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Compensation for Financial Mis-selling – Tax Treatment of Interest

A significant number of individuals are being paid compensation for the “mis-selling” of certain financial products, such as mortgage endowment policies. We are sometimes asked whether an enhancement element added to the compensation is interest, and so taxable under Case III of Schedule D. This article outlines the principles we apply in considering whether a payment is, or includes, interest, and addresses some questions we are frequently asked.

All interest is chargeable to tax under Case III by virtue of Section 18(3)(a) of the Income & Corporation Taxes Act 1988. However, whether a particular payment is interest to start with can only be answered by reference to principles of common law.

Characteristics of interest

A well respected legal authority describes interest as “the return or compensation for the use of or retention by one person of a sum of money belonging to or owed to another”. We also have judicial definitions for guidance. For instance, in the case of *Westminster Bank Ltd v Riches* (28 TC 159), Lord Wright said that “... *the essence of interest is that it is a payment which becomes due because the creditor has not had his money at the due date. It may be regarded either as representing the profit he might have made if he had had the use of the money, or, conversely the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for the deprivation*”.

This theme was expanded upon in *Re Euro Hotel (Belgravia) Ltd* (51 TC 293). Mr Justice Megarry said that as a general rule, there are two requirements that must be satisfied for a payment to be interest. First, there must be a sum of money by reference to which the payment is to be ascertained; second, that sum of money must be due to the person entitled to the alleged interest.

It is clear from these cases that entitlement is an essential feature of interest. An entitlement to interest arises under common law where there is an express agreement to pay interest or such agreement can be inferred from the circumstances.

Does the compensation include interest?

As methods of calculating compensation vary within the financial services industry, and from case to case, it is not possible to provide a comprehensive list of which methods will or will not give rise to taxable interest. The Inland Revenue has not entered into any agreements or understandings with representative bodies or particular institutions on this subject. Whether the hallmarks of interest are present

in a particular case will depend on the basis on which the compensation is calculated.

We understand however that payers may offer compensation based on one of a number of formulas approved by the Financial Ombudsman Service and similar bodies, according to the circumstances of the claim. While detailed approaches may vary, we understand that the broad aim is to put investors back in the position they would have been in had they not bought, or put money into, the product. One way of doing this is to refund the premiums (or other amounts) paid by the investor together with an additional amount to compensate for the time he or she did not have use of the money.

Where this approach is adopted, we consider there can be little doubt that the additional payment is interest. The hallmarks of interest discussed above are present. It is calculated by reference to a sum of money which the investor is entitled to be repaid, and compensates him or her for being deprived of the use of that money.

Where other methods are used, the tax treatment of any enhancement element will depend on whether the characteristics of interest are present. There is further guidance on the meaning of interest in the Inland Revenue's Inspectors' Manual (IM1500 to IM1507) which is available on our website. Where a payment fits the description of interest, it will normally be paid net of income tax by the company paying the compensation. However, whether or not tax is deducted, the interest is still taxable and should be included on the recipient's Self-Assessment (SA) Return. A recipient who does not normally receive an SA Return should tell his or her tax office about any untaxed interest.

Frequently asked questions

Interest as damages: It is sometimes suggested that where interest is included in a compensation award, it cannot be "true" interest because it is "damages" or "redress". The authorities do not support this. The case of *Westminster Bank Ltd v Riches* (28 TC 159) explained that there is no distinction between "interest proper" and "interest as damages". What matters is the intrinsic nature of the receipt. Words like "damages" merely explain the reason why interest is being paid; they do not alter its nature as interest.

Ex-gratia or voluntary payment: It is sometimes suggested that an interest addition is not taxable because it, or the compensation on which it is calculated, is paid "*ex-gratia*" or voluntarily. We accept that a truly voluntary payment cannot be interest, even if described as such, because the essential feature of an entitlement to it is absent. In practice, however, we consider it will be extremely rare for any payment arising from claims that a financial product has been mis-sold to be truly voluntary, since the redress is given in consideration of the complainant giving up a right of action.

Global settlements: It is also sometimes argued that where interest is added to other elements of an award, and the whole amount paid in one "global sum", it loses its identity in the bundle. Here again, case law does not support such a contention. *Sir Robert Megarry V.C.* held in *Chevron Petroleum (UK) Ltd & Others v BP Petroleum Development Ltd & Others* (57 TC 137, at page 142) that where a settlement is made in a global amount, the interest element is still interest.

Comparison with pensions mis-selling compensation:

Another suggestion that has been put to us is that interest on compensation paid for mis-sold endowments and so on should be treated in the same way as interest on compensation payment for mis-sold pensions since they are similar in nature. The latter is specifically exempt from income tax by an Act of Parliament (section 148 of Finance Act 1996). In the absence of similar provisions for other types of mis-selling, the general principles outlined above have to be followed.

Personal injury: We understand that some settlements may include payment for personal injury, for example damage to feelings. Such payments are exempt from capital gains tax by section 51(2) of the Taxation of Chargeable Gains Act 1992. Interest on such payments is also exempt from income tax by virtue of s329 of the Income & Corporation Taxes Act 1988. There is further guidance in the Inland Revenue's Inspectors' Manual (IM1526).

Guidance Note on Manufactured Payment Unallowable

Purpose Provision

1. New rule
2. Commencement and transitional arrangements
3. Questions and answers
4. Examples of schemes

1. New unallowable purpose rule

Finance Bill 2004 introduces an "unallowable purpose" rule for manufactured payments. It applies only where the manufactured payment is made by a company. This article gives an overview of the new rule and sets out the circumstances in which the Revenue will, and will not, seek to apply it.

1.1 Background

Manufactured payments are payments which arise under a contract or other arrangement for the transfer of securities that are representative of interest or dividend payments on securities. They typically arise under stock lending or repo arrangements and are intended to compensate the original holder of the securities for not receiving real interest or dividends.

The legislation that deals with manufactured payments is at Schedule 23A ICTA1988. The regime applies to three categories of payments: payments that represent dividends on UK equities, those that represent dividends on overseas equities and those that represent interest. In many circumstances the payment qualifies for deduction either in computing profits for CT purposes or against total profits.

The Revenue has become aware of a number of schemes that seek to reduce corporation tax liabilities by the use of manufactured payments. A few of the schemes are described in outline in part 4 of this article. These schemes exploit different parts of the manufactured payments legislation. The new rule counters any such scheme by introducing an “unallowable purpose” test similar to that used elsewhere in the tax legislation¹.

This article describes the rule in detail and answers questions on how it will be applied. Three initial points may be made:

Firstly, very few transactions will be affected. “Arrangements” (see 1.5 below) will not have an unallowable purpose if a company has been party to them solely for commercial reasons and entered into them on commercial terms.

Secondly, the rule is closely modelled on the unallowable purpose test that is a feature of the 1996 loan relationship regime and a similar rule introduced for derivative contracts in 2002. The principles used in the guidance that the Revenue has already published on the operation of these rules will be followed here.

Thirdly, transitional rules make proper provision for companies which are already committed to such arrangements, as described below.

1.2 Description of rule

A new paragraph 7A is inserted into Schedule 23A which provides for “relevant tax relief” to be restricted where that relief is attributable to manufactured payments made by a company in pursuance of arrangements having an unallowable purpose. The restriction applies only to the extent that, on a just and reasonable basis, the relief is attributable to the unallowable purpose.

¹See paragraph 13 Schedule 9 FA 1996 (loan relationships) and paragraphs 23 & 24 Schedule 26 FA 2002 (derivative contracts).

1.3 Conditions for rule to apply

Before paragraph 7A can apply the following conditions must be met:

- a company must make, or be deemed to make, a manufactured payment in pursuance of arrangements to which it is party, and
- the arrangements, or any transaction entered into in pursuance of them, must have an unallowable purpose.

Arrangements have an unallowable purpose at any time where the purposes for which the company is party to the arrangements or to any transaction in pursuance of them or to any related transaction (see 1.5 below) include a purpose which is not amongst the business or other commercial purposes of the company.

The business or commercial purposes of a company are defined to exclude the purpose of any part of its activities which is outside the scope of corporation tax.

Tax avoidance is an unallowable purpose if it is the main or one of the main purposes for which the company is party to the arrangements. Tax avoidance means a purpose that consists in securing a tax advantage for the manufacturer or any other person. Tax advantage takes its meaning from section 709 ICTA1988.

Where the relevant conditions are met then relevant tax relief (1.6) attributable to the manufactured payment is disallowed on a just and reasonable basis. The restriction can apply only to the company that makes the payment. It follows that where that person would not otherwise receive relief for the payment, for instance because it is representative of a dividend on UK equities and the manufacturer is not within the scope of section 95 ICTA1988, then the rule can have no effect.

1.4 Interaction with other “unallowable purpose” rules

The rule will not operate where any relief for the manufactured payment could be restricted under the existing unallowable purpose rule in the loan relationships legislation. For accounting periods starting on or after 1 April 2004, the new management expense rules contain an unallowable purpose test. Again, the new manufactured payments rule will not apply where relief is restricted under this provision.

1.5 Scope of “arrangements”

The “arrangements” to which the rule can apply include schemes, arrangements and understandings of any kind whether or not legally enforceable. Their scope is extended to include any transaction, a “related transaction”, that it is reasonable to assume would not have been entered into independently of the arrangements themselves. For instance,

if a company acquires shares as part of any arrangements, then their later sale will be a related transaction if it is reasonable to assume that it would not have occurred independently of the arrangements under which the shares were acquired. A transaction is not prevented from being a related transaction just because the transaction is not between the parties to the arrangements.

1.6 Relevant tax relief

Relevant tax relief is any of the following:

- a) any deduction in computing profits or gains for the purposes of corporation tax (including any deduction to which a financial trader might otherwise be entitled under section 95 ICTA1988);
- b) any deduction against total profits;
- c) any debit brought into account under the loan relationship provisions;
- d) the surrender of any amount by way of group relief.

2. Commencement

The basic rule is that the clause applies to all manufactured payments made on or after 2 July 2004 (“commencement date”), the date the clause was tabled. But this is subject to the transitional rules described below.

2.1 Transitional arrangements

The rules distinguish between old and new arrangements. “Old arrangements” means arrangements some part of which was entered into or acted upon before commencement date. “New arrangements” means any arrangements that are not old arrangements.

The unallowable purpose rule will apply fully to all new arrangements. The transitional rules will be relevant only to old arrangements where the manufactured payment is made on or after Royal Assent. This means that companies that were committed to any arrangements which might have been subject to the rule will have had a short window up to Royal Assent of the Finance Bill to unwind those arrangements without the new unallowable purpose rule applying.

Where manufactured payments in pursuance of old arrangements are paid after the date of Royal Assent, there is a further provision restricting the extent to which the unallowable purpose rule can apply. In determining whether relevant tax relief may be restricted, it is necessary to establish whether any income or capital gain from the arrangements arose to, or accrued to, the company before commencement date and was within the charge to corporation tax (whether or not covered by losses brought forward). Relevant tax relief is not denied to the extent that

the manufactured payment represents, on such just and reasonable apportionments as may be necessary, the income or gains.

Where no income or capital gain accrued or arose under the arrangements prior to 2 July 2004 or, where it did, none of the income or gains was within the charge to CT, then tax relief for the manufactured payment can be disallowed in full, if that is the correct result using the main just and reasonable apportionment test.

3. Questions and answers

Q1. Will this affect normal commercial stock lending and repo transactions?

No. Very few transactions will be affected. Provided that companies are entering into transactions for genuine commercial activities or making investments on normal commercial terms then the rule will not apply.

Q2. Will companies be unwittingly caught by the rule?

No. As was noted when the original loan relationship unallowable purpose test was introduced, companies that enter into arrangements with the primary aim of avoiding tax will invariably be aware of the fact. As the examples in part 4 of this note show, the arrangements at which the rule is aimed typically involve “funny” shares, abnormal dividends or contrived structures that are intended to produce a tax result which is more favourable than would be given if the economic substance of the transaction were followed. Often, this will be reflected by a deduction in the tax computation not featuring in the accounts.

Q3. Will this rule be applied in the same way as the loan relationship and derivative contract unallowable purpose tests?

Yes. In determining whether arrangements have an unallowable purpose the Revenue will follow its existing guidance in CT12670+, CFM6210+ and CFM13610+.

Q4. What is to stop an individual inspector applying the rule in an inconsistent and inappropriate way?

In any case where the unallowable purpose rule may apply, inspectors are required to refer to the Revenue’s Special Investigations Section. Companies who disagree with the Revenue’s view will have the right of appeal to the Commissioners and the Courts.

Q5. Will deemed manufactured payments be subject to the rule in the same way as real ones?

Yes. The test is whether the arrangements have an unallowable purpose. The rule will operate in the same way for deemed and for real payments.

Q6. Will the rule affect normal transactions where the pricing reflects the tax status of the counterparty, e.g. the pricing of a stock loan involving a pension fund that reflects its tax-exempt status?

No. The guidance given by the Economic Secretary when the loan relationship unallowable purpose test was introduced is still applicable:

“Where a company is choosing between different ways of arranging its commercial affairs it is acceptable for it to choose the course that gives a favourable tax outcome. Where the rule will come into play is where tax avoidance is the main, or one of the main, objects of the exercise.”

Q7. Will arrangements that give rise to manufactured payments paid to non-UK recipients be treated differently from those that involve only domestic counterparties?

No. The fact that a company makes manufactured payments to companies outside the UK tax net will not by itself be relevant to whether the new rule applies.

Q8. Is there a clearance procedure?

No. But in accordance with its existing Code of Practice 10, the Revenue will give its view on the application of the law to a particular proposed transaction if the full facts and circumstances are provided and it is clear the transaction was not designed to avoid tax.

Q9. Will any additional documentation be required to satisfy the Revenue that arrangements do not have an unallowable purpose?

No. Companies should already keep the appropriate documentation for self-assessment purposes.

4. Schemes

In all the examples that follow the manufactured payments are made on or after Royal Assent. The examples are without prejudice to technical challenges that may be possible using other legislation or case law. In particular, some of the schemes may already be capable of challenge using the loan relationship or management expense unallowable purpose rules.

4.1 Scheme one

1. A tax avoiding company (Company A) acquires overseas shares (of a special purpose vehicle set up to facilitate the arrangements), which have a value of £500m, from their original owner under a stock loan.

2. The shares are due to pay a dividend of £450m, after which they will be worth £50m. Company A immediately sells the shares for their market value of £500m. Under the terms of the stock loan, Company A pays a manufactured overseas dividend (“MOD”) of £450m to the original lender of the shares at the time the dividend is paid to their new holder. After that payment, Company A buys the shares back for £50m. This results in a capital gain on the shares of £450m (500m – 50m), but there is no tax to pay because of other agreed CG losses.

3. Company A then returns the shares to the original owner under the stock loan. Company A is commercially flat because it has made a capital gain of £450m balanced by paying a MOD of the same amount.

4. The £450m MOD payment is claimed for tax relief against Company A's total profits either as a management expense or a charge on income.

5. The end tax result is that Company A makes a capital gain of £450m and claims relief of £450m for the MOD against total profits. Since the capital gain is covered by CG losses, there is a net reduction in taxable profits of £450m even though the transaction has no commercial purpose or effect at all.

Analysis

Company A is party to the arrangements only for a tax avoidance purpose: it has sought to obtain an immediately effective tax deduction of £450m at the cost of £450m possibly worthless capital losses. On the facts given the Revenue would seek to restrict relief for the whole of the manufactured payment.

If the scheme were an old arrangement and the gain had accrued before commencement day then the unallowable purpose rule would not apply. Had the gain arisen after commencement day then the rule would apply as if it were a new arrangement.

4.2 Scheme two

1. A non-resident company (Company A) acquires overseas shares under a repo which does not make provision for manufactured payments for £500m. The shares then pay a dividend of £300m to Company A, after which they are worth £200m. The dividend is not taxable because the company is not UK resident (foreign dividends are taxed on a receipts basis).

2. Just before the repo is due to unwind, Company A is acquired by UK avoider who arranges for it to become UK tax resident. The repo is then completed by Company A selling the shares back to their original owner for £200m (£500m sale price adjusted for the £300m dividend foregone by original owner).

3. Again, all parties are commercially flat. But the effect of the repo tax legislation is that Company A is deemed to pay a MOD of £300m on the day the repo unwinds, which is after it has become UK resident. There is no loss on the shares as the repurchase price is increased by the amount of the deemed MOD payment (and thus no interest deemed by section 730A ICTA1988).

4. The MOD is treated as a management expense or charge on income and full relief is claimed against total profits of Company A. The £300m dividend is not taxable at all because the company was not UK resident at the time it was received.

5. Company A therefore claims tax relief of £300m on the MOD (tax saving £90m) but is not taxable on the equivalent dividend received.

Analysis

Company A is party to the arrangements only for a tax avoidance purpose. On the facts given, the Revenue would seek to disallow relief for the whole of the manufactured payment. This would be true whether the scheme was a new arrangement or old arrangement, but in the latter case only where all income from the arrangements had been outside the charge to corporation tax.

4.3 Scheme three

1. Company A, a financial trader, wishes to borrow £150m. Instead of doing so it acquires UK shares from a bank or other lender for £300m. The shares have a value of £450m, the difference of £150m being in substance a loan (and accounted for as such).

2. The shares are shares in a special purpose entity that will pay a dividend of £165m in 3 years' time, and thereafter a fixed dividend of 3 % per annum. The agreement under which Company A acquired the shares requires it to make what it terms a manufactured payment of £165m to the bank at the same time as payment of the real dividend. In substance, this represents repayment of the loan plus interest. No further "manufactured payments" will be made by Company A.

3. After acquiring the shares in the special purpose entity, Company A immediately disposes of them for £450m under a long-term repo transaction under which it will not receive payments representative of dividends on the shares. Instead it will repurchase the shares in 30 years for £285m. It is therefore left with £150m cash this being the amount it originally wished to borrow. After 3 years it makes a manufactured payment of £165m on which it claims tax relief in full under section 95 ICTA1988.

4. The result is that company A claims tax relief on £165m. It would not be deemed to receive an equivalent manufactured dividend for 30 years; there is no assurance the company will still be UK resident at this time. In substance it receives a loan of £150m but claims tax relief for repayment of principal plus interest.

Analysis

One of Company A's main purposes in being party to the arrangements is a tax avoidance one. The Revenue will seek to restrict relief in respect of the manufactured payment.

Had this been an old arrangement the Revenue would still seek to restrict relief in respect of the payment provided no income had arisen to the company before commencement day. On the other hand, had Company A received an initial dividend before commencement day (and been within the charge to CT in respect of it), but had only made the corresponding manufactured payment after the Royal Assent then the rule would not apply to that part of the manufactured payment. This ensures that the company is protected against disallowance of later manufactured payments where income within the charge to CT has arisen from the arrangements prior to commencement.

4.4 Scheme four

1. This scheme is intended to give company A a deduction for what in substance is a distribution of profits. The scheme is promoted by a financial trader that hopes to receive relief for manufactured payments by securing a tax advantage for another person.
2. Company A wants to raise money in the market by issuing £100m of 4.5% preference shares. It issues the shares to company B for £100m. At this stage Company B is a wholly owned subsidiary of a financial trader unconnected to Company A.
3. Company B immediately stock loans the shares to the financial trader, who sells the shares into the market for £100m.
4. The financial trader provides company B with £100m cash collateral as security for the return of the shares. The stock loan is intended to be permanent. Company B will pay interest on the collateral equal to the dividends on the preference shares, i.e. 4.5% per annum, and receive manufactured payments from financial trader of the same amount.
5. Company A purchases the Company B shares from the financial trader for £100m so that Company B is now a subsidiary of Company A. Company B lends the £100m cash collateral to Company A, effectively completing the cash injection into Company A.
6. Company A pays dividends on its preference shares for which it receives no deduction. At the same time, Company B receives equivalent manufactured payments from the financial trader on which it is not taxable since section 208 ICTA1988 applies. Although Company A obtains no deduction for the dividends paid, Company B is entitled to a deduction for the equivalent amount payable as interest on the cash collateral. The group has therefore effectively converted non-deductible dividends into tax deductible interest.

Analysis

The financial trader will seek a deduction under section 95 ICTA1988 for the manufactured payments that it makes under the stock loan. One of its main purposes in being party to the arrangements is to secure a tax advantage for another person: it has devised the arrangements and carefully engineered them to allow the group to which Company A belongs to obtain a deduction it would not otherwise obtain. The Revenue would seek to restrict relief in respect of the manufactured payments.

Quality Standard and online filing

The Quality Standard (Statutory Instrument 2003 No. 2682 Regulation 209) sets out what is expected of employers and intermediaries when they file their Employer's Annual Return online for the tax year 2004-05.

Online filing means sending information direct from your computer to ours, by using our PAYE Internet services or Electronic Data Interchange. A large employer (250 or more employees) must file their Return online by 19 May next year. A medium-sized employer (50-249 employees) must file online the year after. Small employers do not have to file online until 2010 but they can receive tax-free payments of up to £825 if they file online from 2004-05 onwards.

The Quality Standard was one of the recommendations from Patrick Carter's review of payroll services and it also covers Simplified PAYE Deduction Schemes (P12s).

If an employer's annual return fails to meet the Quality Standard, we will reject it and treat it as not having been sent. The employer will have to correct the return and resubmit it to us by the deadline date, if the late filing penalty is to be avoided.

It is very important for software developers, and the employers who rely on them, to ensure that their products meet the Quality Standard.

The final version of the Quality Standard as well as the Quality Standard for 2004-05 can be found on our website: www.inlandrevenue.gov.uk/ebu/qual_stand.htm

Penalties

A penalty of up to £3000 has been introduced for employers who do not send their return online when they should have done so. This is in addition to the existing late filing penalty.

The penalty for not filing online is based upon the number of P14s, which should have been included in the employer's Return (Statutory Instrument 2003 No. 2682 Regulation 210).

To enable us to quickly decide the level of penalty we will, for 2004-05 only, base it on the number of employees the employer had as at 26 October 2003. If an employer feels the outcome is excessive, they may appeal to have the penalty calculated on the statutory basis.

In the vast majority of cases, the number of employees at 26 October will provide a lower figure, which we will not seek to increase when the exact size of employer's Return is known.

An Update on Double Taxation Agreements (DTAs)

Annual Review

The Government reviews the UK's treaty priorities each year to ensure that the DTA network continues to meet the needs of those receiving income from abroad. The Inland Revenue monitors the effectiveness of the UK's DTAs and invites representations from business, individuals, representative bodies, other Government departments and others with an interest in this area. The comments received provide useful information on problems experienced with existing treaties and potential gaps in the treaty network.

The Paymaster General, Dawn Primarolo MP, recently announced details of the negotiating programme for DTAs for the year to 31 March 2005. Full details were given in the Inland Revenue News Release issued on 15 July 2004 and a summary is given below.

The Paymaster General said, "I am pleased to announce the programme of work on double taxation agreements for the year to 31 March 2005. Bilateral double taxation agreements represent a well established approach for helping business deal with tax systems across borders and have an important role to play in facilitating trade and investment by streamlining the interfaces between national tax systems."

DTA Negotiating Programme

- We plan to complete work on new treaties with Botswana, Poland and Slovenia.
- We intend to progress negotiations with Bahrain, the Cayman Islands, Greece, Iran, Italy, Luxembourg, the Netherlands, Saudi Arabia, Serbia and Montenegro, Thailand and UAE.

New / Exploratory Talks

- We plan to open negotiations with Hungary and Macedonia.

We assess the need to negotiate new or updated treaties, balanced with the available resources and the prospect of reaching agreement within a reasonable time. We will make further announcements about talks with other countries as and when arrangements are made.

Representations on these and other negotiations are welcome (see the section below for details). We will generally invite country-specific representations through an Inland Revenue News Release shortly before we begin any initial negotiations.

Tax Information Exchange Agreements (TIEAs)

We have opened negotiations on TIEAs with Jersey, Guernsey, Isle of Man and the British Virgin Islands. This is

part of our programme of establishing TIEAs with jurisdictions that have made commitments to the OECD to improve transparency and effective exchange of information in tax matters.

Work is already in hand to finalise the EU Savings Directive related agreements with UK dependencies and the Dutch dependent territories.

Negotiations in Progress

Australia

The DTA with Australia, signed in Canberra on 21 August 2003, entered into force on 17 December 2003. The provisions of the DTA apply in the UK from 1 April 2004 (for corporation tax), from 6 April 2004 (for income tax and capital gains tax) and from 1 July 2004 (for tax withheld at source). The provisions of the DTA apply in Australia from 1 April 2004 (for fringe benefits tax) and from 1 July 2004 (for other taxes and for tax withheld at source).

Bahrain

A second round of talks took place in London from 1 to 3 December 2003.

Canada

The Protocol to the DTA with Canada, signed in London on 7 May 2003, entered into force on 4 May 2004. The provisions of the DTA will apply in the UK from 1 April 2005 (for corporation tax) and from 6 April 2005 (for income tax and capital gains tax) and in Canada from 1 January 2005.

Cayman Islands

A first round of talks on a comprehensive DTA was held in London from 6 to 7 May 2004.

Chile

The Chief Secretary to the Treasury, Rt Hon Paul Boateng MP, and the Chilean Finance Minister Mr Nicolas Eyzaguirre signed a comprehensive DTA between the UK and Chile in London on 12 July 2003. The DTA was approved by the Eighth Standing Committee on Delegated Legislation in the House of Commons on 13 November 2003. The DTA will enter into force once both countries have completed the necessary legislative procedures.

Croatia

A second round of talks was held in Zagreb from 21 to 24 October 2003.

France

A comprehensive DTA between the UK and France was signed in London on 28 January 2004 by the Paymaster General, Dawn Primarolo MP, and the French Ambassador, M. Gérard Errera. The text of the new DTA can be accessed on the Internet at www.inlandrevenue.gov.uk/pdfs/uk/france_dtconvention.pdf.

The text will in due course be laid as a Schedule to a Draft Order in Council for consideration by the House of Commons and will then also be available from the Stationery Office.

Greece

A first round of negotiations on a comprehensive DTA took place in London from 9 to 12 December 2003.

Georgia

The Foreign Secretary, Rt Hon Jack Straw MP, and Her Excellency Mrs Salome Zurabishvili, the Foreign Minister of Georgia signed a comprehensive DTA between the UK and Georgia in London on 13 July 2004. The text of the DTA is available on the Inland Revenue's website, at <http://www.inlandrevenue.gov.uk/international/uk-georgia.pdf> and will be published in due course as a schedule to a draft Order in Council and laid before the House of Commons for approval. The DTA will enter into force once both countries have completed their constitutional procedures.

Hong Kong

A first round of negotiations on a comprehensive DTA took place in London between 11 and 15 September 2003.

Iran

The first round of negotiations on a comprehensive DTA took place in Tehran from 6 to 9 July 2003 followed by a second round in London from 26 to 30 July 2004.

Italy

The first round of talks on an updated comprehensive DTA was held in London from 9 to 11 June 2004.

Luxembourg

A first round of talks on a comprehensive DTA was held in London from 13 to 16 October 2003.

Mauritius

The Protocol to the DTA with Mauritius, signed in Port Louis on 27 March 2003, entered into force on 22 October 2003. The provisions of the Protocol apply in the UK from 1 April 2003 (for corporation tax) and from 6 April 2003 (for income tax and capital gains tax) and in Mauritius from 1 July 2003.

New Zealand

The Protocol to the DTA with New Zealand, signed in London on 4 November 2003, was approved by Parliament on 31 March 2004 and entered into force on completion of the legislative processes by both countries on 23 July 2004.

Poland

A first round of negotiations to update the comprehensive DTA took place in Warsaw from 29 March to 2 April 2004.

Saudi Arabia

A second round of negotiations took place in London from 14 to 17 April 2003.

Thailand

A first round of negotiations took place in London from 24 to 28 May 2004.

UAE

A third round of negotiations took place in London from 14 to 15 November 2000.

Representations

General representations concerning new DTAs, or suggestions about changes to existing agreements, are welcomed and should be addressed to:

Mrs Jas Sahni
Revenue Policy International
Inland Revenue
Victory House
30-34 Kingsway
London WC2B 6ES

Email: Jas.Sahni@ir.gsi.gov.uk

Queries regarding the effects of a DTA on a particular taxpayer's tax liability should always be referred to the Inland Revenue office responsible for dealing with that taxpayer's affairs.

Further Information

Further information on double taxation and related issues can be obtained via the Internet on the Inland Revenue website at www.inlandrevenue.gov.uk

Copies of double taxation agreements published from 1997 onwards can be found on the Stationery Office's website at www.hms.o.gov.uk or purchased via www.tso.co.uk

Copies of older agreements can be obtained from the Stationery Office - Telephone 0870 600 5522. The Statutory Instrument number should be quoted (see the following list).

General double taxation issues arising in connection with estates, inheritances and gifts should be addressed to:

Angela Cole
Inland Revenue
Revenue Policy Capital and Savings
Room 121, 3rd Floor
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United Kingdom Double Taxation Agreements

Position as at 1 August 2004

NOTES

Type of Agreement: The term **Comprehensive** refers to a DTA concerning taxes on income, and sometimes also taxes on capital gains; **Limited** means a DTA dealing solely with taxes on profits from air transport (**a**) and/or shipping (**s**); **Estates** refers to a DTA which deals with taxes on estates, inheritances and gifts; a **Protocol** is an amendment to an existing DTA. In all cases reference is necessary to the text of the DTA to ascertain the specific taxes dealt with.

The **official designation** of the DTA is indicated by:

[C]: convention; [Ag]: agreement; [Ar]: arrangement; [P]: protocol; [ex]: except IHT imposed on lifetime gifts

The **date of signature** is given in the second column; an asterisk (*) indicates the date of the Order in Council, in the case of DTAs which do not contain signatures.

Unless otherwise annotated, all DTAs shown are **in force**.

No mention is made in this list of **negotiations** in progress.

The former Soviet Union:

Statement of Practice 4 of 2001 explains the present position.

Former Yugoslavia: The UK's DTA with **Yugoslavia** (SI 1981 No.1815) is currently to be regarded as in force between the UK and **Croatia** and **Slovenia** only. The position with regard to Yugoslavia (i.e. Serbia and Montenegro) **Macedonia** and **Bosnia-Herzegovina** is uncertain [Statement of Practice 6 of 1993].

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
ALGERIA			
Limited (a) [Ag]	27.05.81	1984 No.362	
ANTIGUA AND BARBUDA			
Comprehensive [Ar]	19.12.47*	1947 No.2865	
- Protocol [Ag]	05.12.68	1968 No.1096	
ARGENTINA			
Comprehensive[C]	03.01.96	1997 No 1777	
ARMENIA			
		former UK-USSR DTA will cease to apply wef 6.4.02 [SP4/01]	
AUSTRALIA			
Comprehensive [C]	21.08.03	2003 No 3199	
AUSTRIA			
Comprehensive [C]	30.04.69	1970 No.1947	
- Protocol [P]	17.11.77	1979 No.117	
- Protocol [P]	18.05.93	1994 No.768	
AZERBAIJAN			
Comprehensive [C]	23.02.94	1995 No.762	
BANGLADESH			
Comprehensive [C]	08.08.79	1980 No.708	
BARBADOS			
Comprehensive [Ag]	26.03.70	1970 No.952	
- Protocol [P]	18.09.73	1973 No.2096	
BELARUS			
Comprehensive [C]	31.07.85	1986 No.224	Continuation of DTA with Soviet Union
<i>Comprehensive [C]</i>	<i>07.03.95</i>	<i>1995 No.2706</i>	<i>Not yet in force</i>
BELGIUM			
Comprehensive [C]	01.06.87	1987 No.2053	
BELIZE			
Comprehensive [Ar]	19.12.47	1947 No.2866	, DTAs with British Honduras
- Protocol [Ar]	08.04.68	1968 No.573	
- Protocol [Ar]	12.12.73	1973 No.2097	
BOLIVIA			
Comprehensive [C]	03.11.94	1995 No.2707	
BOSNIA-HERZEGOVINA - see introductory notes			
BOTSWANA			
Comprehensive [Ag]	05.10.77	1978 No.183	

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
BRAZIL			
Limited (a & s) [Ag]	08.04.68*	1968 No.572	
BRUNEI			
Comprehensive [Ar]	08.12.50*	1950 No.1977	
- Protocol [Ar]	04.03.68*	1968 No.306	
- Protocol [Ar]	12.12.73*	1973 No.2098	
BULGARIA			
Comprehensive [C]	16.09.87	1987 No.2054	
BURMA (MYANMAR)			
Comprehensive [Ag]	13.03.50	1952 No.751	
- Protocol [P]	04.04.51		
CAMEROON			
Limited (a) [Ag]	11.09.81	1982 No.1841	
CANADA			
Comprehensive [C]	08.09.78	1980 No.709	
- Protocol [P]	15.04.80	1980 No.1528	
- Protocol [P]	16.10.85	1985 No.1996	
- Protocol [P]	07.05.03	2003 No 2619	
CHILE	12.7.03	2003 No 3200	not yet in force
CHINA			
Comprehensive [Ag]	26.07.84	1984 No.1826	
- Protocol [P]	02.09.96	1996 No 3164	
CROATIA			
Comprehensive [C]	06.11.81	1981 No.1815	DTA with <i>Yugoslavia</i> still applies
CYPRUS			
Comprehensive [C]	20.06.74	1975 No.425	
- Protocol [P]	02.04.80	1980 No.1529	
CZECH REPUBLIC			
Comprehensive [C]	05.11.90	1991 No.2876	DTA with <i>Czecho- slovakia</i> still applies
DENMARK			
Comprehensive [C]	11.11.80	1980 No.1960	
- Protocol [P]	01.07.91	1991 No.2877	
- Protocol [P]	15.10.96	1996 No 3165	
EGYPT			
Comprehensive [C]	25.04.77	1980 No.1091	

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
ESTONIA			
Comprehensive [C]	12.05.94	1994 No.3207	
ETHIOPIA			
Limited (a) [Ag]	01.02.77	1977 No.1297	
FALKLAND ISLANDS			
Comprehensive	17.12.97	1997 No 2985	
FIJI			
Comprehensive [C]	21.11.75	1976 No.1342	
FINLAND			
Comprehensive [C]	17.07.69	1970 No.153	
- Protocol [P]	17.05.73	1973 No.1327	
- Protocol [2nd.P]	16.11.79	1980 No.710	
- Protocol [3rd.P]	01.10.85	1985 No.1997	
- Protocol [4th.P]	26.09.91	1991 No.2878	
- Protocol [P]	31.07.96	1996 No 3166	
FRANCE			
Comprehensive [C]	22.05.68	1968 No.1869	
- Protocol [P]	10.02.71	1971 No.718	
- Protocol [P]	14.05.73	1973 No.1328	
- Protocol [P]	12.06.86	1987 No.466	
- Protocol [4th.P]	15.10.87	1987 No.2055	
Comprehensive [C]	28.01.04		Not yet in force
Estates [C] [ex]	21.06.63	1963 No.1319	
GAMBIA			
Comprehensive [C]	20.05.80	1980 No.1963	
GEORGIA			
Comprehensive [Ag]	13.07.04		Not yet in force
GERMANY			
Comprehensive [C]	26.11.64	1967 No.25	
- Protocol [P]	23.03.70	1971 No.874	
GHANA			
Comprehensive [C]	20.01.93	1993 No.1800	
GREECE			
Comprehensive [C]	25.06.53	1954 No.142	
GRENADA			
Comprehensive [Ar]	04.03.49*	1949 No.361	
- Protocol [Ag]	25.07.68	1968 No.1867	
GUERNSEY			
Comprehensive [Ar]	24.06.52*	1952 No.1215	
- Protocol [Ar]	14.12.94*	1994 No.3209	

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
GUYANA			
Comprehensive [C]	31.08.92	1992 No.3207	
HONG KONG			
Limited [a]			
air transport	25.07.97	1998 No 2566	
Limited [a] shipping	25.10.00	2000 No 3248	
HUNGARY			
Comprehensive [C]	28.11.77	1978 No.1056	
ICELAND			
Comprehensive [C]	30.09.91	1991 No.2879	
INDIA			
Comprehensive [C]	25.01.93	1993 No.1801	
Estates [Ag] [ex]	03.04.56	1956 No.998	
INDONESIA			
Comprehensive [Ag]	05.04.93	1994 No.769	
IRAN			
Limited (a) [Ag]	21.12.60*	1960 No.2419	
IRELAND, Republic of			
Comprehensive [C]	02.06.76	1976 No.2151	
- Protocol [P]	28.10.76	1976 No.2152	
- Protocol [P]	07.11.94	1995 No.764	
- Protocol [P]	04.11.98	1998 No 3151	
Estates [C]	07.12.77	1978 No.1107	
ISLE OF MAN			
Comprehensive [Ar]	29.07.55	1955 No.1205	
- Protocol [Ar]		1991 No.2880	
- Protocol [Ar]	14.12.94*	1994 No.3208	
ISRAEL			
Comprehensive [C]	26.09.62	1963 No.616	
- Protocol [P]	20.04.70	1971 No.391	
ITALY			
Comprehensive [C]	21.10.88	1990 No.2590	
Estates [C] [ex]	15.02.66	1968 No.304	
IVORY COAST (COTE D'IVOIRE)			
Comprehensive [C]	26.06.85	1987 No.169	
JAMAICA			
Comprehensive [Ag]	16.03.73	1973 No.1329	
JAPAN			
Comprehensive [C]	10.02.69	1970 No.1948	
- Protocol [P]	14.02.80	1980 No.1530	

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
JERSEY			
Comprehensive [Ar]	24.06.52*	1952 No.1216	
- Protocol [Ar]	14.12.94*	1994 No.3210	
JORDAN			
Limited (a & s) [Ag]	06.03.78*	1979 No.300	
Comprehensive [C]	22.07.01	2001 No 3924	
KAZAKSTAN			
Comprehensive [C]	21.03.94	1994 No.3211	
- Protocol [P]	18.09.97	1998 No 2567	
KENYA			
Comprehensive [Ag]	31.07.73	1977 No.1299	
- Protocol [P]	20.01.76		
KIRIBATI			
Comprehensive [Ar]	10.05.50*	1950 No.750	DTAs with <i>Gilbert</i>
- Protocol			<i>and</i>
[Limited (a) [Ag] SA]	04.03.68*	1968 No.309	<i>Ellice</i>
			<i>Islands</i>
- Protocol [Ar]	25.07.74*	1974 No.1271	
KOREA (S)			
Comprehensive [C]	25.10.96	1996 No.3168	
KUWAIT			
Comprehensive [C]	21.07.99	1999 No 2036	
KYRGYZSTAN			
		Former UK-USSR DTA will cease to operate wef 6.4.02 [SP4/01]	
LATVIA			
Comprehensive [C]	08.05.96	1996 No.3167	
LEBANON			
Limited (a & s) [Ag]	26.02.64*	1964 No.278	
LESOTHO			
Comprehensive	17.12.97	1997 No 2986	
LITHUANIA			
Comprehensive	19.03.01	2001 No 3925	
-Protocol	21.05.02	2002 No 2847	
LUXEMBOURG			
Comprehensive [C]	24.05.67	1968 No.1100	
- Protocol [P]	18.07.78	1980 No.567	
- Protocol [2nd.P]	28.01.83	1984 No.364	

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
MACEDONIA			
Comprehensive [C]	06.11.81	1981 No.1815	DTA with <i>Yugoslavia</i> still applies
MALAWI			
Comprehensive [Ar]	25.11.55	1956 No.619	1955 DTA with
- Protocol [Ag]	02.09.64*	1964 No.1401	<i>Federation of</i>
- Protocol [Ag]	12.07.68*	1968 No.1101	<i>Rhodesia and</i>
- Protocol [Ag]	10.02.78	1979 No.302	<i>Nyasaland</i>
MALAYSIA			
Comprehensive	17.12.97	1997 No 2987	
MALTA			
Comprehensive [C]	12.05.94	1995 No.763	
MAURITIUS			
Comprehensive [C]	11.02.81	1981 No.1121	
- Protocol [P]	23.10.86	1987 No.467	
- Protocol [P]	27.03.03	2003 No 2620	
MEXICO			
Comprehensive [C]	02.06.94	1994 No.3212	
MOLDOVA			
	Former UK-USSR DTA will cease to operate wef 6.4.02 [SP4/01]		
MONGOLIA			
Comprehensive [C]	23.04.96	1996 No.2598	
MONTserrat			
Comprehensive [Ar]	19.12.47*	1947 No.2869	
- Protocol [Ar]	08.04.68*	1968 No.576	
MOROCCO			
Comprehensive [C]	08.09.81	1991 No.2881	
MYANMAR - see BURMA			
NAMIBIA			
Comprehensive [C]	28.05.62	1962 No.2788	Extension of UK-South Africa DTA (SI 1962 No.2352) to <i>South West Africa</i>
- Protocol [P]	14.06.67	1967 No.1490	Extension of UK-South Africa protocol (SI 1967 No.1489) <i>South West Africa</i>

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
NETHERLANDS			
Comprehensive [C]	07.11.80	1980 No.1961	
- Protocol [P]	12.07.83	1983 No.1902	
- Protocol [P]	24.07.89	1990 No.2152	
Estates [C]	11.12.79	1980 No.706	
- Protocol [P]	07.09.95	1996 No.730	
NEW ZEALAND			
Comprehensive [C]	04.08.83	1984 No.365	
- Protocol	04.11.04	2004 No.1274	
NIGERIA			
AComprehensive [Ag]	09.06.87	1987 No.2057	
NORWAY			
Comprehensive [C]	12.10.00	2000 No 3247	
OMAN			
Comprehensive [C]	23.02.98	1998 No 2568	
PAKISTAN			
Comprehensive [C]	24.11.86	1987 No.2058	
<i>Estates [Ag] [ex]</i>	08.06.57	1957 No.1522	
PAPUA NEW GUINEA			
Comprehensive	17.09.91	1991 No.2882	
PHILIPPINES			
Comprehensive [C]	10.06.76	1978 No.184	
POLAND			
Comprehensive [C]	16.12.76	1978 No.282	
PORTUGAL			
Comprehensive [C]	27.03.68	1969 No.599	
ROMANIA			
Comprehensive [C]	18.09.75	1977 No.57	
RUSSIA			
Comprehensive [C]	15.02.94	1994 No 3213	
ST. CHRISTOPHER (ST. KITTS) AND NEVIS			
Comprehensive [Ar]	19.12.47*	1947 No.2872	
SAUDI ARABIA			
Limited (a)	10.03.93	1994 No.767	
SIERRA LEONE			
Comprehensive [Ar]	19.12.47*	1947 No.2873	
- Protocol [Ag]	18.03.68	1968 No.1104	

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
SINGAPORE			
Comprehensive	17.12.97	1997 No 2988	
SLOVAKIA			
Comprehensive [C]	05.11.90	1991 No.2876	DTA with <i>Czecho- slovakia</i> still applies
SLOVENIA			
Comprehensive [C]	06.11.81	1981 No.1815	DTA with <i>Yugoslavia</i> still applies
SOLOMON ISLANDS			
Comprehensive [Ar]	10.05.50*	1950 No.748	} DTAs with " <i>British Solomon Islands</i>
- Protocol [Ar]	08.04.68*	1968 No.574	
- Protocol [Ar]	25.07.74*	1974 No.1270	
SOUTH AFRICA			
Comprehensive [C]	04.07.02	2002 No.3138	
Estates [C]	31.07.78	1979 No.576	
SPAIN			
Comprehensive [C]	21.10.75	1976 No.1919	
- Exchange of Notes	15.03.95	1995 No.765	
SRI LANKA			
Comprehensive [C]	21.06.79	1980 No.713	
SUDAN			
Comprehensive [C]	08.03.75	1977 No.1719	
SWAZILAND			
Comprehensive [Ag]	26.11.68	1969 No.380	
SWEDEN			
Comprehensive [C]	30.08.83	1984 No.366	
Estates [C]	08.10.80	1981 No.840	
- Protocol [P]	21.12.87	1989 No.986	
SWITZERLAND			
Comprehensive [C]	08.12.77	1978 No.1408	
- Protocol [P]	05.03.81	1982 No.714	
- Protocol [P]	17.12.93	1994 No.3215	
Estates [C]	17.12.93	1994 No.3214	
- Protocol [P]	17.12.93	1994 No. 3214	
TAIWAN			
Comprehensive [C]	08.04.02	2002 No 3137	

Country Type of Agreement	Date of Signature	Statutory Instrument: Year/Number	Notes
TAJIKISTAN			Former UK-USSR DTA applies [SP4/01].
THAILAND			
Comprehensive [C]	18.02.81	1981 No.1546	
TRINIDAD AND TOBAGO			
Comprehensive [C]	31.12.82	1983 No.1903	
TUNISIA			
Comprehensive [C]	15.12.82	1984 No.133	
TURKEY			
Comprehensive [Ag]	19.02.86	1988 No.932	
TURKMENISTAN			Former UK-USSR DTA applies [SP4/01]
TUVALU			
Comprehensive [Ar]	10.05.50*	1950 No.750	} DTAs with <i>Gilbert and Ellice Islands</i>
- Protocol [Ar]	04.03.68*	1968 No.309	
- Protocol [Ar]	25.07.74*	1974 No.1271	
UGANDA			
Comprehensive [C]	23.12.92	1993 No.1802	
UKRAINE			
Comprehensive [C]	10.02.93	1993 No.1803	
UNITED STATES			
Comprehensive [C]	27.04.01	2002 No 2848	}
- Protocol [P]	19.07.02		
Estates [C]	19.10.78	1979 No.1454	
UZBEKISTAN			
Comprehensive [C]	15.10.93	1994 No.770	
VENEZUELA			
Comprehensive [C]	11.03.96	1996 No. 2599	
VIETNAM			
Comprehensive [Ag]	09.04.94	1994 No.3216	
YUGOSLAVIA - see introductory notes			
ZAIRE			
Limited (a & s) [Ag]	11.10.76	1977 No.1298	
ZAMBIA			
Comprehensive [C]	22.03.72	1972 No.1721	
- Protocol [P]	30.04.81	1981 No.1816	
ZIMBABWE			
Comprehensive [C]	19.10.82	1982 No.1842	

interpretations

Large scale transfers of Local Authority housing to Registered Social Landlords (RSL)

We have been asked to comment on the Corporation Tax consequences where a RSL acquires social housing from a Local Authority and takes advantage of what has misleadingly, become known as the 'VAT shelter' arrangement. An RSL is a 'not for profit' body whose members include representatives of the social housing tenants and of the Local Authority.

A 'VAT arrangement' is intended to take advantage of a Local Authority's ability to reclaim VAT on repair/renovation expenditure on its domestic housing stock.

Situation without VAT arrangements

A typical example of the transfer involves properties valued, in their existing state, at £1m. The properties require £10m expenditure on repairs and improvements to bring them up to the 'decent homes' standard. If the Local Authority transfers the properties to the RSL for £1m and the RSL then expends £10m on repairs/improvements, the £1m is capital as is the improvement element of the £10m. Repair expenditure would be allowable. But the RSL is not able to reclaim the VAT it pays on those repairs.

Situation with VAT arrangements

Under the typical form of the VAT arrangements

- the properties are transferred to the RSL for £11m;
- the Local Authority enters into an undertaking to expend £10m on bringing the properties up to standard;
- the Local Authority enters into a collateral development agreement with the RSL under which the RSL will do the work of bringing the properties up to standard;
- the RSL pays the Local Authority £1m in cash and satisfies the balance of £10m by doing work to that value.

VAT arrangements of this type are effective in enabling VAT to be reclaimed because the Local Authority retains a contractual obligation to upgrade the properties transferred to the RSL. In these circumstances the Local Authority can recover VAT paid on the services of upgrading the properties, provided that the contract for the works is between the Local Authority and the building contractor, and the works are solely referable to the Local Authority's commitment to upgrade the housing.

We take the view, based on long established tax principles about the distinction between (non-deductible) capital expenditure and (deductible) revenue expenditure, that the effect of the arrangement is to turn the otherwise deductible repairs into the acquisition cost of a capital asset. We have received confirmation from Counsel that our analysis of the tax position is correct. So, in the example above, the whole £11m is capital expenditure on the acquisition of property and RSL is not entitled to deduction for any that sum in computing the amount of its Schedule A profit.

miscellaneous

Management Expenses – Finance Act 2004 Changes

Relief for the management expenses of investment companies has been available since 1915 and has remained broadly unchanged since then.

As part of the Corporation Tax Reform Project the tax differences between trading and investment companies are being reviewed. As a result the rules for management expenses have been overhauled and the eligibility for relief has been extended.

Following a period of consultation Finance Act 2004 (Section 38 to 46) introduced substantial changes to the previous legislation which took effect from 1 April 2004.

Section 130 ICTA (defining the companies eligible for the relief) has been amended, section 75 (containing the principal computational rules) has been replaced and two new sections have been introduced. Section 75A sets out for which period relief is due and section 75B deals with the recovery of excessive relief. Commencement and transitional provisions are in sections 42 and 43 of Finance Act 2004.

The new legislation can be found on the HMSO website at: <http://www.legislation.hmso.gov.uk/acts/acts2004/20040012.pdf>

There were also major changes to the rules in section 76 ICTA concerned with the expenses of insurance companies but these are not the subject of this article.

Company with Investment Business

From 1 April 2004 relief for expenses of management is no longer limited to 'investment companies' as defined in the previous legislation. The relief is now available to "companies with investment business" which is defined as '...any company whose business consists wholly **or partly** in the making of investments.'

Previously, to qualify, a company had to have a business that consisted 'wholly or mainly' in the making of investments and the principal part of its income also had to be from the investments. That income test has also been dropped. But the requirement that the business must involve the 'making of investments' (the meaning of which has been considered by the courts) has been retained.

These changes will be of particular importance to companies which manage investments consisting of shares in subsidiaries but also carry on a trade.

Management Expenses: computational rules

The main changes to the relief are:

- specific exclusion for capital expenditure (section 75(3)),
- relief is not available where the investments are held for an unallowable purpose (section 75(4)(b) and (5)),
- a new timing rule aligning the tax deduction with a company's accounting treatment entries (section 75A) with parallel rules to recognise for tax accounting entries which reverse earlier deductions (section 75B),
- appeals will no longer automatically be heard by the Special Commissioners,
- the relief is no longer limited to companies which are resident in the UK.

Some elements of the previous legislation have been retained:

- the exclusion of expenses which are otherwise deductible in computing profits,
- the deduction from management expenses of income that derives from a source not charged to tax,
- the carry forward of excess management expenses and the facility to surrender them as group relief,
- the treatment of unrelieved capital allowances and charges on income as management expenses.

Moreover, apart from the changes outlined above, there has been no attempt to change the meaning of the expression 'expenses of management', as considered by the Courts in construing the previous provisions.

Capital expenditure and unallowable purposes

Detailed draft guidance on the exclusion of capital expenditure as an expense of managing investments and the unallowable purpose test has been published on the Internet and is available at:

http://www.inlandrevenue.gov.uk/finance_bill2004/revclause38-46.pdf

The final version of this guidance will shortly be inserted in the Inland Revenue's Company Tax Manual together with guidance on the other changes.

Timing of relief and reversals

There is no longer a requirement that management expenses must be "disbursed" to qualify for relief. From 1 April 2004 to be eligible for relief an expense must be referable to an accounting period. The rules linking expenses with accounting periods are in the new section 75A ICTA. The relief follows the accountancy treatment, so long as that conforms with UK generally accepted accounting practice and subject to any specific statutory timing rules which otherwise apply, for example section 44 Finance Act 1989 concerned with late paid remuneration.

The new rules ensure that there is an adjustment for tax where the debit for an expense of management is reversed in the accounts of a subsequent accounting period (section 75B). This is necessary principally because there is no longer a requirement that only expenses which are paid out ('disbursed' under the old rules) may be deducted.

Where this applies, the adjustment should first reduce the management expenses available for the period (but not below nil) and any excess should then be charged under Case VI of Schedule D for that period.

Commencement and Transitional Provisions

The new provisions apply to accounting periods beginning on or after 1 April 2004.

Many accounting periods will straddle that date. To enable the correct amount of management expenses (due by virtue of section 75 itself) to be calculated for that period, and for those purposes only, the straddling accounting period is to be treated as two separate accounting periods. The management expenses available are calculated under the old rules up to 31 March 2004 and the new rules are applied for the period that commenced on 1 April 2004. The two figures are then added together (along with any sums specifically treated as management expenses of the straddling period by legislation other than that in section 75) to arrive at the figure of management expenses that are available for the whole straddling accounting period.

There are also rules to ensure that expenses are only allowed once and to ensure that management expenses will qualify for relief where they fall between the old and new rules.

The straddling period rules do not apply to the provisions about reversals described above. Only reversals made in accounting periods beginning on or after 1 April 2004 come within these provisions (though they apply regardless of when the expense reversed was charged in the accounts).

SP 02/04 - Allowable Expenditure: Expenses Incurred by Personal Representatives and Corporate Trustees

A new Statement of Practice, SP2/04, replaces SP8/94 in relation to certain expenses incurred by the personal representatives of deceased persons where the death in question occurred on or after 6 April 2004, and to expenses incurred by corporate trustees in making transfers and disposals on or after 6 April 2004. The text of SP2/04 is reproduced below.

Both Statements of Practice set out standard scales of allowable expenses which may be used for certain purposes of the Taxation of Chargeable Gains Act (TCGA) 1992 in place of the actual allowable expenditure incurred.

The main changes introduced by SP2/04 are:

- an increase in the monetary values set out in the scales broadly in line with the increase in the Retail Price Index since 1994, and
- the introduction of two new higher bands to cover larger estates.

In addition, there are some minor changes in wording to improve the clarity of the text.

Text of SP2/04

Expenses incurred by personal representatives

1. Following consultation with representative bodies, the scale of expenses allowable under Section 38(1)(b), TCGA 1992, for the costs of establishing title in computing the gains or losses of personal representatives on the sale of assets comprised in a deceased person's estate, has been revised. The Board of Inland Revenue will accept computations based either on this scale or on the **actual** allowable expenditure incurred.

2. The revised scale is as follows:

Gross value of estate	Allowable expenditure
A. Not exceeding £50,000	1.8% of the probate value of the assets sold by the personal representatives.
B. Over £50,000 but not exceeding £90,000	A fixed amount of £900, to be divided between all the assets of the estate in proportion to the probate values and allowed in those proportions on assets sold by the personal representatives.
C. Over £90,000 but not exceeding £400,000	1% of the probate value of the assets sold.
D. Over £400,000 but not exceeding £500,000	A fixed amount of £4,000, to be divided as at B. above.
E. Over £500,000 but not exceeding £1,000,000	0.8% of the probate value of the assets sold.
F. Over £1,000,000 but not exceeding £5,000,000	A fixed amount of £8,000, to be divided as at B. above.
G. Over £5,000,000	0.16 per cent of the probate value of the assets sold, subject to a maximum of £10,000.

3. The revised scale takes effect where the death in question occurred on or after 6 April 2004.

Expenses incurred by corporate trustees

4. Following consultation with representative bodies, the Inland Revenue have agreed the following scale of allowable expenditure under Sections 38 and 64(1), TCGA 1992, for expenses incurred by corporate trustees in the administration of estates and trusts. The Board of Inland Revenue will accept computations based either on this scale or on the **actual** allowable expenditure incurred.

5. The scale is as follows:

Transfers of assets to beneficiaries etc

(i) Publicly marketed shares and securities

(A) One beneficiary	£25 per holding transferred
(B) Two or more beneficiaries	As (A), to be divided in equal shares between the beneficiaries
	between whom a holding must be divided

(ii) Other shares and securities	As (i) above, with the addition of any exceptional expenditure
(iii) Other assets	As (i) above, with the addition of any exceptional expenditure

For the purpose of this statement of practice, shares and securities are regarded as marketed to the general public if buying and selling prices for them are regularly published in the financial pages of a national or regional newspaper, magazine, or other journal.

Actual disposals and acquisitions

(i) Publicly marketed shares and securities	The investment fee as charged by the trustees
(ii) Other shares and securities	As (i) above, plus actual valuation costs
(iii) Other assets	The investment fee as charged by the trustees, subject to a maximum of £75, plus actual valuation costs

Where a comprehensive annual management fee is charged, covering both the cost of administering the trust and the expenses of actual disposals and acquisitions, the investment fee for the purposes of (i), (ii) and (iii) above will be taken to be £0.25 per £100 on the sale or purchase moneys.

Deemed disposals by trustees

(i) Publicly marketed shares and securities	£8 per holding disposed of
(ii) Other shares and securities	Actual valuation costs
(iii) Other assets	Actual valuation costs

6. This scale takes effect for transfers of assets to beneficiaries, actual disposals and acquisitions, and deemed disposals by corporate trustees on or after 6 April 2004.

Working Together Publication

We have decided to stop sending out copies of Working Together to subscribers of Tax Bulletin because many of you are also on the Working Together distribution list and so receive two copies.

If you would like to continue to receive Working Together and do not normally receive a copy from the Working Together Team, please contact them at:

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Prosecutions

The Inland Revenue has a policy of selective prosecution involving the most serious cases across the whole range of the tax system. The Board sees this as an important part of its strategy to deter fraud and evasion. As part of the wider publicity for this strategy, details of Revenue Prosecutions are occasionally published in Tax Bulletin.

Hamdi and Mohsen Bichara

Brothers Hamdi and Mohsen Bichara, who were each sentenced to four years in prison in November 2003, have been ordered to pay Inland Revenue and HM Customs & Excise a total of £1,502,028 in a confiscation order issued by Liverpool Crown Court.

The charges related to the defrauding of both the Inland Revenue and Customs & Excise. The loss to the Inland Revenue was more than £785,000 and the loss of VAT to Customs in excess of £443,000.

Mohsen (50) was ordered to pay £826,983 by December 2005. Failure to pay will result in an additional prison sentence of 5 years. Hamdi (60) was ordered to pay £675,045 and failure to pay will result in an additional 4 years.

The Bichara brothers, both with two children, were directors of a company, Fiestatime Ltd, which operated a busy and successful restaurant known as Uncle Sam's Bistro from Renshaw Street in central Liverpool. They had owned the restaurant since the late 1980's. The fraud had been going on since 1995, culminating in a raid by Customs and Excise on the restaurant premises and the Bichara's homes in February 2001.

The brothers were both interviewed under caution by officers from the Inland Revenue Special Compliance Office, Manchester, where they admitted failing to declare the correct receipts for the restaurant for a number of years. Following extensive further investigations by Revenue and Customs officers, it was established that the fraud was carried out by manipulating the tills within the restaurant to the extent that takings of £3.2 million were not recorded. These sums were used to pay tax-free wages to restaurant staff.

Inland Revenue Financial Investigator James McColgan said:

“This is a very successful outcome and extremely good example of the investigation work undertaken between the Inland Revenue and Customs & Excise. Both departments will prosecute fraudsters and will seek to recover the money taken from the public purse.”

Philip Roy Harris

Philip Roy Harris, aged 47, of Windsor Close, Towcester, was sentenced to 8 months imprisonment at Aylesbury Crown Court. He pleaded guilty to 12 charges of cheating the Inland Revenue. This involved deducting tax and National Insurance from employees but failing to pay it over, understating the number of employees he had and under declaring profits his business had made.

His Honour Justice Rodwell took account of his guilty plea when he sentenced him to 4 months immediate imprisonment, with a further 4 months imprisonment on licence, in respect of each of the charges.

Prior to setting up in business on his own account on 15 August 1995, Mr Harris had a number of employments, primarily specialising in security work, including being a Scenes of Crime Officer (SOCO) with the Metropolitan Police Force.

Mr Harris, a father of three, ran a recruitment agency from offices in Conniburrow Boulevard, Milton Keynes, supplying other businesses with office workers, packers and warehouse operatives, but mainly specialising in supplying staff as security guards. He traded under the names of Pip Security, Harris Commercial and Harris Commercial Ltd.

Mr Harris set up PAYE schemes for the purpose of deducting Income Tax and National Insurance Contributions from the salary of his employees. This fraud concerns, primarily, the “theft of Deductions”, in that Mr Harris intentionally failed to remit PAYE Tax and NIC that he deducted from his employees, to the Inland Revenue from August 1995 to December 2001.

The fraud was discovered when Inland Revenue Employer Compliance Officers carried out a routine inspection of his business records. A detailed examination of them showed false addresses for certain employees, where Harris had included those of his golf-playing partners to throw the Revenue off the scent.

Nick Niewdach, a spokesman for the Inland Revenue said:

“The Inland Revenue will prosecute where people commit fraud. Those caught doing so can expect to be dealt with by the courts and possibly face going to prison. Given the circumstances surrounding this case, the result is considered to be a satisfactory outcome.”

The Inland Revenue is committed to continuing its investigations to uncover this kind of fraud. Individuals who make a voluntary disclosure of their income by coming forward before the Inland Revenue starts an investigation, can normally expect to settle with the Inland Revenue for tax, interest and penalties.

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

Extra Statutory Concessions

Number	Title	Date of Issue
A104	Employee Benefits: ‘Double Counting’ of car/car fuel benefits	05/07/2004

Statements of Practice

Number	Title	Date of Issue
02/04	Allowable Expenditure: Expenses incurred by Personal Representatives and Corporate Trustees	

You can get copies of SPs and ESCs by telephoning Chandra Chandramohan, on 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. 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

The subscription for 2004 is £22. If you would like to subscribe to Tax Bulletin please send your name and address together with your cheque to Inland Revenue, Finance Division, Barrington Road, Worthing, West Sussex BN12 4XH. Cheques should be crossed and made payable to "Inland Revenue".

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