

**TAXATION OF PRE-OWNED ASSETS:
FURTHER CONSULTATION**

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A consultation document

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Summary

This is a second consultation on the taxation of pre-owned assets. We would like your views to help us prepare draft regulations and associated guidance as well as identifying any other matter of operational concern.

How to Respond

The consultation period begins **today 16 August 2004** and will run until **18 November 2004**, although early responses by the end of September would help us greatly. Please ensure that your response reaches us by **18 November 2004**.

Please send consultation responses by e-mail to Alice.Wayte@ir.gsi.gov.uk or by post to:

Joanna Bigmore
Inland Revenue, Capital Taxes Policy Group
Room 121, New Wing
Somerset House
Strand
London WC2R 1LB
Telephone: 020 7438 7825
Fax: 020 7438 6380

Telephone enquiries on this consultation should be addressed in the first instance to Joanna Bigmore at the number above.

If you would like further copies of this consultation document it can be found at http://www.inlandrevenue.gov.uk/consult_new/index.htm or be obtained free of charge from the following address:

Inland Revenue Visitors Information Centre,
Ground Floor, South West Bush, Strand, London, WC2B 4RD

Confidentiality

The information you send us may be published in a summary of responses to this consultation. We will assume that if you are replying by e-mail, any confidentiality disclaimer that is generated by your

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organisation's IT system is overridden unless you specifically include a request to the contrary in the main text of your submission to us. Please note that confidentiality cannot be guaranteed where a response includes evidence of a serious crime.

If taxpayers or their advisers need to seek advice on particular points before our guidance is available, they are invited to contact the IHT Helpline on 0845 30 20 900.

Background

The Chancellor of the Exchequer announced proposals in his Pre-Budget Report on 10 December 2003 to impose an income tax on the benefit from enjoyment of “pre-owned assets”. Further details were published on 11 December 2003 in an Inland Revenue consultation document (“Taxation of Pre-Owned Assets”) which is available at http://www.inlandrevenue.gov.uk/consult_new/taxtreat_preowned_assets.pdf.

2. The Chancellor confirmed his intention to proceed with this proposal at Budget 2004: further details were published in Inland Revenue Budget Note BN40 (also “Taxation of Pre-Owned Assets”) published on 17 March 2004. In particular REV BN40 confirmed (paragraph 11) that the taxable benefit would be calculated broadly as originally announced (that is by reference to market rentals in the case of land, and by applying an imputed yield to capital values in the case of chattels and intangible assets); but indicated that further consultations would follow to settle the applicable rates of yield and other operational matters. Regulations addressing these matters will then be made before the charge comes into effect on 6 April 2005.

Scope of this document

3. This consultation seeks your views to help us prepare the draft Regulations. It also outlines our expected timetable for completing the regulations and publishing the guidance on how the charge in Schedule 15, Finance Act 2004 will operate. We would like your comments on the matters to be covered by this guidance; and your views on how it will operate.

Valuing assets and quantifying the chargeable benefit

4. The rules for establishing the benefit which is chargeable are set out in Schedule 15, Finance Act 2004. The precise machinery – and therefore the matters to be covered in the forthcoming regulations – depends on the nature of the assets in question.

5. In the case of land, the “cash equivalent” of enjoyment in a particular tax year is derived from market rental that would be paid for use of the land over the “taxable period” (that is, the tax year or any shorter period for which the asset is “caught” by Schedule 15). This figure is then scaled down, in cases where the taxpayer’s “stake” in the caught asset is less than 100 per cent, in the proportion DV/V , where V is the value of the whole asset on the “valuation date” for the year, and DV is the value reasonably attributable to the taxpayer on that date. In many cases, however, we would expect that taxpayers and their advisors will be able to establish the ratio DV/V from the surrounding circumstances without necessarily establishing the absolute amount of V or DV .

6. In the case of chattels, the “cash equivalent” of enjoyment in a particular tax year is found by applying a specified rate-of-return, over the “taxable period”, to the capital value of the asset as at the “valuation date” for the year. As with land, the cash equivalent may then fall to be scaled down in the proportion DV/V , though again we would generally expect this ratio to be found without the absolute values of DV and V needing to be estimated.

7. In the case of intangible assets, the cash equivalent is calculated, as for chattels, by applying a specified rate-of-return, over the “taxable period”, to the capital value of the assets as at the “valuation date”. There is, however, no provision for scaling down this figure, equivalent to that made for land and for chattels.

Matters that must be covered in regulations

8. It follows therefore that the following regulations must cover two matters in order for the charge in Schedule 15 to be fully operational at the beginning of tax year 2005-06:

- a valuation date must be specified for all assets in each tax year from 2005-06 onwards;
- a rate-of-return must be specified for chattels and for intangible assets from 6 April 2005 onwards.

In both of these respects, the primary legislation is compatible either with a uniform rule for all assets in question, or with regulations specifying distinct dates.

The valuation date

9. As noted above, the capital value of “caught assets” will directly affect the charge in the case of chattels and intangible assets, but not generally in the case of land. So the way that the “valuation date” is fixed is likely to be material in the case of chattels and intangibles rather than land. The relevant considerations differ to some degree between these two cases.

10. Values of the chattels most likely to be “caught” by Schedule 15 (for example high-value antiques and art objects) will generally be subject to quite wide margins of uncertainty. These uncertainties are likely to swamp any fluctuations in estimated value arising from the precise way that the “valuation date” is fixed in a given year. For formal purposes, however, we propose that the valuation date should be fixed at the earliest time in the tax year when Schedule 15 applies to the asset in question. This has the advantage of relative simplicity, and adopting an early date is likely, other considerations being equal, to give taxpayers a marginally lower nominal value than other dates would.

11. If in practice taxpayers find it more convenient to do their valuation at a later date in the tax year or in the period from the year-end to their filing date, we would not generally expect to challenge the amounts returned to us unless there is some indication that the date was chosen for tax-saving reasons.

12. Similar considerations may apply to some intangible assets: their values will be subject to a sufficient margin of uncertainty that the

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precise timing of the valuation date will be relatively immaterial. In other cases, however, intangible assets will be capable of precise valuation and their values may fluctuate materially from day to day – where for example the assets are quoted securities or reflect the value of quoted securities. In such cases we would expect taxpayers to return amounts determined for the particular valuation date specified in the regulations. In the absence of any obvious reason for adopting any other approach, however, we propose that the valuation date should again be the earliest time in the year when Schedule 15 applies: it should be no more burdensome in compliance cost terms than any other date, and as before should, other things being equal, be marginally favourable to the taxpayer.

13. We would like your views on whether there are any important exceptions to this general picture. It is conceivable that some assets may have a “natural” valuation date which will not necessarily coincide with a date specified in regulations – for example, where intangibles take the form of a proprietary financial product such as a life policy. We would generally expect such products to be continuously valued, (e.g. where they are linked to a unitised fund) so that taxpayers could readily satisfy a standard valuation rule. It is conceivable, however, that arrangements already in place will mean that good valuations are available at relatively low compliance cost at particular times of year – e.g. on policy anniversaries.

We would welcome your views on whether such situations are likely to be found often enough to merit special consideration; if so;

a) what provision might be possible for them without significant risk to the Exchequer, and

b) whether this should be embodied in the regulations or treated as a matter of operational good practice to be covered in the Revenue’s guidance?

Consultation Questions

Question 1. Ministers propose that the “valuation date” for purposes of Schedule 15 should, as a general rule, be 6 April of the tax year in question, or if later the first day of the “taxable period” for the asset in question. Do you agree that this should be the general rule?

Question 2. If not, what should be the alternative?

Question 3. Are there, in any event, particular cases which call for special treatment, either in the regulations or in guidance?

There could be different rates for different cases. In the interests of simplicity, however, Ministers are starting from the presumption that uniform rules will apply to all cases unless they are satisfied, following this consultation, that a case has been made to justify distinct provision for different cases.

Valuation at longer than annual intervals

14. The basic valuation rule in the primary legislation requires the taxable benefit to be computed afresh each year by reference to values as at the valuation date for that year. The forthcoming regulations may however, but need not, provide for the value for an earlier year to be carried forward (more strictly, the valuation date for an earlier year can be “re-used” to make valuations for a later year: in practice this will generally allow valuations already made to be re-used). Such regulations may, but need not, provide for “old” valuations to be adjusted, e.g. by increasing or reducing them in line with intervening movements in an index of prices.

15. This provision was made to address the concerns expressed in earlier consultations that repeated annual valuations could involve substantial compliance costs. But that is not true for all assets subject to Schedule 15. And even where costs are high, invoking this power to “re-use” valuations would itself mean increased complexity and hence extra compliance costs. It could also involve costs to the Exchequer, to the extent that nominal values of assets “caught” by Schedule 15, and the corresponding rental values in the case of land, are likely to increase over time. And it would be positively counter productive in compliance-cost terms if any special valuation regime functioned primarily to allow taxpayers a choice of valuations, so that taxpayers

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would incur all the compliance costs of applying both possible valuation bases for the purpose of seeing which one gave the lower liability.

16. It follows, therefore, that Ministers will only invoke the power allowing valuations less frequently than annually if they are satisfied following this consultation that to do so would make an overall improvement, taking compliance costs and Exchequer costs together.

17. More particularly, they believe that any special rule for valuation

- should apply only to assets where the compliance costs of valuation are high relative to the tax at stake between one valuation and the next
- should be as simple as possible, consistently with Minister's other objectives; and
- should be focussed on prospective compliance costs, and allow the minimum temptation for taxpayers to fine-tune their decisions, or to change from one valuation rule to another, in order to minimise prospective liability.

Which assets?

18. For the reasons already noted, the compliance costs of an annual valuation, or an annual assessment of rentals, seem likely to be high for land generally and for chattels generally, but not as a rule for intangible assets.

Question 4. Do you agree that any special valuation regime should be restricted to land and chattels? If so:

a) should it extend to intangible assets; and

b) which ones should it apply to; and

c) why?

A detailed argument in your reply to question 4.c) would help us assess the merits of the case for individual types of asset.

Should extended-interval valuations be compulsory or voluntary?

19. It would be simpler if any special valuation regime applied to all assets of an eligible kind which are caught by Schedule 15, and need to be valued for more than one income tax year. But this approach could in some cases involve higher liabilities than a strict annual valuation – and could seem particularly harsh from the taxpayers’ perspective if prevailing market prices (or market rents) fell sharply soon after an “actual” valuation having effect for an extended period of years. It would also require taxpayers to keep track of each asset’s valuation status (particularly if indexation were required in “non-valuation” years) over an extended period of years.

Question 5. Do you accept that a special valuation regime would be compulsory for eligible assets; or would taxpayers always want the option of a strictly-annual valuation?

20. Even if “extended-interval” valuations were in principle voluntary, we propose that the choice once made for a particular asset should be binding for the whole of a given “cycle”. If, for example, the rules permitted an actual value to be used for five years before re-valuation, a taxpayer would have the choice of valuation approach in this scenario to re-use the actual value for year 1 of the charge in their return for year 2 (after adjustment, if that were required): but having done so they would also be obliged to re-use it in years 3, 4 and 5 before the revaluation in year 6. And similarly if they chose to revalue on an actual basis in year 2 they would be obliged to use an actual value in years 3 to 5, as well as year 6 – following which the choice would be available again for the next cycle. (This does not, of course, exclude the possibility that the actual value estimated for, say, year 3 might be the same amount as the actual value estimated for year 2.)

21. The significance of the remaining design features obviously depends to some degree on whether the regime as a whole was voluntary. And, they are also inter-related. In particular, if there were a long period between successive valuations, and no provision for indexation of the figures in intervening years, this could involve significant Exchequer cost, and a risk that taxpayers would choose the option (if it were voluntary) primarily for tax-saving reasons. The corollary of that is that requiring indexation of asset values (up or down) in the years between “actual” valuations could allow longer intervals between valuations. But indexation of this kind would in itself significantly complicate the regime particularly given the difficulty in specifying an index – or different indices for different asset types –

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which are simultaneously authoritatively easy for taxpayers to find and use, and relevant to the actual assets which fall to be valued.

22. In very broad terms, we see a choice between a scheme which is
- compulsory for all land and chattels; simple, with no indexation of values in years between valuations; and operating over a relatively short cycle of, say, actual valuations every three years; or
 - a voluntary system (but with the choice made once-for-all-years in each cycle, as above); possibly with indexation; and possibly therefore operating over a longer cycle of, say, 5 years or more.

23. It is very much for taxpayers and their advisers to judge in the light of their own circumstances if either of these broad approaches offer advantage over an annual revaluation.

Question 6. Are either of these options attractive? If so:

a) which and why? and

b) do you have any comments on the design issues discussed here?

Special cases

24. We have assumed so far that any regime permitting valuation at less-than-annual intervals would operate over a cycle running from the tax year in which the asset in question first becomes chargeable under Schedule 15. That seems the right approach as a general value. But it is conceivable that it could cut across a “natural” cycle of valuation for the asset involved. For example, it is possible that some land covered by Schedule 15 might be subject to rental payments by the former owner (though not, ex hypothesi, payments which are high enough to extinguish liability under Schedule 15) and these are subject to revision at regular intervals but less frequently than annually. There might in principle be advantage in synchronising tax calculations with such an existing third-party commitment.

Question 7. Are situations like this likely to arise in practice? If so, how could they be accommodated without risk to the Exchequer, either in the regulations proper or in our operational guidance?

The imputed yield on chattels and intangible assets

25. It is necessary to specify the rates-of-returns to be used in the calculations at paragraphs 7(2) and 9(1) of Schedule 15.

26. As already noted, the regulations may, but need not, make different provision for different cases. They may also, but again need not, specify the rates in such a way that they vary over time (e.g. by following an externally-determined rate) rather than being determined in particular numerical amounts.

27. In consultation to date, Ministers have taken as their starting point a single rate for both chattels and intangible assets at the level currently applying (and known as the “official rate”) to “beneficial loans” to employees. Ministers continue to see this as the right starting point. They see strong arguments on grounds of simplicity for applying a single rate, or the simplest possible structure of multiple rates; and so far as possible to use rates which are already familiar to taxpayers and practitioners. And they think it would be out of place, given the objectives of Schedule 15 and the range of circumstances to be covered, to attempt a close analysis of each case in order to determine the rate to be applied. It is fair to say that the responses generally have not so far commented in detail on the consideration. It has, however, been argued that the rate on intangible assets should be lower than that on chattels. The argument, put shortly, is that the benefit from intangibles is of a different character from that from chattels, or from land. The benefit from intangible assets caught by Schedule 15 is the comfort from these assets being available to the taxpayer (but outside the taxpayer’s inheritance tax charge): any actual benefit they get by way of income or appointment of capital is already taxable in the normal way. Taxpayers enjoying chattels or land caught by Schedule 15, by contrast, get all the benefits following from actual possession which are properly measured by a full rental value, or a value approximating to that where the “official rate” applies to the capital value.

28. Even if the fundamental distinction were accepted, there is clearly further analysis required to explore what would be an appropriate rate of return for intangible assets.

Question 8. Do you have comments on these issues, or do you have any other points which you think would inform Ministers’ judgement on these rates?

Other operational matters

29. Schedule 15 imposes a charge to income tax. Tax returns for the year 2005-06 and onwards will make provision for amounts chargeable under Schedule 15, and anyone who finds in due course that they are liable but have not received a return should notify their chargeability to tax in the normal way. We are also preparing the forms that taxpayers will require to make the election contemplated by paragraph 23 of Schedule 15. We expect these to be available for the beginning of the 2005-06 tax year. We are also willing to implement the election through e-mail channels.

30. Once the Schedule 15 charge is fully in force, we expect that taxpayers and their advisers seeking day-to-day advice on the application of the charge will approach our Capital Taxes, Nottingham office which will have overall responsibility for implementing the legislation and carrying out any appropriate compliance checks. That office is currently drafting our guidance on the operation of Schedule 15; we expect to publish it in draft shortly after this consultation closes, and in final form early in the New Year. The guidance in preparation will be informed by the points and problem cases that have already been put to us in early consultations and during the passage of the legislation, so far as not overtaken by the amendments reflected in the Finance Act as passed.

Question 9. Do you have further points that you would like to see covered by our guidance, or are there any other points that you would like to re-emphasise?

Early responses to this question would be especially helpful – if possible by the end of September 2004. In any event your reply should reach us by 18 November 2004.

Next Steps

31. We will publish draft regulations and draft guidance shortly after this consultation closes. The regulations will be made, and final guidance will be published, early in the New Year.

The Consultation Criteria

The consultation is being conducted in line with the Code of Practice on Consultation. The Criteria are listed below. The full version can be accessed at <http://www.cabinet-office.gov.uk/regulation/Consultation/Code.htm>

The Six Consultation Criteria:

- 1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.**
- 2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.**
- 3. Ensure that your consultation is clear, concise and widely accessible.**
- 4. Give feedback regarding the responses received and how the consultation process influenced the policy.**
- 5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.**
- 6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.**

RIA

We will consider publication of an RIA to accompany the draft regulations.

Complaints

If you feel that the consultation does not satisfy these criteria please contact:

Steve Webster, Inland Revenue, Room 34, New Wing Somerset House, Strand, London, WC2R 1LB. Tel: 020 7438 6535, Fax: 020 7438 9191
E-mail: Steve.Webster@ir.gsi.gov.uk.

Internet access at: http://www.inlandrevenue.gov.uk/consult_new/index.htm

Appendix A

List of Questions

Question 1. Ministers propose that the “valuation date” for purposes of Schedule 15 should, as a general rule, be 6 April of the tax year in question, or if later the first day of the “taxable period” for the asset in question. Do you agree that this should be the general rule? (Page 9)

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Question 4. Do you agree that any special valuation regime should be restricted to land and chattels? If so:

- a) should it extend to intangible assets; and**
- b) which ones should it apply to; and**
- c) why? (Page 10)**

Question 5. Do you accept that a special valuation regime would be compulsory for eligible assets; or would taxpayers always want the option of a strictly-annual valuation? (Page 11)

Question 6. Are either of these options attractive?

If so;

- a) which and why? and**
- b) do you have any comments on the design issues discussed here? (Page 12)**

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Question 7. Are situations like this likely to arise in practice? If so, how could they be accommodated without risk to the Exchequer, either in the regulations proper or in our operational guidance?

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