

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HMRC</b>	<b>Title:</b> <b>Impact Assessment of repeal of obsolete anti-avoidance legislation</b>	
<b>Stage:</b> Final	<b>Version:</b> One	<b>Date:</b> 12 March 2008
<b>Related Publications:</b> Anti-avoidance Simplification Review: Simplifying Anti-avoidance Legislation		

**Available to view or download at:**

<http://www.hmrc.gov.uk>

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**What is the problem under consideration? Why is government intervention necessary?**

The Government announced a simplification review of anti avoidance legislation in its 2007 Pre-Budget Report. The preliminary work on this review identified four pieces of anti avoidance legislation which are now obsolete and which could therefore be repealed, removing unnecessary burdens on businesses and charities.

**What are the policy objectives and the intended effects?**

The policy objective is to reduce the burden on businesses and charities from their obligation to comply with rules under which there is no longer any significant tax at risk.

**What policy options have been considered? Please justify any preferred option.**

- (1) "Bond Washing" : repeal the relevant legislation at sections 731 to 735 and at section 736 of the Income and Corporation Taxes Act 1988. The repeal will have no measurable tax consequence and will reduce charities' annual administrative costs by around £400,000.
- (2) "Dividend Stripping": repeal section 704, paragraph B of the Taxes Act 1988 and its equivalent in the Income Tax Act 2007.
- (3) "Employment Securities": repeal 7 pages of legislation to deal with cases where securities were acquired at times before 26 October 1987 where liabilities are now unlikely to arise

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** Anti avoidance legislation is kept under constant review as new circumstances arise. Compliance costs are routinely reviewed 1-3 years after implementation.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of this policy, and (b) the benefits justify the costs.***

Signed by the responsible Minister:

Jane Kennedy.....Date: 11 March 2008

## Summary: Analysis & Evidence

Policy Option: 1

Description: Repeal of obsolete anti-avoidance legislation

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups'
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	<b>£ 0</b>		
	<b>Average Annual Cost</b> (excluding one-off)		
	<b>£ 0</b>		<b>Total Cost (PV)</b> <b>£ 0</b>
Other <b>key non-monetised costs</b> by 'main affected groups' These reforms should not impose any costs on either businesses or charities, nor on HMRC.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' The primary saving will be in reduced compliance costs for large charities and certain insurance companies. This is because they will no longer have to routinely run extensive internal audits of financial assets in order to check that they are complying with these aspects of the CT legislation.
	<b>One-off</b>	<b>Yrs</b>	
	<b>£</b>		
	<b>Average Annual Benefit</b> (excluding one-off)		
	<b>£ 400k</b>		<b>Total Benefit (PV)</b> <b>£ 400k</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' This will strengthen the perception among charities that we are sensitive to their business needs and will act quickly when issues are raised with HMRC.			

**Key Assumptions/Sensitivities/Risks** The estimates of potential compliance savings are based on the known costs of recent audits by some very large incorporated charities. These costs have been extrapolated to the full population of charities and trusts that may be affected in order to arrive at the total potential saving

Price Base Year 2008	Time Period Years 0	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £ 400k
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What is the geographic coverage of the policy/option?			
On what date will the policy be implemented?			
Which organisation(s) will enforce the policy?			
What is the total annual cost of enforcement for these organisations?		£ not applicable	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		Not applicable	
What is the value of the proposed offsetting measure per year?		£ not applicable	
What is the value of changes in greenhouse gas emissions?		£ not applicable	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium      Large
Are any of these organisations exempt?	No	No	No      No

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)	
Increase of    £ 0	Decrease of    £ 0	<b>Net Impact</b>	<b>£ 0</b>

Key:      Annual costs and benefits: Constant Prices      (Net) Present Value

## Evidence Base (for summary sheets)

### Background

1. Introducing anti-avoidance legislation into the direct tax system is nothing new. The settlements legislation, which was the subject of the Arctic Systems case, dates from 1922 and other legislation from the 1930s is still on the statute book. More of the current anti-avoidance legislation dates from the 1960s. Some of this was in response to the then approach of the courts which was to take an extremely literal view of tax law and there were also major changes in the taxation system.
2. We have concentrated in our review on legislation dating from periods up to 1970: this is because in many cases tax law has changed so much that many of the provisions from then no longer seem to have any useful part to play, at least in the form they currently stand.
3. There are three areas we have looked at. They relate to transactions in shares (often referred to as 'bond washing'), primarily by financial dealing companies like banks, insurance companies and share dealers or as employment rewards. Each of these areas is considered in turn below.

### Bond washing

4. A particular issue of concern was the ability of a financial dealer to (a) buy shares which were "cum-div" (i.e. on the point of paying a dividend) (b) receive the dividend and (c) sell the shares. Shares which pay a dividend generally decrease in value as a result by an amount roughly equal to the dividend.
5. Before 1973 dividends were received after income tax had been deducted but the drop in value was usually greater than the net dividend received. The transaction therefore would usually give rise to a small loss pre-tax.
6. But at that time dividends were not taxable on a financial dealer and so, for tax purposes, the dealer could claim a loss equal to the difference between the cost of the shares and their sale price, without taking the dividend into account. It could then claim to set that loss against the dividend and claim back the tax that had been deducted. In this way its after-tax result was higher than its pre-tax result and the company made a profit at the government's expense.
7. Legislation was introduced to prevent this. But in 1997 all dividends received by financial dealers in the course of their business (with the exception of some insurance companies) became chargeable to tax. The earlier legislation therefore became completely unnecessary.
8. In addition there were provisions preventing a body which was exempt from tax (pension fund or charity for example) from buying shares cum-div, receiving the dividend and reclaiming the tax. This activity also no longer works since payable tax credits were abolished in July 1997. This legislation, however, actually imposes a charge to tax on exempt funds - but the burden of showing this requires the examination of all share transactions, some of which may have been carried out by

different investment managers, and is an enormous burden on exempt bodies for very little result.

9. The repeal will take about 1 page of Finance Bill space but will remove 12 pages and take away major compliance burdens from exempt funds (mainly charities) and financial dealing companies.

### **“Transactions in securities”**

10. This is a targeted anti-avoidance rule dating from 1960. The 1950s saw a great deal of extremely complex and detailed anti-avoidance legislation to deal with transactions involving shares and securities. These transactions were generally known as “dividend stripping”. In 1960 the Government decided on a then radical course of introducing what it described as a “general anti-avoidance rule” relating to transactions in securities.
11. These provisions were identified as being among the most complex and difficult to understand legislation; and, in particular, being legislation which imposes a huge compliance burden on business. The reason for this is that the legislation is cast in extremely wide terms, but contains a let-out for genuine commercial transactions not entered into for a tax avoidance purpose and a clearance procedure to enable HMRC to say that a transaction will not be affected. As a result a very large number of clearance applications are made purely as a precaution.
12. We have examined the legislation to see if there are any provisions which can be repealed, primarily with a view to reducing the compliance burden.
13. The legislation sets out five circumstances in which it might apply. There are three circumstances which apply to all companies and deal with specific types of transaction including dividend stripping; and there are two others which deal with much more general transactions involving the conversion of what would be income receipts into a non-taxable capital receipt. These latter provisions apply only to companies under the control of five or fewer people.
14. We think these latter provisions still have a role to play. The dividend stripping etc. provisions seem to have a far narrower field of application. We have identified one circumstance where it is clear that the legislation is now wholly redundant and we are repealing that alongside the repeal of the bond-washing legislation.

### **Employment securities rules**

15. We have a modern system of taxation of securities obtained in the course of employment in Part 7 of the Income Tax (Earnings and Pensions) Act 2003. It is now very effective, especially following the Paymaster-General’s announcement of 2 December 2004 which threatened to close down schemes that exploit it retrospectively.
16. The current system replaced two previous ones – one dating from 1972 and one dating from 1987. However, some of the provisions of the first system still remain on the statute book to deal with cases where securities were acquired at times before 26 October 1987. Given the negligible likelihood of employment-related securities of this age having yet to give rise to an income tax charge, we feel these are now wholly redundant.

## **Costs/benefits**

17. There are no significant costs to either taxpayers or HMRC
18. Anecdotally we are aware that one large charity incurred a compliance cost in the region of £100,000 to establish that it had a liability of only £10,000 arising from the application of the bond-washing legislation
19. There could be up to 200 large incorporated charities and trusts that this legislation may affect or have affected at one time or another. Hence the potential benefits of removing this legislation may be significant. We have assumed a tentative (and slightly conservative) estimate of a £400,000 reduction in aggregate compliance costs per annum. There is no impact on HMRC's admin burden baseline as measured by the Standard Cost Model.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Note: HMRC has considered each of the above tests, but none of the issues mentioned is significantly affected by this reform.