arrangement whereby the investing company agrees to subscribe for shares in the target company provided that the existing shareholders, one of whom already has a material interest, also put in new equity: the definition is wide enough in this case for the target company itself to be 'a related company'. What seems to be needed in order to achieve the apparent purpose of this paragraph, without unduly restricting the relief, is a definition to the effect that a related company is a company in which the investing company or a person connected with it has a material interest.

Paragraph 10

60. The general effect of paragraph 10 of Schedule 15, and the way it is paraphrased in paragraph 7 of the Explanatory Notes, is that the investing company has to be either a single company which exists wholly for the purpose of carrying on one or more non-financial trades, or a member of a non-financial trading group. However, in the group case, the legislation actually imposes more specific requirements on the investing company itself, in paragraphs 10(3)(c) and (4). Provided the group as a whole meets the 'non-financial trading' condition there is no apparent policy reason for these additional restrictions, particularly as the parent company of the group is allowed to be the investing company irrespective of the nature of any additional activities it may have. Paragraph 10(3)(c) and (4) therefore seem to introduce an unnecessary complication in legislation which is already excessively complex, and we recommend that they be removed.

61. We take it that the purpose of paragraph 10(5) is to allow, *inter alia*, a group property holding company in a non-financial trading group to qualify as the investing company. As it stands however it seems not to achieve that result. If, as directed, one disregards the property holding activity and the corporate venturing investment the company would be deemed to have no activities or purposes at all, and therefore would not meet the test in paragraph 10(4)(a). To correct the problem the activities listed in paragraphs (a) to (c) of paragraph 10(5) should be deemed for this purpose to be part of the non-financial trade, rather than simply being disregarded.

Paragraph 12

62. We believe that paragraph 12(3) to Schedule 15 requires a further exclusion, corresponding to that found in paragraph 23(7)(d) for incidental activities of a non-financial trading company.

Paragraph 19

63. The expression 'joint venture' is not a clearly defined term, and is not defined in the Taxes Acts. We believe that a statutory definition is required for the purposes of paragraph 19(3).

Paragraph 23

64. Subparagraphs 23(6)(a) and 23(7)(b) should each end with the words 'or to be carried on by it', to cover the case where the qualifying trade has not yet commenced.

Paragraph 26

65. We understand that paragraphs 26(1)(i) and (j) exclude the operation or management of hotels, nursing homes etc. because the value of the property used in such businesses is regarded as making them less risky than other trades. However, even if one accepts that principle, we are unable to see why trades of this sort should be discriminated against even where the company merely occupies the premises without having any proprietory interest (via paragraphs 31(3) and 32(4)). The same point arises in the existing EIS legislation, but so far as we are aware no adequate explanation has ever been given in that context either. We would welcome clarification of this point.

Paragraph 39(2)

66. We assume that for the purposes of paragraph 39(2), a company's 'liability for corporation tax' is the figure before set-off of income tax under section 7(2), ICTA 1988, but would welcome confirmation of this point.

Paragraph 40

67. Paragraph 40(4) is not easy to follow. Are we correct to say that in a case within paragraph 25(2), it is the research activities which have to be carried on for four months before a claim can be made, rather than the actual trade which is to benefit from those activities? If this is correct, we suggest that the wording be improved so that this is clear.

Paragraph 46

68. It would be helpful for paragraph 46 to clarify that it does not apply to share exchanges which fall within paragraph 83. At present it is possible to arrive at this conclusion by a complicated route via paragraphs 82 and 96(1).

Paragraph 47(7)(b) and 57

69. The Revenue should issue practical guidance as to what it regards as 'insignificant' for the purposes of paragraphs 47(7)(b) and 57.

Paragraph 49

70. The final 'sweeping up' provision in paragraph 49(1)(i) is wide enough to treat as 'value received' many payments which are clearly not intended to be caught, because they are expressly excluded from one of the earlier paragraphs. An example would be the making of a loan to the investing company which is repaid in full before the issue of the relevant shares. We understand that in practice when the question arises in relation to the EIS the Revenue do not treat such payments as involving receipt of value, but it is not satisfactory that this potentially very important problem should be dealt with on a non-statutory basis. At least for the purposes of the new relief it should be dealt with in the legislation.

Paragraph 64

71. It appears that relief under paragraph 64(1)(b)(iii) can only be withdrawn, not reduced, by virtue of paragraph 59. Is this what was intended?

Paragraph 65

72. Paragraph 65(2) appears unnecessarily broad. It should be amended so that notice of the same facts does not have to be given by both the company and all persons connected with it who have the relevant knowledge, where one party has already provided the Revenue with the necessary information.

Paragraph 78

73. Paragraph (1)(b) appears unduly harsh. Deferral relief is withdrawn in full when there is any reduction in the relief attributable to the qualifying shares, for example on a small return of value, notwithstanding that such an event will also result in a tax charge under Part VI. We think that deferral relief should be withdrawn proportionately.

Paragraph 83

74. We appreciate that these rules closely follow the equivalent rules for EIS, but the conditions required in order for a share for share exchange not to be treated as a disposal are unduly restrictive. In particular, they appear to require the new company to acquire all the securities as well as all the shares in the existing company on identical terms. This is liable to give rise to commercial difficulties. For example, if the existing securities are secured on the assets of the existing company, the new company will not be able to issue new securities with identical rights.

Paragraph 91

75. It is not entirely clear in paragraph 91(2) whether the last of the notices is the last to be issued or the last to be complied with. We would welcome clarification of this point.

Paragraph 101

76. It is probably reasonable under paragraph 101(b) for the monetary limits to be variable by Treasury Order. However, we do not think that the Revenue should have power under paragraph 101(a) to amend the actual conditions for the relief. We are opposed in principle to extensive powers being granted to the Revenue to amend primary legislation by way of secondary legislation. We therefore request that this provision be deleted.

Clause 63 and Schedule 17 – Enterprise investment scheme (EIS)

77. Paragraph 13 of Schedule 17 extends the definition of trade so that it includes receipts from royalties and licence fees attributable to the exploitation of relevant intangible assets. However, it only applies to shares issued after 5 April 2000. Thus existing EIS companies are still prohibited from exploiting their own research and development in this way. We would suggest that the definition be amended to apply to all qualifying companies, providing the change in trade did not occur before 6 April 2000.

Clause 64 and Schedule 18 – Venture capital trusts (VCT)

78. Also, paragraph 8 of Schedule 18 introduces paragraph 11B to Schedule 28B, ICTA 1988. However, this is all dependent on the Treasury making regulations. We do not feel that exchanges of shares are a matter that should be left to regulation. It has been possible to formulate primary legislation to deal with such transactions for other taxes. We also would like confirmation of when any regulations on this issue will be made available.

Clauses 65 and 66

79. Whilst taper relief may appear a commendable system in principle, as presently enacted it can only be described as the highlight of insanity. It fails to satisfy our ten tenets for a better tax system (referred to in the introduction). It demonstrates the difficulties that arise where a new tax regime is enacted without adequate consultation. For example, taper relief started off with two types of asset: the relaxations, whilst welcome in themselves, effectively create further types of asset. We submitted to the Revenue in January 2000 recommendations on how taper relief might be made more practicable (TAXREP 4/00).

Clause 65 – Taper relief: taper for business assets

General comments

80. In clause 65(2), the annual nature of taper relief has been retained. We believe it is a pity that the opportunity was not taken to introduce a relaxation for months held rather than full years. The alterations retain the commercial distortion of vendors' waiting to capture another full year's taper relief. The acceleration of taper relief for years three and four increase the desirability of 'holding on'. The use of whole months worked well and was easily understood for retirement relief so we believe it could work equally well for taper relief.

81. In clause 65(3), the new rules apply for disposals post 6April 2000, which is to be expected. However, insufficient consideration has been given to dealing with assets which have changed their nature for taper relief purposes due to the new definitions of business assets. As outlined in our comments on clause 66 below, it would have been far simpler if assets held on 5 April 2000, which were reclassified at that date under the new definitions of business assets, could be regarded as if they had been business assets throughout their period of qualifying ownership.

82. We suggest that the opportunity be taken to correct an anomaly which exists when incorporating a previously unincorporated business. Except in the case of a share-for-share exchange, the taper relief qualifying holding period starts again and this is disadvantageous when compared to a business which does not incorporate or which started out as a company. In order that entrepreneurs are not discouraged by fiscal disincentives from trading in the most commercially-efficient manner. The period of ownership of the shares for taper relief should be treated as starting when the unincorporated business was started.

Clause 66 – Taper relief: assets qualifying as business assets

83. Now that the definition of 'business assets' is to become even more significant, it is a sensible time to eradicate some of the difficulties in this area. For example, we believe that consideration should be given to relaxing the definition of 'trading company or holding company of a trading group'. To come within the current definition a company must exist wholly to carry on a trade, or any non-trading activities must not have a substantial effect on the value. Following the increased value of business asset taper relief over non-business asset taper relief the risk arising from undertaking even limited investment activity in a company or group will be far greater. Furthermore, if one has excepted assets there is an 'all or nothing' element to the relief. In the light of the shortened period and the revised definitions of business and non-business assets, it makes sense to offer at least proportionate relief in such cases.

84. The extension of business asset relief to employees of listed companies and the inclusion of part time employees will be a welcome boost for participants in the numerous share schemes that are available. However, clause 66(6) restricts the application of the new definitions to disposals after 5 April 2000 but more importantly no attempt is made to restate the status of assets acquired prior to that date but still retained at 6 April 2000. This further complicates the system unnecessarily and particularly when the relief has been widened to benefit those likely to be less financially aware of the complications.

85. The new rules lead to surprising results when comparing the same asset purchases today as opposed to three years ago. An individual acquiring an asset after 5 April 2000 which qualifies as a business asset for taper relief purposes solely due to the proposed changes only has to hold that asset for four years to attract the maximum possible taper relief. However, a taxpayer who acquired that exact same asset ten years ago will have to wait until April 2010 until the non-business asset element of his taper relief no longer falls within the qualifying period. This clearly is an unsatisfactory situation. It will lead to the situation that provided he knows he will retain the asset for a full four years it will become sensible to dispose of this asset and reacquire it, possibly by the use of trusts, to restart the clock on the whole asset at the more favourable business asset taper relief rate.

Research and development

Clause 67 and Schedule 19 - Meaning of 'research and development'

86. We welcome the statutory clarification of the meaning of 'research and development' (previously referred to as 'scientific research'), and we believe that the guidelines which have been drafted provide a great deal of practical help on the difficult borderline issues which inevitably arise. However, we do not consider that the way in which the guidelines are to be linked in with the primary legislation is appropriate, or provides a sound basis for the resolution of disputes by the courts if the need arises.

87. The primary rule in section 837A(2) is that normal accounting practice is to be followed in identifying research and development (R&D). We believe that this is the correct approach bearing in mind that accounting standards are developed following full consultation.

88. It is undesirable that the application of such standards should be circumvented by giving the Treasury an apparently unfettered power to extend or restrict the definition by regulations. We also consider that powers of this sort, to make substantive changes by secondary legislation, are objectionable in principle. The fact that, so far as we are aware, the only regulations which are currently expected to be made are those which will give statutory effect to the guidelines makes subsection (3) in its present broad form all the more inappropriate. Moreover even the guidelines are, as we understand it, intended to clarify the basic rule in subsection (2) rather than to override it as subsection (3) implies.

89. In any event the draft legislation as it stands would not, we believe, provide the necessary vires for the courts to apply the guidelines as they are intended to be applied. Subsection (3) allows the Treasury to prescribe that particular activities are, or are not, R&D, and it is true that the guidelines do mention various activities which they say are or are not R&D; but those are given merely as examples, and represent only one aspect of the guidelines. To make effective use of the guidelines one has to read them as a whole. The activity under consideration may happen to fall exactly within one of the specific examples but equally likely it will not, and one then has to work out by analogy whether the case in hand is closer to the activities which the guidelines say are R&D or to those which are not.

90. But subsection (3) gives no authority for applying an inferential process of this sort. We believe that a court, treating the guidelines as an implementation of subsection (3), would only be able to look at whether the activity in question is specifically mentioned in the guidelines as being or not being R&D and would have to ignore the more general explanatory content.

91. We therefore recommend that an alternative approach be adopted, which is sounder in principle and accords better with the intention of this legislation as discussed during the consultation process. This would be to follow the precedent set by paragraph 2 of Schedule 28AA ICTA 1988, by providing that section 837A is to be construed in such manner as best secures consistency between the effect of subsection (2) and the effect of the guidelines. The guidelines would thus still have statutory effect, but in the form of an aid to construction of the primary legislation rather than an override of it.

Clause 68 and Schedules 20 & 21 - Tax relief for expenditure on research and development

Schedule 20

Paragraph 3(5)

92. We would welcome confirmation that this condition will be regarded as satisfied either if the R&D is unsuccessful, so that as a matter of fact it does not create any intellectual property, or if it creates only know-how, which does not come within the definition of intellectual property, just so long as the intellectual property would have vested in the company if there had been any.

Paragraph 10

93. Since this paragraph is concerned with a subcontractor rather than an agent the words 'on behalf of the company' in paragraph 10(2)(a)(i) are inappropriate.

Paragraph 14

94. There seems to be a problem if the company chooses not to elect for the alternative treatment of pre-trading expenditure. One would expect the normal rule then to apply, that the expenditure is deemed to be incurred on commencement of trading and qualifies for relief in the normal way at that time. However, because of paragraph 1(3), such expenditure would not count towards the £25,000 threshold in the first period of trading, so unless the actual R&D expenditure of that period exceeds the threshold the pre-trading expenditure would never qualify for the relief. There seems to be no policy reason for this anomaly, we suggest that it be corrected.

Paragraph 15

95. We would welcome confirmation that the brought-forward losses which are to be ignored under subparagraph (5)(a) are only those attributable to the trade in question? It would seem anomalous if for the purpose of paragraph IS(4)(a) one had also to recalculate the amount of relief which could have been claimed for the period under section 393A(1)(a), ignoring the effect of any losses brought forward in any other trade which the company might have, and indeed any capital losses brought forward.

Paragraph 23

96. In order to carry back the trading loss in accordance with paragraph 23(2) it appears to be sufficient that the company should have had R&D expenditure in the earlier period in respect of which it was entitled to make a paragraph 14 claim. We would however confirm welcome action that it is not necessary for that paragraph 14 claim actually to have been made.

Capital allowances

Clause 70 – First year allowances for ICT expenditure by small enterprises

97. We would welcome confirmation that the class of assets listed in A includes components of computers such as memory chips.

Capital gains tax: gifts and trusts

Clauses 89 to 95

General comments

98. These clauses introduce a substantial amount of legislation, covering well over 20 pages, to block various perceived tax schemes. Much of this legislation is overly complex and of the 'sledgehammer to crack a nut' school of drafting. There is a real danger of innocent transactions being caught. We also question whether some of the provisions are necessary. For example, clause 94 attacks any exploitation of a special relief provided by section 85(2), TCGA 1992. However, the changes made to section 76 TCGA 1992 in FA 1998 has already effectively ended any tax schemes which exploited tax relief. Therefore, clause 94 seems to us unnecessary and a good example of legislative overkill. Similarly we would welcome an explanation as to why clause 92 is thought to be necessary. This appears to counter a theoretical scheme which was generally accepted to be ineffective.

Clause 90 and Schedule 24 - Disposal of interest in settled property: deemed disposal of underlying assets

Clause 90

99. Clause 90(1) introduces new Schedule 4A TCGA 1992. It provides an extended meaning to 'interest in settled property' but this definition is not put into section 76 TCGA 1992. It is therefore possible for a charge to arise under new Schedule 4A even though there is no exempt disposal under section 76. We imagine that the intention of this new provision is to prevent a perceived mischief when disposals are made which are exempted by section 76, therefore this new section and new Schedule need to be tied into the same disposal.

100. Clause 90(3) provides that the charges apply to any disposal of an interest in settled property made, or the effective completion of which falls, on or after 21 March 2000. It appears at first sight that it only applies to 'effective completion' where a contract is made in one tax year and completion takes place in another. But that is not in fact so. Under sub-paragraph 13(2)(b) of Schedule 4A(b) in most cases the effective completion of a disposal is the point at which the person acquiring the interest becomes for practical purposes unconditionally entitled to the whole of the intended subject matter of the disposal. The meaning of this phrase in unclear but we are concerned that where a disposal is conditional then it may well have the result of bringing into the new charge disposals of interests made before Budget Day. We would welcome confirmation that this is not the case.

Schedule 24

Paragraph 2 –' interest in settled property'

101. Paragraph 2 of new Schedule 4A defines an interest under a settlement as including 'any right…in connection with…the enjoyment of benefit…arising as a result of the exercise of a discretionary power…by any person in relation to settled property'. We are concerned at the extremely wide breadth of this provision.

102. For example, suppose that trustees grant a lease of farmland to a beneficiary at an under value. That is a right arising as a result of the exercise of a discretionary power by the trustees. The beneficiary grants rambling rights to a local walking club. That is a beneficiary enjoying his benefit. The club's licence to ramble on the land is therefore a right in connection with the enjoyment of a benefit arising as a result of the exercise of the discretionary power. As such it is therefore an interest in settled property. The walking club then incorporates, transferring its assets, including the rambling rights, to a company in exchange for shares. There has been a disposal for a consideration. Accordingly, a charge arises under the new provisions. The interest disposed of is a right in relation to a defined part of the settled property, that is the land. The trustees are therefore deemed to dispose of their land and reacquire it at a market value. The same point could apply to a sub-letting of the land even if the lease was granted only at a small under value. We cannot believe that either situation is intended to be caught, and would welcome confirmation of whether the foregoing is the correct analysis.

Paragraph 3 – 'for consideration'

103. This paragraph provides an extended definition of a disposal for consideration. Read literally, this provision ought to catch virtually every disposal of an interest under a settlement. It is very rare to dispose of such an interest without paying a lawyer to engross documentation. So consideration would have been given to a person who receives it in connection with the transaction 'by virtue of which' the disposal is effected. We would welcome clarification of whether this is intended.

Paragraph 6 – UK residence of settlor

104. This paragraph applies where the settlor has been resident in the UK or ordinarily resident in the relevant year of assessment in any of the previous five years of assessment. This is likely to be capricious.

105. Imagine an Israeli who has established a UK trust primarily for his grandchildren with UK trustees. Four years ago he came to the UK for treatment for heart disease and became resident here because he remained here for 190 days. That is his only connection with the UK other than the establishment of the trust. He has now fallen on hard times and wants to realise the value of his interest. He cannot sell the trust assets because he does not own them. He sells his interest in the trust and the trustees are charged to capital gains tax. We would welcome clarification of why UK tax should be charged in such circumstances.

Paragraph 7 – settlor interest

106. This paragraph defines the condition as to the settlor interest. This condition is satisfied if the settlor has an interest in the settlement (broadly as under section 77, TCGA 1992) in any time in the 'relevant period'. The definition of relevant period may give rise to tax being charged in inappropriate situations.

107. For example, in 1999/2000 a Venezuelan come to live in the UK for a year. He meets his future wife, marries her and makes a marriage settlement under which she has a life interest. They move abroad and never return to the UK. The settlement, however, has his mother's family as trustees. In 2003/04 his wife dies. In 2004/05 his son sells his interest in the settlement. This is caught because the condition as to UK residence of the settlor was satisfied and the condition as to the settlor's interest is satisfied. We would welcome clarification of why UK tax should be charged in such circumstances.

Paragraph 13 – 'beginning' and 'effective completion'

108. This paragraph applies where there is a period between the beginning of the disposal of an interest in settled property and the effective completion of the disposal.

109. The effective completion of the disposal is defined in paragraph 13(2)(b) as the point at which a person acquiring the interest becomes for practical purposes unconditionally entitled to the whole of the intended subject matter of the disposal. We would welcome clarification of when a person becomes unconditionally entitled to an asset 'for practical purposes' as opposed to simply being unconditionally entitled to it and if there is no difference, why it is necessary to introduce this uncertainty.

110. The market value rule in paragraph 13(4)(b) is very harsh. Imagine that Mr A is a life tenant of a trust where the trustees invest in internet stocks so as to maximise capital growth for the remainder. Such stocks have high capital values but typically yield either low or very low income. The beneficiary decides to dispose of his interest. He does so to a purchaser contingently on his reaching the age of 25 or when his interests vests absolutely for £1,225,000. Between his making the contract and the contingency being satisfied there is a catastrophic fall in the capital value of the internet stocks from £10.0m to £2.0m. Their base costs are inconsiderable. The trustees find themselves with a liability to pay capital gains tax of £3,400,000, whilst holding not easily realisable assets of £2,000,000. The beneficiary has received only £125,000 for his interest. The effect of this provision is to tax illusory gains and we would welcome confirmation of whether this is intended.

Clause 91 and Schedules 25 and 26 – Transfers of value by trustees linked with trustee borrowing

111. This clause was introduced to stop the use of 'flip-flop' schemes. There are a number of points relating to this clause which may cause difficulties.

Schedule 25- transfers of value linked with trustee borrowing

Paragraph 2

112. Schedule 25 inserts a new Schedule 4B to the TCGA 1992. Paragraph 2 of new Schedule 4B TCGA 1992provides no let-out for transfers which do not confer a gratuitous benefit i.e. a transfer of value which is a bad bargain. This could cause real hardship and is not consistent with similar clauses in the inheritance tax legislation.

113. Paragraph 2(1)(c) mentions trustees issuing a security. We would be grateful for clarification of what this is intended to cover. Paragraph 2(2) refers to acquiring an asset unconditionally for 'practical purposes'. Again we would welcome clarification of what this is intended to mean.

114. Paragraph 2(3) appears to state that when a trustee makes a loan to any person, not just a beneficiary, the transfer value is deemed to be the full market value of the loan. Is this what is intended and if so, why?

Paragraph 4

115. Paragraph 4(a) appears to create an anomalous situation. Assume there is a transfer of value relating to a house. If the value is not attributable to the trustees of borrowing, the value of the transfer should be the value of the asset less any consideration. However, if the transfer is connected to trustee borrowing but is at a small undervalue, for example due to a mistake, the value of the transfer is taken to be the full value of the house. This seems unreasonable.

Paragraph 7

116. Paragraph 7 makes no reference to intellectual property. We would like to know why this is excluded. One solution would be for paragraph 7(1) to state that the definition 'includes' the following items.

Paragraph 9

117. Paragraph 9 gives the Treasury power to make such regulations as 'they may think fit'. We do not believe this is an appropriate power to be granted, particularly if its use is unlikely to be subject to detailed scrutiny.

Paragraph 11

118. Paragraph 11 includes formulae to determine whether a disposal is of the whole or of a proportion of an asset. The principle underlying these formulae is not explained nor is it evident. We would like to know what the underlying policy is. Running simple figures through the formulae appears to produce unexpected results. For example, suppose the trust has £10 of assets and borrows £10; it then advances £5 to a beneficiary thus reducing the net assets by 50%. One would expect the deemed disposal to be half of the trust assets but the formulae appears to create a disposal of all the trust assets. We suggest that this provision be clarified and simplified.

Schedule 26 – attribution of gains

119. We remain unconvinced that Schedule 26 is needed. It would be for simpler to deal with any perceived difficulties by amending section 76 TCGA 1992. It seems to introduce a new version of the capital payments charge whilst excluding matters caught by section 86 TCGA 1992.

Paragraph 7

120. Paragraph 7 of the Schedule deals with set-off for losses arising on deemed disposals. However, there is no set off for realised losses which are brought forward. Why not?

Groups and group relief

Clause 96 and Schedule 27 - Group relief for non-resident companies etc.

121. Schedule 27 introduces a new section 403E(2), Taxes Act 1988. The test is whether the loss 'is (in any period) deductible ….against non-UK profits of a person other than the resident company'. We would like confirmation that this is indeed a deductibility test i.e. that the UK group relief will not be debarred simply because of the potential for foreign relief (other than against the company's own non-UK profits) in a future period.

122. A related point arises if the deduction is the subject of a foreign claim at a local management level. Is the company still penalised it has not made the claim? We would welcome clarification of this point.

123. The proposed legislation also fails to cover link companies i.e. companies that are both a member of a consortium and a group relief group. We have information from members where the Revenue has been contending that the because the legislation proceeds in terms of a link company only being able to pass on as consortium relief the relief the company itself could have claimed, then an EU or EEA but non-resident link company which is not trading in the UK via a branch or agency cannot pass that consortium relief on. We believe that this is a very debatable contention and the proposed legislation should be rectified to clarify this issue.

Clause 97 and Schedule 28 - Recovery of tax payable by non-resident company

124. We are very concerned about the shifting of corporation tax liability onto other companies unconnected with the transaction.

125. According to the Treasury's explanatory notes these provisions are being introduced as a consequence of the 'modernisation' of the group relief rules. They allow the Revenue to recover any tax which is unpaid by a non-resident company from any other company which is a member of the same 51% group, (or is a member of a consortium which owns the taxpayer company, or is a member of the same group as a member of such a consortium). Furthermore they apply even where the group or consortium relationship no longer exists, if it existed within the 12 months prior to the beginning of the accounting period to which the tax relates.

126. We appreciate the attraction to the Revenue of taking power to collect tax from innocent third parties if the actual taxpayer company fails to pay (most probably due to bona fide insolvency). However we consider that it is disingenuous to suggest that this proposal is a necessary consequence of the relaxation of the group relief rules, or even closely related to it. The new recovery power does not depend on any of the companies concerned ever having claimed or surrendered group relief, or even on the existence of the 75% group relationship which would have been necessary if they were to do so.

127. If these provisions are enacted, a contingent liability of unquantifiable amount will attach to any company which has been in a 51% group relationship with a non-resident company, and will continue for at least five years after the group relationship has been broken and in many cases longer (allowing for the notice period in paragraph 4 of Schedule 28). This is despite the fact that a fellow subsidiary in a 51% relationship would not normally have benefited in any way from the non-resident company's default, would not have controlled that company and would probably not even have had knowledge of its affairs. As it will be practically impossible to give or obtain effective indemnities against an unquantifiable and in many cases unidentifiable liability of this sort, it is likely to be damaging to the sale of companies.

128. We are not even sure exactly what type of situation the proposed legislation is trying to against. Of course there may be difficulties in recovering tax from foreign companies, but that is a fact of life and the problem is not obviously made more severe by the change in the group relief rules. If there is have some particular problem in mind, a properly targeted provision should be introduced after proper consultation, which, like the existing paragraph 75A of Schedule 18 FA 1998, should limit the recovery power by reference to the amount of tax which has actually been saved by a group relief claim.

Clause 101 and Schedule 29 - Chargeable gains: non-resident companies and groups

129. We object strongly to a number of aspects in this clause, in particular the provisions in paragraph 9 as outlined below.

Schedule 29

Paragraph 7

130. A consequential amendment is also necessary in the definition of the 'entry date' in paragraph 7(1) of Schedule 7A TCGA 1992, to replace 'it became a member of the relevant group' by 'the relevant event occurred in relation to it'.

Paragraph 9

131. The proposed new section 190 TCGA 1992 would allow the Revenue to recover unpaid tax on chargeable gains of a company from any other company which is a member of the same 51% group as the taxpayer company, or was a member of the group within the 12 months before the gain arose, or from any controlling director of the taxpayer company. This is subject to very much the same objections as those expressed above in relation to Schedule 28 of this Bill, but is even more ambitious in its scope. Again, although the Treasury's Explanatory Notes imply that the proposed change is a consequence of the extended rules for tax-free transfers of assets between groups, it in fact applies irrespective of whether any asset has ever been transferred under the protection of the capital gains grouping provisions, let alone whether the company to be assessed has actually benefited from such a transfer; it applies whether or not the defaulting company, or indeed any other company in the group, is non-resident; and even if there is no 75% group and therefore could ever have been a tax-free transfer of assets.

132. As with Schedule 28, the proposed change goes far beyond what is reasonably needed to protect the revenue, and the unquantifiable contingent liability created by new section 190 would impose a major barrier to the purchase and sale of companies.

133. We are particularly concerned that new section 190 goes much further than Schedule 28, by imposing liability on controlling directors. It allows the Revenue to recover from such directors any tax which is attributable to chargeable gains realised by a company, such as if the company is unable to pay the tax as a result of insolvency, without the tiresome necessity of proving misfeasance or wrongful trading under insolvency law which alters creditors' force. This is a breathtaking piercing of the corporate veil.

134. It also fits uneasily both with the Government's proposed changes to insolvency law to reduce the effect of insolvency on a person whose business fails through no fault of his own and with other aspects of the tax legislation intended to encourage entrepreneurial activity. Holding the entrepreneur liable for the tax debts of the company is likely to be a substantial deterrent to the creditors of new businesses.

135. We can see that the relaxation of the grouping provisions calls for some change in the existing section 190. However it would be sufficient to meet concerns if the companies which can be assessed under section 190(1)(a) were extended to include the top UK-resident company in the group as well as the ultimate parent, which may now be non-resident. If there are specific concerns which to the belief that more fundamental changes are needed, properly-targeted measures should be put forward, which should be subject to consultation before enactment.

International matters

Clause 102 and Schedule 30 - Double taxation relief (DTR)

General

136. We have already expressed our serious concerns about the proposed changes to offshore mixer companies (TAXREPs 26/99 and 14/00 and in a letter sent in April 2000 to the Chancellor) and the separate but related changes to the rules for controlled foreign companies (CFCs). These proposals will severely damage UK business. They make the UK very unattractive to multi-nationals in comparison to our international partners, including G7 countries. This is surely the wrong approach to be taken for the economic well-being of the UK. Furthermore, the Revenue estimate that the DTR provisions will only raise £100 million in tax, which appears a small 'reward' for such a damaging proposal.

137. We would stress that the vast majority of mixer companies do not protect tax haven income from UK tax; they iron out fluctuations in overseas tax rates arising from different depreciation rules and timing differences.

138. The nine month deferral to 31 March 2001 of the introduction of the DTR changes announced on 3 May does nothing to alleviate the serious problems to which they give rise. What is needed is a fundamental review of the impact of the proposals. We believe that their cost effectiveness in terms of the UK economy has not been fully analysed. These changes are likely to result in behavioural changes by UK multinationals that in the long-term are likely to have adverse consequences which outweigh any short-term benefit to the UK Exchequer. For example, multinationals may decide to stop paying up substantial dividends to the UK, instead leaving cash offshore and decreasing UK taxable profits.

139. This clause and Schedule should be withdrawn from the Finance Bill pending further consultation as part of an overall 'package' of DTR, CFC and related measures. At the very least, DTR changes should be dealt with within the ambit of the proposed consultation covering share rollovers and tax depreciability of intellectual property, including goodwill.

140. We have already responded to the request for comments on the draft DTR legislation (TAXREP 14/00). Most of the points that we made in that submission remain valid and apart from the few overtaken by subsequent developments including the Revenue press release dated 3 May 2000 are included below.

Schedule 30

Implementation dates

141. There are a number of different dates for the implementation of these rules. For example:

- paragraph 9 applies to dividends paid on or after 1 April 2000;
- paragraph 10 as amended by the Revenue announcement dated 3 May 2000 applies to dividends paid on or after 31 March 2001 (formerly 1 July 2000 in the Bill as published on 7 April); and
- paragraph 12 applies to dividends paid on or after 21 March 2000.

Thus, even if we consider only the introduction of these three specific changes, within a twelve-month period there will be four different DTR regimes for incoming dividends. We cannot see how this is consistent with the intended objective of minimising compliance and administrative costs.

Paragraph 2 - tax sparing

142. We are surprised that this proposal applies in respect to dividends paid on or after 21 March 2000. Relief for tax spared is important for a number of UK companies and we think that grandfathering rules should be introduced to protect existing investments that may have been made on the basis of the current rules and cannot easily be unwound

Paragraph 6 - minimisation of foreign tax

143. New section 795A is unsatisfactory and we are not convinced that it is right to include such a provision in UK legislation. First, it appears wrong in principle that the UK Revenue will have a power to limit UK tax credits by reference to the extent that a UK company undertakes foreign tax planning. Secondly, the provision is uncertain in scope. We would welcome clarification of what precisely will count as 'all reasonable steps' for these purposes. Will this penalise a company that does not undertake aggressive overseas tax planning? What happens if there are other shareholders who may not agree with the proposed tax planning?

144. The paragraph appears to imply that companies should not have too much trouble with the provisions in practice since autonomous subsidiaries can be expected to minimise their local taxes anyway. However, suppose a UK-based group has a branch in a country that gives accelerated capital allowances or some other timing difference. If the branch claims the allowances, its local tax bill will be lower in the early years but higher in later years as the timing differences reverse. As a result, there may well be excess foreign tax credits in the later years that are wasted, giving an increase in the overall tax burden. The limited carry back that is proposed in new sections 806A and 806B is unlikely to be much help.

145. We are concerned that this test needs to be met on a claim by claim basis. In principle, if there is to be such a provision, we think that it should be applied by looking at the position over a longer period, say six years.

Paragraph 8 – computation of underlying tax

146. Although this provision is designed to be a codification of the decision in *IRC v Bowater Property Developments Ltd* [1988] STC 476, we note that new section 799(6)(b) ICTA 1988 appears to modify the application of the decision. In principle, we welcome formal codification of UK tax rules. However, if the rules are to be codified, then they need to be drafted so as to deal adequately with the variety of circumstances that may arise in practice. For example, we understand that under US company law there is not always a requirement to produce accounts. What happens then? Does the company nevertheless need to produce accounts notwithstanding no local law requirement merely for the purposes of this provision and would this in any event meet the onerous test (set out in new section 799(6)(b)) of the provision being required under local law?

147. We are also concerned that for these purposes no deductions would be allowed even where they would be allowed under UK GAAP. Further, new section 799(6)(b) appears unworkable where accounts merely need to be prepared on a true and fair basis rather than prescribing what is or is not to be deducted.

Paragraph 10 – restriction of relief for underlying tax

148. Whilst we welcome the 3 May 2000 announcement of an extension of the start date of 1 July 2000 to 31 March 2001, this provision is highly controversial.

149. These proposed changes will lead to practical problems and increased administrative and tax costs, as follows:

- existing computations will need to be reworked to take account of the capping and the removal of the ability to specify profits out of which the profits are paid;
- if the rate of UK corporation tax changes, all of the underlying calculations will need to be re-performed;
- it is unclear how the rules work where part of the reserves have already been paid out; and
- the complexity of the rules will mean that in some cases double taxation will occur even where the rate of tax paid overseas is greater than in the UK.

150. The revised timing is still unrealistic for such a major change to the UK rules for calculating DTR. Many overseas companies cannot pay dividends except at certain specified times, and they may be unable to pay a dividend before that date. Companies subject to these restrictions will therefore be penalised. Further, many countries have a one-year holding period that must be satisfied before a dividend can be paid with the benefit of the treaty.

151. The changes to section 801(2) ICTA 1988 in paragraph 10(2) affect all dividends or transfers of profit between non-UK resident companies that are not paid on to the UK before 1 July 2000 (now to be 31 March 2001) including those paid before 21 March 2000. This retrospective element to the legislation is unnecessary and inappropriate for legitimate tax planning of this kind and creates further administration costs for taxpayers who have paid dividends or merged companies prior to Budget Day, and who had planned on the basis of full credit on ultimate repatriation to the UK.

152. It is not clear whether capping is to take place at every level. The complexities and costs would be eased if the capping applied at the territory level rather than the company level.

153. The repeal of section 799(3)(b) ICTA 1988 denies taxpayers the ability to source dividends paid on or after 1 July 2000 (now to be 31 March 2001) from particular profits (although period specification will be maintained). This brings obvious problems to companies who, for example, wish to return overseas gains to their shareholders and who will be unable to forecast the tax rate on these gains on repatriation.

Paragraph 11 – dividends paid out of transferred profits

154. We understand that in broad terms this is meant to be a welcome codification and extension of an existing FICO practice. However, the provision does not appear to be comprehensive. For example, the provision does not appear to cover UK tax paid on, say, profits of a UK branch of a US company which subsequently merges with another US company. We would also appreciate confirmation as to the DTR position where a merger took place before 21 March 2000 but a dividend is paid out after that date

Paragraph 12 – Underlying tax: foreign taxation of group as a single entity

155. We believe that this provision is not sufficiently robust to deal adequately with all of the situations that are likely to be encountered in practice, with the result that it will fail in its objective. We think that this provision should be designed so that the fundamental principle is set out clearly in primary legislation, with tailored rules to meet individual situations dealt with by way of secondary legislation.

156. We welcome the confirmation in the Revenue's press release dated 3 May 2000 that these rules will apply wherever the group of companies is situated in the ownership chain below the UK company.

157. Nevertheless, we would welcome clarification as to the scope of new section 803A as there are a number of problems that the provision does not address. For example:

- what is the position where dividends have already been paid out?
- what is the position where companies join and leave a consolidated group?

158. We would also welcome confirmation that the provision actually applies to US consolidated groups.

159. Further, we understand that this provision is not a codification of existing FICO practice. For example, we understand that currently the US tax charge is apportioned on the basis of the US taxable profits of the subsidiaries. In future, the apportionment will need to be made on the basis of the relevant profits, and this will require calculations to be reworked.

160. We do not see why the provision should apply to dividends paid after 21 March 2000. We are concerned that it may be necessary to recompute underlying tax rates that have already been agreed in the past. This will result in administrative problems and does not fit with self assessment. Suitable grandfathering provisions should be included.

Paragraph 14 – carry forward or carry back of unrelieved foreign tax

161. In principle we welcome the ability to carry forward tax credits indefinitely and carry them back for one year. This will make the UK DTR system more flexible, but these provisions as framed merely highlight the restrictive nature of the UK's source by source rules for the purposes of calculating DTR. In practice these relaxations may be of limited benefit to UK companies as new sections 806A and 806B are extremely restrictive. As we can see no rationale for this, we consider that they should be widened.

162. First, these provisions apply only to directly held subsidiaries. Dividends from second tier and below companies are not only restricted to 30% under the rules in paragraph 10, but are denied any flexibility in managing fluctuations in the underlying rate.

163. Secondly, new section 806A(4)(a) refers only to Schedule D Case I profits if they arise from an overseas branch or agency and the carry forward and back seems not to extend to all income taxable, or which would be taxable if it were not for other provisions, under Schedule D Case I. This would appear to mean that it excludes Schedule D Case I profits which are not those of a branch or agency through which the company carries on a trade outside the UK, for example technical service fees or certain royalties, which, in common with Schedule D Case V trading profits, we would not expect to be excluded from a relieving provision of this nature.

164. New section 806A(4)(b) prevents the carry forward and back of credits on dividends chargeable under Schedule D Case V if they constitute trading income for the purpose of section 393 ICTA 1988. It would seem therefore that unrelieved tax on dividends received by banks and finance companies which would be regarded as falling within Case I but for the fact that they are specifically chargeable under say Case V cannot be carried forward or back. This seems unfair.

165. Thirdly and finally, the provision will almost certainly not be sufficiently flexible to deal effectively with the position which will be forced upon some taxpayers as a result of the introduction in paragraph 6 of new section 795A. In many cases a claim period of only two years will prove insufficient. For example, the company may not be in a position to know the total level of foreign tax by that date. We suggest that the general claim period of six years would be a more realistic and practical limit.

Paragraph 17 – royalties: special relationship

166. Intellectual property, by its very nature, is a distinct and critical piece of the framework of a business. In the modern business world it is increasingly becoming a key asset that requires explicit management. It provides a competitive advantage that may be the only means by which a company can maintain its edge over its rivals. As currently drafted, paragraph 17 imposes an artificial and unrealistic burden on multinationals to prove that they would have behaved as if they were not multinationals. This seems to be a very aggressive and burdensome application of both the arm's length principle endorsed by OECD and of the Special Relationship provisions of treaties.

167. There is a reference in new section 808B(3) to 'any asset which that asset represents or from which it is derived'. Taking this to the extreme, a new product developed entirely offshore could be said to be 'derived' from UK intellectual property which was, say, purchased from an independent party some years ago. Even though that product is created, financed and developed entirely offshore, it could be said to be 'derived' from the original intellectual property thus denying relief on royalty payments from the UK exploitation of that new product. We would welcome clarification as to the circumstances in which assets will be regarded as derived from other assets for these purposes.

168. We believe that, at the very least, new section 808B should be relaxed to recognise genuine commercial behaviour, which would make it more aligned with accepted interpretation of OECD treaty convention and other domestic UK provisions, such as section 808A ICTA 1988 on interest.

Paragraph 20 – Mutual agreement procedure

169. We would welcome confirmation that new section 815AA is merely codifying existing Revenue practice.

Clause 103 and Schedule 31 - Controlled foreign companies

General

170. We have already requested in separate submissions (TAXREP 14/00) that the controlled foreign company (CFC) clauses be withdrawn from the Finance Bill pending further consultation as part of the overall 'package' of DTR, CFC and related measures. As referred to above, we believe that at the very least, the DTR measures should be dealt with within the ambit of the proposed consultation covering share rollovers and tax depreciability of intellectual property, including goodwill.

171. As we mentioned in paragraph 36 of our representations on double taxation relief (TAXREP 14/00), changes made to the CFC rules in FA 1998 specifically encouraged UK multinationals to establish exempt superior holding companies. However, it now appears that the Government has changed its mind in this respect. UK multinationals are therefore faced with a major change in policy within two years of its introduction. This latest change calls into question the value and purpose of the lengthy consultation exercise on CFCs undertaken over the last few years.

Schedule 31

Paragraph 2

172. While it is conceivable that a UK resident company could influence the price at which it trades with an overseas company in which it has more than 40% (but not a controlling interest) it is difficult to imagine that it could control the distribution made by that company. If this proposal has to be enacted then only 90% of the CFC attributed profit should be taxable, as if an acceptable distribution had in fact been made.

173. The commencement provisions allow little or no time for UK companies to address the issues created by this provision. The amount of tax at stake cannot be significant and time should be given to companies to try to rearrange their affairs and renegotiate shareholder agreements to accommodate the new provisions.

Paragraph 3

174. It is regretted that more legislation is to be introduced by way of Regulations. The commencement date of up to fifteen months before the date on which the first Regulations are likely to be made is in addition unwelcome and in our view unwarranted retrospective legislation.

Paragraph 7

175. This is a major change to the taxation of CFCs. Its impact is considerably more than the estimated £200m mentioned in the Budget Day Press Release. The change should be re-examined in the light of evidence on the true cost. In the meantime, the commencement date should be postponed until Ministers have concluded whether or not UK based multinationals would be put at an unacceptable competitive disadvantage.

Clause 104 - Corporation tax: use of currencies other than sterling

176. This clause uses the same expression with different definitions which is confusing in the extreme. New section 94(8) defines 'the relevant day' in different ways according to the context. It says that meaning (a) applies for the purpose of subsection (2), but it appears that in fact meaning (a) should apply only for the purposes of subsection (2)(a), and meaning (b) for the purposes of subsection (2)(b). As it stands, subsection (2)(b) contemplates that the accounts would be prepared by using an average rate for a period, of unspecified length, ending with the day when each particular transaction takes place, which seems unlikely.

Insurance

Clause 106 - General insurance reserves

177. By itself this clause says very little other than giving the Board of Inland Revenue power to draw up regulations in order to introduce a new regime for allowing/taxing insurance reserves set aside to meet future claims. However, it raises two major points. First, why does the Revenue want to enforce discounting to such a degree on a major UK industry? In recent years there has been a growing acceptance that accounts prepared in accordance with generally accepted accounting practice should form the basis of the calculation of taxable profits. We think it a retrograde step to deport from such accounting principles except in exceptional circumstances. If accounting requires discounting we believe it right that tax should also require discounting. Conversely where accounting adopts current values without any discount we can see no reason why the tax system should not follow suit.

178. Secondly, is the level of uncertainty these proposals raise an appropriate way to treat an important UK industry? We believe that the perception of over-reserving is not substantiated and as the barriers in the EU in this field are coming down, the UK is being placed in an overly restrictive and damaging position in relation to our EU partners.

179. At the same time as the Finance Bill was released, the Revenue issued a consultative document as a pre-cursor to the regulations, setting out how it intended the new legislation to work and seeking feedback on a number of prescribed parameters, limits and rates to be applied. Again, there is little concrete to comment on other than to say that most of the additional burden of reporting the information required for the legislation to work will fall on syndicate managing agents and their advisors although this is unlikely to be too onerous. There is little detail on how these new rules will actually work in practice.

180. One of the parameters subject to consultation is a de minimis limit of syndicate capacity below which a member or Nameco will be exempted from the legislation. Clarification is needed as to whether this de minimis limit will apply to a MAPA as a single entity or whether it will be possible to 'look through' the MAPA to establish individual members' shares of the syndicate capacity within the MAPA as a whole. If the latter, it is anticipated that this will take the vast majority of individual Names and Namecos out of the scope of these regulations which will then only affect the dedicated and integrated Lloyd's vehicles and larger group Namecos.

PART IV

STAMP DUTY

Clauses 113 to 130

General

181. Stamp Duty has traditionally been regarded as a simple tax and easy to collect. It consequently has developed with a very broad-brush approach, which has led to anomalies. Whilst unwelcome, these anomalies were less intrusive when the top rate of Stamp Duty was 1%. They are more problematic now that the top rate has risen to 4% and therefore it is of greater importance to deal with the distortions and unfairness in the operation of Stamp Duty. For example, it is irrational that the sale of shares should attract a 0.5% duty whilst the sale of business assets, such as business premises and goodwill, are taxed at a 4%. We suggest that the legislation relating to Stamp Duty should be brought forward in the Tax Law Rewrite programme and consideration should be given to a thorough review of this area.

Clause 116 and Schedule 33 – Power to make regulations

182. We believe it is fundamentally wrong that the tax authorities should be given the power to change tax law. Although the powers to make regulations in Schedule 33 are limited in various ways the power to alter the descriptions of document to which duty, or a particular rate of duty, is applicable as long as it is a 'relevant property instrument' is very wide in practical terms. It effectively gives a power to change the tax rate on certain types of document by changing the head into which it falls even though paragraph 3 of Schedule 33 purpose to prevent this. This mechanism to tackle avoidance might be a little more acceptable if it was balanced by a commitment to review and revise the substantive provisions. There should be an obligatory saving for documents executed after the regulations come into force but pursuant to a prior binding commitment, not just a power under paragraph 8 of Schedule 33 to make transitional provisions. The erosion of Stamp Duty as a documentary tax makes unreasonably vulnerable the later execution of a document relating to a prior binding transaction.

Clause 117 - Transfer of land for other property

183. We would welcome clarification of what mischief this clause is aimed at. The Budget Day press release and the Treasury Explanatory Notes to Clauses say that it is aimed at transfers of land etc which avoid there being a conveyance on the sale of the land or property concerned. However, the clause is obscure. If the provision is aimed solely at is the exchange of land etc for a liquid asset, it can and should be more tightly drafted. For example, a similar effect could have been obtained by limiting the provision to cases where gifts of land were followed by a sale of shares within a short time period, such as 2 years. However, we are unconvinced that is a major problem in this area and we were under the impression that section 241 FA 1994 already covered this point.

184. The clause as drafted is not only obscure but by being so broadly drafted could damage genuine commercial transactions. Alternative courses of action could include deeming the sale of shares to be subject to duty at a rate that would have applied on the sale of the underlying property. Or the section could be applied at the time of the transfer of the property if an onward sale of shares was in contemplation. There is already a test that applies for exemption to inter-group transactions which does not give rise to too many practical problems.

185. We would also welcome consideration of an exemption from Stamp Duty on the incorporation of a business. It is an historic anomaly that this does not currently exist and similar provisions are found in the capital gains tax and income tax fields.

186. We would also welcome clarification whether clause 117 will apply if land were instead ‘other property’. It would if such a ‘part sale’ was not a ‘sale’ for Stamp Duty purposes but not if it was the Stamp Office view per the August 1995 Tax Bulletin that it was indeed a ‘sale’. It accordingly appears that clause 117 will only apply where there is an ‘exchange’ without equality ‘money’ (provided that is more than a nominal amount, say the Stamp Office) i.e. where the ‘consideration’ comprises something other than cash, debt, shares or securities or unit trust units of more than nominal value.

187. Could that ‘other property’ be ‘intellectual property’ exempted by Clause 127(1)? The answer is yes, because Clause 127 only applies where it is the subject of the sale; it can still be ‘consideration’ for Clause 117. It could also be a ship, another asset ‘exempt’ on sale.

188. The effect of Clause 117(3) on an ‘exchange’ of land, whether freehold or leasehold, is to reduce the duty to that on the more valuable land being exchanged.

189. This legislative approach is confusing and obscure. It illustrates perfectly how the high rate has stimulated avoidance by encouraging less than straightforward commercial transactions which are in turn counteracted in a manner far removed from the concept of a documentary tax on sales.

Clause 118 – Transfer of land to connected company

190. As drafted, it appears to us that this clause catches two types of transaction.

191. Clause 118(1)(a) catches innocent commercial or financial transactions well beyond the device of enveloping land in a company. Clause 118 (1)(b), to the extent it does not overlap, catches a transfer of land to a non-connected company for the issue or transfer of shares in a connected company as consideration given by the transferee company, which is not a routine type of transaction.

192. Clause 118(1) (a) applies to any transfer of land by a person to a company with which he is connected. As such it will catch a gift and an arm’s length sale at less than market value eg a bad bargain.

193. Under section 839(3) ICTA 1988 an individual is connected as settlor with a person, which includes a company, who is the trustee of his settlement. Stamp duty does not respect the distinction between legal and beneficial interests unless the statute is clear for example section 42 FA 1930 (associated companies). Clause 118(1) (a) charges to duty at a possible rate of 4% land settled by an individual on a corporate trustee. It may be that this can be avoided by ensuring that, at the time of the transfer, they are not connected even though they become so by virtue of the transfer if for example, the settlor should not transfer the land to a pre-existing settlement he has made with a cash sum. It appears illogical that an anti-avoidance rule should catch a transfer from a nominee to a principal but clause 118(1)(a) does just that.

194. The second aspect of clause 118 catches the transfer of land by a person to a company with which he is not connected (so that it would not be caught by the first limb) but some or all (however little) of the consideration consists of the issue or transfer of shares in a company with which he is connected.

195. A gift or sale at substantial undervalue to a company with which the transferor is already connected <u>at the time</u> is caught by clause 118(1)(a). Even if he only becomes connected to the corporate transferee of the land by virtue of the transaction, clause 118(1)(b) will not necessarily apply e.g. if he was not connected <u>at the time of issue or transfer</u> with the company whose shares were transferred or issued to him.

196. The scope of clause 118(1)(b) is unclear. It appears to be limited to where the consideration consists of the issue or transfer of shares in a pre-existing connected company, X Ltd, and the transfer of land is made to a different non-connected company, Y Ltd. As consideration consisting only of shares is a sale without needing to be deemed to be, the main thrust of the clause in this context is the charge on market value; but this is to be reduced by ‘so much of any actual consideration as does not consist of property’. Does ‘property’ here include the share element of the actual consideration? In clause 117, while not defined, that term clearly means consideration which would not make the transfer a sale i.e. <u>not</u> ‘stock or marketable securities’. In clause 118 it is surely meant to be included. If only part of the consideration is shares and the balance is property which is not consideration for duty purposes the charge on the deemed sale is on the market value of the land less the value of actual consideration which is not ‘property’. Here again this term presumably includes the share consideration, so that it is not deducted. Surely the mischief, if it exists, could have been better identified and targeted.

Clause 119 – Grant of lease to connected company

197. Similar comments apply here as apply to clause 118.

Clause 120 - Marketable securities transferred to exempt property

198. This clause protects a 0.5% charge if its objective is to prevent the conversion of assets within the charge to duty and Stamp Duty Reserve Tax (SDRT) into assets outside SDRT (if not automatically outside Stamp Duty).

199. The clause does not apply to a gift but it applies where there is any consideration of the proscribed kind however small.

200. The transferred marketable securities, if they are within the scope of stamp duty and SDRT to begin with, do not cease to be so merely by virtue of the exchange. If the true mischief is that the ‘qualifying’ property received in exchange could be sold without

SDRT (as is self-evident) or Stamp Duty (as is not) this measure could surely have been better targeted by linking the exchange and the onward sale.

Clauses 121 to 123 - Associated companies

201. There is now considerable conformity between Stamp Duty and corporation tax on what kind of group companies should enjoy tax-free transfers of assets between group members. Clause 100 will reduce further the number of actual transfers within a group. It might be worthwhile to go further and sweep away section 27 FA 1967, and its multiple difficulties, by providing for an initial exemption for any transfer between eligible associated companies and a later charge if the transferred asset or its owner 'leaves the group' within a specified period after the transfer, in a way comparable to section 179 TCGA 1992. This period could be relatively short: under the present law, if relevant 'arrangements' are operative at the date of transfer, they are likely to be implemented, if at all, shortly afterwards. The focus would then be altered from the uncertain and faintly absurd position of subjectivity, predicting before the event what parties might have in mind, to that of objectivity, analysing what has happened in fact.

Clause 124 – Future issues of stock

202. This is a classic example of a measure which does fundamental violence to the structure of stamp duty. It is unreasonable that the contingency principle, when it works to the taxpayer's advantage should be overridden, while the principle is allowed to operate unchecked where it has the opposite effect and unfairly so e.g. *LM Tenancies 1 plcv IRC:*

Clause 125 – Company acquisition reliefs: redeemable shares

203. We recognise that the early, and intended, redemption of shares is contrary to the spirit of sections 75 and 76 FA 1986 and their prohibition of or limit on cash consideration.

204. The increase of the maximum rate to 4% on transfers of undertakings justifies reconsideration of these sections, and indeed of section 77 also, to ensure that transfers are exempt which are technically sales but where there is substantial identity of buyer and seller. The conditions for relief are too restrictive at this rate. There is no magic in shares being issued to 'all the shareholders' in section 75(4), as opposed to a substantial majority, nor in the permitted cash consideration in section 76(3)(b) being limited to 10% (and of nominal not market value) and no other non-share other consideration (other than the assumption of liabilities).

205. We can see no justification for SP5/85 (Division of a company on a share for share basis) not being extended to Stamp Duty.

Clause 126 - Surrender of leases

206. It is not the first time (compare section 88(2) Companies Act 1985 and section 66 FA 1986) that a document has had to be contrived into existence to maintain the pretence of Stamp Duty being a tax on documents.

207. If a document is deemed to exist for the basis of notifying the Registrar of a charge to tax, it is necessary for the legislation to specify exactly what the document should be, in order to prevent it applying to several documents and so giving rise to multiple changes of duty on a single transaction. The clause should therefore be limited in its ambit to the items found in clause 126(7) to prevent uncertainty.

PART V

OTHER TAXES

Value Added Tax

Clause 131 and Schedule 35 – Supplies to which reduced rate applies

General

208. This clause and Schedule relate to the VAT rate on energy saving materials. We welcome these provisions but are concerned at the cost and complexity of compliance.

209. Extensive changes are being made to this area of VAT and we believe this would have been a good opportunity to overhaul and rewrite Schedule A1 to the VAT Act 1994. Instead, these new provisions make a complex area even more impenetrable.

Schedule 35

General

210. Schedule 35 applies inter alia to grant funded supplies. These provisions appear to involve obtaining a reduced VAT rate that then leads to a reduced grant. This appears to be a circular provision simply passing funds round between different Government departments. We would suggest that this is a complicated provision offering no real help and increasing administration.

Paragraph 9

211. Paragraph 9 to the Schedule offers a prescriptive list of inclusions which appears to set up artificial boundaries. For example, are items in a building which are installed in common parts included? Is the pipework related to solar panels included by the list or is it just the solar panels themselves which are covered, as it is only solar panels which are expressly mentioned? We would recommend that the paragraph is rephrased to state that the list 'includes' the following items.

212. Also in paragraph 9 there is a list of 'qualifying security goods'. When these are linked to grant-aided work it is not clear if the provision of security equipment has to be undertaken at the same time as the central heating work to which the grant applies. We would be grateful for clarification on this point.

Clause 132 and Schedule 36 – Disposal of assets for which a VAT repayment is claimed

213. This provision appears to be a unilateral attempt to reverse an Eighth VAT Directive entitlement. It will potentially catch innocent transactions and impact on cross-border leasing. It is also potentially discriminatory against other EU countries and will be vulnerable to an attack under EC law.

PART VI

MISCELLANOUS AND SUPPLEMENTARY PROVISIONS

Information powers

General

214. We note that Lord Grabiner's report on the 'Informal Economy' was endorsed in the Chancellor's Budget speech and he looked to implement its main findings. We have grave misgivings about many aspects of the Grabiner Report and we will be submitting these under separate cover.

Clause 140 – Information powers about interest etc paid, credited or received

215. This clause imposes upon the banks the obligation of ascertaining the name and address of the person beneficially entitled to interest paid or credited (clause 140 (2)(b)) It is difficult to see how the banks can ascertain that information or what evidence the Revenue will require to be satisfied that they have discharged this intended new legislative duty. The necessary criteria need to be detailed in the proposed legislation.

216. Although the clause is concerned with data which the Inland Revenue may require of bankers under section 17 TMA 1970, without knowing exactly what is proposed by secondary legislation it is impossible to be satisfied that the Revenue will restrict itself to effecting the necessary audit power enabling it to check that banks have made proper returns of interest paid/received. Clause 140 (3)(aa) provides that the Revenue can, amongst other things, make provisions with regard to the furnishing of information '… including the inspection of books, documents and other records on behalf of the Board.'

217. We are concerned as to whether the Revenue is, by way of Statutory Instrument, being approved to circumvent section 20(3) TMA1970. This would suggest that the authorities should have access to the banks' databases. As scripted at the moment, the intended power looks to be very broadly drawn with plenty of scope for expansion. We therefore strongly recommend that the intended secondary legislation should be part of the primary rules so that the full scale of what is intended is clear for Parliamentary debate.

Clause 141 – International exchange of information: general

218. We would like confirmation that, as with double taxation treaties, the Revenue will give notice when it starts any negotiations with countries under this provision. This will enable interested parties to register any concerns that they may have.

219. We would welcome clarification of the 'rules of confidentiality' referred to in clause 141(2) under the new section 816 (2ZA) ICTA 1988.

220. We trust that the Government will also bear in mind the need for a sensible international approach to this issue and not seek to rush ahead of EU and EEA members in pursuit of this provision.

Clause 144 – Orders for the delivery of documents

221. We are concerned with the intention to pursue this intended legislation - a new section 20BA TMA 1970 seeking documentation primarily from accountants. We believe any required changes could be obtained by revising existing statute, for example, by amending section 20(3), TMA 1970 to provide that original documents must be supplied in response to the notice. We do not think it is acceptable or necessary for the Revenue to be given the same power as the Police and Customs and Excise, as the duties of those organisations are far broader than the Revenue's.

222. There are certain safeguards associated with section 20C TMA 1970. For example, the case of *Kingston Smith* has effectively curbed the Revenue's power to put a professional firm out of business by seizing all its hard and software. Indeed since this tax case the Revenue has been far more circumspect in its use of section 20C, TMA 1970 notices in that they now tend to state greater particularity, thus avoiding the need for excessive zeal in exercising the warrant.

223. Further, the intended new power will not protect journalistic, religious and medical material from seizure whereas the allegedly more draconian section 20C TMA 1970 power cannot be employed to seize such documents. Conceivably, the intended power if enacted, would enable a Revenue Officer to demand documents from an editor or other employee of a newspaper in a deemed appropriate case, such as documentary sources underpinning an article specifying certain reported tax evasion.

224. We believe it is wrong that the Board of Inland Revenue is to be permitted to make regulations concerning the custody of a document subject to a claim to legal privilege, the appointment of an 'independent' arbiter to decide such a document's status, the procedures to be followed and who should meet the costs of the arbitration (new Schedule 1AA (6)). Such rules should preferably form part of the primary legislation or alternatively be settled in regulations to be issued by the Lord Chancellor's Department.

225. The original Revenue proposals envisaged that an officer of not less than Principal rank would make the initial case for seeking a section 20BA order to his Assistant Secretary who would then authorise an application for it before the appropriate judicial authority. Now that that 'appropriate authority' is specified as a circuit judge (in England) then the authorising officer within the Revenue should be a Board member as befits the application for and exercise of such an important power. After all, failure to comply with a notice would result in contempt of court proceedings. It seems strange that the Revenue intends to use the new power against upright members of the professions when the action to be taken against the black sheep of the professional community will be section 20C TMA 1970 which now is better policed by the courts and respected by the department than it used to be.

Clause 145 – Search warrants: miscellaneous amendments

226. We welcome the protection for legal communication in the hands of accountants but we are puzzled as to why this was not extended to protection for all tax advice from accountants.

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