

# **TAXREP 23/01**

## **TAX & ACCOUNTING: CHANGES IN LAW AND PRACTICE**

*Text of a memorandum submitted in October 2001 to the Inland Revenue in  
response to draft clauses and schedules published in August 2001*

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# **TAX & ACCOUNTING:**

## **CHANGES IN LAW AND PRACTICE**

### **INTRODUCTION**

- 1 We welcome the opportunity to comment on the draft clauses and schedules published on 9 August 2001.

### **GENERAL COMMENTS**

- 2 We were disappointed that the original press release published on 1 August 2001 was unclear and confusing. For example it was not clear to us:
  - whether the Revenue had decided to revise its view of the law in relation to the mark to market basis;
  - what were the particular court cases which had prompted the Revenue to revise its view of the law; and
  - what was the real impact of the proposed changes.
- 3 Whilst we appreciate that press releases are not intended to be highly technical documents, the premature publication of the press release created needless confusion. It would have been preferable if the press release had been delayed slightly and published at the same time as the draft clauses and explanatory notes on 9 August 2001.
- 4 We would welcome confirmation that the particular case being referred to is the case of *Herbert Smith v Honour* [1999] STC 173.
- 5 We also understand that this development reflects a judgment given by Lord Millett in a Hong Kong tax case heard late last year of *CIR v Secan Ltd & Ranon Ltd* (Court of Final Appeal Hong Kong SAR 9/2000 (Civil)). If our understanding is correct, we would welcome an explanation as to why this case was considered relevant.

### **SPECIFIC COMMENTS**

- 6 As explained in the notes, the draft legislation differs from section 44, FA 1998 in providing that the old basis can be in accordance with *either* the law *or* practice, in order to cover cases where the previous practice is found to be incorrect in law. However it still requires the new basis to be in accordance with both law *and* practice, apparently assuming that the new practice will always be correct in law.
- 7 However, this need not necessarily be the case. It would seem that the new basis should also be specified to be in accordance with either law *or* practice. Otherwise what is to happen if the Revenue changes its practice as a result of a change in its

view of the law but it is then found, possibly as a result of a court case some time later, that the new practice is the one that is wrong?

- 8 The 'practice applicable' is defined, in clause 1(1) and in paragraph 3(3) of the schedule, as 'the accepted practice in cases of that description'. The notes confirm that this is intended to mean in *all* cases of that description.
- 9 However, we are concerned that this may not always be the appropriate starting point. An 'accepted practice' in such cases may not even exist. It is not uncommon to find two companies in similar circumstances applying tax adjustments on different bases, particularly where the Revenue has no published view on the point at issue. There may not even be anybody, in either the companies or the Revenue, who is familiar with both cases and so can recognise that the inconsistency exists. And even if the Revenue does have a published view, it is not necessarily generally 'accepted'.
- 10 The new provisions should apply in any case where the old basis is one which:
- has been consistently applied by the company in question;
  - was a reasonable approach in the circumstances; and
  - was not challenged (or not successfully challenged) by the Revenue

irrespective of what any other companies might have been doing.

- 11 The new section 473(2A), ICTA 1988 as inserted by clause 3(2) seems not to apply in a case where no unrealised profit or loss is taken into account in the period of account because the value of the securities has not changed in that period. We presume that this is not intended and the new subsection should be drafted in terms of the accounting policy which is being applied, rather than the adjustments actually made.
- 12 It is not clear whether new section 473(2A), ICTA 1988 works as intended in the case of a share exchange affecting securities within the transitional rule for existing assets in clause 2(5). In such a case there should be deemed to be no disposal, so that the transition period is not triggered prematurely, but the effect of subsection (2A) as it stands is unclear because it seems to involve a logical circularity. It says that section 473 does not apply if unrealised profits or losses on the securities are taken into account; but whether unrealised profits or losses are taken into account depends on whether section 473 applies (because if it does not, the 'new holding' is not equated with the 'original holding', and so is not 'assets held ... on 1st August 2001' for the purposes of clause 2(5)).
- 13 Item 3 in each of the first and second steps of the calculation in paragraph 2 of Schedule 1 each appear to need to be extended to cover assets which are sold or used in the course of trade, and are carried on the balance sheet, but are not strictly stock in trade or work in progress. The main example is securities held by insurance companies but there are others, such as consumable stores.
- 14 We accept that one way of looking at the accounting for such items is that there is a notional receipt equal to the closing balance sheet value in each period of account, and a notional expense equal to the opening value, so they are covered by items 1 and 2;

paragraph 7(2) of the schedule implies that the legislation is meant to work in that way. However it is anomalous to rely on this rather old fashioned formulation for these items when stock in trade and work in progress are dealt with explicitly. It would be much better to extend item 3 to cover trading stock using the extended definition found in section 100, ICTA 1988.

- 15 If you have any questions, please let us know.

FJH  
10 October 2001  
14-5-15