THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

Tax Faculty

Tax Representation

TAXREP 29/05

FINANCE BILL OF SUMMER 2005

Second memorandum submitted in June 2005 to the Paymaster General by the Tax Faculty of the Institute of Chartered Accountants in England and Wales

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FINANCE BILL OF SUMMER 2005

INTRODUCTION

1. This memorandum sets out our comments for the Standing Committee on the Finance Bill published on 26 May 2005.

2. We submitted on 9 June 2005 (published as TAXREP 26/05) comments on Clauses 11 and 40 and Schedule 8 which were to be debated by a Committee of the Whole House on 13 June 2005. Comments on those clauses are included in this briefing in a separate section.

3. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty and how to contact us are set out in Annex A.

GENERAL COMMENTS

4. We have reviewed the Finance Bill in the light of our 'Ten Tenets for a Better Tax System' (Annex B). These are our ten fundamental principles that we believe should underpin a good tax system.

Do the UK's tax rules put us at a competitive disadvantage?

5. We are concerned about the cumulative effect of lengthy, complex and onerous tax legislation on the international perception of business people that the UK is a good place to do business. We understand the Government's policy to counter tax avoidance and accept that tax policy needs to strike a balance between raising revenue and encouraging inward investment. We welcome the measures introduced in recent years to encourage inward investment, for example the substantial shareholdings exemption and the rules for intangible property. However are worried that this Bill will act as a disincentive to inward investment.

6. People are attracted to do business in the UK for a variety of reasons, and tax will be an important consideration. This is reflected in our Tenth Tenet, which is that the UK tax system must be competitive. In practice, we think this means that the UK tax system needs to:
   - have reasonable rates of tax;
   - provide full and effective relief for overseas income and taxes; and
   - be simple, straightforward and certain with the minimum of red tape.

7. We are concerned that the UK is under pressure in all of these areas. In respect of tax rates, the Republic of Ireland now has a 12½% corporation tax rate and it appears to be highly successful in attracting business that hitherto would probably have come to the UK.

8. In respect of full relief for overseas income and taxes, most European countries have an 'exemption' system for foreign source income whereas the UK has a credit system

of double taxation relief. Although the application of either system may result in the same net effect, the perception is that an exemption system is easier to understand and apply and it will tend to encourage business. In 2000, the UK made some highly controversial changes to the rules that made the system highly complicated and the arbitrage provisions in Clauses 24-31 and Schedule 3 of this latest Finance Bill now add yet more layers of complexity.

9. If we compare the UK to the US, both jurisdictions appear to be facing similar competitive issues. The US also has high headline rates of corporate tax, a complicated tax credit system and highly complicated tax rules. Whilst evidence is anecdotal, our members detect a concern in the wider business community that the latest changes in this Finance Bill, in particular the arbitrage provisions and the financial avoidance rules, have tipped the balance of competitive advantage in favour of the US and against the UK.

10. In summary, we are concerned that this Bill tends to put the UK at a competitive disadvantage and that in comparison with Europe and the US, the perception of the business community is that the UK is becoming a less attractive place to do business.

11. We believe the Government should now conduct a full review of existing tax policy in relation to encouraging inward investment and the fostering of the use of the UK as a base for international business. The review should consider:
    - the headline rates of corporation tax;
    - whether the UK should move to an exemption system; and
    - whether the current complexity of the UK tax system can be simplified.

12. We would be very happy to participate in such a review.

Consistency with EU Law

13. We are concerned that several of the measures in Bill may not be consistent with EU law and EU case law. We believe more attention should be paid to a number of the clauses in this regard. We have on more than one occasion in recent years expressed our concern that certain provisions in Finance Bills do not comply with European Union Law or Treaties and these have often been borne out by judgements in the European Court of Justice. Attention to such issues before UK tax law is enacted improves the certainty of UK tax law and reduces the costs of tax administration for both tax authorities and tax payers.

14. Further details of a recent EU ruling which may have significant relevance to measures contained within this Finance Bill are included in Annex C.

Estimates of compliance costs and exchequer losses

15. We suspect that the estimates of additional compliance costs are generally too low. Tax gap estimates are dealt with in more detail under the VAT general comments and under Clause 6. Highly complicated legislation will increase the costs for businesses and foster the worry that the UK is becoming an expensive place to do business.

Use of secondary legislation

16. As we have said in the past, we are concerned at the ever-increasing reliance on secondary and tertiary legislation, for example in Clause 1. Our first Tenet is that tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament. Whilst in some cases delegating powers to secondary legislation allows time for consultation and for further refinement, too often this is not the case, a recent example being the VAT (Amendment) Regulations 2005 (SI 2005/762) on VAT partial exemption, made and laid on 16 March 2005 and which came into force on 1 April 2005.

DETAILED COMMENTS FOR STANDING COMMITTEE

PART 1
VALUE ADDED TAX

Detailed comments on VAT clauses

Clause 1: Goods subject to warehousing regime: place of acquisition or supply

17. This clause introduces enabling legislation to disapply the rules relating to supplies of goods within a bonded warehouse. The clause is needed to combat an avoidance scheme and regulations will be introduced prescribing the circumstances in which the relief from VAT will not apply. We would welcome sight of the draft regulations because the enabling legislation is quite wide. The Explanatory Notes on this clause indicate that the changes will affect a tiny minority of those making supplies of goods within UK customs warehouses. It is essential that the new power should be properly targeted and apply only where tax avoidance is in point. In particular, we would welcome clarification of how HMRC intend to distinguish between genuine unregistered companies and those engaged in the avoidance scheme described in the Explanatory Notes.

18. Giving powers to the executive to make regulations rather than including the provisions in primary legislation will allow HMRC to decide what is and what is not avoidance, and thus when to apply the new provisions, without the benefit of the legislation having had open Parliamentary debate. We are concerned that this gives too much discretion to HMRC without the necessary checks and balances.

Clause 3: Credit for, or repayment of, overstated or overpaid VAT; and Clause 4: Section 3: consequential and supplementary provision

19. New section 80(4ZA) in Clause 3(8) reduces the time limit for retrospective claims by, on average, one month, from three years after the date that payment was made (existing section 80(4)) to three years after the end of the prescribed accounting period. We would welcome clarification as to why this change is considered desirable, bearing in mind that many of these claims arise because the UK has failed to implement EU Law correctly.

20. Secondly, we consider that the deadline for making claims should be no shorter than at present. Whilst we appreciate that it is impossible to take the date that VAT was paid as the start point where no payment has been made, given that in practice most payments will be made on or very near to the latest due date, we consider that the deadline should be three years from the due date for payment of VAT for the prescribed accounting period, ie, in broad terms, one month after the end of the prescribed accounting period.

21. We note the extension HMRC's defence of unjust enrichment to credit for VAT as well as actual payments. Whilst this can be seen as a 'tidying-up exercise', it further restricts the likelihood of repayments in practice. Since many claims result from the UK's failure to implement EU law correctly, looked at another way this could be seen as enabling the state to profit from its own erroneous acts. This cannot be correct as a matter of principle.

22. We therefore recommend that Parliament should take the opportunity to make the defence of unjust enrichment work as intended, that is to say, for the benefit of the overtaxed final customer who paid the VAT in good faith. The existing UK law on unjust enrichment often results in the overcharged customer not obtaining a proper repayment, because the supplier obtains no benefit from pursuing the claim. This is for two reasons:

i) where VAT was charged on an output that should have been treated as exempt, the supplier is unable to deduct the irrecoverable VAT on related inputs when calculating the repayment of tax to his customer. This means that the supplier will be out of pocket.

ii) suppliers are unable to deduct reasonable costs of making the repayment, acting as a further disincentive.

23. For these and other reasons we doubt that the UK unjust enrichment rules are intra vires EU law. In particular, EU case law suggests that it takes more than mere passing on to constitute unjust enrichment. Whilst we can see a superficial argument that the state as a whole should be the beneficiary where VAT has been charged to customers and cannot practically be repaid, where the state has brought into force national law which is later ruled to be illegal in EU law, it is difficult to see why the state should profit from its original illegal action. We therefore recommend that the whole area be subject to a formal consultation exercise.

Clause 6 and Schedule 1: Disclosure of value added tax avoidance schemes

General comments

24. The provisions in substituted paragraph 2 (in para 3 of Schedule 1) extend the meaning of tax advantage to include non-refundable tax suffered by a taxable person. We consider that extending the rules to such situations is going beyond the mischief that the new regime was supposed to be trying to counter.

25. As noted last year, we consider the provision to be far too widely drawn. HMRC have recently confirmed that they consider the normal confidentiality condition in a standard adviser's engagement letter to constitute one of the 'hallmarks of tax avoidance' in SI 2004/1933. If that is correct, then any advice given by a tax adviser

to a client with a VAT turnover of over £10million pa (or £5m pa if the business acquires goods from another EU Member State) with the intention of reducing irrecoverable input tax will be reportable as a 'scheme'. This means that no 'hallmark' specific to the scheme is needed.

Proportionality

26. The Directives may not specify the manner in which a European Tax such as VAT is to be managed but it is clear from the wording of article 22.8 of the Sixth VAT Directive that the powers must be proportionate. This is confirmed in the ECJ decision in *Scmeink* (C-454/98) on article 22.8, as follows:
'Measures that a member state may adopt under Article 22.8 ... must go no further than is necessary to attain such objectives. They may not therefore be used in such a way that would have the effect of undermining the neutrality of the tax, which is a fundamental principle of the common system established by ... Community legislation.' .

27. The absence of proportionality is likely to render the disclosure provisions ultra vires EU law.

UK estimates of exchequer losses

28. We noted last year that no credible estimate of VAT avoidance had been made to justify the compliance cost to business of the 2004 VAT reporting requirements. This unfortunately remains the case: the only published estimates date from 2002 with HMRC relying on the unsatisfactory and clearly inaccurate figures in Customs' 2002 paper 'Measuring Indirect Tax Losses' on which we commented adversely in our submissions last year. We are writing in detail on this matter separately to HMRC.

PART 2
INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER 1
Personal Taxation

Social security pension lump sum

Clause 7: Charge to income tax on lump sum

29. Clause 7(2)(b) provides that the lump sum is to be treated as income but not as part of the recipients 'total income'. The advantage of this to the individual is that the lump sum does not affect the person's age related personal allowance nor the rate of tax on other income. It is not clear whether it can be relieved by the set off of trading loss relief in the year. Since it is likely that an older person may have been running down his business in the years up to retirement (deliberately or otherwise) and a loss may be the result, we consider that when he decides to take his pension (and so the lump sum) the loss should be able to be offset against the lump sum.

30. We would welcome clarification of whether the lump sum is 'income' for tax credit purposes.

31. In the case of a separating couple, we would welcome clarification of whether the 'person entitled to the lump sum' referred to in clause 7(3) is both partners where pension rights are split as part of their agreement, or just the person who had previously owned the pension.

32. We would welcome clarification in clause 8(8) of the meaning of 'applicable year of assessment'.

33. Under the rule as drafted, an individual could arrange with his pension provider to choose his 'applicable year of assessment' so that it is one with a low marginal rate of tax. For example, he could arrange matters so that he retires on 1 January 2007, with the first benefit paid on 1 February 2007 and the lump sum received on 1 June 2007. The applicable year of assessment is 2006/07 even if the marginal rate is greater in 2007/08 when the lump sum is actually received. We would welcome confirmation that this will not be treated as unacceptable avoidance.

Employee securities

Clause 12: Employee securities: anti-avoidance

34. As noted in our previous representations to the Paymaster General (TAXREP 8/05 dated 10 February 2005 on retrospective legislation) and to the Revenue (TAXREP 13/05 dated 14 March 2005 on the draft legislation), the legislative provisions here are very wide and uncertain in scope. Our second Tenet is that tax rules should be certain. Due to uncertainty, the risks for employers and employees of being considered to be the wrong side of the avoidance line are so great as to make it likely that commercial incentive arrangements of the type that it is government policy to encourage will not be entered into.

35. We do not think that redeemable securities should be brought into the restricted securities regime with retrospective effect (ie. with effect from 2 December 2004) as we think it is contrary to EU law. (See Annex C, applying the case of *Stichting Goed Woenen* (C-376/02 17.4.05)).

36. The new tax charges imposed by section 446UA (inserted by para 15 of Schedule 2) will result in double taxation and needs to be amended. First, there appears to be no allowance of the amount of this charge in the base cost for capital gains tax. Secondly, once the tax has been paid, the employee may 'make good' the amount of the notional loan, for example by paying up the outstanding part of the subscription price of the shares, but will obtain no credit for the tax paid (new sections 446U and 446UA).

37. The extension of the scope of section 447 Income Tax (Earnings and Pensions) Act 2003 in paragraph 18 of Schedule 2 may prove to be unreasonable. It appears to give HMRC power to tax dividends paid by small companies (particularly personal service companies) as employment income, with an associated national insurance charge, subject only to the taxpayer being able to substantiate that there was no tax avoidance motive . Thus, where a sole trader incorporates his business and receives 'employment related securities', and subsequently decides to pay a dividend on those

shares in order to avoid a national insurance charge, he may be taxed both under section 447 and under the dividend rules. We would welcome confirmation that it is not intended to use section 447 as amended in this way.

CHAPTER 4
Avoidance Involving Tax Arbitrage

Clause 24 et seq

General comments

38. We appreciate the opportunity to discuss these provisions on 20 May 2005 at a meeting with HMRC and HM Treasury and at the HMRC Open Day on 6 June 2005 and for the helpful comments, and for HMRC undertaking to agree our notes of the discussions for publication (TAXGUIDE 3/05 agreed note of meeting on 20 May2005 has been published).

39. We think that these rules will make the UK a less competitive place to do business and we think that they should be withdrawn from the Finance Bill pending a rethink of UK tax policy in this area. Of course we understand the need to counter avoidance. Whilst we note that the Government is not seeking to take on the role of 'policing' other tax systems as well as that of the UK, the fact remains that these provisions will damage the competitive position of the UK from the point of view of many non-UK investors.

40. Ideally, any action to counter international tax avoidance should be taken through concerted action by tax jurisdictions rather than the UK adopting a 'stand alone' policy. The danger for the UK is that in seeking to curb avoidance, investments are instead directed to other jurisdictions that do not have such rules.

41. We believe that a full regulatory impact assessment should be made for these provisions and in particular it should focus on the extent to which these measures will damage the attractiveness of the UK as a place for inward investment.

42. The main purpose test is clearly a key determinant as to whether or not a direction will be made. We appreciate that this test was discussed at the recent Open Day but it would be helpful if HMRC published guidance on this test as soon as possible.

43. The phrase 'a minimal amount' is uncertain in scope. We think that HMRC should clarify what it is likely to regard as 'minimal'.

44. We welcome the fact that these rules will at least only apply where a direction is made by HMRC rather than taxpayers having to self assess whether they apply. Given the complexity and uncertainty of these provisions, we think that these rules should only ever apply under a direction and we would welcome confirmation that this is the long-term intention.

Clearance applications

45. We welcome the fact that there will be a clearance procedure but do not think that this should be an informal procedure for post transaction rulings set out in Code of Practice 10 (COP 10). Given the complexity and uncertainty of these provisions, we believe that the rules should be amended to include a statutory clearance procedure.

46. At the recent Open Day, HMRC confirmed that companies would be able to simultaneously seek thin capitalisation and arbitrage clearances. However, it was unclear as to whether the same individual in HMRC will deal with both matters. As this would ensure consistency, this would obviously be preferable from the taxpayer's perspective and we would welcome confirmation as to whether this is the case.

Clause 24 and Schedule 3: Deduction cases

47. In Clause 24(5), our view remains that a UK refinancing of a non-UK headquartered group to bring the level of UK gearing into line with a higher level of market-accepted group gearing does not of itself involve a UK tax avoidance purpose, but merely redistributes group indebtedness rateably, according to the location of interest/asset cover. Accordingly, even if the new debt is used to pay down UK equity, we do not see that Condition C in Clause 24(5) would be met and we would welcome confirmation.

Clause 25: Rules relating to deductions

48. In Clause 25(4), the requirement to disregard a disallowance of a deduction in another country will lead to a double disallowance, similar to that arising under section 403D(1)(c) and (6) in respect of the US Dual Consolidated Loss Regulations anti-mirror rule. Insofar as this is in respect of a cross border situation intra-EU (or EEA), this is in our view contrary to the freedoms under the respective EU/EEA treaties, and disproportionate and therefore unenforceable. This point was communicated to HM Treasury/HMRC on 20 May 2005 and we are disappointed that the legislation remains unchanged in this respect.

Clause 31: Commencement

49. We welcome the extension of the grandfathering period from 1 July to 31 August 2005. Nevertheless, given that this is the period covered by the Summer holiday period, it is still, in practice, a very tight time limit. We think it would be more reasonable to extend the period to at least, 30 September and ideally 31 December.

CHAPTER 6
Miscellaneous

Financial avoidance etc

Clause 39 and Schedule 7: Avoidance involving financial arrangements

General comments

50. We appreciate the opportunity to discus these provisions at the meeting on 20 May referred to above and at the HMRC Open Day on 6 June 2005 and for the helpful comments, and for HMRC undertaking to agree our notes of the discussions for publication (TAXGUIDE 3/05 agreed note of meeting on 20 May2005 has been published).

51. Similar general comments apply here as noted under Clause 24 et seq above.

Paragraph 10 of Schedule 7 inserting new sections 91A et seq.

52. A number of questions were raised at the HMRC Open Day on 6 June 2005 in relation to the operation of these rules that we would like to consider further. For example, it was stated by HMRC that the amortised cost basis would not be made available because HRMC is not convinced that it would not be abused. Given that tax is increasingly following GAAP, we would appreciate clarification as to how HMRC thinks that this would be abused.

53. It was also mentioned that a double charge does not arise in respect of repos. We would welcome clarification of the HMRC reasoning for this view.

54. We remain concerned that the legislation is not properly targeted and that multiple charges will arise. Taking Example One provided at the Open Day, let us assume a structure where Company A owns Company B which in turn owns Company C. The underling assets of Company C consist solely of cash on deposit and Company B has no activities other than holding shares in Company C. Although Company B is not caught by section 91B in relation to its investment in Company C, Company A **is** caught in relation to its investment in Company B.

55. The Revenue's response to this example was that many groups would be in this position and if they were the solution would be to remove Company B. However, this might not be possible for commercial reasons.

56. In respect of new sections 91A to 91E (as inserted by paragraph 10 of Schedule 7), current ECJ jurisprudence is that where a Member State's tax legislation restricts cross-border activity intra-EU, then even if there is no differential treatment as compared to an entirely domestic comparable transaction, that restriction is likely to be a breach of the EC Treaty's fundamental freedoms (establishment, movement of capital or services), and, if disproportionate, incapable of justification and therefore unenforceable. It appears to us therefore that the removal of the substantial shareholding exemption and the limited granting of double taxation relief via section

807A (as extended by paragraph 5 of Schedule 7 in this Finance Bill) only in respect of withholding tax and not underlying tax in non-portfolio situations is almost certainly a restriction on cross border investment when intra-EU/EEA and a breach of the EC/EEA treaty/agreement fundamental freedoms and incapable of justification.

57. The provisions also appear to fall foul of the EU doctrines of certainty and legitimate expectation.

58. Moreover, in extra-EU/EEA situations, Article 56 of the EC treaty will apply (and the Article 57 derogation will not, as this is a new post 31 December 1993 restriction), so that even in extra-EU/EEA situations, the section 91B rule will in our view be a breach of the EC Treaty (whether portfolio or non-portfolio). We made this point in our note of the meeting held on 20 May 2005.

59. Given that the scope of much of these rules remains uncertain and that transactions that were not designed to avoid tax may be caught, we think it is unfair that these provisions apply with effect from 16 March 2005. We believe that the start date should be amended to allow taxpayers time to unwind transactions that may be caught.

PART 3
STAMP TAXES

Stamp duty land tax

Clause 49 & Schedule 10: Miscellaneous amendments

Paragraph 6 of Schedule 10 - Withdrawal of group relief in certain cases involving successive transactions

60. This anti avoidance provision would appear to cause a double clawback of relief in certain cases where no avoidance is intended, as set out in the following example:

61. If Company A sells to Company B and Company B then sells to Company C, all within a group, and then Companies B and C leave the group together, this provision deems the sale from Company B to Company C to be a sale from Company A to Company C and the group relief claimed in respect of the Company B to Company C transfer is clawed back. But there would also be a clawback of the relief claimed in respect of the Company A to Company B transfer under para 3(1) of Schedule 7 to the FA 2003.

62. We request that this provision is amended so that no double clawback occurs in such a situation as outlined above.

Paragraph 8 of Schedule 10 - Reconstruction and acquisitions relief

63. These reliefs are to be restricted to transfers of trades which do not consist of ‘dealing’ in land or interests in land’. However, the term ‘dealing’ is imprecise and needs to be clarified. We would welcome clarification of whether it excludes

property development or housebuilding businesses which both involve the purchase of land to be sold on or does the fact that the significant development activity involved takes these businesses beyond the scope of mere 'dealing'.

Paragraphs 19 & 20 of Schedule 10 - Group relief: avoidance arrangements

We are also concerned about the uncertainty created by the proposed new 'bona fide commercial purpose/no tax avoidance motive' test in respect of SDLT group relief and acquisitions relief. Whilst the bona fide and main purpose tests are used elsewhere in the Taxes Acts, we consider that the meaning of 'tax' in new paragraphs 2(4A) of Schedule 7 (inserted by para 19) and new paragraph 8(5B) (inserted by para 20) is too wide and should be restricted to stamp duty land tax and not include also stamp duty, income tax, corporation tax and capital gains tax. In the context of a self assessed tax, we do not consider it acceptable to impose this uncertainty, and effectively the burden of policing tax structuring, on taxpayers and their advisers.

64. Specific anti avoidance legislation has been introduced to combat SDLT avoidance. In addition, the application of the disclosure of tax avoidance rules to SDLT will enable the Revenue to decide which structures are unacceptable and the best ways of closing them down. We therefore believe that there are sufficient revenue protection measures in place without the need for this provision.

65. We therefore believe that this provision should be withdrawn from the Finance Bill.

COMMENTS FOR COMMITTEE OF WHOLE HOUSE

The Clauses below were commented on in TAXREP 26/05.

Gift aid

Clause 11: Donations to charity by individuals

66. New clause 25(5H)(b) provides that charities have to calculate a 'notional' admission fee to check the 10% test. We would welcome clarification of how would an individual would be expected to know that this had been done correctly in order correctly to self assess a gift aid donation.

Financing of companies etc

Clause 40 and Schedule 8: Transfer pricing and loan relationships

67. We have a number of fundamental problems and regret the introduction of this clause and Schedule. The proposed legislation is not properly targeted and appears to be predicated on a misunderstanding of the role played by private venture capitalists in the UK. This provision is likely to damage the UK financial markets and hence the competitiveness desirability of the UK as a centre in which to raise capital.

68. We are concerned that the proposed legislation will not only distort the efficient working of the private equity market, but is also likely to have far wider implications

than those that have probably been anticipated. For example, it is likely to cause collateral damage to the private financing initiative (for example the St Pancras Channel Tunnel project costing over £5billion).

69. Such wide-ranging legislation needs to be the subject of thorough scrutiny and debate to ensure that if there is a mischief which needs to be eliminated, then the legislation is properly targeted and proportionate, and accords with our Ten Tenets for a Better Tax System.

70. We believe that this legislation should be removed from the Finance Bill and that there should be a period of proper consultation before new draft legislation is circulated that is properly targeted, fair and reasonable and proportionate to the problem this provision seeks to address.

71. The very wide definition of persons acting together in relation to financing arrangements in new paragraph 4A of Schedule 28AA, ICTA 1988 (inserted by paragraph 1(3), Schedule 8) would seem to catch not only private equity houses but also banks and other lenders and bring them all within the proposed new ''transfer pricing' rules which are designed to limit tax deductions on the financing costs of management buy-outs.

72. The precise scope of the provisions are uncertain and concern has been expressed that the rules could catch 'mezzanine' finance. We do not think that it is caught but would welcome clarification that our view is correct.

73. In paragraph 4 of Schedule 8, we welcome the grandfathering until 1 April 2007 as announced on 4 March 2005 for arrangements in place on that day. However, , but we would reiterate our view expressed in a meeting on 20 May 2005 with HM Revenue and Customs and HM Treasury that the grandfathering should be extended indefinitely, not least because otherwise it is likely prove contrary to the European Union doctrines of legal certainty and the preservation of legitimate expectations.

74. Grandfathering comes to an end when a contract is 'varied' after 4 March 2005 (paragraphs 4(2) and (3), Schedule 8). However, it will be very difficult in practice to know whether a contract has been varied. We would welcome clarification of the tests that should be applied to ascertain whether a debtor relationship is 'varied' after 4 March 2005. In particular, we would welcome clarification that an increase or decrease in a floating rate loan will not amount to a variation in terms when interest rates are varied.

75. Given the uncertainty of the above provision, we doubt whether the EU doctrines of certainty and legitimate expectation are met, with the result that these provisions are also likely to be contrary to EU law.

FJH/PCB
17.6.05

ANNEX A

ICAEW AND THE TAX FACULTY: WHO WE ARE

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

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

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

To contact us, telephone 020 7920 8646 or email tdtf@icaew.co.uk.

ANNEX B

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

The tax system should be:

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

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

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

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

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

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

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

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

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

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

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99; see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160.

ANNEX C

FURTHER DETAIL ON COMPLIANCE WITH EU LAW

1. In the December 2004 Pre-Budget Report, changes to the recovery of input VAT on share issues were announced when HMRC were aware (since the UK took part in the case) that the issue was under consideration by the European Court of Justice (*Kretztechnik*, Case C-465/03). Now that the ECJ judgment has been published, it is clear that the UK law will need to be amended, less than six months after the changes were announced.

2. We are concerned that in like fashion several of the anti-avoidance provisions may be contrary to EC law. These include in particular the employee securities, tax arbitrage and financial avoidance provisions. The recent ECJ judgment in *Stichting Goed Woenen* (C-376/02 17.4.05) confirms that anti-avoidance provisions taking effect from the day announced, eg via a Ministerial Statement or by press release, where the announcement is not 'sufficiently clear', run counter to two principles of EU law, namely legal certainty and preservation of legitimate expectations. Set out below are the key paragraphs of the judgment.

3. *Paragraph 31: '...the general principles of Community law, and in particular, the principles of the protection of legitimate expectations and legal certainty must be examined in order to determine whether they preclude the adjustment resulting from the deduction which was revoked by the retroactive effect of a law'.* This was in the context of Dutch VAT legislation taking effect eight months prior to the date of enactment in respect of VATable but below market value 'sales' of property being effected to trigger a right to claim prior input VAT exceeding that due on the below market sale. It could equally apply to the retrospective denial of interest relief under Clauses 24 to 31 or the retrospective withdrawal of substantial shareholdings relief and underlying double tax relief under Schedule 7 (inserting sections 91B-G, FA 1996).

4. *Paragraph 32*: '*The principles of the protection of legitimate expectation and legal certainty form a part of the Community legal order. They must accordingly be observed by the Member States…'* (in that case in implementing Community directives, but under the European Community Act 1972, also in respect of post-UK accession domestic legislation, even if not implementing directives - see section 2(1) & (4), ECA 1972).

5. *Paragraph 33: 'Although in general the principle of legal certainty precludes a Community measure from taking effect from a point in time before its publication, it may* ***exceptionally*** *be otherwise where the purpose to be achieved so demands* ***and where the legitimate expectations of those concerned are duly respected'*** (our emphasis).

6. The ECJ went on to state in its judgment:
Paragraph 43: 'As the case in the main proceedings concerns national legislation, the procedures for dissemination of information normally used by the Member State which adopted it and the circumstances of the case must be

taken into account when the question whether the legitimate expectations of the economic operators covered by that legislation were duly respected in the specific case is assessed'.

7. *Paragraph 44: 'According to the order for reference, the Staatssecretaris van Financiën officially announced, by press releases of 31 March and 3 April 1995, that the Council of Ministers intended to submit to the Netherlands Parliament a draft amendment to the Wet OB 1968, relating inter alia to Articles 3(2) and 11(1)(b), point 5 thereof, and to give effect to the amending law as from 31 March 1995 at 18.00 hours.* ***It is however for the national court to determine whether those documents were sufficiently clear to enable an economic operator carrying out economic transactions such as those referred to by the law to understand the consequences of the legislative amendment proposed for the transactions it carries out'*** (our emphasis)**.**

8. The common view in the Netherlands (with which we agree) is that the Dutch Supreme Court will have little difficulty in deciding that the Press Releases were 'sufficiently clear…'. They did contain considerable detail. However, we doubt that anyone reading the Budget Day Press Releases could have identified what would be the final actual wording of either Schedule 2, or Clauses 24 to 31, or Schedule 3 or Schedule 7 of this Finance Bill.

9. We are therefore of the view that owing to the absence of sufficient clarity, the twin EU law principles of legal certainty and preservation of legitimate expectation have not been respected for certain clauses in this Bill with the result that these provisions appear to be in breach of EU law.