HOUSE OF LORDS

Select Committee on Economic Affairs

1st Report of Session 2005-06

The Finance Bill 2005

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The Economic Affairs Committee

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NOTE: (Q) refers to a question in oral evidence, which will be published in Volume II (HL Paper 13–II).

ABSTRACT

This Report on Finance Bill 2005 by a sub-committee of the House of Lords Economic Affairs Committee is the third in a sequence which began with Finance Bill 2003. Our terms of reference, which have remained the same since we were first established, enable us to consider technical issues of tax administration, clarification and simplification, but not rates or incidence of tax.

We chose Countering Tax Avoidance as the focus of our inquiry this year because of its importance at the centre of the Government's taxation strategy and the size of the projected yield from this source.

Three key provisions were examined:
Clause 6 and Schedule 1: Disclosure of Value-Added Tax Avoidance Schemes
Clause 12 and Schedule 2: Direct Tax – Employee Securities: Anti-Avoidance
Clause 39 and Schedule 7: Avoidance Involving Financial Arrangements.

These measures were informed by the disclosure rules introduced in 2004 which were said by the Government to be designed to provide early warning of avoidance schemes, thus enabling HM Revenue and Customs (HMRC) to respond to avoidance in a targeted manner, whether by means of legislation or litigation, without creating unnecessary burdens for compliant taxpayers.

We first explored with our witnesses their impressions of the conduct and outcome of the consultations that followed the introduction of the disclosure rules in 2004, and their experience so far of the practical application of those rules. We are pleased to record that both private sector and official witnesses agreed that the consultations had been helpful and constructive and had led to workable rules. We do, however, draw to the attention of HMRC the perception of the Institute of Chartered Accountants in England and Wales that more feedback on VAT should be given as part of the continuing consultation process. We found the statistics of disclosures on direct tax a convincing demonstration that the rules had served to exclude unnecessary disclosures, thus keeping down resource costs for taxpayers, their advisers and HMRC.

As regards the new VAT disclosure measure, we are satisfied from the congruity of comments received from both sides that this was proportionate and appropriately targeted. We welcome the fact that HMRC acknowledge the scale and seriousness of the problem concerning the risk of confidentiality clauses in standard terms of engagement constituting a VAT hallmark. The potential for triggering disclosures in unwanted numbers, thus causing unnecessary resource costs for business and HMRC, has been plain to see. We look forward to a positive outcome of benefit to both sides from the consultations that were continuing as this report went to press.

Turning to the new anti-avoidance provision affecting cases where securities, interests in securities or securities options have been included in employee remuneration packages, particularly bonuses to the higher paid, we accept that a convincing case has been made out for setting 2 December 2004 as the effective date for any future blocking legislation that becomes necessary. We welcome an assurance from HMRC that they stand ready to advise in response to enquiries from those wishing to set up share schemes and share option plans for the generality of employees. We do, however, recommend that HMRC should give

careful consideration to the case put to us that certain employees remunerated by a convertible security could ultimately be taxed on a greater value than the true value of the convertible security. If that were indeed found to be the case, it is our view that the Government should consider introducing the necessary amendment(s) to avoid any element of double taxation.

Our private sector witnesses raised with us just two of the group of provisions concerning avoidance involving financial arrangements contained in Schedule 7. On rent factoring, concern was expressed that the measure had created uncertainty for normal commercial sale and leaseback arrangements. We urge that this issue be taken up directly with HMRC. Similarly, in the case of shares treated as loan relationships, it was represented to us that the provision could have an unintended harmful effect on group finance companies carrying out normal foreign exchange risk operations. The issue was raised too late for us to put it to HMRC ourselves, but we trust that, now it has surfaced, it will be explored thoroughly in direct consultations with them, and that a solution will be found.

Finance Bill 2005

CHAPTER 1: INTRODUCTION

1. In the last two years a sub-committee of the House of Lords Economic Affairs Committee has examined, in consultation with government and private sector witnesses, selected issues from the Finance Bills of those years. The aim, following a recommendation of the Procedure Committee adopted unanimously by the House on 24 July 2002[1], was to address technical issues of tax administration, clarification and simplification rather than to inquire into the rates or incidence of tax. The aim has also been to publish the sub-committee's findings after completion of the Commons committee stage of the Finance Bill but before the Commons remaining stages in order to enable the Government, if it so wished, to move amendments to the Bill at the report stage in the Commons as well as informing the second reading debate in the Lords.

2. This year the situation was complicated by the Dissolution of Parliament in April prior to a General Election on 5 May. As a result of this situation the Government published two Finance Bills—one (Bill 92 in the 2004/5 session) in March, some of the provisions of which were enacted by Parliament prior to the Dissolution; and the other (Bill 8 in the 2005/6 session) in May, containing the provisions left over from the earlier Bill. Because of the delay occasioned by the re-appointment of the Economic Affairs Committee in the new session of Parliament and the need to await publication of the second Finance Bill (26 May), the sub-committee was unable to begin its work until the second week of June. In view of the need to report by early July, at which point it was estimated that the Report stage of the Bill would be reached in the Commons, the sub-committee decided that it must address just one issue from the second Finance Bill. The issue selected was Countering Tax Avoidance, both for its importance as part of the Government's strategy for protecting tax revenues and because it was an issue which had been examined in the 2004 inquiry and therefore offered an opportunity to the sub-committee to review progress over the preceding 12 months as well as to inquire into the relevant provisions in the new Bill.

3. Even within this one topic, however, it was necessary to be selective if the inquiry was to be conducted in a sufficiently streamlined way to meet the required time constraints. For this reason the sub-committee, while recognising that there were a number of clauses and schedules in the Bill which related in one way or another to countering tax avoidance, decided to focus on three of them, as follows:

   Clause 6 and Schedule 1: Disclosure of Value-Added Tax Avoidance Schemes

   Clause 12 and Schedule 2: Direct Tax—Employee Securities: Anti-Avoidance

   Clause 39 and Schedule 7: Avoidance Involving Financial Arrangements

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[1] House of Lords Hansard Vol. 638, No 176, Col. 508

4. In addressing these clauses the sub-committee requested written evidence and took oral evidence from PricewaterhouseCoopers and Grant Thornton, from the Chartered Institute of Taxation, from the Law Society and from the Institute of Chartered Accountants in England and Wales. Evidence was also taken from HM Treasury and HM Revenue and Customs. The written and oral evidence collected will be published separately in Volume II of the report. The sub-committee would like to take this opportunity to thank all those who gave their time and efforts to setting out their perspectives of these clauses of the Finance Bill.

CHAPTER 2: COUNTERING TAX AVOIDANCE

Setting the Context

5. The provisions requiring disclosure of certain tax planning arrangements in three areas—VAT, rewards from employment and financial products—were a significant innovation of Finance Act 2004. One of our accountant witnesses called them "revolutionary" in their effect (Q 1). We took note that in 2005 the Government continues to set a high priority on protecting tax revenues, placing this activity at the centre of its strategy for delivering a modern and fair tax system.[2] The high profile that this topic enjoys is reinforced by the estimated yield from blocking loopholes in the three taxation areas affected, totalling £660 million in 2005–06 and rising to £700 million in 2007-08[3].

6. A Budget Day Press Release[4] announced no fewer than twelve measures intended "to tackle tax fraud and avoidance". Its preamble singled out for special mention those new measures which "have been informed by the disclosure rules introduced in 2004. These provide early warning of avoidance schemes, enabling the Government and Revenue Departments to respond to avoidance in a targeted manner, whether by means of legislation or litigation, without creating unnecessary burdens for compliant taxpayers." These provisions (listed in paragraph 3, above) have been selected as the focus of our Inquiry into Finance Bill 2005.

Consultations

7. To set this year's inquiry in context and before getting down to the detail of the draft legislation, we explored with our witnesses their impressions of the conduct and outcome of the consultations that followed the introduction of the disclosure rules in 2004, and their experience so far of the practical application of those rules. We sought to pick up the story at the point where last year's Inquiry was obliged to leave it. In particular, the backing Statutory Instruments were published in draft form only after our inquiry was under way, and we were told by officials that they would be the subject of full consultations before being finalised[5]. It was already clear that a period of constructive consultation would be crucial: the considered view of the Chartered Institute of Taxation (CIOT) was that "the initial drafts were not well thought through and aroused considerable concern as to their practicability". [6]

8. The quality of the consultation process occasioned some divergence of view among our private sector witnesses as between the direct taxes and VAT. Regarding the direct taxes, Peter Cussons, representing the Institute of Chartered Accountants in England and Wales (ICAEW) said: "The consultations were extremely helpful" (Q 45). John Whiting (PricewaterhouseCoopers (PwC) and representing also the CIOT) likened

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2 Pre-Budget Report (PBR), December 2004, HM Treasury, Cm 6408 at paragraphs 5.83–5.90; and Memorandum of Evidence by HM Treasury, 15 June 2005, at paragraph 1 (Volume II, HL Paper 13–II)

3 PBR, December 2004, at Table B4

4 PN 3; Protecting Tax Revenues, HMRC

5 *The Finance Bill 2004*, 1st Report of Session 2003-04, HL Paper 109-I, at paragraph 27

6 See evidence by John Whiting for CIOT (Volume II, HL Paper 13-II)

the consultation process to a long and painful journey, but called the end product "a reasonable result" (Q 2). He singled out the inclusion of additional filters as the main positive outcome, "filtering out what I might term the chaff, the bits and pieces that, frankly, were not necessary for disclosure because they are just well known" (Q 2). Speaking for the Law Society (LS) Mike Hardwick concurred. He said: "On the direct tax side those consultations were ultimately very helpful and constructive and I think did achieve a lot in terms of focusing the rules and making them workable" (Q 45). Grant Thornton's written evidence was in virtually the same terms: "… the final set of legislation was far more workable".[7]

9. Reactions to the course of consultation on the VAT side were more mixed. While he welcomed the amendments[8] to prevent taxpayers having to report the same scheme if they had previously provided prescribed information in relation to that scheme, John Arnold (ICAEW) criticised lack of feedback during consultations. He mentioned that the Institute had "put in nine pages of written comments and we got, I think, about a third of a page in reply a few months later". It was not easy to see from that reply what notice had been taken of the Institute's comments (QQ 41–42). Mike Hardwick (LS) said: "On the VAT side I think our experience was that not much changed in the course of the consultation" (Q 45). The ICAEW took the view that the consultations were too rushed, instancing as an example being given "from recollection four days" in which to comment on some draft guidance (as compared with the 12 weeks set out in the code of conduct on consultations) (Q 46).

10. Derek Jenkins (PwC) identified as a particular difficulty in the consultation process the "stop-go" imposed as a result of firm deadlines created by the timetable for legislation. This led, in his view, to "a requirement to come to a conclusion on the consultation at that point, even if both sides know they have not got the correct answer." He made a plea for a continuous process of consultation, which should not lead to "unsatisfactory conclusions passing into law to be amended some bit later" (Q 5).

11. At our meeting with officials from HM Treasury (HMT) and HM Revenue and Customs (HMRC) we began by asking generally for their views about the way things had evolved since we had last met them some 12 months ago to consider the disclosure of VAT and direct tax avoidance provisions in Finance Bill 2004. As regards direct tax, Dave Hartnett (HMRC) said that more than 500 disclosures had been received, of which around a quarter had concerned employment products. Summarising their experience, he said: "We have seen some things which have surprised us, some real creativity and ingenuity in the tax avoidance industry in the way things have been packaged, in the way loopholes have been found, in where we thought legislation was sound and it has turned out not to be, and some things that we have had to think very hard about, partly to understand but more to work out how to counter them… In summary, for direct tax I think this has been a very productive experience and helped us enormously to counter tax

7 See evidence by Mike Warburton and Lindsey Ashby, 17 June 2005 (Volume II, HL Paper 13-II)

8 These amendments were highlighted in the Memorandum of Evidence by HM Treasury, 15 June 2005, at paragraph 8 (Volume II, HL Paper 13–II)

avoidance faster than we would ever have done without this legislation" (Q 84).

12. Turning to VAT, Chris Tailby (HMRC) said that the total number of disclosures was over 700. He added: "We have been looking at schemes which businesses are currently using, so not necessarily new schemes but ones which are in existence. We have got much more information about new users. We have got something like 55 new users and some 15 actual new schemes we did not know about." By implication he cautioned against trying to compare outcomes with direct tax by counting the number of new Finance Bill provisions. With VAT "we are dealing with a European tax with European vires and, of course, our scope for making immediate legislative change is somewhat limited, so our initial approach is to challenge by looking to see whether we can introduce legislation but principally to challenge by means of litigation" (Q 84).

13. Regarding specific criticisms of the consultation process, which certain private sector witnesses had described to us as "stop-go", rushed and lacking in the amount of feedback from officials, Dave Hartnett (HMRC) told us that he was not sure he recognised the description of "stop-go", although he accepted that, in the matter of feedback, in the case of certain of the representative bodies the process had been "perhaps not as continuous for everybody as they would have liked". From the department's perspective consultations were continuous, and they included regular meetings with the big four [accountancy firms] and City law firms. He added: "We built a trusted group as well whom we tried out our ideas on quite frequently, continually going back to them." (Q 89) He instanced the total number of disclosures finally received as evidence of the success of the consultation process. "We listened and we actually spent a huge amount of time with them, with solicitors and barristers, accountants and others, and one of the so-called big four firms of accountants actually invited us into their tax planning centre to see how they do business, and that helped us enormously to frame the rules differently than we actually started out. That has helped us keep out the huge number of disclosures we were promised that would be of no value". (Q 85) Chris Tailby (HMRC) picked out "the educative process that we embarked upon" on VAT as a prime reason for containing to a minimum the number of disclosures that were really of no concern (Q 85).

14. **The direct tax disclosure rules, as finally adopted, were acknowledged by all our witnesses to be greatly changed for the better from the early drafts which we considered in last year's report. We found the statistics of disclosures (500, of which a quarter concerned employment products) to be a convincing demonstration that the rules had served to exclude unhelpful and unnecessary disclosures, thus keeping down resource costs for taxpayers, their advisers and HMRC. The fact that they were the outcome of a consultation process reflects credit on all who participated, private sector and officials alike. We do, however, draw to the attention of HMRC the perception of the ICAEW, as reported to us, that more feedback on VAT should be given as part of the consultation process.**

The Disclosure Rules in Operation

15. Our private sector witnesses drew a distinction between the VAT rules and the direct tax rules. John Whiting (PwC and CIOT) put the matter in

concrete terms[9]. "The direct tax rules started with broad definitions but have been narrowed; the VAT rules similarly started broad but have not been narrowed by the equivalent of the filters in the direct tax rules. As an example, 'confidentiality' is a feature of both sets of rules but, whereas the direct tax rules filter out such things as normal commercial arrangements in letters of engagement, those dealing with VAT rules still consider this could trigger a disclosure." Other private sector witnesses spoke about the issue of confidentiality as one of the hallmarks of tax avoidance in VAT in oral evidence. John Arnold (ICAEW) expressed the same views about letters of engagement as the CIOT (Q 53), later reiterating them even more strongly (Q 61). He remained concerned that the VAT rules had "the ability to be interpreted far too widely to catch… normal commercial transactions" and he was worried that there had been no published analysis of the 700 disclosures referred to recently during the Second Reading of the Finance Bill (Q 44). Mike Hardwick (LS) speculated that "the VAT disclosure rules could learn from the direct tax disclosure rules in that filters have worked well in direct tax, so I cannot myself see why they should not also work in the context of VAT" (Q 61). Looking at the number of new anti-avoidance provisions in FB2005, he observed that: "On the indirect tax side it is perhaps surprising that there does not seem to be much… which either means there is not much going on or maybe the targeting of the rules is not working as well" (Q 47). Grant Thornton concluded that "… lack of guidance will continue to create a dilemma for businesses, as they will have to decide whether or not they are affected"[10].

16. Turning to the direct tax rules, there was a measure of unanimity of response among our witnesses. For the ICAEW Peter Cussons said that "they are operating pretty well" and Mike Hardwick for the LS said: "I think we would echo that… It seems in practice that the rules have struck a reasonable balance, that the Revenue are getting disclosed the tax avoidance schemes they wanted disclosed but at the same time we do not find that there are excessive amounts of run-of-the-mill tax planning requiring to be disclosed. I think the evidence from this year's Finance Bill is that the direct tax ones have proved effective in requiring the disclosure of tax avoidance schemes" (Q 47). Nevertheless, the CIOT said of the rules: "For the moment, they remain complex with a good deal of work involved in their operation"[11].

17. Against that overall positive assessment our witnesses made a number of detailed criticisms and suggestions for improvements. These included (a) the difficulty and resource cost of complying with the five-day reporting requirement in the case of providing one-off "bespoke advice" on the structuring of a commercial transaction; (b) in spite of the considerable efforts (which they acknowledged) that had gone into producing successive versions of guidance notes and FAQs, applying the rules in practice remained over-complicated because certain key terms remained so widely defined—instances being when is something "made available", what is a "premium fee", and what is a "tax advantage"; and (c) continuing uncertainty, in the absence of feedback, about what constitutes "acceptable disclosure" in the sense of how much detail must be provided.

9 See evidence by John Whiting for CIOT (Volume II, HL Paper 13-II)

10 See evidence by Grant Thornton, 17 June 2005, at paragraph 1.5 (Volume II, HL Paper 13-II)

11 See evidence by John Whiting for CIOT (Volume II, HL Paper 13-II)

18. We took note of the Treasury's statement to us that "the number and quality of disclosures received by HMRC is as projected…".[12] In oral evidence we explored with them the three points raised with us. On (a), Dave Hartnett (HMRC) stressed that there had been a lot of discussion about the five-day time limit while the rules were being developed with the help of accountants and lawyers. He explained that, in the context of bespoke planning (perhaps a big M & A deal such as had been raised with us), HMRC had agreed that, if a decision to adopt a particular structure from among a number of options was taken only at the last minute before the contract was signed, "then there was not five days in which they could tell us, they told us at that moment in time". He added that another concern that had been raised with HMRC was that five days was not really long enough to enable the tax adviser to put everything in place to make it proof against the challenge he anticipated. "It was very open of them to tell us that", he remarked. He gave another instance of "planners lining [schemes] all up and all the customers up and not quite finishing the arrangement and then selling at the earliest moment with five days to go". He commented: "I think that is testimony to how the more extreme parts of this industry behave" (Q 93). The difference between a five-day limit and a 30-day limit was that "an awful lot… can happen in 30 days" and the time lapse could also lead to a significant loss of tax (Q 96). It was not a viable option to seek to block the avoidance from Day 1 of the 30-day period on the grounds that the consequential degree of uncertainty relative to the amount of tax at stake could be held to raise human rights issues (QQ 95-103).

19. As regards the broadness of the definitions instanced, Dave Hartnett (HMRC) said that this was deliberate. "…We thought the terms should be as broad as was commensurate with being understood. Terms like "premium fee" were actually offered to us by City lawyers, who thought these were terms that were well understood and that, if we supplemented them with guidance, then they would not only be well understood but widely understood". The risk with adopting too narrow a focus for counter-action in this area is that "we merely incite people to go somewhere else"(Q 94).

20. As to (c), what constituted "acceptable disclosure" in the sense of how much detail had to be provided, HMRC's experience to date was that there had not been much unacceptable disclosure. Where officials had sought additional information, they had done so informally and found respondents cooperative in filling in the gaps. But this was "an area where we and the tax avoidance industry need a bit more time to see how it is working" before reaching any conclusions.

21. **We received strong representations about the five-day reporting time limit last year and the issue continues to evoke disquiet from some private sector witnesses in the area of "bespoke schemes". However, in the light of the evidence from HMRC, which we find compelling, we are not repeating our recommendation of last year that further consideration should be given to increasing the time limit to 30 days. Indeed, given the reported attempts at exploitation of the five-day rule, we are glad to note that HMRC are thinking very hard about how to address that. Similarly, we accept the arguments in favour of a**

[12] Memorandum of Evidence by HM Treasury, 15 June 2005, at paragraph 5 (Volume II, HL Paper 13–II)

broad approach to the definition of the terms brought to our attention and we respect the need to allow time for more experience of the disclosure rules to be gained by both tax advisers and HMRC before it is appropriate to attempt to elaborate on what constitutes "acceptable disclosure".

Disclosure of VAT Avoidance Schemes: Clause 6 and Schedule 1

22. The Explanatory Notes (EN) described the effect of the provision as to "amend the requirement for businesses using VAT avoidance schemes to disclose their use. The definition of 'tax advantage' is extended to include cases where the amount of a person's non-deductible VAT is reduced as a result of using an avoidance scheme. The duty to notify avoidance schemes is amended accordingly".[13] The EN went on to identify a further amendment relieving the user of a newly designated scheme of the obligation to notify, provided he had previously notified it as a scheme including, or associated with, a prescribed provision.

23. In their written evidence[14] HMT set the measure in context by restating the catchment area: the VAT disclosure rules required businesses with an annual turnover of more than £600,000 to notify HMRC when they use a scheme prescribed in a list of known avoidance arrangements. Businesses with an annual turnover exceeding £10 million must also notify schemes that include, or are associated with, characteristic "hallmarks" of avoidance. They summed up the intended effect of the changes introduced in the Finance Bill as "to improve the effectiveness of these rules, drawing on the experience of disclosures to date".

24. The ICAEW told us that the criticism they had advanced last year about the VAT disclosure regime as a whole applied to the current proposals[15], namely that they are "so widely drawn that anything that does not maximise the VAT cost to business can be classed as a tax avoidance scheme". They picked up the point about confidentiality clauses in standard engagement contracts constituting a "hallmark" (see above at paragraph 15), adding: "If that is correct, then any advice given by a tax adviser to a client with a VAT turnover of over £10 million pa (or £5 million pa if the business acquires goods from another EU Member State) with the intention of reducing irrecoverable input tax will be reportable as a 'scheme'". In addition they raised the issue of the measure being "disproportionate as it imposes significant administrative burdens", and thus possibly in breach of EU law[16].

25. The PwC/CIOT memorandum of evidence[17], while noting that the changes would introduce a further degree of complexity, described the effect of the measure as "not unreasonable and might have been expected from the start". They picked out one practical difficulty of implementation, saying that "the

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13 Explanatory Notes Finance Bill 2005, HM Treasury, May 2005, referring to Clause 6 and Schedule 1, at paragraphs 1 and 13-17

14 Memorandum of Evidence by HM Treasury, 15 June 2005, at paragraphs 6-8 (Volume II, HL Paper 13–II)

15 Memorandum of Evidence by ICAEW, 15 June 2005, at paragraphs 7-10 (Volume II, HL Paper 13-II)

16 Memorandum of Evidence by ICAEW, 15 June 2005, at paragraph 10, citing article 22.8 of the Sixth VAT Directive (Volume II, HL Paper 13-II)

17 Memorandum of Evidence by PwC/CIOT, June 2005 (Volume II, HL Paper 13-II)

test can be one of who was the economic beneficiary of a purported tax saving—which inherently can be difficult to ascertain".

26. In oral evidence our witnesses developed their views of the potential impact on VAT generally, and on the VAT disclosure regime in particular, of cases being litigated both in the United Kingdom and elsewhere in the European Union (QQ 20–24). To illustrate the point John Whiting (PwC/CIOT) instanced one case[18] where the issue is "fundamentally what planning is acceptable and when it tips over into the European concept of abuse of rights." He added: "We wait to see what the decision will be" (Q 20).

27. For the ICAEW John Arnold, noting that the United Kingdom was unique among EU Member States in having a VAT disclosure scheme, pressed the criticism of its being too widely drawn. Citing an example of a day-to-day commercial decision about whether to buy a piece of equipment outright or to lease it at arm's length, he suggested that taking the latter course could be construed as a discloseable scheme. He added: "This is where I am saying the danger is. We have got to narrow it down to what the Customs part of HMRC really see as the mischief of the tax avoidance. If we do not do that and we leave it too wide, then the innocent are going to be caught…" (Q 60). The real problem of having such a wide net was the compliance cost. "The cost is not just the cost of disclosure. The cost is the cost of checking whether you have to disclose, and every major company has had to set up procedures to go through this for almost every new transaction they do" (Q 61).

28. We took up these points with officials from HMT and HMRC. Dave Ramsden (HMT) in his framing comments pointed to continuing concern at the size of the tax gap (the difference between what is collected and what is due under the law) for VAT. Putting the size of the tax gap at "very nearly 13%", he added: "When you think how much VAT we collect, that is a very significant amount of revenue that we are losing, and of that amount a significant proportion is through avoidance activity" (Q 105). Chris Tailby (HMRC) said that there was "no inherent difficulty" about the steps taken by the measure to pick up a potential lacuna in the original drafting, noting that this "seems to be borne out by the witnesses". He took us step by step through an example of schemes "where the advertising is diverted to a company offshore and falls outside the scope of the tax and the advertising is re-imported as some part of an exempt service". He confessed to some difficulty in understanding the specific problem that had been put to us about identifying the "economic beneficiary" of such an arrangement, adding: "It is not the sort of scenario that one would expect a business to fall into in an innocent way, it is clearly contrived to take out the VAT cost. It is that sort of scheme that we would want to find out about" (Q 105).

29. HMRC acknowledged that the confidentiality hallmark for VAT was currently (indeed, on the very day that we were meeting) the subject of consultation and discussion with practitioners. Chris Tailby said: "Where we have got to on that is that we are reviewing the provisions on confidentiality and, indeed, across the piece with both sets of disclosure arrangements to try and ensure there is as much convergence as possible; and, as far as confidentiality on VAT is concerned, we are seeking to reach an agreeable way forward until we can resolve the matter on a longer term basis" (QQ 106–107 and 128).

[18] The case concerns Halifax plc, BUPA and the University of Huddersfield (Q 20)

30. **As regards the Schedule 1 measure we were satisfied from the congruity of comments received from both sides that it was proportionate and appropriately targeted. We were not persuaded by the view of a private sector witness that there could be a difficulty in interpretation for legitimate businesses, and we accept the proposition put forward by HMRC that "it is not the sort of scenario that one would expect a business to fall into in an innocent way".**

31. **We welcome the fact that HMRC acknowledge the scale and seriousness of the problem concerning the risk of confidentiality clauses in standard terms of engagement constituting a VAT hallmark. The potential for triggering disclosures in unwanted numbers, thus causing unnecessary resource costs for business and HMRC, is plain to see. We look forward to a positive outcome of benefit to both sides from the consultations.**

Employee Securities: Anti-Avoidance: Clause 12 and Schedule 2

32. The EN[19] summarised the effect of the changes as to strengthen the effect of the anti-avoidance rules "in cases where securities, interests in securities or securities options are acquired in connection with employment". The intention of the underlying legislation[20] was said to be "to ensure that all of the value received by way of remuneration in the form of shares or other securities is subject to income tax and NICs at an appropriate time. The rules provide flexibility in the timing of the charges." As a result of the disclosure rules introduced in Finance Act 2004, HMRC had become aware "of a number of schemes which use shares or other securities in order to pass remuneration value to employees in a way that attempts to avoid or reduce Income Tax and NICs".

33. The PBR of December 2004[21] had indicated that a particular focus of the anti-avoidance effort in this area was "against a variety of schemes, particularly ones designed to avoid tax and NICs on bonuses received by higher paid employees". Unusually, the mention in the PBR was given an even higher profile by being made the subject of a separate Government statement issued alongside it. Quite apart from the amending legislation foreshadowed for 2005 it was made plain that further blocking provisions would be introduced to counter any schemes of this type which are developed in future, and that these would be effective from 2 December 2004 (the date of the statement).

34. HMT placed great stress in their evidence to us on the scale of the tax at risk. This was put at around £500 million in tax and National Insurance per annum. They said: "The Government estimated that around £2 billion of payments were intent on going through these schemes in 2004–05. The response was therefore fair and proportionate given the substantial amounts of revenue at risk and the history of previous attempts made by some taxpayers and their advisers to get round legislation aimed at stopping their avoidance schemes." They defended the decision to announce that future legislation on these schemes would, where necessary, be effective from

19 Explanatory Notes Finance Bill 2005, HM Treasury, May 2005, referring to Clause 12 and Schedule 2, at paragraphs 1 and 61-64

20 Part 7 of the Income Tax (Earnings and Pensions) Act 2003, as amended by Finance Acts 2003 and 2004.

21 Pre-Budget Report (PBR), December 2004, HM Treasury, Cm 6408 at paragraph 5.89

2 December 2004. It could not be made any clearer that the objective was to close down the targeted activities permanently. So, "only those who despite these warnings choose to avoid their responsibilities and pass more of a burden on to other taxpayers will be affected" [22].

35. The ICAEW expressed concern that the provisions were "very widely drafted and uncertain in scope"[23]. They thought that they could have the unintended effect of discouraging employers and employees from entering into "commercial incentive arrangements of the type that it is government policy to encourage". A further objection was that, as drafted, the provisions might lead to double taxation. Grant Thornton considered that "the threat of retrospective legislation is unwarranted as, in the majority of cases, the five-day disclosure rule should be sufficient to close the market for promoting packaged solutions".[24] They pointed to the difficulty of advising clients on how the legislation will impact on current transactions, as the taxation of these transactions could change in the future. They also considered that lack of clarity in the purpose tests reduced certainty for taxpayers and their advisers. PwC/CIOT also took up the theme of uncertainty of effect.[25] As a specific instance they picked out imprecision in the wording of Paragraphs 5 and 6 of Schedule 12—that "something… has been done". They stated: "There is of course no argument with an objective to curb unacceptable avoidance". But they went on to express the view that lack of precision in the law as drafted could lead to "the giving of relief [varying] according to what is viewed from time to time as 'the proper amount of tax and NICs'". They anticipated that one effect of the new measures would be to "generate a further deterrent for employers in terms of operational costs and delays, as increasing numbers of employers see no alternative to seeking the Inland Revenue's views on how the law impacts on their specific share plan proposals".

36. In oral evidence Ashley Greenbank (LS) gave a graphic account of the immediate impact of the 2 December statement (Q 70). "[Usually] coming up to Christmas you get a lot of bonus schemes from investment banks coming across your desk. If you are judging it in those terms the legislation was very effective in terms of reducing the numbers of those sorts of scheme in the employment-related securities area". As to appropriateness, he expressed "some serious concerns that some of the legislation at least is disproportionate in the way it operates". He gave details of three paragraphs (9, 15 and 18 of Schedule 2) where there was a perceived risk that a taxpayer who received convertible securities could ultimately be taxed on a greater value than the true value of the convertible security.

37. John Whiting (PwC/CIOT) took the view that the objective should be "to corral what we might term acceptable share schemes and unacceptable". Starting from the premise that for proprietors and staff to have an interest in the company was very much encouraged by government, and given the fact that the rate of tax on capital gains was 10% compared to a marginal rate of

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22 Memorandum of Evidence by HM Treasury, 15 June 2005, at paragraph 11 (Volume II, HL Paper 13– II)

23 Memorandum of Evidence by ICAEW, 15 June 2005, at paragraphs 11-12

24 Memorandum of evidence by Grant Thornton, 17 June 2005, at paragraph 4.1-4.3 (Volume II, HL Paper 13-II)

25 Memorandum of Evidence by PwC/CIOT, June 2005 (Volume II, HL Paper 13-II)

over 50% in terms of income tax and NICs combined, "it is not wholly clear where the boundary is and whether it is acceptable to give them a capital gains based reward rather than an employment reward" (Q 25). Mike Warburton (Grant Thornton) concurred. "Uncertainty is bad for business, bad for the economy and the threat of retrospective legislation is an uncertainty we could do without" (Q 25).

38. Dave Ramsden (HMT) chose to focus first on the issue of alleged practical difficulties for practitioners in advising clients in current circumstances. He said: "We think the position is very clear. Clause 12 and Schedule 2 are targeted at contrived arrangements designed to avoid tax and NICs on reward for employment. We think they are entirely consistent with the clear steers that Government has set out in this area, particularly in the statement made by the Paymaster General alongside the PBR, which you referred to, and in the technical note that was also published on PBR day. The point that we have reiterated in a number of places, and again in our memorandum to you, is to highlight that in this area of tax… the amount of revenue which would have been put at risk was from up to £2 billion paid in bonuses in 2004–05 if we had not taken the action that we did" (Q 109).

39. Dave Hartnett (HMRC) set the Schedule 2 measures in an historical context, which he traced back to removal of the upper level for National Insurance Contribution for employees in the late 1980s. In the ensuing years tax planners came up with an extraordinary variety of schemes with a twofold objective: "[to] defer the operation of Pay-As-You-Earn by transferring the income tax liability from the employer to the employee—the employee paid later than the employer; and to remove the liability of National Insurance Contributions". The authorities' response (at least until 2 December 2004) had been to block offending schemes piecemeal by specific anti avoidance legislation. But by late 2004 a "stage of exasperation" had been reached (Q 109).

40. Turning to detailed criticisms from witnesses that we had put to him, Dave Hartnett first defended the deliberately broad drafting of "something… has been done" on the grounds that such provisions "are intended to have a broad impact to stop people weaving their way around the provision and coming up with something new" (Q 109). Second, on the matter of a perceived risk that a taxpayer who received remuneration in the form of a convertible security could ultimately be taxed on a greater value than the true value of the convertible security, his response was robust: "I am not sure we agree with this at all but, if there is a double charge, then in a sense that is part of the jeopardy of entering into these very fancy arrangements—less than straightforward arrangements—for remuneration" (Q 109). Third, concerning the problem that had been put to us about the practical difficulty for tax professionals of advising on remuneration packages in the current situation, he said that nothing in the legislation applied to "genuine share schemes made available to employees and share option plans", adding that this had been made clear in the statement. He held out an offer to tax advisers to talk to HMRC about any case "of genuine difficulty", saying that the Department would do its best to respond. In appropriate circumstances that response would be in a form that could be relied upon (QQ 110–115).

41. Finally, as prompted by our witnesses, we explored the practical implications for taxpayers and their advisers of the novelty implicit in the Paymaster General's announcement that any legislation that might be needed in the

future to block new schemes would be backdated and be effective from 2 December 2004. Dave Hartnett (HMRC) sought to distinguish this action from the general view about retrospective legislation in the sense discussed earlier (at Paragraph 18). He said: "I do not think there is anything retrospective here in terms of what we were discussing earlier. The Paymaster General has put businesses and their advisers on notice prospectively as to the action the government will take if these fancy schemes continue. Anyone bold enough to market something which is akin to what has been seen before knows exactly what they are doing and the risk they take. In the context of human rights and other issues that arise, there are both formal and widely publicised notices…" (Q 110).

42. In his concluding remarks Dave Hartnett (HMRC) explained that the avoidance industry and its clients were now "on notice that this huge range of arrangements that they have seen in the past to reduce tax and national insurance liability has reached a stage where a much broader response is needed than has been given in the past. As a measure, as an approach, it does seem to be working. We have seen a reduction in teams selling this sort of arrangement in accountancy and legal firms and we also think we have seen a significant reduction in the incidence of it" (Q 114).

43. **We listened with increasing concern to the catalogue of ingenious schemes devised over the years in order to pass remuneration value to employees (particularly bonuses to the higher paid) in a way that attempted to avoid or reduce income tax and NICs. We took note of the view of HMRC that, even after the measures in the present Bill had passed into law, "there will be something new, the whole history of this suggests there will be, and we will have to counter that when we get there" (Q 109). Given the vast amount of tax at stake and in the light of that history we were persuaded that an exception to the normal approach to backdating was justified. Moreover, it seemed to us that the suggestion that professionals might now find it difficult to advise about remuneration packages that included share schemes and share option plans for the generality of employees was an exaggeration. In any case, HMRC assured us that they stand ready to respond to enquiries in a form that could be relied upon in appropriate circumstances, and we welcomed that assurance.**

44. **At the same time, we were not persuaded of the justification for the robust line taken by HMRC to the case put to us that certain employees remunerated by a convertible security could ultimately be taxed on a greater value than the true value of the convertible security. Where a scheme is deemed to be abusive, frustrating its application should do no more than ensure that the correct amount of tax and NICs are paid. We recommend that HMRC and the professions should consult further on this point and that the Government should consider introducing the necessary amendment(s) to avoid any element of double taxation.**

Avoidance involving Financial Arrangements: Clause 39 and Schedule 7

45. Schedule 7 of the Finance Bill comprises 36 pages of very detailed technical legislation, amounting to nearly a quarter of the total number of pages in the

Bill. The EN[26] explained that the measures "close a number of loopholes and block a number of avoidance schemes disclosed under Part 7 Finance Act 2004 and elsewhere. They all exploit legislation relating to financial products and arrangements of the types for which disclosure of schemes is required." A series of bullet points identified the main categories of affected schemes as ones which:

- convert interest type income into a capital gain or an untaxed receipt;
- exploit a loophole in the loss-buying rules;
- involve capital redemption bonds and the creation of artificial losses;
- exploit the 15-year cut off in the rent factoring rules;
- attempt to claim a double deduction under both the manufactured interest rules and the accrued income scheme;
- exploit perceived weaknesses in the arm's length rule for loan relationships and the group continuity rules for them and for derivative contracts; and
- use strips of corporate bonds to create discount which is not taxable under existing legislation, and strips of annuities and annual payments to exploit existing anti-avoidance legislation.

46. We invited our witnesses from the private sector to be selective among the measures included in Schedule 7, if they so wished, in offering evidence to us. In the event they chose to address us on two: rent factoring (Paragraph 1 of Schedule 7) and shares treated as loan relationships (Paragraph 10 of Schedule 7).

Rent Factoring

47. The EN [27]stated that, while schemes have different mechanisms, they share the same fundamental approach. "In the most common type of scheme[28], in exchange for a lump sum, in essence a loan, a company diverts future rents from property to a financier, usually a bank. The rents repay the capital element of the loan as well as paying the interest. By exchanging future income for a lump sum taxable only (if at all) under the rules in the Taxation of Chargeable Gains Act 1992, the borrower aims to get relief (by foregoing the rents no tax is paid on them) that would not otherwise be available for loan repayments."

48. PwC/CIOT told us[29]: "The key concern is that this new anti avoidance provision is effectively retrospective, in that it hits existing transactions entered into based on a legitimate (one would have thought) reliance on a position arising from specific statutory provisions which enabled commercially driven financing to be implemented using rent factoring arrangements of more than 15 years. An amendment to restrict the

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26 Explanatory Notes Finance Bill 2005, HM Treasury, May 2005, referring to Clause 39 and Schedule 7, at paragraph 1

27 Explanatory Notes Finance Bill 2005, HM Treasury, May 2005, referring to Clause 39 and Schedule 7, at paragraph 11

28 Such as the one examined in the case of *John Lewis Properties plc v CIR* 2003 [STC] 117

29 Memorandum of Evidence by PwC/CIOT, June 2005 (Volume II, HL Paper 13-II)

application of this provision to rents sold on or after 16 March 2005 would address the point". Derek Jenkins (PwC) amplified the point: "That was a very clear set of rules for taxpayers and many of them said to us that the legislature and the Inland Revenue had given them clear guidance… A proper commercial decision that was taken on the basis of clearly stated legislation and that drew a dividing line now has its viability destroyed" (Q 29). Mike Hardwick (LS) was equally concerned at the impact of the measure on what could be regarded as simply commercially driven ways of releasing money, namely a sale and lease-back or a lease and leaseback. He identified a need to avoid collateral damage to innocent transactions. He said: "With the removal this year of the 15-year limit that applied in the original legislation it now becomes more difficult to do a sale and lease-back to raise money… Those difficulties could be avoided if we had a purpose test" (Q 79). Peter Cussons (ICAEW), who focused his remarks principally on Paragraph 10 of Schedule 7 (see Paragraph 42 below) raised a practical issue concerning all the measures for which Budget Day (16 March 2005) was set as the effective date. Affected taxpayers and their advisers would need time to assimilate the effect of the change in the law on their particular circumstances and, as they judged it necessary, to unwind transactions. In these circumstances he thought a start date of 16 June would be better than 16 March (Q 75).

49. Richard Thomas (HMRC) told us that the Department had had directly "very little reaction or comment" about the rent factoring proposal. While acknowledging that a decision on deferring the commencement date was a policy matter for Ministers, he shared with us the background to some of the considerations that had informed thinking about the timing of implementation. First and foremost was the fact that "most tax avoidance schemes contain a provision for quick unwind in the event that legislation is introduced to stop them. That is one of the hallmarks that the US uses for determining what a tax avoidance scheme is. If it is capable of being shut down immediately and everybody is put back to the position they were in the first place, it must be tax avoidance". He went on to outline and distinguish between the two types of rent factoring schemes targeted by the measure, which have two different commencement rules. "For the assignment cases, where all you did was sell your future rents for a lump sum immediately and nothing else happened, the new rule would apply to assignments on or after Budget Day. For the interposed lease cases, it was said that they will apply whenever they were entered into as long as it was after 2000, but only in relation to rents payable after Budget Day (Q 119). Summing up he said: "There is no significance in 16 June compared with any other date. It would allow a more leisurely unwind than would otherwise have had to take place but most of these arrangements contain their own self-destruct button, should the legislation be announced, [so] that they can be closed down. They will revert back to the original position. The effect of not bringing the date forward to 16 June means that approximately three months of rents that would otherwise have been deductible in computing tax which the Government thought should not be deductible would have been allowed for that period" (Q 121). He frankly admitted: "The thinking at the time in 2000 was that 15 years was probably too long a period for someone to be able to create an effective tax avoidance scheme, but unfortunately that turned out not to be the case (Q 124).

50. **We took note of the fact that the "bright line" rule embodied in the 15-year cut off point in the rent factoring legislation had been deliberately selected by the Government of the day, and that to abolish it now implied something of a change of view about, or at any rate a deliberate moving of the boundary line between, acceptable tax planning and abusive exploitation of loopholes in the tax law. It seems to us that it should not have taken the authorities unawares that making the rule would give rise to the creation of "leases for 16 years or 15 years and a few days" (Q 119). Be that as it may, we accept that there was a need for second thoughts once it was adjudged that the cost of tax relief had become disproportionate**.

51. **We were surprised, in the light of what our private sector witnesses told us about the uncertainty the measure had led to for normal commercial sale and leaseback arrangements, that HMRC had found reactions "very muted indeed" (Q 119). We trust that those witnesses who expressed concerns to us will take them up directly with HMRC, who will now have been alerted by this Report.**

Shares Treated as Loan Relationships

52. The EN[30] set out the effect of the measure in the following terms: "These paragraphs deal with a number of schemes disclosed under Part 7 FA 2004 and elsewhere which exploit the fact that increases in value and gains from the disposal of shares are subject only to the rules for corporation tax on chargeable gains, if at all. The schemes use derivatives in conjunction with shares, or deferred subscription agreements to create what is in form a share but in economic substance a deposit or loan, since in most of them the risks associated with equity investments, as well as the rewards, are removed or significantly reduced, leaving the share giving a return, either by the payment of 'dividends' or by a wholly predictable increase in value, which is the type of return expected from debt."

53. Of the avoidance schemes closed down with effect from Budget Day, HMT identified this measure as the most important [31]. This assessment was borne out by the evidence given to us by the private sector. PwC supplied us with a supplementary memorandum[32] in which they acknowledged that the draft legislation had already been amended compared to what appeared in the March 2005 Finance Bill. They said that the changes (following exchanges with HMRC) were designed to mitigate the effect of "multiple taxation of the same passive income in any group of companies where multi-tier structures exist (a very common occurrence—usually for commercial non-tax reasons). The new provisions have mitigated this in part, but instead of every company in the ownership chain bearing tax as income on interest earned at the bottom tier, now alternate companies pay tax on the same income, so the problem is halved rather than eliminated." PwC also claimed that many of the definitions remained unclear or ambiguous and that an effect of the

30 Explanatory Notes Finance Bill 2005, HM Treasury, May 2005, referring to Clause 39 and Schedule 7, at paragraph 117

31 Memorandum of Evidence by HM Treasury, 15 June 2005, at paragraph 15 (Volume II, HL Paper 13–II)

32 Note from PricewaterhouseCoopers of amendments required to deal with anomalies, 17 June 2005, Shares treated as loan relationships (Volume II, HL Paper 13–II)

measure was "a targeting of preference shares, whether or not they are being used to create a tax advantage". They considered that a purpose test that would have the effect of limiting the scope to tax-driven structures could be effective. Finally, they thought that group finance companies might find themselves caught by these provisions "although all they do is raise and lend funds within the group in a tax-neutral way, i.e. ensuring that unpredictable foreign exchange movements are kept out of tax". This picked up a theme of other representations to us, that the package of measures could have the unintended effect of making the United Kingdom a less welcoming location for groups (Q 33 and QQ 37–39).

54. Peter Cussons (ICAEW) summed up his view of the measures as being that they were too widely drawn. He too acknowledged the degree of openness in the consultations that had been ongoing, but changes made so far had not succeeded in solving "the Section 91B problem". His understanding of the HMRC position was that "the whole purpose of 91B is to shore up this section which, one understands, is trying to stop banks putting part of their loan book into special purpose vehicles and not paying tax on what in commercial terms is an interest-like return. The issue that we have with the provision is that in our opinion it is untargeted because it applies to the whole corporate sector, not to banks only and dealers in securities" (Q 73). The ICAEW returned to the point in a supplementary note[33], adding a recommendation that the effective start date should be deferred from 16 March, as proposed, to 26 May 2005, "when taxpayers have the benefit of the second draft Finance Bill provisions". They considered that not to adopt the later date could conflict with EU law "where taxpayers' legitimate expectations are respected"[34].

55. Richard Thomas (HMRC) told us that the so-called Section 91B problem covered three different types of case, all describing shares which had characteristics of deposits or loans. The object of the legislation was to treat shares that had been using schemes to avoid tax on interest income as if they were in fact loans or deposits. He went on to explain that the provisions as drafted in the March 2005 Finance Bill had led to complaints that the descriptions of the class of shares used for the purposes of 'preference share lending' "went too wide and caught a lot of innocent transactions. When the current Bill was published, there had been a number of changes to this legislation and that included an absolute exclusion for some shares and a purpose or motive test for others. The two other conditions do not have a purpose test because they are much more restricted in their scope, especially following changes made in the current Bill. We do not think it is possible for a group or company just to stumble accidentally into those conditions, which they might have done under the preference share rules. We think there is no need for a purpose test here" (Q 121).

56. **We took note of the assertion by HMRC that "the types of shares to which the legislation as it is currently drafted applies are almost all highly contrived" (Q 122). Given that fact, we have a better appreciation of why purpose tests have not been thought appropriate for all elements of this complex legislation. Nonetheless, we remain**

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[33] "Supplementary written submission on paragraph 10 of Schedule 7", 16 June 2005 (Volume II, HL Paper 13–II)

[34] Citing the judgment of the ECJ in the case of *Stichting Goed Woenen* (C-376/02), at paragraph 33

concerned at some indications that anxieties which have been put to us—including, for example, the apparent harm to the position of group finance companies carrying out normal foreign exchange risk operations—have either not yet been put to HMRC or, if they have been, have not been fully taken on board and responded to. Given the positive overall view taken by our private sector witnesses about consultations in the disclosure rules context, we trust that direct contacts on outstanding issues identified in our Report will prove fruitful.

CHAPTER 3: SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

57. The direct tax disclosure rules, as finally adopted, were acknowledged by all our witnesses to be greatly changed for the better from the early drafts which we considered in last year's report. We found the statistics of disclosures (500, of which a quarter concerned employment products) to be a convincing demonstration that the rules had served to exclude unhelpful and unnecessary disclosures, thus keeping down resource costs for taxpayers, their advisers and HMRC. The fact that they were the outcome of a consultation process reflects credit on all who participated, private sector and officials alike. We do, however, draw to the attention of HMRC the perception of the ICAEW, as reported to us, that more feedback on VAT should be given as part of the consultation process. (Paragraph 14)

58. We received strong representations about the five-day reporting time limit last year and the issue continues to evoke disquiet from some private sector witnesses in the area of "bespoke schemes". However, in the light of the evidence from HMRC, which we find compelling, we are not repeating our recommendation of last year that further consideration should be given to increasing the time limit to 30 days. Indeed, given the reported attempts at exploitation of the five-day rule, we are glad to note that HMRC are thinking very hard about how to address that. Similarly, we accept the arguments in favour of a broad approach to the definition of the terms brought to our attention and we respect the need to allow time for more experience of the disclosure rules to be gained by both tax advisers and HMRC before it is appropriate to attempt to elaborate on what constitutes "acceptable disclosure". (Paragraph 21)

59. As regards Schedule 1, we were satisfied from the congruity of comments received from both sides that it was proportionate and appropriately targeted. We were not persuaded by the view of a private sector witness that there could be a difficulty in interpretation for legitimate businesses, and we accept the proposition put forward by HMRC that "it is not the sort of scenario that one would expect a business to fall into in an innocent way". (Paragraph 30)

60. We welcome the fact that HMRC acknowledge the scale and seriousness of the problem concerning the risk of confidentiality clauses in standard terms of engagement constituting a VAT hallmark. The potential for triggering disclosures in unwanted numbers, thus causing unnecessary resource costs for business and HMRC, is plain to see. We look forward to a positive outcome of benefit to both sides from the consultations. (Paragraph 31)

61. We listened with increasing concern to the catalogue of ingenious schemes devised over the years in order to pass remuneration value to employees (particularly bonuses to the higher paid) in a way that attempted to avoid or reduce income tax and NICs. We took note of the view of HMRC that, even after the measures in the present Bill had passed into law, "there will be something new, the whole history of this suggests there will be, and we will have to counter that when we get there" (Q 109). Given the vast amount of tax at stake and in the light of that history we were persuaded that an exception to the normal approach to backdating was justified. Moreover, it seemed to us that the suggestion that professionals might now find it difficult to advise about remuneration packages that included share schemes and share option plans for the generality of employees was an exaggeration. In

any case, HMRC assured us that they stand ready to respond to enquiries in a form that could be relied upon in appropriate circumstances, and we welcome that assurance. (Paragraph 43)

62. At the same time, we were not persuaded of the justification for the robust line taken by HMRC to the case put to us that certain employees remunerated by a convertible security could ultimately be taxed on a greater value than the true value of the convertible security. Where a scheme is deemed to be abusive, frustrating its application should do no more than ensure that the correct amount of tax and NICs are paid. We recommend that HMRC and the professions should consult further on this point and that the Government should consider introducing the necessary amendment(s) to avoid any element of double taxation. (Paragraph 44)

63. We took note of the fact that the "bright line" rule embodied in the 15-year cut off point in the rent factoring legislation had been deliberately selected by the Government of the day, and that to abolish it now implied something of a change of view about, or at any rate a deliberate moving of the boundary line between, acceptable tax planning and abusive exploitation of loopholes in the tax law. It seems to us that it should not have taken the authorities unawares that making the rule would give rise to the creation of "leases for 16 years or 15 years and a few days" (Q 119). Be that as it may, we accept that there was a need for second thoughts once it was adjudged that the cost of tax relief had become disproportionate. (Paragraph 50)

64. We were surprised, in the light of what our private sector witnesses told us about the uncertainty the measure had led to for normal commercial sale and leaseback arrangements, that HMRC had found reactions "very muted indeed" (Q 119). We trust that those witnesses who expressed concerns to us will take them up directly with HMRC, who will now have been alerted by this Report. (Paragraph 51)

65. We took note of the assertion by HMRC that "the types of shares to which the legislation as it is currently drafted applies are almost all highly contrived" (Q 122). Given that fact, we have a better appreciation of why purpose tests have not been thought appropriate for all elements of this complex legislation. Nonetheless, we remain concerned at some indications that anxieties which have been put to us—including, for example, the apparent harm to the position of group finance companies carrying out normal foreign exchange risk operations—have either not yet been put to HMRC or, if they have been, have not been fully taken on board and responded to. Given the positive overall view taken by our private sector witnesses about consultations in the disclosure rules context, we trust that direct contacts on outstanding issues identified in our report will prove fruitful. (Paragraph 56)

APPENDIX 1: SUB-COMMITTEE ON THE FINANCE BILL 2005

Sub-Committee on the Finance Bill 2005

The members of the Sub-Committee which conducted the inquiry were:

Rt Hon the Lord Barnett
The Lord Blackwell
Rt Hon the Lord Kingsdown
Rt Hon the Lord Lamont of Lerwick
The Lord Paul
Rt Hon the Lord Roper
Rt Hon the Lord Sheldon
The Lord Sheppard of Didgemere
Rt Hon the Lord Wakeham

Mr Brian Shepherd CBE, a retired senior official of the Inland Revenue, was appointed as Specialist Adviser for the inquiry.

Declaration of Interest

BARNETT, Lord

**12(d) Non-parliamentary consultant*
Advisory Board, EHS & Partners
**12(e) Remunerated directorships*
Chairman, Mercury Recycling Group plc and Director of all its subsidiary companies
Chairman, ATOS Origin (UK) Ltd
Chairman, Xploit International Ltd
**13(a) Significant shareholdings*
Mercury Recycling Group plc
15(a) Membership of public bodies
Chairman, Education Broadcasting Services Trust (EBS) Ltd (non-remunerated)
Trustee, Open University (non-remunerated)

BLACKWELL, Lord

**12(e) Remunerated directorships*
Non-executive Director Smartstream Technologies Ltd (15 February 2005)
Non-executive Director, Slough Estates plc
Non-executive Director, The Corporate Services Group plc
Non-executive Director, Standard Life Assurance
Non-executive Director, Kinnect Holdings Ltd (subsidiary, Lloyds' of London) (15 February 2005)
**12(f) Regular remunerated employment*
Non-executive Board Member, Office of Fair Trading
Special Advisor, KPMG Corporate Finance
**13(a) Significant shareholdings*
Shareholder, 4C Associates Ltd (business consultants)
**13(b) Landholdings*
Joint Owner (with wife) of an apartment in SW1, let on an assured short hold tenancy

15(c) Office-holder in pressure groups or trade unions
Member of Council, Vote-no (15 February 2005)
15(d) Office-holder in voluntary organisations
Chairman and Director of the Centre for Policy Studies (Independent 'Think Tank')
Trustee of the Friends of the University of Pennsylvania

KINGSDOWN, Lord
**13(b) Landholdings*
38 acres of woodland in North Kent
15(d) Office-holder in voluntary organisations
President, Canterbury Cathedral Trust
Chairman, Canterbury Cathedral Council
President, Kent County Agricultural Society
Trustee, Leeds Castle, Maidstone, Kent
Honorary Trustee, Royal Agricultural Society of England
Trustee, East Malling Trust for Horticultural Research
Emeritus Trustee, Royal Academy of Arts

LAMONT OF LERWICK, Lord
**12(d) Non-parliamentary consultant*
Consultant, Rotch Property Group
Consultant, Fintrade
Stanley Leisure plc
**12(e) Remunerated directorships*
Chairman, East European Food Fund (Investment Fund)
Director, Anglo-Arabian Projects Limited
Director, Balli Group plc (steel and commodity trading house)
Director, Compagnie Internationale de Participations Bancaires et Financieres (Investment Company)
Director, European Growth and Income Trust (Investment Trust)
Director, Jupiter Finance and Income Trust (Investment Trust)
Director, Scottish Annuity and Life Holdings (Reinsurance Company)
Director, RAB Capital plc
Member of the Advisory Board, MerchantBridge & Co
**12(h) Secretarial research and assistance*
Secretary and office at Balli plc (steel and commodity trading house) (Secretary primarily business and personal but some parliamentary work)
15(c) Office-holder in pressure groups or trade unions
Chairman, Le Cercle
Chairman, British Iranian Chamber of Commerce
President, British Romanian Chamber of Commerce
Co-Chairman, Bruges Group

PAUL, Lord
**12(e) Remunerated directorships*
Chairman and Director, Caparo Group Ltd
Board Member, London Development Agency
**12(i) Visits*
Visit to Scotland (16-17 June 2004) to view various power facilities as a delegate with the Parliamentary Group for Energy Studies
**13(a) Significant shareholdings*
Caparo Group Ltd (Lord Paul, Hon.Ambar Paul, Hon. Akash Paul and Hon. Angad Paul are jointly interested in the whole of the issued share capital of the Company through shareholdings registered in the name of Caparo

International Corporation, a Company registered in the British Virgin Islands)
Caparo Group, through its subsidiary Caparo plc, has a 35.5% interest in Core Growth Capital LLP, which manages two venture capital trusts, Core VCTI and Core VCTII plc
15(a) Membership of public bodies
Chancellor of the University of Wolverhampton
Member of the DTI Industrial Development Advisory Board
Member of the Corporation of the Hall of Arts and Sciences
Co-Chairman, UK-India Round Table
Advisory Board Member, Foreign Policy Centre
Member of the Board of London 2012
Non-executive Director, London 2012 Ethics Advisory Group
Director, Parliamentary Broadcasting Unit Limit (11 January 2005)
15(c) Office-holder in pressure groups or trade unions
Vice President, Engineering Employers' Federation
Co-Chairman, Associated Parliamentary Manufacturing Industry Group (11 January 2005)
15(d) Office-holder in voluntary organisations
Chairman of the Board of PiggyBankKids (a children's charity) and its trading subsidiary PiggyBankKids Projects Limited
16(a) Trusteeships
Trustee, Ambika Paul Foundation
16(b) Voluntary organisations
President, Family Service Units
Patron, Plan International
Patron, UK Youth

ROPER, Lord
**12(i) Visits*
Visit to Kotor, Montenegro (22-24 November 2003) as a guest of the Transfuse Association, Berlin
Visit to Flanders (October 2004) with the all-party War Graves and Battlefields Heritage Group; all expenses met by Thales plc (9 November 2004)
15(a) Membership of public bodies
Hon. Professor, University of Birmingham
Member of Council, Executive Committee and Finance Committee, Royal Institute of International Affairs
15(d) Office-holder in voluntary organisations
Vice President, Manchester Statistical Society
16(b) Voluntary organisations
Council of Christian Approaches to Defence and Disarmament
International Institute for Strategic Studies
Royal United Services Institute

SHELDON, Lord
**13(a) Significant shareholdings*
Tonrose Ltd (textile distribution)
16(a) Trusteeships
Trustee, Sheldon Group Pension Fund

SHEPPARD OF DIDGEMERE, Lord
**12(d) Non-parliamentary consultant*
Didgemere Consultants Ltd

**12(e) Remunerated directorships*
Non-executive Chairman, McBride plc (household and personal care products)
Non-executive Chairman, Unipart Group (automotive, rail, telecommunication, logistics etc)
Non-executive Chairman, One-Click HR plc (HR software etc)
Non-executive Director, Nyne Ltd (investor group) (currently not directly remunerated)
Non-executive Chairman, Global Tote Ltd (Satellite transmission services to Russia and Eastern Europe)
Non-executive Chairman, Namibian Resources Ltd (Diamond Mining)
**12(g) Controlling shareholdings*
Didgemere Consultants Ltd (business advisory service)
Didgemere Farms Ltd (farming)
**13(a) Significant shareholdings*
McBride plc (household and personal care products) (shareholding with a nominal value of over £50,000)
One-Click HR plc (human resources management systems) (shareholding of more than 5% of issued share capital of the company)
DeltaDot Limited (an unquoted biotechnology) (shareholding of more than 5% of issued share capital of the company)
Namibian Resources Ltd
**13(b) Landholdings*
Farmland in Essex
15(a) Membership of public bodies
Chancellor, Middlesex University
Hon. Fellow, Governor, London School of Economics
15(c) Office-holder in pressure groups or trade unions
President, London First
Director, East London Business Alliance
Director, Central London Partnership
Director, London Business Board (London First/London Chamber/London CBI)
Vice President, Beer and Pub Association (formerly Brewers Society)
Member of the Various Professional Bodies (accountants etc)
Hon. Doctorate/Hon Fellow of various universities
Member, Protection of Roydon and Area (PORA) Committee
15(d) Office-holder in voluntary organisations
Vice President (formerly Appeal Chairman for 'Sheppard House') of Blue Cross (animal/peoples charity for pets of those unable - for reasons of health, etc - to pay vet fees)
Vice President United Response (charity for people with learning difficulties)
Fellow, Animal Health Trust
Member, UK Cancer Research Charity
Vice President, (past Chairman) Business in the Community
Past Chairman, The Prince's Trust (and Prince's Youth Business Trust) (now only infrequently involved)
Chairman of Trustees, Civilians Remembered Trust (Trust developing memorial park, etc for 60,000-plus civilians killed by bombing in 1939-45 war)
Patron of Trees for Cities

WAKEHAM, Lord

**12(e) Remunerated directorships*
Advisory Board, LEK Consultancy
Chairman, Genner Holdings plc
**13(a) Significant shareholdings*
Genner Holdings Ltd (Investment Company)
Genner Farms Ltd (small family company)
15(a) Membership of public bodies
Chairman of Governors, Cothill House
Chairman, Alexandra Rose Day
Chancellor, Brunel University
Deputy Lieutenant for Hampshire
Governor, Sutton's Hospital, Charterhouse
Justice of the Peace, Inner London Commission (Non-active)
Member of Council, St. Swithun's School
President, Brendoncare Foundation
16(a) Trusteeships
Trustee, H.M.S. Warrior 1860
Trustee Carlton Club

APPENDIX 2: LIST OF WITNESSES

The following bodies made their views known to us in evidence. Those marked * gave oral evidence.

* Chartered Institute of Taxation

* Grant Thornton

* HM Revenue and Customs

* HM Treasury

* The Institute of Chartered Accountants in England and Wales

* The Law Society

* PricewaterhouseCoopers