Tax Bulletin

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THE NEW TRANSFER PRICING LEGISLATION

The 1998 Finance Act (FA 98) introduced a comprehensive modernisation of the UK's transfer pricing legislation. The changes are part of a wider reform of the Corporation Tax regime which includes the introduction of self assessment for companies (CTSA). For accounting periods ending on or after 1 July 1999 and years of assessment 1999/2000 *et seq.*, Sections 770 to 773 of the Income and Corporation Taxes Act (ICTA) 1988 will be replaced by Sections 108-111 and Schedule 16 FA 98, with the full text of the basic rule appearing at Schedule 28AA ICTA 1988. Two notable changes are that there will be no requirement for the Board of Inland Revenue to give a direction before the legislation applies - companies will be expected to self assess in accordance with the arm's length principle; and the new wording is more closely aligned than was the old with Article 9 (the 'Associated Enterprises Article') of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital.

The new legislation was the subject of extensive consultation with taxpayers, tax advisers, and representative bodies. During the consultations, requests were made for guidance on certain issues following the integration of transfer pricing into the CTSA system. Foremost among these issues were record keeping, financial transactions and arrangements ('funding'), and penalties.

Reproduced below is the text of guidance notes on record keeping and funding. The guidance on penalties will be published shortly. These notes will be incorporated into Departmental guidance manuals in due course.

The notes refer to 'the OECD Guidelines'. These are the 1995 *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, available from HMSO in the UK or the OECD at 2 rue André-Pascal, 75775 Paris Cedex, France.

Record keeping

Under the new transfer pricing legislation, taxpayers are required to recognise the arm's length principle in reporting income, profits or losses for tax purposes. Where transactions within the scope of the new rules have taken place on other than arm's length terms to the disadvantage of the UK Exchequer, appropriate computational adjustments must be made in the Tax Return.

Section 12B Taxes Management Act 1970 and paragraph 21, Schedule 18 FA 1998 require taxpayers to keep and preserve the records needed to make and deliver a correct and complete Return for any chargeable period.

In interpreting those rules for transfer pricing purposes, the Inland Revenue will be guided by Chapter V of the OECD Guidelines. This is designed to assist tax administrations in developing their approaches to documentation rules, and taxpayers in identifying the

(continued on page 580)

records that would be helpful in demonstrating how their methodologies satisfy the arm's length principle.

The Inland Revenue does not want taxpayers to suffer disproportionate compliance costs, nor to be required to prepare and retain documentation which is out of keeping with the nature, size, and complexity of their business, or with the transaction (or series of transactions) in question.

At the same time, taxpayers will be required to self assess accurately, and may be called on by the Inland Revenue to justify their transfer prices and the quantum of income, profits or losses returned for tax purposes.

Taxpayers should therefore prepare and retain such documentation as is reasonable given the complexity or otherwise of the relevant transaction (or series of transactions), and which identifies:

- relevant commercial or financial relations falling within the scope of the new legislation;
- the nature and terms (including prices) of relevant transactions (including transactions which form a series, and any relevant off-setting transactions). Transactions which are clearly in one family (e.g. regular purchases made by a distributor throughout a return period of the same or similar products for resale) may be aggregated, provided any significant changes during the period in the nature or terms of the transactions are recorded;
- the method or methods by which the nature and terms of relevant transactions were arrived at, including any study of comparables and any functional analysis undertaken;
- how that method has resulted in arm's length terms etc. or, where it has not, what computational adjustment is required and how it has been calculated. This will usually include an analysis of market data or other information on third party comparables;
- the terms of relevant commercial arrangements with both third party and affiliated customers. These will include commercial agreements (e.g. service or distribution contracts, loan agreements), and any budgets, forecasts or other papers containing information relied on in arriving at arm's length terms etc. or in calculating any adjustment made in order to satisfy the requirements of the new transfer pricing legislation.

Current arrangements need not be freshly documented for the first CTSA return period, provided the existing documentation is sufficient to enable the taxpayer to make a complete and correct Return for that period.

Where arrangements continue in force for more than one return period (e.g. a distribution agreement lasting several years), there is no need to prepare fresh documentation for each return period, provided the original documentation is sufficient to demonstrate that the taxpayer has made a complete and correct return for that later period. Any significant changes in the nature or terms of the transaction or transactions in question should be recorded.

The documentation should exist at the latest by the time the Return is made.

The rules governing the period for which records generally must be preserved are described on page 587 of this issue and apply as much to transfer pricing documents as to other records. In summary, this means that transfer pricing documents should be preserved until the later of:

- six years from the end of the chargeable period to which they refer or for which there could be a related tax effect; or
- the date on which enquiries to which the documents are relevant are complete.

Financial transactions and arrangements ('funding')

Paragraph 1 of the new transfer pricing legislation is framed in terms of provision being made or imposed between two persons by means of a transaction or series of transactions. Paragraph 3 defines "transaction" and "series of transactions" in wide-ranging terms. The basic pricing rule works by substituting the provision which would have been made between independent enterprises ("the arm's length provision") for the actual provision in defined circumstances. This is a more broadly based formulation than the narrow transactional approach of Section 770 ICTA 1988, but the rule of construction in paragraph 2 of Schedule 28AA ensures that the legislation will not go further than the formulation of the arm's length principle contained in Article 9 of the OECD Model.

Inward investment: interest reclassified as a distribution

The new legislation applies to non-arm's length interest, discounts and other payments for the use of money which create a UK tax advantage, although for inward investment where the borrower is a company, an interest *rate* which exceeds a reasonable commercial return will continue to be reclassified as a distribution under Section 209(2)(d) ICTA 1988. Where the borrower is a partnership however an excessive rate of interest may be considered under Schedule 28AA where the requisite control relationship exists.

Interest or discounts payable on funds obtained from connected persons may be excessive for reasons other than the existence of an excessive rate. The amount of the loan or terms other than

the rate may not reflect what would have been agreed if the parties had been unconnected and acting entirely at arm's length, or the transaction might not have taken place at all.

In this context the guidance on when transactions should be disregarded at 1.37 of the OECD Guidelines is particularly relevant. One example quoted is that of an investment in an associated enterprise in the form of interest-bearing debt when, at arm's length, and having regard to the economic circumstances of the borrowing company, the investment would not have been expected to be structured in that way. In such circumstances it is recognised that it might be appropriate to treat the loan as a subscription of capital.

Interest, discounts, etc. which are excessive for reasons other than the rate being excessive will continue to be reclassified as distributions under Section 209(2)(da) ICTA 1988 where the borrower is a 75% subsidiary of the lender or both are 75% subsidiaries of another company. Such excessive interest is not allowed as a deduction in the corporation tax liability of the paying company and, until its abolition, ACT will be payable at the time the payment is made.

The factors which we take into account to determine whether interest is excessive for any reason for the purposes of Section 209(2)(da) ICTA 1988 are discussed in Tax Bulletin Issues 17 and 35 (June 95 and June 98). The approach outlined in these articles will also apply for the purposes of Schedule 28AA - see below - including the normal focus on the UK grouping in determining borrowing capacity.

Inward investment: where excessive interest is not reclassified

Where subsections (d) and (da) of Section 209 ICTA 1988 are not in point, but loan funding has been provided between two parties which are connected within the terms of the new legislation, excessive interest is payable for whatever reason and this has conferred a tax advantage on one or both parties, the tax computation will require adjustment to eliminate the effect of the excessive interest or discount. However there are no ACT consequences as the excessive interest is not reclassified as a distribution.

As provision may be made by means of a series of transactions, the situation where a related party provides a guarantee to a bank which then, on the strength of this, makes a loan, or an additional part of a loan, available to a UK borrower will be within the scope of the legislation. If, however, the effect of the guarantee is solely to reduce the rate of interest being charged and the UK borrower is not thinly capitalised the legislation will not apply, since no tax advantage is being conferred.

Where there is a special relationship between the borrower and lender or between them and another person, in addition to the tax treatment of the interest expense incurred by the borrower, it is necessary to consider the liability of the non-resident lender in respect of UK source interest income. In these circumstances the terms of a particular double taxation treaty may not allow excessive interest to be paid without deduction of income tax at the UK domestic rate. Consequently, in such situations interest will both be disallowable in the borrower's tax computation and also suffer deduction of income tax at source without the benefit of any reduced rate which might otherwise have been available under the treaty. In the absence of a special relationship between the borrower and lender, interest paid to an unconnected bank would not fall foul of such a treaty provision even if the loan is backed by a parental guarantee.

Off-Setting transactions

Some separately contracted transactions between associated enterprises may be evaluated together in order to determine whether a tax advantage arises. However this must involve the same associates and the separately evaluated transactions must form part of the same overall provision. So, for example, it may be argued that the "margin" earned on loans routed through the UK is consistent with the arm's length standard despite both the inward price from one associate and the outward price to a different associate being non-arm's length. Nevertheless, because the same associate is not involved in both transactions, the two elements cannot be "off-set". To provide for off-setting in such circumstances would expose the UK exchequer in the event of Competent Authority intervention in relation to one of the transactions.

Outward Investment: interest-free loans

Loans provided to an overseas associate at a nil or low rate of interest have always been within the scope of Section 770 et seq., ICTA 1988, and will continue to be within the scope of the new legislation, so that the market rate of interest should be charged. However, until now, where it has been accepted that the Competent Authority process would result in agreement that the recipient would have been unable to obtain an interest-bearing loan at arm's length then the discretion which comes with the directional nature of the legislation has been exercised so as not to impute interest. This is often referred to as acceptance that the loan performs an "equity function". Importantly this treatment has depended on the existence of a double taxation treaty with the country concerned providing for a Mutual Agreement procedure and has involved consideration of the contention by the UK Revenue in every case. In future, the UK lender will have to consider only whether an outward interest-free loan is in practice standing in the place of equity when deciding whether a transfer-pricing adjustment should be made in its self-assessment. The existence of a double taxation treaty with the recipient's country will not be relevant and the Revenue will only

become involved where we think the lender's conclusion may be incorrect.

Foreign Exchange movements
If an inward or outward loan is made in a currency other than sterling, there are likely to be foreign exchange movements which will normally result in debits or credits to the profit and loss account. Because these may distort the effects of an incorrect transfer-price they are not taken into account in calculating whether there is a UK tax advantage arising from the transaction. They will continue to be dealt with as a separate matter under existing Foreign Exchange and Financial Instruments legislation.

Charities
In principle the funding by UK charities of their UK trading affiliates falls to be considered under Schedule 28AA since it does not fall within the scope of the paragraph 5 exemption for UK-UK transactions. However charities are expected to follow the general advice and guidelines of the Charity Commission in considering the nature of their investments in trading affiliates. When reviewing the funding of charities and their associates, we will respect the fact that they are following these. This is consistent with paragraph 1.55 of the OECD Guidelines. Where, exceptionally, charities enter into financial arrangements which are other than in accordance with the Commission's advice or guidelines, or where avoidance is present, the provisions of Schedule 28AA could be in point. This is an area in which International Division will be willing to offer up-front advice.

Interaction with other provisions
There are various parts of both domestic legislation and treaties which are concerned with thin capitalisation and other ways in which interest paid or accrued may be excessive. This to some extent reflects the wide variety of ways in which loan finance can be provided to a company, but the Government recognises that the result is unattractive and may give scope for some uncertainty. Consequently a review will be undertaken of the full range of currently applicable legislation with a view to establishing whether there is scope for rationalising the law in ways that do not put the UK exchequer at risk.

Help and advice
International Division already operates a system offering pre-transaction assistance as publicised in the Tax Bulletin Issue 17 (June 1995). This enables groups and their advisers to approach International Division at the time when finance is in the process of being put in place to obtain guidance on their plans. Where sufficient information to reach a view has been available, we have normally been able to give groups some certainty as to the tax treatment likely to apply to what they propose. We are happy to confirm that this service will continue to apply to the new legislation in relation to proposed funding structures. While we are sensitive to the commercial deadlines to which groups are subject, we cannot guarantee delivery against unreasonably tight timetables and request early notification of proposed arrangements to enhance the quality of the service we are able to provide. The contact address for advice on particular cases is:

International Division
Room 311
Melbourne House
Aldwych
LONDON WC2B 4LL

Questions on the record keeping content of this note should be directed to:

Richard Coombes
International Division
Room 409
Melbourne House
Aldwych
LONDON WC2B 4LL

Tel: 0171-438 6842
Fax: 0171-438 7518

and on the funding guidance to:

Susan New
International Division
Room 307
Melbourne House
Aldwych
LONDON WC2B 4LL

Tel: 0171-438 7596
Fax: 0171-438 7511

The Revenue recognises that these are sensitive issues. It will monitor closely the use and usefulness of this guidance, and update or amend it as the need arises.

EMPLOYMENT TERMINATION SETTLEMENTS

Section 148 and Schedule 11 Income and Corporation Taxes Act 1988 (ICTA) deal mainly with payments and benefits made in connection with termination of employment which are not otherwise charged to tax. This article describes changes to those rules made by the Finance Act 1998 (FA98) and associated Regulations.

Background

The structure of an employment termination settlement package is a matter between the employer and the employee. Modern termination packages sometimes include provision for non-cash benefits to continue after termination. However, under the old legislation (Sections 148 & 188 and Schedule 11 ICTA prior to the FA98 changes), such an approach could generate administrative burdens for employers.

The Revenue introduced alternative arrangements as an interim measure to alleviate the worst problems generated by structuring termination packages in this way. These interim arrangements (detailed in a Press Release of 17 March 1997) which taxed non-cash benefits only when they were received,

were optional and available for terminations taking place during 1996-97-1997-98. (Cash awards were already taxable only when they were received.) The response to the interim arrangements led to the issue, in December 1997, of a Consultative Document proposing similar provisions on a statutory basis.

Support for the proposals put forward in the Consultative Document resulted in legislation in the last Finance Act (Section 58 and Schedule 9 FA98). To a large extent the new rules, which tax cash instalments and non-cash benefits in the year in which they are received, build upon the interim arrangements as outlined in the Consultative Document. In addition, some obsolete material (including Part II of Schedule 11 dealing with payments under pre-1981 obligations) has been dropped and the opportunity taken to rewrite the existing legislation in simpler form using techniques developed as part of the Tax Law Rewrite project. This rewrite process does not of itself change the legislation.

The new rules affect all payments and receipts made on or after 6 April 1998 unless there has been a previous charge to tax on them - the commencement provisions are considered in more detail below.

Other (non-termination) payments and benefits (for example, compensation for changes in terms of employment) can fall within Section 148. Such awards are subject to the same new rules - but, for the sake of simplicity, are not referred to explicitly in the following commentary.

Year of assessment

Under the old rules, and even under the interim arrangements, everything chargeable under Section 148 was assessed in the year of termination. This meant that finalising an assessment might be delayed and an assessment might have to be revised several times.

Example A

Alan's employment terminated in June 1996. The termination package consisted of £50,000, paid in 5 annual instalments each July starting in July 1996. The package is taxable only under Section 148. The £30,000 general exemption available against charges under Section 148 covers the payments made during 1996-1998. The payments of £10,000 received in July 1999 and July 2000 are both assessable as income of 1996-97.

Under the new rules, payments and benefits are assessed in the year they are received.

Example B

Brenda's employment terminates in June 1998. The termination package consists of £50,000, paid in 5 annual instalments each July starting in July 1998. The package is taxable only under Section 148. The £30,000 general exemption available against charges under Section 148 covers the payments made during 1998-2000. The payments of £10,000 received in July 2001 and July 2002 are assessable as income of the tax years 2001-2002 and 2002-2003 respectively.

Receipt

The new rules state that:

- a cash benefit is received when:
  - payment is made of or on account of the benefit or
  - the recipient becomes entitled to require payment of or on account of the benefit;

- a non-cash benefit is received when:
  - it is used or enjoyed.

Example C

Clive's employment is terminated with effect from 6 April 1999. Clive receives an employment termination package consisting of £40,000 (£20,000 on 6 April 1999 and £20,000 on 6 April 2000), a case of wine (eventually consumed 6 April 2005) and 3 years continued use of a company car. The cash payments are treated as received in 1999-2000 and 2000-2001 respectively. The benefit of the car is received in 1999-2000, 2000-2001 and 2001-2002. The benefit of the wine is received in 1999-2000 (the 'enjoyment' being the transfer of ownership rather than the consumption).

Treatment of non-cash benefits

Under the old legislation, non-cash benefits came within the description "valuable consideration other than money" and the employer had to establish the value of the consideration at the time it was given. Benefits provided after termination could be difficult to value accurately.

Example D

As part of a termination settlement, Deborah was given use of a car for 3 years post-termination. The *valuable consideration* was the promise to provide that facility and it was that promise at the time of termination which had to be valued.

Under the old legislation, the charge could not be adjusted if for some reason the value of the benefit turned out to be quite different.

Example E

As part of a termination settlement Eric was given use of a car for 5 years post-termination. The *valuable consideration* was the promise to provide that facility; the value of that promise was taken to be equivalent to the open market lease or hire charge Eric would have had to pay at the date of termination for 5 years use of the car concerned. However, after less than one year, the former employer went out of business and the car was taken back by the company from which it had been leased. No adjustment could be made to the charge based on the earlier valuation.

The concept of *valuable consideration* is not present in the new rules. The right to receive a benefit is not itself a benefit. So, for example, the promise to provide a car in future years is not itself a benefit - the benefit is the provision of the vehicle (whether or not any use is made of it). This places the ex-employee on essentially the same ground as the employee receiving a non-cash benefit.

Valuation of non-cash benefits

There are new rules for determining the value of non-cash benefits. The amount of such a benefit is its ‘cash equivalent’. The cash equivalent is defined as the *greater* of:

(a) the sum that would be chargeable under Section 19 ICTA if the benefit were an emolument from employment

and

(b) a sum calculated in accordance with the provisions of Section 596B ICTA (which deals with the valuation of non-cash benefits from a non-approved retirement benefits scheme).

Under Section 596B, the cash equivalent of a non-cash benefit is in general arrived at by assuming that the benefit is chargeable under the “appropriate provision” of the rules which apply to certain employees’ benefits (i.e. the rules of Chapter II Part V ICTA). The only exception to use of the Chapter II rules is where the benefit consists of provision of living accommodation - detailed rules for determining the cash equivalent for provided accommodation are given within Section 596B.

Example F

As part of a termination settlement Fiona was given use of a car for 5 years post-termination. The *appropriate provision* within Chapter II for this is Section 157 - dealing with cars available for private use. That Section says that the cash equivalent for that benefit is to be found in Schedule 6 ICTA. From that in turn we arrive at 35% of the price of the car as the cash equivalent of one year’s availability of the car. Of course, there can be no reduction for business travel.

It is expected that the Section 19 test in (a) above will result in a greater figure only where, for example, a termination package includes transfer of an asset which has appreciated in value since the employer acquired it.

Example G

As part of his termination settlement, Gordon receives a house which cost his employer £5,000 some years ago. The *appropriate provision* in Chapter II for this is Section 154 - since such a benefit is not dealt with anywhere else in the Chapter. Section 156 tells us that the cash equivalent for a benefit within Section 154 is the cost of its provision i.e. £5,000.

However, the house is worth £150,000 when transferred to Gordon. If the house had been given as an emolument from Gordon’s employment, the amount chargeable under Section 19 ICTA 1988 would have been £150,000 - its “money’s worth”.

The value of the house for Section 148 purposes is the greater sum i.e. £150,000.

It is important to remember that these rules are used only to measure what the amount of the cash equivalent of a Section 148 benefit is. Rules in Section 596B and Chapter II which deal with *other* matters are not imported into Section 148 in any way. For example, there are rules (Section 167 ICTA) which apply Chapter II only to directors and higher-paid employees. They are not part of the rules for establishing the amount of a cash equivalent and so do not apply for Section 148 purposes. There is a further example of this point in the section on ‘interest relief’ below.

Operation of the £30,000 exemption

A £30,000 exemption is available against amounts chargeable under Section 148. The new rules on assessment upon receipt mean that payments and benefits from a termination may be assessed in several years. However, the £30,000 exemption is not confined to the year in which the termination occurs. Under the new rules, the exemption can be carried forward from year to year and used until exhausted.

Example H

Hannah’s termination settlement awarded on 1 May 1998 comprises £40,000 payable in annual instalments of £20,000, plus use of a car for two years. In 1998-99 the first £20,000 is chargeable together with (say) £8,500 as the cash equivalent of

the car use. The total of £28,500 is covered by the £30,000 exemption so that no tax is due in 1998-99 in respect of the termination. This leaves £1,500 of the exemption unused which is carried forward to 1999-2000 and is available to be used against the amounts within Section 148 in respect of the termination settlement which are received in that year.

In applying the £30,000 exemption, the old rules about aggregating amounts from the same or associated employers remain the same. So if in the example above Hannah also received a sum within Section 148 of £5,000 from an associated employer in 1998-99, the total amount would be over £30,000 for that year and the exemption would be exhausted - leaving no exemption to be carried forward.

Interest relief

Employees with beneficial loans (broadly loans carrying a rate of interest lower than the official rate) can claim relief for *notional* interest. Section 160 ICTA, which deals with the tax charge with respect to beneficial loans, says that the cash equivalent of the benefit of the loan is treated as 'interest paid'. This allows the employee to claim relief for that interest 'paid' (subject to the usual qualifications). However, under the old rules, this did not apply for Section 148 purposes. As explained above, we go to Chapter II (in this case Section 160) *only* to find the cash equivalent of the benefit - the rules about treating interest as paid are not part of that process.

The new rules provide equivalent relief for ex-employees where there is a Section 148 charge. This is achieved by treating the cash equivalent as interest paid.

Example I

Ian's termination settlement includes the continuation for two years of a beneficial loan granted by his employer. The *appropriate provision* within Chapter II for this non-cash benefit is Section 160. So we find the *cash equivalent* in Part II Schedule 7 ICTA and that amount can be claimed as interest 'paid'.

The cash equivalent is treated as interest 'paid' only to the extent that the Section 148 charge exceeds £30,000.

Example J

Jane receives cash of £27,000 and a beneficial loan with a cash equivalent of £4,500. Only £1,500 of the latter is treated as taxable under Section 148 and hence only £1,500 is treated as interest paid and available for a claim to interest relief.

Commencement

The new rules apply to all payments and benefits *received* on or after 6 April 1998 - except where there has been a previous charge.

Example K

Kevin's employment was terminated in 1996-97. It was agreed by the Inspector that the promise to provide non-cash benefits for 10 years was *valuable consideration* of £35,000. Taking into account the £30,000 exemption, £5,000 is assessed for 1996-97. After 6 April 1998, Kevin continues to enjoy the ongoing benefits but there is no further charge to be made in respect of them under Section 148.

Example L

Lucy's employment was terminated in 1996-97. She opted for the transitional arrangements in force for 1996-97 and 1997-98. Her receipts on or after 6 April 1998 are dealt with under the new rules since they have not been charged before that date.

PAYE procedures

There is no change in the requirement for employers to operate PAYE on cash payments both in relation to the year of termination and subsequent years, or for the employer to take into account non-cash payments in deciding whether or not a cash payment is covered by the £30,000 exemption.

To simplify the operation of PAYE following the move to tax cash payments and non-cash benefits in the year in which they are received, the new rules prescribe that in any tax year any balance of the £30,000 exemption is set first against cash payments in that year. Any balance remaining after off-set against the cash payments made in the year is off-set, at the end of the year, against the aggregate of the non-cash benefits received in the year.

Example M

Martin's employment is terminated. He receives £35,000 in cash and £14,000 non-cash benefits - with the provision of both cash and benefits spread over two years.

Year 1 Cash payments £20,000; non-cash benefits £6,000.

£20,000 of the £30,000 exemption is set against the £20,000 cash payments and then £6,000 is set against the £6,000 non-cash benefits, leaving £4,000 exemption to carry forward to year 2.

Year 2 Cash payments £15,000; non-cash benefits £8,000.

The £4,000 unused exemption brought forward from year 1 is set against the £15,000 cash payments, leaving £11,000 subject to PAYE. Tax will also be due on the £8,000 non-cash benefits.

An employer making a payment liable to PAYE may believe that part of the £30,000 exemption is still available but, at the time of payment, not know the exact cash equivalents of non-cash benefits provided in previous years. In such circumstances the employer should work on the basis of an estimated balance of exemption - calculated by taking into account payments already made and a best estimate of the cash equivalents of non-cash benefits actually provided in previous years. For this purpose it will generally be appropriate to use the estimates provided in the original report, for example where the actual provision of non-cash benefits is the same as that forecast in the original report.

So if, in example M above, the £15,000 cash payment in year 2 is paid very early in that year before the cash equivalents of the year 1 non-cash benefits have been calculated, the employer should simply use a best estimate of the cash equivalent of the year 1 benefits in deciding what part of the £30,000 exemption is available in year 2.

Reporting requirements

Under the old rules, an employer had to send a report to the Inland Revenue within 30 days of the end of a tax year in which payments chargeable to tax under Section 148 were made.

Under the new rules, an employer will not be obliged to send yearly reports. A one-off report will have to be made to the Inland Revenue where an employment is terminated and a settlement is provided with respect to that termination which includes non-cash benefits and is estimated, over its lifetime, to exceed £30,000. So no report is required where the settlement package consists of cash only or, where it includes non-cash benefits, it has an estimated total value of £30,000 or less. The Inland Revenue will not regard employers as having failed in their reporting obligations where, in good faith, a report is not sent about a package including non-cash benefits because it is estimated not to exceed £30,000 but, in the event, without a change in the nature of the package, the £30,000 limit is exceeded.

The report, and a copy to the employee, have to be provided by the 6 July following the tax year in which the termination occurred (in line with the P11D timetable). Subject to this time limit, the employer is free to send the report (and the copy to the employee) at any time after the termination has occurred. There is no prescribed form or format and employers can prepare the reports in the way which best suits their businesses.

Once an employer has sent a report there is no need for any further report unless, exceptionally, there is a significant variation increasing the total value of the package. The Inland Revenue will regard as significant any variation producing an increase in value of more than £10,000. Where there is a significant variation a report of the variation should be made, to the Revenue only, by 6 July following the end of the tax year in which the variation occurs.

There may be some cases where a report is not sent after the end of the year in which termination occurs as, initially, a package containing non-cash benefits is not estimated to exceed £30,000 but later the package is changed so that it still contains non-cash benefits and does exceed £30,000. Where this happens the employer should, by the 6 July following the end of the year in which the package was changed, send a report to the Inland Revenue, with a copy to the employee. The report should be for the year in which termination occurred as if one had been required in the first place. The same approach should be taken where a package initially consisting entirely of cash is varied to incorporate non-cash benefits - producing a mixed package with a total value in excess of £30,000.

The information which should be contained in any termination report is as follows:

- the total estimated value of the termination package;
- details of the cash payments made and the cash equivalents of non-cash benefits provided in the year in which the termination occurred (where the report is made in the tax year best estimates should be supplied);
- an estimate of the cash payments to be made after the first year;
- an estimate of the total lifetime of the package with details of any contingency factors (for example payments or benefits ceasing if the employee finds alternative employment);
- details of the nature of the benefits to be provided after the first year and the terms of their provision, for example car for three years, medical insurance for ten years etc.

The regulations dealing with the reporting requirement will take effect from 6 April 1999. The first reports required will be for terminations in tax year 1998-99.

The purpose of the report is to provide something against which to check data subsequently produced by ex-employees with respect to payments and benefits received. So in arriving at figures for the cash equivalents of non-cash benefits to be provided in years

following the award, so as to determine whether or not the one-off report is needed, employers are required only to produce reasonable estimates, using the rules in force in the year in which the termination occurs.

The copy of the report which is to be sent to employees will help them to complete any self assessment returns sent to them.

RECORDS TO BE KEPT UNDER SELF ASSESSMENT

Introduction

This article is mainly about the record keeping requirements for corporation tax purposes under self assessment. It is intended that the key points will in due course become the subject of a formal Statement of Practice. But the section on the preservation of records in an alternative form is also relevant to unincorporated businesses. We will revise the next edition of our booklet on record keeping for the self employed (SA/BK3) to record it.

Paragraphs 21 to 23 of Schedule 18 to Finance Act 1998 require companies and other concerns within the charge to corporation tax to keep and preserve records. The provisions mirror those in Section 12B Taxes Management Act (TMA) 1970, which brought in, for 1996-97 and subsequent years of assessment, a record keeping requirement for individuals and partnerships. Paragraphs 21 to 23 have effect for accounting periods ending on or after 1 July 1999.

As noted above, these rules apply not only to ordinary limited companies but to all concerns within the charge to corporation tax including for example industrial and provident societies, authorised unit trusts, clubs and societies as well as ordinary limited companies. Except in the paragraph referring to the Companies Act record keeping requirements we use 'companies' as convenient shorthand for all concerns within the charge to corporation tax.

Summary

The legislation requires companies to keep and preserve sufficient records to enable them to make a correct and complete company tax return. Should the Revenue decide to make enquiries into a return, the company will need to be able to explain and substantiate the information it contains. Companies with systems in place to enable them to do that should be affected by the new legislation only to the extent that they may have to retain records for longer than they do at present.

Our approach in practice

Concern has been expressed that, on a strict interpretation, the legislation would impose an additional and unwarranted burden on companies by extending the requirement to preserve greater quantities of prime records than is currently the case. That is not the purpose of the legislation.

We issued guidance on how Section 12B TMA affects self employed taxpayers in leaflet SA/BK3, 'Self Assessment: a guide to keeping records for the self-employed', published in June 1995.

The leaflet gives guidance on the practical effect of the legislative requirement. In particular, it makes clear that:

- the taxpayer is required to keep sufficient records to make a correct and complete return;
- the taxpayer will also need to be able to demonstrate in response to Revenue enquiries that that is the case;
- the precise nature and extent of the records needed to discharge that obligation to be kept will be dependent on the type and size of business.

This statement is equally applicable to companies and other concerns within the charge to corporation tax.

Interaction with the record keeping requirements of the Companies Act

Companies to which the Companies Act applies are already required by Section 221 Companies Act 1985 to keep and preserve specific accounting records in terms which are close to the tax requirements. We can confirm that any company satisfying the requirements of the Companies Act will have satisfied the requirement to keep and preserve records for tax purposes. This is subject to keeping adequate records for arm's length pricing purposes and to the rules on the period for which records must be preserved. These provisos are discussed further below.

Records for arm's length pricing purposes

A particular issue here concerns the 'transfer pricing' legislation. These provisions require taxpayers to apply the arm's length standard to certain arrangements and transactions for the purpose of making their tax returns and self assessments.

The legislation applies primarily to dealings between a UK taxpayer and an associate operating outside the UK. It will generally not be relevant where the parties are unconnected, unless the dealings in question constitute individual transactions within a "series of transactions" to which the legislation applies. And - with very limited exceptions - the legislation is of no relevance where the parties to a transaction are both subject to UK tax in respect of it.

Where the transfer pricing legislation may be in point, the records required by Paragraph 21 of Schedule 18 to the

Finance Act 1998 to enable a company to deliver a correct and complete return, and to substantiate the figures in the return on enquiry, may well go beyond those required for the purposes of Section 221 Companies Act.

Following extensive consultations, we are also issuing guidance in this issue of Tax Bulletin on how we will interpret and apply the SA documentation requirements for transfer pricing purposes.

Period for which records must be retained

The Companies Act requires private companies to retain their accounting records for a period of only three years. For tax purposes, once Corporation Tax Self Assessment is introduced, such companies will need to preserve their records for the longer period prescribed in Paragraph 21 of Schedule 18.

Normally, records for an accounting period will have to be preserved for six years from the end of that period. But in three cases they have to be kept for longer. The second and third cases in particular will be very rare in practice.

First, if an enquiry into the return for an accounting period remains open at the six year point the records for that period must be retained until that enquiry is completed.

Secondly, where no such enquiry has been started but the statutory period for doing so has not expired at the six year point (because the return is late) the records for that accounting period must be retained until the latest date for starting an enquiry has passed or, if later, the date such an enquiry is completed.

The third case is where, contrary to the first two situations, the date on which a company is requested to complete a tax return for an accounting period is itself more than six years after the end of that period. In that case the records in existence at that date must be retained as in the second situation, that is until the latest date for starting an enquiry has passed or, if later still, the date such an enquiry is completed.

Preservation of records in an alternative form (see below) should make it easier for some companies to retain their records for this longer period.

Records preserved in an alternative form

For unincorporated business we have already indicated in Tax Bulletin Issue 21 (February 1996) that records may be preserved on optical imaging systems, and the originals discarded, provided that what is retained in digital form represents a complete and unaltered image of the underlying paper document. We are now able to go further. Both in the case of companies and unincorporated businesses we can accept other methods which preserve the information in the records in a different form. This is so long as those methods capture all the information needed to demonstrate that a complete and correct tax return has been made and are capable of yielding up that information in legible form. Businesses need to bear in mind this second condition when they change or up-date computerised accounting packages and ensure they have the software to access the old data.

Precisely what information needs to be preserved in this way will vary from business to business. But standard information, such as contractual terms and conditions printed on all invoices, need not be reproduced as part of the record of each transaction.

We accept of course that companies which store information in accordance with the Code of Practice on the Legal Admissibility of Information stored in Electronic Document Management Systems (BSI 1996 DISC PD 0008) will thereby automatically satisfy the tax requirements.

The exceptions, where the original record must be retained, are set out in Paragraph 22 of Sch 18 to Finance Act 1998. In essence they consist of vouchers for tax suffered or for tax credits in respect of incomings. But photocopies of foreign tax assessments, rather than the assessments themselves, will remain acceptable for the purposes of claims to double taxation relief in respect of foreign tax underlying dividend income from abroad.

Penalties for record keeping failures

We have been asked to clarify what constitutes a failure for the purpose of the penalty provisions in the record keeping rules (Paragraph 23 of Sch 18 to Finance Act 1998 and Section 12B(5) TMA 1970). These penalty provisions relate the penalty to a year of assessment (for income tax) or to an accounting period (corporation tax). The effect is that there can only be one penalty of a maximum £3,000 in relation to all the offences relating to that year of assessment or accounting period.

We have given assurances in connection with self assessment for individuals and partnerships that penalties under S12B(5) will only be sought in the more serious cases - where, for example, records have been destroyed deliberately to obstruct an enquiry, or where there has been a history of serious record keeping failures. We are now able to offer equivalent assurances to companies. We can also confirm that a penalty would only be sought from companies, as in the case of individuals and partnerships, following approval by Compliance Division.

Pay As You Earn (PAYE) Records

The requirement to create and preserve records to enable a correct and complete tax return to be filed applies to records relating to employee costs in the same way as other business costs. Some employee records will almost

automatically be required for Company Tax Return purposes. Where records of employee costs are used for this purpose they must be preserved for the longer period specified in Paragraph 21 of Sch 18 to the Finance Act 1998, described above.

But companies which are employers must also preserve PAYE records, that is those additional records created to show that the PAYE system has been operated in a satisfactory manner. Regulation 55(12) of the Income Tax (Employments) Regulations 1993, SI 1993 No. 744, requires these additional PAYE records to be preserved for three years after the end of the tax year to which they relate.

Unlike Paragraph 22 of Sch 18 to the Finance Act 1998, the PAYE regulations do not provide for preservation of information in the records in another form. To help employers we have recently changed our view on the use of optical imaging to preserve such records which were originally created in paper form. Any paper records may now be preserved by the use of optical imaging systems, provided that what is retained is a complete and unaltered image of the underlying paper document.

STAMP DUTY RESERVE TAX (SDRT)

PENALTIES FOR FAILURE TO NOTIFY LIABILITY

This article explains the Stamp Office's practice in relation to the penalties to which an accountable person may be liable in the event of a failure to notify SDRT liability before the accountable date.

Background

Broadly speaking, SDRT is charged on agreements to transfer shares where no stock transfer form is used (and accordingly no Stamp Duty is paid).

Most SDRT arises on transfers of dematerialised shares held in CREST, where the SDRT concerned is accounted for centrally through CREST. However not all securities are able to be held in CREST and so SDRT also arises in a variety of other situations. One common example is where such 'residual' securities that have been purchased but not yet delivered are soon sold again and accordingly registered directly into the name of the second purchaser.

Where SDRT arises that is not accounted for in CREST, Regulation 4 of the SDRT Regulations SI 1986 No 1711 (as amended by SI 1997/2430) requires the accountable person to give written notice of each charge to SDRT, and to pay the SDRT due direct to the Inland Revenue, on or before the accountable date.

The written notice (which should set out the date of the agreement, and the parties, securities and consideration involved) should be sent together with the SDRT itself to the Shares Unit of the Stamp Office at the address below.

Where the shares are purchased on an exchange the accountable person, as defined by Regulation 2 of the SDRT Regulations 1986, will be one of the brokers (or qualified dealers) involved in the transaction. Otherwise the purchaser is accountable.

The accountable date is the seventh day of the month following the month in which the trade date of the transaction occurred. Interest is charged from that date on any SDRT paid late.

Penalties apply to late notices under Section 93 Taxes Management Act (TMA) 1970, as applied to SDRT by SI 1986/1711 (as amended by SI 1997/2430). The level of penalties depends on how late the notice is provided as set out below.

Notice given late but within one year of the accountable date

Section 93(2) TMA 1970 states that each Regulation 4 failure will incur a liability to a penalty of £100; that is to say that each transaction which is accounted for to the Stamp Office after the accountable date will attract a potential penalty of £100. Composite monthly notifications are very welcome, but it should be noted that a late composite notice covering say 10 transactions would potentially be liable to 10 penalties of £100.

However, to prevent the size of the potential penalty being disproportionate to the amount of SDRT involved, the amount of the statutory penalty in relation to each individual transaction will normally be limited to the lesser of:

- the total SDRT due on the transaction reported, and
- £100.

So, for example, if a late composite notice for a particular month relates to just two transactions attracting SDRT of £10 and £1000 respectively, the mitigated penalty would normally be £110 rather than £200.

Whenever an agreement to transfer chargeable securities is not reported before the accountable date the accountable person can now expect to have to account for a maximum penalty of £100 along with interest on the SDRT from the accountable date to the date of payment.

Notice given more than one year after the accountable date

In addition to the penalty described above, if the failure continues for twelve months or more the accountable person becomes liable, under Section 93(5) TMA 1970, to a tax geared penalty not exceeding the amount of SDRT which should have been paid. In the event of such a penalty becoming

due, consideration will be given to mitigating the amount charged in line with the Board's established policy. Full details are given in Stamp Office leaflet SO14 (available from the address below) but, briefly, the three factors taken into consideration are; the readiness with which the disclosure is made, the amount of co-operation given and the overall gravity of the offence committed.

Cases where transfer document stamped after accountable date

SDRT arises whenever a stock transfer form relating to a transaction in securities is not stamped before the accountable date. However, in practice accountable persons handling residual securities sometimes find they cannot get stock transfer forms stamped by that time, but are nevertheless confident that such a form will be stamped shortly thereafter (which will then cancel the SDRT charge).

Where a stock transfer form relating to residual securities is stamped within 60 days of the date of the transaction the Stamp Office will not seek interest on the SDRT in the meantime and no notice need be given. This extends the practice set out at the end of paragraph 1.11 of the SDRT Notes for Guidance published in February 1998.

However, should a stock transfer form not in fact be duly stamped within this time then interest on the unpaid SDRT will still run from the accountable date. In addition, if a notice was not delivered by that date the penalties described above will apply.

It should also be noted that if the stock transfer form is presented for stamping more than 30 days after it is executed there may be a penalty for late stamping.

Contact point

SDRT Notices and payments, and requests for further information, should be sent to:

Shares Unit
Ground Floor
East Block
Barrington Road
Worthing BN12 4SE

Telephone: 01903 509467/471

SECTION 703 ICTA 1988 AND SHARE BUY BACKS

Before September 1994, a company wishing to reduce its issued share capital usually did so by purchasing the shares through a market-maker and the sale proceeds were treated as a capital receipt in the hands of the vendors in the same way as any other on-market transaction.

Between September 1994 and October 1996, a number of companies purchased their own shares using a new type of buy back whereby shareholders were invited to sell their shares to an agent for the company: under these arrangements the proceeds became a qualifying distribution in the hands of the vendors, except to the extent that they represented the return to shareholders of the original subscribed capital.

The Section 703 Compliance Unit is investigating shareholders who participated in these buy backs to see if the tax credits paid to them should be recovered under the anti-avoidance provisions at Section 703-9 ICTA 1988 which enables the Revenue to counteract a "tax advantage" (defined at Section 709(1)) obtained in consequence of a "transaction in securities" (Section 709(2)) in any of the circumstances defined at Section 704A-E.

Where an exempt body receives an "abnormal dividend" as a result of selling shares in a buyback, the relevant circumstance is at subsection (a) of Section 704A which catches the receipt of "an abnormal amount by way of dividend [which is] taken into account for .... (a) any exemption from tax."

The purpose of this article is to assist those shareholders who may be involved in this investigation by giving the answers to some of the questions which we have most frequently been asked in connection with our enquiries into share buy backs.

Why didn't we challenge these buy backs under Section 703 at the time?

We explained in Tax Bulletin Issue 8 (August 1993) that following the High Court decision in Sheppard v CIR (No 2) we were seeking clarification from the Courts on the application of Section 703 to exempt bodies but that meanwhile we would continue to operate Section 703 on the basis that exempt bodies obtained a tax advantage whenever they received an abnormal dividend. Following representations received in response to the Tax Bulletin article, we subsequently agreed that as far as the collection of tax was concerned, taxpayers who received abnormal dividends would be entitled to rely on the Sheppard case until the position was clarified in the Courts.

On 30 October 1996 Sir John Vinelott, giving judgement in the case of CIR v Universities Superannuation Scheme Ltd (TL 3499) upheld the Revenue's view that a tax exempt body which was entitled to "relief" on the income which arose when it received a distribution in the course of a share buy back had obtained a tax advantage within Section 709(1). This gave us the judicial authority to challenge the new type of share buy back under Section 703. See Tax Bulletin Issue 34 (April 1998) for further comment on the USS decision.

But doesn't that mean that the Revenue is applying the law retrospectively?

No, because the decision in the USS case is not new legislation but a judicial interpretation of how the existing legislation at Section 703 applies in the case of exempt bodies.

Why were shareholders not warned that the buy backs might be caught by Section 703?

We had already made clear our position on Section 703 and exempt bodies in Tax Bulletin Issue 8 (August 1993). And shareholders were specifically alerted to the possible application of Section 703 by the companies which carried out the buy backs - for example, the "Repurchase Announcement" issued by the first company to carry out the new type of buy back in September 1994 told shareholders that "In certain circumstances, any benefit arising to a shareholder from treatment of part of the sale price as a distribution may be counteracted by the Inland Revenue under Section 703 of the Income and Corporation Taxes Act 1988" and that they "should obtain their own advice as to the specific tax consequences for them of selling their shares." Announcements in similar terms were made by the other companies which carried out this type of buy back over the next two years.

But why should shareholders who leave all the investment decisions to their fund managers have to worry about the legislation at Section 703?

Because it is the shareholders and not the fund managers who have obtained the tax advantage and because the responsibility in law for complying with their tax obligations falls on the shareholders and not on the persons by whom investments are managed on their behalf.

What makes a dividend "abnormal"?

Section 709(4) - (6) defines an "abnormal" dividend as one which "substantially exceeds a normal return on the consideration provided by the recipient for the relevant securities" having regard to "the length of time previous to the receipt of [that dividend] that the recipient first acquired any of the relevant securities and to any dividends and other distributions made in respect of them during that time".

This is why when shares are sold in a buy back, we need to know when they were "first acquired" and how much the shareholder paid for them so we can work out the return represented by the distribution received on the buy back.

There is no statutory definition of a "normal return" or of the extent to which it must be exceeded before the dividend becomes "abnormal". The question of whether a dividend is abnormal is ultimately a question of fact for determination by the Special Commissioners.

Why don't we deduct the cost of the shares from the disposal proceeds in arriving at the return under Section 709(4)-(6)?

Because "dividends" are defined at Section 709(2) so as to include "other qualifying distributions", the first step in determining whether a shareholder who participates in a share buy back has received an "abnormal dividend" is to quantify the amount of the disposal proceeds which is a qualifying distribution under the distribution legislation at Section 209.

In accordance with Section 209(2)(b), the amount of the consideration which is not a distribution is the amount, if any, which represents "repayment of capital on the shares or [which is] equal in amount or value to any new consideration received by the company for the distribution".

The "new consideration" cannot exceed what was given for the shares on their issue and may be less, for example where there has been a subsequent bonus issue: the fact that the shares may later change hands at a different price does not affect the amount of the distrubution under Section 209(2)(b). For the purposes of Section 703 -9, the "dividend" is therefore the amount described as "treated as a distribution for the purposes of the Taxes Act" in the vouchers issued by the company by whom the buy back was carried out *plus* the associated tax credit.

But why is the tax credit added to the distribution to arrive at the amount of the "return"?

Because in the USS case Sir John Vinelott ruled that ……..“ for the purposes of Section 709(4) references to "dividends" must be read as references to the aggregate of the distribution and any associated tax credit".

Some shareholders have been asked for different information at different times - why didn't we ask for everything we needed at the beginning of our enquiries?

Section 703 does not apply to any transaction which the person obtaining the tax advantage shows has been carried out "either for bona fide commercial reasons or in the ordinary course of managing investment" *and* that the obtaining of a tax advantage was not "their main object, or one of their main objects" in carrying out the transaction. This is generally known as the Section 703 "escape clause".

Because Section 704(6)(b) says we must take into account the history of the shares since the date of first acquisition, it was inevitable that *some* shareholders would be asked for information on their holding in a

particular company over a considerable period of time. But in order to keep compliance costs to a minimum, we began by first asking shareholders to provide us with details of transactions in the shares of the relevant company twelve months either side of the buyback. This meant we could eliminate from our enquires those buy backs where the shareholder appeared to be clearly entitled to the benefit of the Section 703(1) escape clause, for example because the sale of shares in the buy back was part of a series of disposals of shares in the company in question including ordinary on market sales.

Why not treat all shareholders who participated in share buy backs as protected by the Section 703 escape clause?

Because the main object or one of the main objects of some transactions will have been to achieve a tax advantage (payment of the tax credit) and it would not be right to treat all transactions as enjoying the protection of the escape clause. Provided that the Revenue can show that a tax advantage has been obtained in one of the circumstances prescribed at Section 704A-E, the burden of proof falls upon *the person by whom the tax advantage has been received* to show that the legislation should not be applied to counteract that tax advantage. And because the shares in these companies could have been sold at any time on the open market, it is up to the shareholders to show that they, or those who acted on their behalf, did not sell shares in a buy back just so that they could claim the tax credit attached to the qualifying distribution.

It is not sufficient for the purposes of the Section 703 "escape clause" for the shareholder or his fund manager merely to assert that the shares were sold in the ordinary course of making or managing investments and did not have as the obtaining of a tax advantage their main or one of their main objects.

What if the shareholder cannot convince us that he is entitled to the benefit of the escape clause?

The question of whether an exempt body is entitled to the benefit of the Section 703 escape clause is ultimately a question of fact for determination by the Special Commissioners. But before we can raise Section 703 assessment to recover the tax credit, the taxpayer is entitled to ask the special Tribunal appointed by the Lord Chancellor under Section 706 to determine whether the Inland Revenue has a prima facie case against him.

What if the shareholder does not provide the information necessary to calculate the return?

Where exempt bodies have held shares in the same company for many years, they may have some difficulty supplying full details of their shareholding since the date of first acquisition. In such cases, we will invite the shareholder to explain the nature of the difficulty, to provide as much information as possible and to provide for our consideration his own calculation of the "return" computed in accordance with Section 709(4)-(6).

Shareholders should however be aware that as the return is calculated by identifying the shares sold in the buy back with the earliest shares acquired this may not produce the most favourable result for the shareholder.

But where there is no good reason why the shareholder or his agents should not supply information reasonably requested in connection with our enquiries, we may ask the Board of Inland Revenue to use the information powers at Section 708 to require production of the necessary information.

TAX LAW REWRITE PROJECT

Background

The aim of the Tax Law Rewrite project is to rewrite all or most of the United Kingdom's existing primary direct tax legislation so that it is clearer and easier to use, without changing or making less certain its general effect. To ensure that the views of all users are taken into account we are publishing the draft rewritten legislation for public comment in a series of Exposure Drafts.

Savings and Investment Income

On 30 July 1998 we published our second Exposure Draft, "Savings and Investment Income of Individuals: Part1". It covers income currently charged to income tax under Schedule D Case III - interest, annual payments (including annuity payments, royalties and maintenance payments), discounts and income from government securities.

The draft clauses in this Exposure Draft set out the legislation in a clearer and more logical structure while preserving the existing meaning. And as in our first Exposure Draft ("Trading Income of Individuals: Part1") we have used numerous innovative techniques - in particular a new format and layout, shorter sentences, easier to understand language and better signposts.

In rewriting the legislation we have suggested a number of minor changes to the law which would make it simpler and easier to use. We would welcome views on whether these changes should be made.

More generally, we would welcome comments on any of the draft clauses. And there are some issues on which we would be particularly glad to receive views highlighted in the Exposure Draft. The deadline for comments is 30 November 1998. They should be sent to:

Kirsty Platts
Tax Law Rewrite Project
Inland Revenue
Room 831
South West Wing
Bush House
Strand
London
WC2B 4RD

Comments can also be sent by e-mail to: poluni.ir.bh@gtnet.gov.uk

Copies of the Exposure Draft can be obtained from Kirsty Platts at the above address. It is also available on the Internet at http://www.open.gov.uk/inrev/rewrite.htm

Purposive Drafting Techniques

In February 1998, we published a Technical Discussion Document "A Purposive Approach to Rewriting Tax Legislation". This document was intended to promote informed discussion on the role - if any - that purposive drafting might play in the rewrite. It illustrated several variants of the approach. The deadline for comments on this document was 29 May 1998. We received 38 responses, and we are grateful for the time and effort put into these replies.

There was general acceptance that the document served a useful purpose in allowing readers to evaluate theoretical options in a practical context. But given the subject matter, and the strong views held by many on the subject of purposive drafting, it was perhaps unsurprising that there was little consensus on the usefulness or otherwise of each variant.

On the basis of the responses received we have concluded that to use purposive drafting systematically throughout the rewrite would not be consistent with the project's objective to preserve, in general, the effect of the existing law. There may be some contexts in which a purpose statement may be helpful, but only where the effect is clear and we are confident that it does not change the existing law or risk introducing ambiguity.

A response paper has been produced which summarises the main points made about each variant and our conclusions. This document is also available on our web site or can be obtained by writing to Kirsty Platts at the above address.

Future Publications

Further Exposure Drafts are planned for 1998-99. We are hoping to produce the next one at the end of October. This document will include rewritten Capital Allowance provisions applying to industrial buildings. Later on we will publish further Exposure Drafts on capital allowances, as well as further rewritten legislation on trading and employment income.

On present plans, the rewritten capital allowances legislation will form the first rewrite Bill. We hope that this will be ready for enactment in early 2000.

interpretations

SELF ASSESSMENT:

(1) INCOMPLETE RETURNS

(2) THE USE OF PROVISIONAL FIGURES IN RETURNS

We have been asked to clarify our position regarding 'incomplete returns' and the use of provisional figures in self assessment (SA) tax returns.

Statutory background

Section 8(1) TMA 1970 allows the Revenue to issue a notice requiring the taxpayer to deliver a return of '*such information as may reasonably be required*' to establish the tax due for any year of assessment. Section 113(1) TMA 1970 provides that any such return shall be '*in such form*' as the Board prescribe. And Section 8(2) TMA 1970 requires that the taxpayer make a declaration to the effect that '*the return is to the best of his knowledge correct and complete*'.

This means that whenever a tax return form is issued the statutory notice incorporated in that form places a obligation on the recipient to make an return of the information required, in the manner specified. If the completed tax return form delivered to the Revenue is not '*correct and complete*' the statutory notice has not been complied with and the relevant sanctions may apply. The relevant sanctions are penalties under either Section 93 TMA 1970 or Section 95 TMA 1970, depending on the nature of the failure and the circumstances in which the failure is identified.

(1) Incomplete returns

In many cases it will be obvious that a tax return form is incomplete **when it is received.** For example, the signature required to satisfy the mandatory declaration may be missing. Or it may be that there is a tick, or note, to the effect that a particular set of pages have been attached to the form, but in fact they are missing. In such cases the return submitted by the taxpayer is clearly deficient in form and the taxpayer has clearly failed '*...to comply with the notice...*' (Section 93(1)(b) TMA 1970). A failure of this sort should be identified during the initial screening of the return and in such cases we will send back the incomplete return almost immediately, to give the taxpayer the opportunity to rectify the omission.

In other cases the fact that the tax return form is incomplete may not come to light until the information in the return is being systematically transferred to our computer database. If so we may try to obtain the missing information from the taxpayer without sending back the return. This would be appropriate where, say, it is clear that there should be an entry in a particular box. But where there is a major omission we send the return back. This

might be the case where, for example, we believe the necessary accounts information is incomplete. Whether we send the return back or not, the action we take has but a single purpose - to give the taxpayer the opportunity to rectify the omission.

Giving the taxpayer an opportunity to rectify an omission in such cases is a means of enhancing voluntary compliance. This is because by sending the incomplete tax return form back we are, in effect, opting to help taxpayers meet their obligations rather than penalising them for not doing so.

Incomplete returns delivered to the Inland Revenue on or before 31 January but sent back close to, or after, the 31st January filing deadline

One of the issues that arose during the first year of self assessment was the treatment of returns delivered to the Inland Revenue on or before 31 January but sent back to taxpayers or their agents, as incomplete close to, or after, the 31 January deadline. If an incomplete return is sent back in these circumstances it may be too late for the omission to be rectified before the filing deadline. If so the taxpayer will face an automatic late filing penalty under Section 93(2) TMA 1970.

In the Inland Revenue Press Release of 3 February 1998, Dawn Primarolo, the Financial Secretary to the Treasury announced a concession addressing this issue. The concession provided that taxpayers whose returns were sent back to them (or their agents) in the circumstances described above would still be treated as having met the filing deadline **provided they sent back a corrected return within a specified period**.

A similar concession will apply for 1997-98 returns. **The concession will apply where:**

- **a return is delivered to the Inland Revenue on or before 31 January 1999, and**
- **the return is subsequently found to be incomplete, and**
- **it is sent back to the taxpayer (or agent) for completion on or after 18 January 1999.**

In such circumstances the taxpayer will be given 14 days in which to complete the return and deliver it back to the Inland Revenue. If a completed return is delivered to us before the end of this 14 day period the taxpayer will be treated as having met the filing deadline.

The concession will also apply to those who file by electronic lodgement. Any rejection is carried out automatically. Accordingly, if a return is rejected shortly before the filing deadline and resubmitted successfully within the 14 day period, the agent will need to take a print-out of the rejection and send it to the office dealing with the return together with an explanation.

We will be monitoring the operation of the concession this year and, depending on the outcome, may recommend that it is established as a formal Extra Statutory Concession. For the avoidance of doubt it ought to be mentioned that the concession will only apply where the return is incomplete as a result of a genuine oversight. It will not apply where the return is deliberately incomplete, in an attempt to take advantage of the concession. For example, the concession will **not** apply if a return is deliberately sent in without a relevant set of pages, to buy a little more time to complete those pages. Nor will it apply if a return is deliberately sent in without a signature, to buy a little more time to obtain the signature.

Examples:

Return submitted on 20 October 1998 and sent back to taxpayer as incomplete on 10 November 1998. **Concession not relevant** because taxpayer still has until 31 January 1999 to meet filing deadline.

Return submitted on 20 January 1999 and sent back to taxpayer as incomplete on 21 January 1999. Concession means that providing the completed return is sent back to the Revenue by **4 February 1999** the taxpayer will be treated as having met the filing deadline.

Return submitted on 20 January 1999 and sent back to taxpayer as incomplete on 10 February 1999. Concession means that providing the completed return is sent back to the Revenue by **24 February 1999** the taxpayer will be treated as having met the filing deadline.

Return submitted on 20 February 1999 and sent back to taxpayer as incomplete on 21 February 1999. **Concession not relevant** because return was not sent in on or before the 31 January 1999 filing deadline.

(2) Use of provisional figures in returns

Given that the purpose of the SA tax return is to establish the tax chargeable for a particular year of assessment it is neither surprising, nor unreasonable, that taxpayers are asked to include correct and final figures of income and gains in their returns.

But it has long been realised that there is an unacceptable tension between an *absolute* requirement to provide correct and final figures and a requirement to provide such information *by a certain date*. Prior to self assessment the Courts supported the view that the paramount requirement was to comply with the statutory filing obligation and

that this may require the taxpayer to use provisional figures in the return (Dunk v General Commissioners for Havant, 51 TC 519; Alexander v General Commissioners for Wallington 65 TC 777). For example:

"If a taxpayer finds particular circumstances that make the best of his knowledge more than usually unreliable, it is open to him to put against his figure for a particular item of income such words as "estimated – see accompanying memorandum", or something of that kind, and explain the circumstances. If he has done his best, and, of course, he is under a duty to use all proper sources of knowledge – he will not, in my view, be guilty of making a false statement, providing, as I say, he puts in a genuine estimate and, if necessary, explains that it is not very reliable." [Goulding, J, in Dunk v General Commissioners for Havant, 51 TC at p521].

Application of Dunk principles to SA returns

We would argue that the time limits for filing an SA tax return are such that it is reasonable to expect the vast majority of taxpayers to be able to provide correct and final figures by the statutory filing date. Nonetheless, we recognise that there will still be some circumstances in which it is impossible for the taxpayer to provide final figures, despite their best efforts to do so. So it is the Inland Revenue's view that the 'Dunk principles' apply equally well to SA returns. Indeed, these principles are clearly identifiable in the guidance published in 1994, at paragraph 2.53 of SAT 2:

'*There will be occasions on which some information cannot be finalised within the formal self assessment time limits despite the taxpayers best efforts to do so. In such cases the taxpayer should include a 'best estimate' of the information in the return and, if appropriate, a corresponding estimate of the tax due...... A return containing any such provisional figure will not be regarded as incomplete.'*

Our views on the use of the continuing application of the Dunk principles are also reflected in the guidance material provided with the SA tax return. For example, there is general advice on the use of provisional figures at page 27 of the main Tax Return Guide:

'*Do not delay sending your Tax Return just because you do not have all the information you need. You must do your best to obtain the information, but if you cannot provide final figures by the time you need to send your Tax Return, then estimate the amount.'*

Circumstances in which the Inland Revenue could regard a return containing provisional figures as 'incomplete'

Despite the general guidance provided in the 1996-97 tax return there appears to have been some confusion as to the circumstances in which the Inland Revenue could regard a tax return as incomplete simply because it contains provisional figures.

The general guidance in the Tax Return guidance tells the taxpayer that '*You must do your best to obtain the information'* and goes on to say that we '*... will not normally regard a Tax Return as incomplete simply because it contains provisional figures, provided you have taken all reasonable steps to get the final figures, and you ensure that they are sent as soon as they are available'*.

It should be clear from this that we expect the taxpayer to have done all they reasonably can to obtain the final figures, or, in the words of Goulding, J., the taxpayer must have *'....done his best...'*. If a taxpayer **has made little or no effort** to obtain the final figures before the filing deadline we would argue that a key element of the 'Dunk' principles is absent and the taxpayer has failed to comply with the notice to make a return. Similarly, we would not accept that **general pressure of work or the complexity of a taxpayers affairs** justify the use of provisional figures. The onus is on the taxpayer (and his agent) to take such factors into account, for example, when considering how long it will take to complete the return.

There is further guidance on the use of provisional figures in the Self-employment pages. This guidance (on page SEN3) allows for the return of a single figure of estimated profit, rather than standard accounts information:

'*If you cannot complete the income and expenses section of your Self-employment pages because it is impossible to prepare the figures from which your taxable profit is to be calculated before the latest date for sending your Tax Return, you should provide an estimate of your taxable profit in box 3.88.........'*.

As is made clear this guidance is to be read in conjunction with the general advice on the use of provisional figures in the main Tax Return Guide. It follows that we expect taxpayers to have done all they reasonably can to obtain the final figures. It was certainly not our intention to accept a single figure of profit when, for example, it was only 'impossible' to prepare final figures because the taxpayer had made little or no effort to have the final figures prepared in time to meet the filing deadline. In such circumstances we would argue that a key element of the 'Dunk' principles is absent and the taxpayer has failed to comply with the notice to make a return. In fact we would expect there to be very few circumstances in which, despite the taxpayer's best efforts, it is genuinely '*impossible'* for the taxpayer to provide us with accounts information. The only common circumstance would be where, in the case of a newly commenced business, the first accounting period does not end until close to, or after, the statutory filing date. (By 'close to' we mean within 3 months of the filing date, so for the

normal 31 January deadline, that means accounting periods ending on or after 1 November).

Even though there are relatively few circumstances in which it would be acceptable for a single provisional figure of profit to be returned there may be circumstances in which it is acceptable for some, or all, of the standard accounts information to be completed on a provisional basis. For example, there may have been a change of accounting date requiring two sets of accounts to be prepared. If only the earlier set of accounts were final then provisional standard accounts information would be required, pending completion of the second set of accounts. In these and similar circumstances (that is where a provisional figure of profit is estimated by reference to an earlier period of account) we would expect provisional figures **for each of the anticipated entries in the standard accounts information**.

In practice it is unlikely that we will send back a 1997-98 tax return as incomplete simply because it contains provisional figures. We would prefer to process the return as received and then hold the taxpayer to the obligation to provide final figures as soon as they are available. We will do this by identifying all those returns which contain provisional figures. If the final figures are not provided by the expected date we will take appropriate action to obtain them and in some cases this will mean opening an enquiry. (The guidance in the 1998-99 returns has been clarified along the lines described above).

SCHEDULE D CASES I AND II ACCOUNTANCY EXPENSES ARISING OUT OF SELF ASSESSMENT ENQUIRIES

We have been asked to clarify the application of Statement of Practice 16/91 ('SP 16/91') to accountancy expenses incurred in connection with self assessment enquiries. We are currently considering the issues that have been raised and will consult with representative bodies before the statement is superseded. But there is one particular point that we would like to clarify immediately.

SP16/91 identifies the circumstances in which we will treat any additional '*accountancy expenses arising out of accounts investigations'* as an allowable deduction. It will be obvious from the quote in the previous sentence that the language used in SP16/91 does not reflect self assessment concepts and terminology, and for that reason alone needs to be updated. But the text of SP16/91 is deficient in one other important aspect. In practice we normally disallow accountancy expenses **only where the additional profits arise out of negligent or fraudulent conduct**. This is not stated explicitly in SP16/91. Instead SP16/91 simply refers to investigations which result in '*..a charge to interest or interest and penalties'*. This phrase is intended to imply some degree of culpability on the part of the taxpayer (so that, for example, the additional profits attract interest under Section 88 TMA and penalties under Section 95 TMA). But '*..without a charge to interest..'* could be read as denying a deduction where there is a charge to interest under Section 86 TMA, a charge which could arise in circumstances where there is no suggestion of negligent or fraudulent conduct at all. This is not the intention. We have no reason to believe that this ambiguity has caused any difficulty in the operation of SP16/91. But it becomes much more relevant in the context of self assessment, because there is now just the one interest charging provision, Section 86 TMA.

Until such time as SP16/91 is superseded the text below should be regarded as a statement of our practice, as it applies to self assessment enquiries.

Accountancy expenses arising out of self assessment enquiries

It is the practice to allow, in computing profits assessable under Case I and II of Schedule D, the normal accountancy expenses incurred in preparing accounts or accounts information and in assisting with the self assessment of tax liabilities.

Additional accountancy expenses arising out of an enquiry into the accounts information in a particular year's return will **not** be allowed where the enquiry reveals discrepancies and additional liabilities for the year of enquiry, or any earlier year, which arise as a result of negligent or fraudulent conduct.

Where, however, the enquiry results in no addition to profits, or an adjustment to the profits for the year of enquiry only and that adjustment does not arise as a result of negligent or fraudulent conduct, the additional accountancy expenses **will** be allowable.

USE OF APPORTIONMENT IN THE CALCULATION OF TRANSITIONAL OVERLAP PROFIT: PARA 2(4), SCHEDULE 20 FA 1994

We have been asked to state our view on the use of apportionments (under Section 72 ICTA 1988) in the calculation of transitional overlap profit (Para 2(4)Schedule 20 FA 1994, as amended by Section 122(2) Finance Act 1995).

Typically the examples referred to us concern a taxpayer who has made up accounts for the 12 months to 30.4.96, the 12 months to 30.4.97 and then the 11 months to 31.3.98. The basis period for 1997-98 is the 23 months to 31.3.98 and transitional overlap relief arises in respect of the period 1.5.96 to 5.4.97. Is the relief due 11/23rds of the profits of the basis period, or 11/12ths of the profit of the 12 month account to 30.4.97?

Our view is that the answer is 11/12ths of the profit of the 12 month account to 30.4.97 (or, more accurately, 340/365ths of that profit). In the absence of an account for the 11 months of the transitional overlap period itself a time-based apportionment of the 12 month account to 30.4.97 is the most accurate measure of the relevant profit available to us.

Example

12 months to 30.4.96	£19,000
12 months to 30.4.97	£24,000
11 months to 31.3.98	£15,000

The profit of the basis period for 1997-98 (the 23 months 1.5.96 to 31.3.98) is **£39,000** (Section 62(2)(b) ICTA 1988)

The profit of the transitional overlap period (the 340 days 1.5.96 to 5.4.97) is 340/365 x 24,000 = **£22,356** (para 2(4) schedule 20, FA 1994).

Strictly the overlap relief available on the change of accounting date to 31.3.98 is 335/340 x 22,356 = **£22,027** (Section 63A(1) ICTA 1988). But if the 31 March concession is adopted, to treat the change of accounting date as if a change to 5.4.98, the full **£22,356** may be deducted.

Assuming the 31 March concession is adopted the taxable profit for 1997-98 is (39,000 - 22,356) = **£16,644** (Section 63A(1) ICTA 1988)

[Note: There is a more detailed explanation of the general principles of apportionment in paras 1.17 to 1.20 of SAT1 (1995). The '31 March' concession is detailed at paras 1.98 to 1.99.]

RECORDING OVERLAP PROFIT CARRIED FORWARD FROM 1997-98: SECTION 63A ICTA 1988

The self assessment returns for 1997-98 include boxes which taxpayers should use to record any overlap profit (including any transitional overlap profit) carried forward to 1998-99. The boxes in question are box 3.77 in the self-employment pages and boxes 4.11 and 4.66 in the partnership pages. (There are also boxes for overlap profit brought forward from the previous year, and for the overlap relief used in computing the profits of the year.)

The boxes for amounts of overlap profit were provided as a convenient means for taxpayers to maintain an accurate record of the amount of relief that will be available in a future year. We have received reports that some agents (and taxpayers) are failing to make entries in the overlap profit carried forward boxes in cases where we would expect entries to be appropriate. Failure to make an appropriate entry does not mean that the entitlement to relief is lost as it ought to be possible to establish the correct position in a future year. But it would be preferable for all concerned if the correct figures were established in the year in which the overlap arises. Where a return has already been sent in a Section 9(4)(b) TMA 1970 amendment should be considered.

AMENDMENTS TO SELF ASSESSMENT RETURNS: ORIGINAL RETURN MADE NEGLIGENTLY OR FRAUDULENTLY: SECTION 9A(4) AND SECTION 12(AB)(2) TMA 1970

There appears to be a mistaken belief in some quarters that amending a self assessment under Section 9(4) TMA 1970, or a partnership statement under Section 12AB(2) TMA 1970, precludes penalty action by the Inland Revenue in relation to the incorrect figures included in the original return.

Self assessment does not alter our policy of considering the imposition of a penalty under Section 95 or 95A TMA 1970 whenever there is evidence that the taxpayer has acted negligently or fraudulently, **even if the error first comes to light as a result of an amendment under Section 9(4) TMA 1970, or Section 12(AB)(2) TMA 1970, rather than as the result of an enquiry under Section 9A TMA 1970**. Any such penalty would be based on the difference between the amount of tax correctly payable and the amount that would have been payable if the original return had been correct.

PAYMENTS UNDER CHARITABLE DEEDS OF COVENANT

We publish a booklet entitled 'Deeds of Covenant - Guidance for Charities' to help charities draw up tax effective Deeds of Covenant. The booklet

contains model Deeds of Covenant, but we are often asked for guidance on Deeds which have a different wording. We cannot comment on the legal validity of such Deeds but we can give a view on their effectiveness for tax purposes. This article clarifies our interpretation of the word 'like' in the phrase 'like annual payments' in Sections 347A(7) and 339(8) ICTA 88, and explains how a tax effective Deed can be written so as to include formula-based payments.

A payment made under Deed of Covenant to a charity is not effective for tax purposes unless it is a 'like' annual payment. We have interpreted this word, based on a series of tax cases, to mean that the covenantor must have a real and continuing commitment to make payments under the Deed, and that there must be a constant element in each payment made.

A series of payments of equal amount will satisfy this interpretation, but covenantors may be concerned that the value of their donations will decrease over the period of the covenant. One way to avoid this is to make an initial payment which is then uplifted in succeeding years by a set percentage, or in line with the Retail Prices Index. We have, however, advised charities and donors that payments are not 'like' if the Deed allows for an initial fixed payment followed by payments increased in accordance with a formula.

We have reconsidered this advice. We now accept that payments under a Deed of Covenant which allows for an initial payment followed by payments based on a formula are 'like' payments provided:

- the second and later payments are calculated under a formula which is applied to the initial payment; and
- the effect of the formula is to preserve the value of the second and later payments.

For example, we now accept that payments under a Deed of Covenant which allows for an initial payment of £50, with successive payments increased by a factor equal to the Retail Prices Index, would be 'like' payments.

Questions about this article or Deeds of Covenant should be addressed to:

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FLAT MANAGEMENT COMPANIES:

NEW CORPORATION TAX SCHEDULE A - RESIDENTIAL SERVICE CHARGES

Section 42, Landlord and Tenant Act (LTA) 1987 provides that contributions to variable service charges (and to sinking funds) in respect of residential property should be paid into a trust fund.

Under the old Corporation Tax Schedule A rules (which applied up to 31 March 1998), the Revenue took the view that service charges received by flat management companies were normally within the scope of Schedule A notwithstanding the provisions of Section 42 LTA 1987. This was because the charge under old Schedule A was based on the receipts to which a landlord was *entitled* in a chargeable period (old Section 15(1) paragraph 2 Income and Corporation Taxes Act (ICTA) 1988). However, where service charges received by occupier controlled flat management companies were matched over a period of up to five years by admissible expenses, no Schedule A charge was normally imposed (see Property Income Manual paragraph 5095 published externally under Open Government).

We have been asked whether the position has changed under the new Schedule A rules introduced by Section 38 and Schedule 5 FA 1998. Under new Schedule A, it is necessary to consider the profits of the Schedule A business (calculated, in the first instance, in accordance with Schedule D Case I rules and correct accountancy principles). As from 1 April 1998, residential service charges received by occupier controlled flat management companies will ordinarily be outside the scope of Schedule A since, under correct accountancy principles, it will not usually be correct to include in the computation of profits sums to which the landlord is not beneficially entitled.

Consequently, where residential service charges are received by an occupier controlled flat management company for periods subsequent to 31 March 1998, such sums will ordinarily be received as capital in the landlord's capacity as trustee (under Section 42 LTA 1987). Investment income arising on such sums held in a designated bank account will be chargeable on the trustee at the rate applicable to trusts (Section 42 contains an implied power to accumulate).

Rents receivable by flat management companies (such as ground rents - other than peppercorn rents) are outside the scope of Section 42 LTA 1987 and remain chargeable under Schedule A.

This article sets out the line the Revenue will take for all flat management companies as from 1 April 1998 but no action will ordinarily be taken to disturb the treatment accepted on specific cases prior to that date.

Where a trust return has not previously been made by flat management companies of investment income arising from a fund within Section 42 LTA 1987 (or from funds otherwise specifically held on trust), the trustees will have the normal obligation to notify chargeability.

miscellaneous

CERTAIN INDIVIDUALS COMING TO THE UK FOR EMPLOYMENT : YEAR OF ARRIVAL

Individuals coming to the UK for the purpose of employment and who:

- remain not resident and not ordinarily resident in the UK for the whole of the year of arrival, and
- are not entitled to claim UK personal allowances under either
  - Section 278 Income and Corporation Taxes Act 1988, or
  - the terms of a Double Taxation Treaty

should strictly be coded OT for the year of arrival. This code gives no personal allowances, but does give effect to the lower and basic rates of tax.

Until recently, such individuals have been allocated either the emergency code, or a code giving full personal allowances on a Week 1/Month 1 basis. Unfortunately this does not result in the correct tax deductions under PAYE and further tax is likely to arise when such individuals calculate their tax due under Self Assessment. So tax offices are now allocating code OT to these individuals for the year of arrival. This should ensure that the correct tax deductions are made for the year.

There is to be no change to the treatment we have applied in respect of those non-resident individuals who are entitled to claim personal allowances.

LLOYD'S UNDERWRITERS 1994 UNDERWRITING ACCOUNT

Most professional advisers who act on behalf of underwriting members of Lloyd's (traditionally known as Names) will be aware that the tax adjusted syndicate results have not yet been agreed for the 1994 account.

A major aspect of examining syndicate accounts is considering how much of the re-insurance to close (RITC) premiums paid by syndicates are allowable deductions in arriving at the profits for tax purposes. One of the issues under discussion is whether the allowable deduction should be restricted to the net present value of the reinsured liabilities, to reflect the fact that the syndicate to whom the premium is paid (the reinsurer syndicate) will receive the investment return on the premium. This principle is referred to as discounting. The effect of discounting is to increase the profit of a syndicate paying an RITC, and to correspondingly reduce the income of the reinsurer syndicate.

For syndicates where agreement has not been reached the Revenue has issued a determination of the taxable profits based on its view of how much of the RITC premium is allowable for tax purposes. Syndicate managing agents have the right to appeal against these determinations (although the Names who are members of the syndicate do not) and these appeals can either be settled by agreement or be determined by the Commissioners.

Lloyd's Members Services Unit (MSU) have issued taxation advices (forms CTA1) to Names which show the two profit figures, one using the Revenue determinations, and the other based on syndicate managing agents' views of the tax adjusted results. The results for the 1994 account are reported by Names on self assessment returns for the year ended 5 April 1998. The Revenue has been asked by taxpayers and their advisers how the discussions regarding the 1994 syndicate result will affect the Lloyd's Pages of their self assessment returns and the answers to some of the more common questions are shown below:

Which of the two figures on the CTA1 do I show on my self assessment return?

The figures on the CTA1 show the upper and lower limits between which the final figure should fall.

When completing the syndicate results box on your Lloyd's Pages you should decide where between those limits you think your figure for syndicate profits will lie. This will be a **provisional** entry on the tax return and you should tick box 22.3 to show that this is the case. Advice regarding provisional figures can be found at page 27 of the Self Assessment Tax Return Guide for the year ended 5 April 1998.

If the final figure is higher than the provisional figure included in my return will I pay interest on the additional tax due on the difference?

Yes, interest is payable on any additional tax from 31 January 1999.

If the final figure is lower than the provisional figure included in my return, will the Revenue pay interest on the excess tax paid on the difference?

Yes, repayment interest will be paid by the Revenue on any excess tax paid as a result of using a provisional profit that is higher than the final agreed figure.

What about surcharge?

Once the amended tax calculation has been issued you have 30 days to pay the additional tax. No surcharge will be payable if the additional tax is paid in full within 28 days of the due date. Thereafter, surcharge at 5% is levied on any part of the additional tax that remains unpaid 28 days after it fell due for payment.

When the final figure is available what do I do?

If the final figure is available by 31 January 1999 you should amend your 1997-98 self assessment in the normal way. Where the final figure becomes available after that date you should notify the Revenue of the agreed figure as soon as you receive the taxation advice (form CTA1) from Lloyd's MSU. We can then amend the 1997-98 assessment to reflect the final figures (there is specific legislation at paragraph 7 Schedule 19 FA93 which allows amendments to assessments which are necessary as a result of adjustments to syndicate determinations).

It is important that any revised figure is notified to the Revenue as quickly as possible. If there is undue delay, say beyond 3 months after the issue of the final CTA1, you may be liable to pay a penalty.

I have paid pension contributions on the basis of the provisional figure I included in the Lloyd's Pages:

(i) if the final profits are higher than the provisional figure I used can I increase my contributions in order to obtain additional tax relief?

Relief cannot be gained on contributions paid outside the normal time limits.

(ii) if the final profits are lower than the provisional figure I used what happens to the contributions that no longer qualify for relief?

Any excess premiums paid under a personal pension scheme should be repaid by the scheme administrator.

If pension payments have started before the final figure is available you will need to contact the Revenue so that the level of payments can be reviewed by the scheme administrator.

Will I need to make any changes to the transfer I have made to my New Special Reserve Fund (NSRF)?

No, the amount you can transfer to your NSRF from the profits of the 1994 account is based on the **commercial** results (which are not affected by the discounting question) and not the tax adjusted results.

MEMBERS CLUBS, SOCIETIES AND VOLUNTARY ASSOCIATIONS

Following the introduction of CT Pay & File in 1993, members clubs and similar organisations which exist primarily for recreational and other non commercial purposes (subsequently referred to as, "clubs") have often been required to make an annual corporation tax return and account for small liabilities.

For many of these clubs their only taxable income is investment income which is taxed at source and prior to April 1996 they had no further tax to pay. However, since that date when the rate of tax deducted at source on some savings income was reduced to 20 per cent, they have been left with small net liabilities of just a few pence, to account for the shortfall with the small companies rate of corporation tax.

Following a review, the Revenue issued fresh guidance to all tax offices so that where certain criteria are met annual returns will no longer be sent to clubs to account for trivial liabilities.

This will also apply in certain circumstances to property management companies, although it specifically excludes any income arising on sinking funds and other assets held on trust. For more information on this subject please see the article on Flat Management Companies on pages 598.

The guidance material is included in the corporation tax instructions at paragraph CT11328. It lists the types of clubs which are specifically excluded, and also the range of requirements which eligible clubs must fulfil. For example any club which provides financial facilities or carries on a trade is excluded.

We still receive occasional complaints from agents and club officials that there is inconsistency in the treatment of these cases, and if readers believe that they have found an instance of that, they should refer the local Inspector to this article.

PENSION SCHEMES OFFICE SYNOPSIS OF UPDATES

The Pension Schemes Office (PSO) has issued several further Updates to all customers on the PSO Mailing List. Updates No 39 and 40 were issued on 25 February, Updates No 41 and 42 on 17 March and Updates No 43 and 44 on 22 April.

Update No 39 is about the following matters:

- Announcing the commencement of a data capture exercise as a result of which the PSO will move over a period of around 4 years to paperless files for the bulk of the 1.15 million records held. At present there are no plans to include

self-administered schemes, self-managed funds or insured schemes that are subject to the Pension Scheme Surpluses (Valuation) Regulations 1987 in the exercise.

- Reminding administrators and insurance companies of the requirements under the Information Powers Regulations (SI 1995 No 3103) to report details of certain chargeable events on forms 1 (SF) and 2 (SF), within specified timescales, otherwise penalties may be imposed.

- Enclosing a questionnaire seeking the views of customers on the level of service provided by the PSO.

- Announcing an easement in relation to the signing of report forms required under the Information Regulations. Where the administrator is more than one person the PSO are prepared to accept forms signed by just one of those persons on behalf of the others provided written authorisation to that effect is received by the PSO with the first such notification.

Update No 40 is concerned with two-stage transfer/benefits payments and supplementary transfer payments. Where a scheme is being wound-up and it is not possible to provide the whole of a member's entitlement at, for example, the time of payment of a transfer to another scheme, or at the time the benefits under the scheme are due to be paid, the Inland Revenue will not object to a scheme making a transfer in two instalments or revisiting the calculation of benefits in payment and, if a further entitlement is found to arise, paying additional benefits, provided Inland Revenue limits are not exceeded. Also, where a member's rights have been transferred or bought-out and a two-stage transfer was not contemplated, the Inland Revenue will have no objection to the making of a supplementary payment in certain specific situations, for example where a scheme receives a further payment from the Occupational Pensions Regulatory Authority (OPRA) or Department of Social Security (DSS).

Update No 41 reports details of the main measures announced in the Budget to stop abuses of the pensions tax reliefs by some pension schemes. These include countering attempts to avoid the 40% tax charge under Section 591C Income and Corporation Taxes Act (ICTA) 1988 when certain retirement benefits schemes lose their approval and, in relation to small self-administered schemes, strengthening the role of the pensioneer trustee. The Update also covers a number of other matters including some discretionary practice changes associated with the anti avoidance measures, the announcement of the increase in the "permitted maximum" under Section 590C ICTA 1988 to £87,600 for the year 1998-99 and various Budget changes applicable to personal pension schemes. The Budget changes are now incorporated in the Finance Act 1998.

Update No 42 announces the revision of the de minimis limit which is contained in the Association of British Insurers (ABI) Guidance Notes "Maximum Permissible Funding Rates on Earmarked Contracts" and is referred to in paragraph 13.9 of the Practice Notes IR12 (1997). The Update also provides clarification of the position regarding continuous service and concurrent employments in an attempt to reduce inappropriate claims for continuous service in respect of controlling directors where the employments have been concurrent rather than consecutive.

Update No 43 sets out the Inland Revenue's views of the consequences of foreclosure on loans made direct to the employer, in relation to a wholly insured scheme, by the Life Office and the actions that are expected from the trustee(s) of the scheme if approval of the scheme is not to be lost.

Update No 44 is concerned with customer service issues. It makes an apology to customers on the PSO Mailing List who have experienced problems in relation to the receipt of Updates; it sets out the PSO's main performance results for 1997-98 and the Office's targets for 1998-99; advises of the application by the PSO for the renewal of the Charter Mark; and sets out all the relevant enquiry numbers that customers may wish to contact in the PSO.

Inland Revenue Statements of Practice and Extra-Statutory Concessions issued between 1 August and 30 September 1998

Extra Statutory Concessions

Number	Title	Date of Issue
C31	Scientific Research Associations	04/09/98

Statements of Practice

02/98	Business By Telephone	24/08/98

You can get copies of SPs and ESCs from Christine Jordan at the Inland Revenue Information Centre, Ground Floor, South West Wing, Bush House, Strand, London WC2B 4RD. Telephone 0171 438 7772

CONTENT

The content of Tax Bulletin gives the views of our technical specialists on particular issues. The information published is reported because it may be of interest to tax practitioners. Publication will be six times a year, and include a cumulative index on an annual basis.

- You can expect that interpretations of the law contained in the Bulletin will normally be applied in relevant cases, but this is subject to a number of qualifications.
- Particular cases may turn on their own facts, or context, and because every possible situation cannot be covered, there may be circumstances in which the interpretation given here will not apply.
- There may also be circumstances in which the Board would find it necessary to argue for a different interpretation in appeal proceedings.
- The Bulletin does not replace formal Statements of Practice.
- The Board's view of the law may change in the future. Readers will be notified of any changes in future editions.

Nothing in this Bulletin affects a taxpayer's right of appeal on any point.

Letters on any article appearing in Tax Bulletin should be sent to the Editor, Jeremy Sherwood, Room 402, 22 Kingsway, London WC2B 6NR. We are sorry though that neither he nor our contributors will normally be able to enter into correspondence about Tax Bulletin or its contents.

SUBSCRIPTION

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