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# Money Laundering Regulations 2003

The Money Laundering Regulations 2003 came into force, in the main, from 1st March 2004. The regulations were accompanied by Orders to amend the provisions on money laundering and terrorist finance in the Proceeds of Crime Act 2002 and the Terrorism Act 2000.

This legislation imposes some important new obligations upon professionals from a wide range of sectors, including Tax advisers, Accountants, Auditors, Insolvency Practitioners and Legal advisers. These obligations relate to the need of such professionals to make reports to the authorities on money laundering and the need to have systems in place to train staff and keep records.

## Introduction

Under Section 330 of the Proceeds of Crime Act 2002 (POCA 2002) individuals carrying on "relevant business" may be guilty of an offence of failing to disclose knowledge or suspicion of money laundering where they know or suspect, or have reasonable grounds for knowing or suspecting, that another person is engaged in laundering the proceeds of crime. This concerns the proceeds of all crime including all acts of tax evasion and fraud.

In addition to the obligation to report, there are three further money laundering offences:

- concealing criminal proceeds;
- assisting another person to retain criminal proceeds; and
- acquiring, possessing or using criminal proceeds.

These "principal money laundering offences" have been in force since 24 February 2003, and apply to any individual or business.

## Consent

The legislation also contains provisions whereby consent may be necessary from NCIS to proceed with a transaction. Where consent is required, time limits have been introduced for the handling of applications. From the working day after consent has been sought, NCIS have undertaken a seven working day notice period in which to either issue or withhold consent. If consent is withheld, law enforcement have a further 31 calendar day moratorium period in which to obtain a restraint order. If neither deadline is met, the person who made the disclosure may proceed with the transaction or continue with the arrangement without committing an offence.

*Tax Bulletin is also available on the  
Inland Revenue Website at  
[www.inlandrevenue.gov.uk/bulletins](http://www.inlandrevenue.gov.uk/bulletins)*

## Relevant business

The Money Laundering Regulations 2003 and accompanying Orders expanded the categories of those carrying on relevant business and falling within the Regulated sector. With effect from 1st March 2004, these categories now include:

- Estate Agency work;
- Casino operators;
- Insolvency practitioners;
- Tax advisers (providing by way of business advice about the tax affairs of another person);
- Accountants (providing by way of business accountancy services);
- Auditors (providing by way of business audit services by a person who is eligible for appointment as a company auditor under section 25 of the Companies Act 1989(c) or Article 28 of the Companies (Northern Ireland) Order 1990(d));
- Legal advisers (providing by way of business legal services which involve participation in a financial or real property transaction);
- Company formation agents (providing by way of business services in relation to the formation, operation or management of a company or trust). This has not been intended to include anyone who assists in the management or operation of that company;
- Dealers in high value goods (by way of business whenever a transaction involves accepting a total cash payment of 15,000 Euro or more). Please note that for high value dealers the regulations will not come into force until 1 April 2004.

In practice a wide variety of business has been brought in the regulated sector such as certain jewellers and car dealers. Businesses may need to seek legal advice to understand the implications of the new legislation for their activities, notably whether or not they fall within the expanded Regulated Sector.

Reports, including those concerning suspicion of tax evasion, are to be made to the National Criminal Intelligence Service (NCIS) on a Suspicious Activity Report form(s).

## Suspicious Activity Report forms (SAR)

With effect from 1st March NCIS have updated and improved the SAR form(s). These can be downloaded from their website at [www.ncis.co.uk/disclosure.asp](http://www.ncis.co.uk/disclosure.asp).

In particular a Limited Intelligence Value report has been introduced for use in circumstances where the information being reported is likely to be of limited intelligence value. The NCIS website provides guidance on the types of circumstances where this abbreviated report can be used.

## Inland Revenue Enquiries and Hansard

Reports that concern evasion of direct tax or NICs, and that are not linked to wider criminality, will be forwarded by NCIS to the Inland Revenue as the investigating body and, in England and Wales, the prosecuting body for these offences. (In Scotland the Procurator Fiscal and in Northern Ireland the Director of Public Prosecutions are the prosecuting bodies).

Inland Revenue enquiries that result will be carried out in the same manner as any other Inland Revenue enquiry. In particular reporting a case to NCIS ahead of notifying the Revenue will have no bearing on how the Revenue may treat a case, if the taxpayer is actively seeking to set their affairs straight. This also applies to cases dealt with under the Inland Revenue approach to civil settlements known as 'Hansard'.

## Marker letters

Where an Agent is acting for a client who wishes to make a voluntary disclosure to the Revenue of their tax evasion the Agent is still required to submit a Suspicious Activity Report to NCIS. As the requirement to submit the Suspicious Activity Report is "as soon as is practicable" (section 330 POCA 2002) this is likely to be before the Agent is in a position to approach the Revenue, on behalf of their client, with full details of the extent of the tax evasion committed.

A number of the professional accountancy and taxation bodies have suggested that Agents in these circumstances, having obtained their client's permission, may wish to send a "marker letter" to the Revenue. This is so that the Revenue knows of their client's intention to make a voluntary disclosure. The "marker letter" will be sent at the same time or shortly after making the report to NCIS. It will provide a date by which the Agent expects, on behalf of the taxpayer, to provide the Revenue with a full disclosure.

In order to ensure that these letters are properly dealt with, Agents sending a "marker letter" are requested to send these to:

SDS Compliance  
Centre for Revenue Intelligence  
Financial Investigation Unit  
Ground Floor  
Ty Glas Road  
Llanishen  
Cardiff  
CF14 5ZG

An acknowledgement letter will be sent to the Agent to confirm receipt.

## Further guidance

Further guidance on the Proceeds of Crime Act 2002 can be found in Issue 13 (June 2003) of Working Together magazine. Guidance is also available on the Home Office ([www.homeoffice.gov.uk/crimpol/oic/proceeds/index.html](http://www.homeoffice.gov.uk/crimpol/oic/proceeds/index.html)), Treasury ([www.hm-treasury.gov.uk/moneylaundering](http://www.hm-treasury.gov.uk/moneylaundering)) and NCIS ([www.ncis.gov.uk](http://www.ncis.gov.uk)) websites.

In addition the professional accountancy and taxation bodies and the Law Society have published extensive guidance in this area.

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## EU Enlargement and NICs

10 new countries join the EU from 1 May 2004. They are **Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia**. This article covers the NICs treatment of people going to those countries from the UK and the treatment of people coming to the UK from the new Member States.

All EU member states have the option of imposing restrictions on free movement of workers from these new member states, with the exception of Cyprus and Malta. Work restrictions do not apply to these two countries.

On Monday 23 February 2004, the Home Secretary made a statement to the House of Commons announcing that workers from the **Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia** will be allowed access to the UK labour market via a **workers registration scheme which will operate from the 1 May 2004 onwards**.

Further information on the registration scheme will be available on the Home Office website shortly, along with details of the forthcoming changes the Government will be making to the law on preventing illegal working- section 8 of the 1996 Asylum and Immigration Act.

You should check the following section of the Home Office's website if you require further details on the new workers registration scheme:

<http://www.ind.homeoffice.gov.uk/default.asp?PagelId=2648>

From 1 May 2004 the UK will - for NICs - apply the same European Community Regulations which apply to migrant workers moving between existing EU Member states.

- Workers coming to work in the UK from the new Member States will pay National Insurance on the same basis as UK workers and others from the EU.

- Posted workers from the new Member States who are sent here to work by their employer in their home State may be covered by form E101 keeping them insured in their home States. Where a person has a valid E101 there will be no UK NIC liability.
- Employees sent by their UK employers to work in the new Member States will be eligible for the Form E101 to confirm they continue to pay NICs and are therefore covered for benefits in the UK. E128 will also be provided for health care purposes.
- The UK already has Reciprocal Agreements with **Malta, Slovenia and Cyprus** which provide for "certificates of posting" - exempting certain posted workers from NICs. The UK will honour any certificates which, at 1 May 2004 still have time to run.

## The EU legislation

Article 42 of the EC Treaty, EC Regulation 1408/71 and 574/72 govern the Social Security treatment of workers who move between Member States. The regulations co-ordinate the Social Security schemes of the Member States and, amongst other things, are intended to prevent clashes of national rules or gaps in social security cover that might discourage free movement of workers.

- The EC Regulations apply to employed and self-employed people who move between Member States to work. The regulations are directly applicable in the UK and modify the way that the UK's Social Security legislation applies to people moving between Member States and the UK.
- The basic rule is that a person must be insured (and pay contributions) in the State where they work. (Article 13 EC Regulation 1408/71).
- There is a system of certificates - the E101 to keep people insured in their home State, when they are sent by their employer in their home State to work in another Member State and the work is not expected to last longer than 12 months, and the person has not been sent to replace another employee whose contract has ended (Article 14 EC Regulation 1408/71).
- Form E101 may be extended, for a further 12 months, using form E102.
- There are special rules for certain groups of people e.g. mariners and civil servants, and people who normally work in several countries.
- The EC Regulations over-ride liability conditions in the UK's Social Security Contributions Regulations 2001 - particularly the "52 week" waiting period before liability starts for certain not ordinarily resident people working for

foreign employers, and for certain types of foreign students, and the “52 week” limit on NICs liability for people sent from the UK to work abroad.

**The EC Regulations can be quite complex. This article only looks at the most common scenarios but more detailed guidance on the NICs rules for workers moving between the UK and the EU can be found in the Inland Revenue’s National Insurance Manual, which is available at**

[www.inlandrevenue.gov.uk/manuals/nimmanual/nim33000.htm](http://www.inlandrevenue.gov.uk/manuals/nimmanual/nim33000.htm)

From 1 May 2004, NIM 33003 will be updated to add the accession States to the list of Member States. A revised list of EEA and Reciprocal Agreement States is reproduced at the end of this article.

## Guidance on Common Scenarios

### INCOMING

#### Workers coming to work in the UK from the new Member States

##### Example 1

**Svetlana comes to the UK from Estonia to work for a UK retail company.**

No change. Svetlana and her employer are liable to pay contributions in the UK. She should obtain an NI Number from her local Department of Work and Pensions / JobCentre Plus office and the employer should operate NICs as they would for their UK employees.

#### Workers Posted to the UK by their employer in their Home State

##### Example 2

**Rula is ordinarily resident in Poland and normally works for a Polish software company in Warsaw. Her employer sends her to the UK to work temporarily as a programmer in their UK subsidiary.**

Before 1 May 2004, Rula would have been exempt from NICs for the first 52 weeks of work in the UK by virtue of Regulation 145(2), which applies to people who are not ordinarily resident nor ordinarily employed in the UK and who work temporarily in the UK in pursuance of their employment outside the UK, for an employer with no place of business in the UK.

The exemption does not apply where the person comes from an EEA, RA or DCC country.

After 1 May 2004, if the posting is expected to be for less than 12 months, Rula may be eligible for an E101 from her home State exempting her from NICs and keeping her insured in Poland.

Without a valid E101, showing that she is insured in Poland, the UK will apply Article 13 and require Rula to pay contributions in the UK from the outset.

EC Regulations over-ride Regulation 145(2) so that Rula is not left without Social Security cover or gaps on her contribution record.

Rula provides personal service for the benefit of a UK “host” employer. The UK host employer is therefore responsible for deducting Rula’s NICs and are the secondary contributor responsible for paying employer contributions. (Paragraph 9 to Schedule 3 of the Social Security (Categorisation of Earners) Regulations 1978).

### Students from the new EU countries

#### Example 3

**Frank is ordinarily resident in the Czech Republic and a full - time Agronomy student in Prague. During his summer vacation he comes to the UK on a temporary basis to work on a farm in the UK.**

Before 1 May 2004, Frank would have been exempt from NICs under a rule in regulation 145 (3)(a) SSCR 2001. For certain students the first 52 weeks of employment in the UK is exempt from NICs. The exemption does not apply to people from EEA, RA or DCC countries.

The conditions for exemption are that the student must be:

- employed under a contract of service; and
- not ordinarily resident in the UK; and
- pursuing a course of full time study outside the UK; and
- employed temporarily in the UK during a vacation from that course; and
- employed in an employment, that is of a nature “similar or related to” the course of studies.

From 1 May 2003, the exemption in regulation 145 (3)(a) will not apply to people from States joining the EU and they and their employers will be liable to pay NICs from 1 May 2004 onwards.

This change will be of particular interest to UK farmers who are currently the main group employing students from the new EU States.

## OUTGOING

### UK employee posted to a new Member State

#### Example 4

**David is ordinarily resident in the UK, employed in the UK and is then posted by his employer to Latvia on a temporary basis, for 11 months, to set up a subsidiary there.**

Before 1 May 2004 David and his employer in the UK would have been liable to pay NICs in the UK ( Regulation 146 SSCR 2001).

From 1 May, under Article 14.1(a) EC Regulation 1408/71 David can continue to pay in the UK (and remains insured here) because he is employed by an employer in his home State and his posting is not expected to last for more than 12 months from the outset. Employers sending employees temporarily from the UK to the new Member States can apply for Form E101 and the health form E128, to keep their employees insured here in the UK.

Without an E101 from the UK, another Member State is likely to deduct Social Security contributions from UK employees working in their territory.

#### Example 5 - Long posting

##### **What if David's posting is expected to last for 3 years at the outset?**

David is to be insured in Latvia.

The basic rule in the EU is that a person is to be insured in the State where they work, (Article 13) so David would pay contributions and be insured in Latvia rather than the UK.

Because the posting is expected to be more than 12 months at the outset, David does not meet the criteria for an E101 to be issued under Article 14.

Where David pays contributions in Latvia, EC Regulations override the requirement in Regulation 146 Social Security Contributions Regulations 2001 to pay in the UK for the first 52 weeks of his employment outside the UK.

Exceptionally it may be possible to keep David insured in the UK scheme and issue him with E101s. This would need to be by special agreement between the UK and Latvian authorities. David's employer can apply to the Centre for Non-Residents.

### What if the employee is overseas longer than expected?

#### Example 6

**Susan is posted to Hungary to work for her UK employer. The job takes longer than expected and she is in Hungary for 18 months rather than the expected 12 months.**

Where the work continues for more than 12 months due to unforeseeable circumstances there is scope under Article 14 to issue further E101s for up to a further 12 months. The employer must apply to the Centre for Non-Residents for renewal before the old E101 expires, and the issue of further E101s is subject to the agreement of the other Member State.

##### **What if an employee is already out in one of the new States at 1 May 2004 - Can they get an E101?**

#### Example 7

**Henrietta normally works in the UK and is sent by her UK employer to work in Prague for 10 months. At 1 May 2004 she has already been in the Czech Republic for 4 months and has 6 months of her posting remaining.**

Henrietta is entitled to remain insured in the UK and be exempt from Czech contributions. [Article 14] Her employer can apply for an E101 and E106 to cover her whilst she is in the Czech Republic. The E101 will prevent Henrietta having to pay Czech contributions.

Providing they meet the normal conditions for issue of an E101, the UK will issue E101s to those UK employees already working in the new Member States.

### More about E101s

The E101 is obtained by the employer on behalf of the employee from the home Social Security authorities prior to posting and is valid for up to 12 months.

The basic conditions that must be satisfied are:

- the employee is sent by the employer in the home State to undertake work for that employer in the host State;
- the work is expected to last less than 12 months at the outset;
- the worker is not replacing another employee who has completed a tour of duty abroad.

There are also some other conditions requiring that the employer applying for the E101 must have significant business activities in the sending State.

**Employers sending employees to the EU and who require E101s or information can contact the Centre for Non-Residents (CNR):**

- visit <http://www.inlandrevenue.gov.uk/cnr/osc.htm>
- phone from within the UK: 0845 9154811 or fax 0845 9157800 (calls charged at BT local rate);
- from outside the UK: by dialling the international code then: phone 44 191 225 4811 or fax 44 191 225 7800

## The Revised list of EEA (EU and EFTA) States, Reciprocal Agreement countries and Double Contribution Conventions

### 1. EEA

#### EU Members

Austria	France	Italy	Republic of Ireland
Belgium	Germany	Luxembourg	Spain
Denmark	Gibraltar	Netherlands	Sweden
Finland	Greece	Portugal	UK

Cyprus	Hungary	Malta	Slovenia
Latvia	Poland	Estonia	Czech Republic
Lithuania	Slovakia		

From 1/6/2002 Switzerland has agreed to apply the EC Regulations to EC Nationals.

### 2. EFTA countries applying EC Regulations

Iceland	Liechtenstein	Norway
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### 3. Reciprocal Agreement/ Double Contribution Conventions countries\*

Barbados	Israel	Mauritius
Bermuda	Jamaica	Philippines
Canada	Japan	Isle of Man
Jersey/ Guernsey	USA	Turkey
Korea	Former Yugoslavian countries	

Switzerland - Non-EC Nationals continue to be covered by the agreement.

\* The old Malta, Slovenia, Cyprus agreements will be largely superseded by the adoption of the EC Regulations from 1 May 2004.

## Contacts

For people going abroad, information and E101 application forms can be obtained from CNR

Centre For Non-Residents  
Insurability Section  
Room BP 1302  
Benton Park View  
Newcastle Upon Tyne NE 98 1ZZ

General advice about operating NICs for people coming into the UK can be obtained from the Employers Helpline on 0845 7 143 143, or from your Local Tax Office.

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## Stamp Duty Land Tax: Group Relief

1. This article gives practical and technical guidance on claims for group relief in Stamp Duty Land Tax under Schedule 7 to the Finance Act 2003. It deals with material which was previously covered by the Statement of Practice issued for stamp duty group relief, SP3/98 published on 13 October 1998. That Statement does not apply to Stamp Duty Land Tax but will continue to apply to stamp duty.

### How to claim group relief in Stamp Duty Land Tax

2. In contrast to stamp duty, documents must not be submitted with a claim. The claim should be made on form SDLT1 by putting a cross at box 9 and inserting code 12.

3. Following procedures for other returns within Stamp Duty Land Tax, the certificate that enables title to be registered will be issued provided that the return is complete. Certificates will not be delayed simply because the Inland Revenue may wish to enquire into particular aspects of the return including a claim to group relief.

4. The relief is self-assessed and will be dealt with on a 'process now/check later' basis along with all other Stamp Duty Land Tax matters. Under Stamp Duty Land Tax the Inland Revenue does not require the preparation and submission of the letter of claim covered in (see paragraph 6.641 of the Inland Revenue Stamp Taxes manual).

5. This means that companies must judge the admissibility of the claim themselves. Under Stamp Duty Land Tax the Inland Revenue has the power to assess and collect under-declared tax and seek penalties in cases where errors in returns (including errors in group relief claims) are the result of negligence or fraud.

## Enquiries involving group relief claims

6. If the decision is taken to enquire into a return where the transaction is subject to a group relief claim, the Inland Revenue will open an enquiry under paragraph 12 of Schedule 10 FA 2003. The enquiry must be made within 9 months of the filing date. Enquiries may cover all aspects of the return and will not necessarily be limited to the group relief claim itself.

7. The decision to enquire into a transaction will be made after the certificate (form SDLT5) is issued and will not therefore delay registration of title. But the issue of the certificate should not be taken as an indication that the Inland Revenue either accepts the validity of a group relief claim or has chosen not to enquire into that return.

8. Enquiries will consider all aspects of the transaction, including the group relief claim. Documents may be called for and these may include the instruments of transfer and related documents. The Inland Revenue may also ask for more information about the claim. In particular, evidence may be sought to show that the tests in paragraphs 1 and 2 of Schedule 7 were met.

9. If the evidence presented does not support the claim the self assessment will be amended to remove the relief.

### Paragraph 1 of Schedule 7

10. Paragraph 1 of Schedule 7 to FA 2003 provides exemption from Stamp Duty Land Tax where, at the effective date of the transaction, the companies are members of the same group. Exemption extends to the grant of leases between group companies.

### Meaning of company

11. Relief is extended to any "body corporate" through the definition of 'company' in section 100(1) FA 2003. To determine whether an entity qualifies as a body corporate the Inland Revenue will follow the guidelines for stamp duty set out at paragraph 6.124 of the Stamp Taxes Manual.

### Meaning of subsidiary

12. Paragraph 1(2)(b) requires that the companies claiming relief must be 75% subsidiaries of one another or 75% subsidiaries of a third company.

13. Paragraph 1(3) provides that for a company (A) to be a 75% subsidiary of another company (B) if:

- company B is the beneficial owner of at least 75% of the ordinary share capital of company A;
- it is beneficially entitled to not less than 75% of profits available for distribution to equity holders; and

- it would be entitled to not less than 75% of any assets of A available for distribution to equity holders on winding up.

14. Paragraph 1(4) provides that 'ownership' for these purposes is either directly or indirectly through another company or group of companies. The rules in section 838(5) to (10) ICTA 1988 apply to determine the amount of ordinary share capital. Paragraph 1(5) defines "ordinary share capital".

15. Paragraph 1(6) applies Schedule 18 ICTA 1988 which defines "equity holder".

16. The meaning of subsidiary is also relevant to the arrangements test in paragraph 2(2)(b) of Schedule 7 (see 19 below).

17. The tests in paragraph 1 of Schedule 7 apply independently of the tests in paragraph 2 and claims are not allowable if these tests are not met.

### Paragraph 2 of Schedule 7

18. Paragraph 2 provides anti-avoidance rules which restrict the availability of group relief. It will prevent relief being allowable in circumstances where certain 'arrangements' are in place.

### Meaning of arrangements

19. "Arrangements is defined generally for the purposes of paragraph 2 in paragraph 2(5) to include any scheme, arrangement or understanding, whether or not legally enforceable". This definition is used in section 76(6A)(b) FA 1986 (inserted by section 112(6) FA 2002) but "arrangements" was not defined for the equivalent stamp duty provisions in section 42(2) FA 1930 or section 27(2) FA 1967. Under this new definition, "arrangements" will include schemes, arrangements or understandings not in writing and the existence of arrangements in a particular claim will depend on a consideration of all of the facts relating to the claim and the surrounding circumstances.

20. In considering whether arrangements exist that might disqualify the claim, the Inland Revenue will seek to establish whether there was any scheme arrangement or understanding.

### Paragraph 2(1): Arrangements for change of control of purchaser

21. Paragraph 2(1) prevents a claim to group relief if arrangements are in existence at the time of the claim for a person (or persons together) to obtain control of the purchaser but not the vendor. Arrangements under paragraph 2(1) have to be in existence at the effective date of the transaction.

22. Where there is a change of control, paragraph 2(1) is intended to prevent avoidance of Stamp Duty Land Tax by passing property, or an economic interest in it, out of the group.

23. The statements of the Economic Secretary during debate in Parliament on the equivalent stamp duty provision in Finance Act 2000 are still relevant. The Economic Secretary said:

*"I have received representations expressing concern about the blocking of relief for transfers from the company about to leave the group to another group member – in other words, when the company leaving the group is the transferor. I am persuaded that there are commercial situations in which an asset is transferred to another group company after arrangements are in place for the transferor company to leave the group. In a sense, therefore, the asset never leaves the original group. I am willing to make a concession for such cases, which will be useful to businesses, as their legal advisers have suggested.*

*I have some worry that it might be possible to construct avoidance devices from the concession, so I have asked the Stamp Office to monitor carefully the use of the relief. If the concession is abused, the Government will not hesitate to act swiftly."*

(see Hansard 18 July 2000, column 253)

24. The Inland Revenue will not argue that paragraph 2(1) denies group relief in cases where the transferor is to leave the group having transferred the land to other group members.

25. Furthermore, paragraph 2(1) does not apply if the arrangements that are in place are those for the acquisition of shares by a company under a reconstruction as long as the conditions in paragraph 2(1)(a), (b) and (c) are met.

These are:

- that section 75 FA 1986 will apply to the acquisition and the conditions for relief under that section will be met;
- that after the acquisition the purchaser will be a member of the same group as the acquiring company.

### **Paragraph 2(2) of Schedule 7**

26. Paragraph 2(2)(a) denies relief where there are arrangements under which consideration is to be provided or received (directly or indirectly) by a person other than a group company.

27. Where group relief is claimed the Inland Revenue will consider all of the facts and interpret paragraph 2(2)(a) as not denying relief unless the loan finance is provided as part of a scheme to save Stamp Duty Land Tax when the property or an interest in it leaves the group.

28. For example, it is unlikely that there will be arrangements within paragraph 2(2)(a) if:

- the claim is not to be followed by a sale or underlease outside the group; or
- the claim is followed by a sale or underlease outside the group but Stamp Duty Land Tax is to be paid by the purchaser outside the group on consideration close to market value (or is deemed to be a grant of a lease under paragraph 11 of Schedule 17A FA 2003), then again it is unlikely that relief will be prevented by paragraph 2(2)(a).

29. Loans from commercial lenders on ordinary commercial terms to facilitate the transfer between group members will also not normally disqualify a claim for the purposes of the arrangements test in paragraph 2(2)(a). For example, a claim can be accepted if:

- a specific loan is taken for the purchase of the asset; or
- the loan is secured on the asset; or
- arrangements are made to replace or novate an existing charge on the property transferred.

30. Paragraphs 27 to 29 above are limited to paragraph 2(2)(a) of Schedule 7. They do not mean that if other tests in paragraphs 1 and 2 of Schedule 7 are not met the claim is acceptable.

31. When an enquiry is opened the case will be considered on their particular facts. Some examples of the type of circumstances which the Inland Revenue might want to examine in more detail during an enquiry are where the claim is part of (or is to be followed by):

- the creation or transfer of loan stock or equity capital;
- a capital reorganisation of the transferee;
- a guarantee by a third party not associated with the group;
- the creation of a new charge or financial arrangement whereby title to the property is, or may be, vested in the lender otherwise than in satisfaction of all or part of the debt; or
- the assignment of the freehold reversion or the intra-group lease to a person outside the group.

32. Other circumstances which can indicate that the claim is not admissible include where:

- all or part of the consideration for the transaction is to remain outstanding or is represented by intra-group debt, (as the aim and effect may be to reduce the value of the transferee company on a possible future sale outside the group); or
- the existing shareholders of the transferee include shareholders outside the group and the transaction is to be followed by the declaration of a dividend in specie, or by the liquidation of the transferee.

### **Subsales and group relief in Stamp Duty Land Tax**

33. Paragraph 2(2) provides rules for Stamp Duty Land Tax based on those for stamp duty in section 27(3) FA 1967. Section 27(3)(b) FA 1967 (intended to prevent acquisitions of land from outside the group without stamp duty being paid) is not included in Schedule 7 and this is because the problem it seeks to address, resting on contracts, is not relevant to Stamp Duty Land Tax. It is not possible to “rest on contract” to avoid Stamp Duty Land Tax because of the ‘substantial’ performance rule in section 44 FA 2003.

### **Paragraph 2(2)(b): arrangements for the purchaser to cease to be a member of the same group**

34. A claim for relief is not appropriate if there are arrangements for the purchaser to cease to be a 75% subsidiary of the vendor or a third company. In deciding whether there are any such arrangements, the practical likelihood of the scheme being carried through is not in itself relevant.

35. But the Inland Revenue will not take the view that just because land is transferred to a group company which does nothing other than hold property it follows that there are arrangements for the purchaser to leave the group. We recognise that there are many commercial reasons why groups may transfer property internally. It is necessary to consider the full circumstances of the case to decide whether such arrangements are in place.

36. Whether such arrangements were or were not in place must be decided at the time of the return and Inland Revenue enquiries will seek to establish the facts at the effective date of the transaction.

### **Relevance of arrangements under paragraph 2 to a recovery of tax under paragraph 3 (“clawback”)**

37. Paragraph 3 of Schedule 7 is independent of paragraph 2. When an enquiry is made into a claim the question will be the admissibility of the claim itself in accordance with the statutory provisions. The fact that the arrangements, if carried out as planned, could lead to a recovery or will be

exempt from a recovery will not mean that claim itself is allowable except as provided in paragraph 2.

### **Paragraph 3(1)(a)(iii): Arrangements during the three year recovery period**

38. Paragraph 3 imposes a requirement to make a return (under section 81 FA 2003) for the withdrawal of relief when the purchaser ceases to be a member of the same group within three years of the effective date of the transaction.

39. Paragraph 3(1)(a) deals with the recovery period. Paragraph 3(1)(a)(ii) provides that group relief will be recovered if the transfer outside the group after the end of the period is under arrangements made before the end of the period.

40. “Arrangements” is defined in paragraph 3(4) with the same definition as in paragraph 2.

41. When there is a transfer outside the group, companies will need to decide whether to make a return under section 81. If the transfer outside the group is after the end of the three year period, companies will still need to consider whether there were arrangements in place for the transfer during the three year period. To make this decision a proper consideration of all of the circumstances will be required.

42. The Inland Revenue will not assume that just because a company is transferred outside the group shortly after the end of the three year period it will be in accordance with arrangements made within the three year period. We will only seek to argue that there should have been a recovery return if the facts of the case point to there having been such arrangements.

### **Section 54(4) FA 2003: exception from the connected company charge on a winding up**

43. Section 54(4) FA 2003 provides the third case of exception from the deemed market value rule in section 53 FA 2003. The exception applies to the distribution of assets on the winding up of a company, as long as the subject matter of the transaction or an interest from which that interest is derived, has been the subject of a transaction in respect of which a claim to group relief was made by the vendor. But it is not the Inland Revenue’s intention that section 54(4) should apply where a group relief claim was made by the vendor but recovered under paragraph 3 of Schedule 7 either at the time of or before the effective date of the transaction.

## RECOVERY OF TAX AND PRIMARY NICs FROM AN EMPLOYEE– NEW APPEALS PROVISIONS

### Background

The Income Tax (Pay As You Earn) Regulations 2003 (the PAYE Regulations) contain provisions at regulations 72 and 81 where an Inland Revenue direction can relieve an employer of the liability to pay tax which the employer failed to deduct. The consequence of a direction is that the employee must bear the tax under-deducted.

The Income Tax (Pay As You Earn) (Amendment) Regulations SI 2004 No. 851 came into force on 12 April 2004. They amend Regulations 72 and 81 and insert new regulations (72A –D and 81A) to provide for the employer and employee to have rights of appeal. Relevant sections of Part V Taxes Management Act 1970 (TMA) will apply to these appeals.

Regulation 86 of the Social Security (Contributions) Regulations 2001 provides that an employer can be relieved of the liability to pay primary Class 1 contributions where the earner commits an act of default. If the Inland Revenue makes a decision that regulation 86 applies the employee becomes liable to pay the primary NICs. The decision is one where section 8 of the Social Security Contributions (Transfer of Functions) Act 1999 applies, and is subject to the appeal provisions in The Social Security Contributions (Decisions and Appeals) Regulations 1999.

The Social Security (Contributions, Categorisation of Earners and Intermediaries)(Amendment) Regulations 2004 SI 2004 No.770 came into force on 6 April 2004. They extend regulation 86 to the circumstance where an earner knows the employer wilfully failed to pay the primary NICs, and they were not deducted from earnings.

These regulations also amend Schedule 4 Paragraph 7 of the Social Security (Contributions) Regulations 2001. This now allows an employer an additional tax year to recover primary Class 1 National Insurance Contributions where they have made a “good faith” error. The criteria for what constitutes a “good faith” error is the same as for tax, but unlike tax, the liability remains with the employer if they do not recover the National Insurance. As the liability is still that of the employer, the employee does not have a right of appeal.

### PAYE – Regulation 72

Regulation 72 provides that the employer may be relieved of liability if either of two conditions is met:

- Condition A is that the Inland Revenue are satisfied that the employer took reasonable care and the under-deduction involved resulted from an error made in good faith;
- Condition B is that the Inland Revenue are of the opinion that an employee received a payment of income knowing the employer had wilfully failed to deduct any or sufficient tax from the payment.

### Condition A

Under the new and revised provisions an employer may request in writing that a direction is made. The request must state the grounds on which it is based and identify the employee and tax under-deducted. Local Recovery Offices in the Receivables Management Service will be responsible for considering requests and making decisions.

If a direction is refused:

- A notice will be sent to the employer ;
- The employer has 30 days from the refusal notice to appeal.

If a direction is given:

- A notice will be sent to the employer and employee;
- The employee has 30 days from the direction notice to appeal.

An employee who appeals must specify the grounds for doing so, and it must include one of these elements:

- That the employer did not take reasonable care, or
- That the employer did not act in good faith, or
- That the amount of tax for which the direction is given is incorrect.

Where an employee appeals we will reconsider the direction. If we change our minds about it we will settle the appeal under section 54 TMA and issue a refusal notice to the employer. The employer is then entitled to appeal, but at any subsequent hearing the employee is enabled by regulation 72D(8) to be heard by the Commissioners or make representations in writing.

If we think that a direction should stand we will keep the employer abreast of any appeal proceedings in respect of the employee because the employer is also enabled under

regulation 72D(8) to be heard by the Commissioners or make representations in writing.

When an appeal is made to the General Commissioners the appellant can choose to have their appeal heard by the Commissioners for the division:

- Where they live; or
- Where they work; or
- If they are in business, where they have their business premises.

Where a direction in respect of the same employer error affects more than one employee then all appeals will be heard at the same place and time. Where there is more than one appeal which involves different places and an appeal hearing is necessary, we will try to settle the place of hearing informally where possible.

Where there is no election for a division of Commissioners to hear a case we will determine the place.

At the appeal hearing the Commissioners may uphold the Inland Revenue decision or where appropriate:

- Direct that the Inland Revenue make a direction in a specified amount;
- Set aside the direction or vary the direction amount.

### Condition B

The appeal here lies only with the employee and not the employer. This is because directions under Condition B are usually made where the employer is no longer available by reason of insolvency or cessation of trade, and in most other circumstances it would be inappropriate to reward an employer who admits to wilful failure.

Directions under Condition B are made by senior officers in the Receivables Management Service following recommendations made by PAYE Directions Units (PDUs). PDUs will usually be responsible for the conduct of correspondence and contact with employees up to the point where a case is to be listed for hearing.

If a direction is made:

- A notice will be sent to the employee;
- The employee has 30 days from the direction notice in which to appeal.

If we are able to reach agreement on these often complex cases we will settle them under Section 54 TMA.

An appeal will be to the General or Special Commissioners, as above. The appeal must be on the grounds that:

- The employee did not receive payment knowing of the employer's wilful failure to deduct, or
- The amount of tax for which the direction is given is incorrect.

The division of Commissioners which will hear the case will be determined in the same way as Condition A, above. The Commissioners may :

- Uphold the Inland Revenue direction, or
- Set aside the direction or vary the direction amount.

### PAYE – Regulation 81

Regulation 81 provides that the employer may be relieved of liability if either of two conditions is satisfied:

- Condition A is that the Inland Revenue are of the opinion that an employee received a payment of income knowing the employer had wilfully failed to deduct any or sufficient tax from the payment.
- Condition B is that the unpaid tax represents an amount for which the employer was required to account under regulation 62(5) in relation to a notional payment to the employee.

### Condition A

To all intents and purposes this is the same condition as Condition B in regulation 72. The only difference between them is that the income in regulation 81 has been included in a regulation 80 tax determination made on the employer and which has become final. As they are otherwise identical, the references above to appeals against regulation 72 Condition B directions apply equally here.

### Condition B

Similarly, the references to appeals in regulation 72 Condition B apply equally here, but the grounds of appeal are:

- The relevant payment was not a notional payment, or
- The amount of tax for which the direction is given is incorrect.

### NICs – Regulation 86 SSCR 2001

The extension to regulation 86 uses very similar language to that in PAYE regulations 72 and 81, and we intend that so far as possible all these regulations are used in the same way and at the same time in respect of 'wilful failures'.

A notice will be sent to the earner if a decision in respect of regulation 86 is made. The earner has 30 days in which to appeal against the notice and the grounds will be that:

- The earner did not know of the secondary contributor's wilful failure to pay, or
- The secondary contributor recovered the primary contributions from the earner, or
- The amount in the notice is incorrect.

The appeals provisions outlined for PAYE apply equally to this new NICs decision. We intend that where notices are issued in respect of PAYE and NICs any subsequent appeals are heard by the same body of Commissioners at the same time.

## Notices

We intend to introduce three standard notices in respect of these provisions. They are:

- A 'direction notice' for employers under regulation 72 Condition A,
- A 'refusal notice' for employers under regulation 72A,
- A 'direction notice' for employees under regulations 72 & 81 Conditions A & B,

For regulation 86 decisions the current form DAA1(A) 'Notice of decision' will be used.

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## UK/USA Double Taxation Agreement – Federal

### Excise Tax

The new UK/USA Double Taxation Agreement was signed on 24 July 2001 with an amending Protocol being signed a year later on 19 July 2002. The treaty came into force on 31 March 2003.

This article deals with new procedures which will be required for UK resident insurers which, without the treaty, would be subject to US Federal Excise Tax on Insurance Premiums (FET). It also deals with UK resident insurers which, having read the treaty in relation to FET, decide that it will be of benefit to elect to 'grandfather' the provisions of the 1975 treaty for a further period of 12 months.

### 2001 Agreement

The provisions of the new treaty with respect to FET took effect for taxable periods beginning on or after 1 January 2004 and are contained in Article 7 (5) dealing with business profits, which provides:

*"The United States excise tax on insurance policies issued by foreign insurers shall not be imposed on insurance or reinsurance policies, the premiums on which are the receipts of a business of insurance carried on by an enterprise of the United Kingdom. However, if such policies are entered into as part of a conduit arrangement, the United States may impose excise tax on those policies, unless the premiums in respect of those policies are, or are part of, the income of a permanent establishment that the enterprise of the United Kingdom has in the United States."*

The meaning of a 'conduit arrangement' is defined as follows at Article 3 (1) (n):

*"the term "conduit arrangement" means a transaction or series of transactions:*

*(i) which is structured in such a way that a resident of a Contracting State entitled to the benefits of this Convention receives an item of income arising in the other Contracting State but that resident pays, directly or indirectly, all or substantially all of that income (at any time or in any form) to another person who is not a resident of either Contracting State and who, if it received that item of income direct from the other Contracting State, would not be entitled under a convention for the avoidance of double taxation between the state in which that other person is resident and the Contracting State in which the income arises, or otherwise, to benefits with respect to that item of income which are equivalent to, or more favourable than, those available under this Convention to a resident of a Contracting State; and*

*(ii) which has as its main purpose, or one of its main purposes, obtaining such increased benefits as are available under this Convention."*

On 10 November 2003 the US Internal Revenue Service (IRS) issued Revenue Procedure 2003-78, (<http://www.irs.gov/pub/irs-irbs/irb03-45.pdf>) which provides instructions for establishing exemption from the Section 4371 excise tax on insurance premiums paid to a foreign insurer or re-insurer when the exemption is based on the provisions of a double tax treaty to which the US is a party. The Revenue Procedure took effect from 10 October 2003 and covers all treaties which contain provisions for exemption from the FET.

With respect to the UK, as long as a UK resident insurer qualifies to receive the benefits of the 2001 treaty under the provisions of Article 23 (Limitation on Benefits), that resident insurer may enter a closing agreement with the IRS and

follow the procedures outlined in Section 3 of Rev.Proc. 2003-78. UK resident insurers should provide a closing agreement in the format outlined at Appendix B to Rev. Proc. 2003-78 (<http://www.irs.gov/pub/irs-irbs/irb03-45.pdf>).

The procedure detailed above supersedes the current procedure relating to the 1975 treaty whereby the Inland Revenue certifies that a UK company wishing to benefit from the exemption to FET contained in that treaty at Article 7 (6A) has been resident for tax purposes in the UK for the 3 months prior to 31 December in any year. The Inland Revenue retains a list of such companies.

### **Election to Apply the 1975 Agreement for 2004.**

UK resident insurers may decide that it is of benefit to continue to operate under the provisions of the 1975 treaty for a further period of 12 months from when the new treaty otherwise would have effect under Article 29 (2). A UK resident may therefore elect to continue to operate under the 1975 treaty. This election is also known as 'grandfathering'. It should be noted that such an election can be made only for the 1975 treaty in its entirety; it is not possible to 'cherry-pick' particular provisions which the resident insurer would wish to apply. Should a UK resident insurer elect to 'grandfather' the 1975 treaty then the following procedure should be operated in relation to FET:

- Where appropriate obtain a US Employer Identification Number (EIN);
- File IRS Form 720 (Quarterly Excise Tax Return) for the first, second, third, and fourth quarters of calendar year 2004. The returns should be filed with the Cincinnati Service Centre as set forth in the instructions to Form 720. The form is on the IRS website at <http://www.irs.gov>. The Form 720 will likely report \$0.00 tax liability, but the IRS assumes some taxpayers may have a liability because a portion of their risk is reinsured with a non-exempt reinsurer.
- Attach a letter to the first Form 720 (first quarter 2004) stating the taxpayer is electing under Article 29 (2) to claim the benefit of the 1975 treaty and is postponing the effective date of the new treaty, for all purposes until 1 January 2005.

Any further enquiries on this issue should be addressed to:

Martin Brooks  
Revenue Policy: International  
Room 310  
Victory House  
30-34 Kingsway  
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WC2B 6ES

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## ***miscellaneous***

### **Corresponding deficiency relief on life insurance policies**

News Release 12/04, which was published on our web-site on 3 March 2004 at [www.inlandrevenue.gov.uk/news/press.htm](http://www.inlandrevenue.gov.uk/news/press.htm), describes a change to the rules governing the amount of deficiency relief which an individual may be entitled to when a life insurance policy, life annuity contract or capital redemption policy comes to an end on or after 3 March 2004. Budget Note (Rev BN27) also gives details.

The new legislation will restrict the deficiency relief available to an individual, to an amount not exceeding the total of any earlier gains which formed part of that same individual's income. It will apply to all life insurance policies, life annuity contracts and capital redemption policies made on or after 3 March 2004. It will also apply to all existing policies and contracts:

- which are assigned on or after 3 March 2004; or
- which become used as security for a debt on or after that date; or
- into which policyholders choose to pay further premiums on or after that date.

The new measure may affect the amount of deficiency relief which an individual is entitled to for tax year 2003-04 and which should be entered in box 12.9 of his or her tax return for this year. SA Helpsheets IR320 and 321 for 2003-04 have been amended to reflect this change in the rules. The amended versions can be found on our web-site.

## The draft Income Tax (Trading and Other Income) Bill

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### Background

At the beginning of March 2004 the Tax Law Rewrite project published for consultation its third draft Bill - the Income Tax (Trading and Other Income) Bill. Publication of this draft Bill represents the final stage of a public consultation process that started with the project's first Exposure Draft in July 1997. In the intervening period a further five Exposure Drafts and various papers have been published.

### Contents of the Bill

The draft Bill contains the rules governing:

- what is chargeable;
- who is chargeable; and
- how to calculate the amount chargeable for each type of income covered in the Bill.

The types of income covered are:

- trading income;
- property income;
- savings and investment income; and
- miscellaneous income.

There are also parts dealing with:

- exempt income;
- rent-a-room and foster-care reliefs;
- special rules for foreign income; and
- partnerships.

### Special features

#### No substantial changes to the law

The remit of the project is to rewrite the existing legislation without changing its effect apart from minor identified changes. These minor changes are explained in detail in Annex 1 of the Explanatory Notes to the draft Bill.

#### The Income Tax Schedules

The draft Bill completes the rewrite of the schedules for income tax. Schedule E was rewritten in terms of types of income in the Income Tax (Earnings and Pensions) Act 2003. This Draft Bill repeals the remaining Schedules, A, D and F for income tax purposes.

#### Case VI

Case VI is "unpacked", to introduce separate charging provisions for the various items currently taxed under Case VI. There is a sweep-up provision for UK and foreign income not otherwise charged to tax.

#### Foreign income

Wherever possible, foreign income is dealt with in the same parts as the equivalent UK income.

#### Income tax only

The project consulted on the question of separating the income tax and corporation tax codes both at the start of the project and more recently at Committee meetings. The view was and remains that greater separation of the codes should be one of the project's aims.

But bringing this separation about is complicated and may not always be practicable.

The draft Bill starts the process of greater separation. Its provisions apply for the purposes of income tax only. But it makes a large number of consequential amendments to the source legislation.

Where that source legislation applies to both income tax and corporation tax it will be made clear that the current provisions continue to apply for corporation tax purposes only. This will add to the volume of tax law. But it will ensure greater clarity and allow users of the corporation tax code to continue as before.

Final decisions on which provisions will be rewritten for both codes and which will cross-refer between the two codes will be taken, after consultation, when the corporation tax legislation is rewritten.

### Consultation

Public consultation on this Bill will run to the end of May 2004. With 903 clauses and 4 schedules this Bill covers a substantial part of the income tax code.

The draft Bill reflects the results of earlier consultation. It seeks views on particular issues and 41 new proposed minor changes. Additional comments on any aspect of the Bill will be welcome. The draft Bill and its Explanatory Notes can be viewed on the Revenue website at [www.inlandrevenue.gov.uk/rewrite](http://www.inlandrevenue.gov.uk/rewrite)

and a limited number of paper copies are available through the contacts shown below.

Comments on the draft Bill should be sent, preferably by e-mail, to Basil.Rajamanie@ir.gsi.gov.uk or by post to:

Basil Rajamanie  
Tax Law Rewrite  
Room 826  
South West Wing  
Bush House  
Strand  
London  
WC2B 4RD

If you have any comments about other aspects of Tax Law Rewrite's work, please send them to David.Mutton@ir.gsi.gov.uk or by post to David Mutton at the address above.

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## Trust Management Expenses

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We have recently become aware that many trustees are confused about which items of expenditure may be claimed as Trust Management Expenses (TMEs). We have therefore been reviewing the law and practice on TMEs in discretionary and interest in possession trusts.

We recognise that the guidance we have provided on TMEs in the *Trusts Settlements and Estates Manual* is not as comprehensive as it could be. So we have obtained full legal advice on this issue.

That legal advice has confirmed that TMEs have been claimed inappropriately in many cases. For example, trustees of discretionary trusts have made substantial claims for:

- items such as providing beneficiaries with a benefit in kind, which are not expenses but distributions of income;

- trustees fees, which are not 'expenses of the trustees' as provided by S686(2AA) ICTA 1988;
- expenses that are capital in nature.

As part of the Trusts Modernisation programme announced in the Pre-Budget Report in December 2003, consultation with representative bodies and others took place in January and February 2004. As announced at the Budget on 17 March 2004, it has been agreed that we will work with the appropriate representative bodies to produce some agreed guidance on TMEs. We aim to publish full guidance by the autumn. Trustees of discretionary trusts and beneficiaries of IIP trusts should use the new guidance to make returns for 2004-05 and subsequent years.

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## Tax Implications of International Accounting Standards (IAS)

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An extensive new section has been added to the Inland Revenue website (<http://www.inlandrevenue.gov.uk/practitioners/moreinfomore.shtml>) outlining the Revenue's current thinking on the tax implications of the move to IAS.

To access the new pages go to the Practitioner Zone – Topics and Publications, and click on Go, under 'Show me all'.

### Correction

Index 2003 incorrectly stated that the article about mileage rates in TB22 (page 12) was superseded by BIM45565.

This should read BIM47701 onwards.

We apologise for any inconvenience

Inland Revenue Statements of Practice and Extra-Statutory Concessions issued between 1 February 2004 to 31 March 2004

### Extra Statutory Concessions

There have been no Extra Statutory Concessions for this period

### Statements of Practice

There have been no Statements of Practice for this period

You can get copies of SPs and ESCs by telephoning 020 7438 4266.

## 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 issued 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.
- All the names referred to in this Bulletin are imaginary and have no relation to real persons, living or dead, except by coincidence

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, Mr Shell Makwana, Room G7, New Wing, Somerset House, Strand, London, WC2R 1LB or e-mail [Shell.Makwana@ir.gsi.gov.uk](mailto:Shell.Makwana@ir.gsi.gov.uk). 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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