TAX LAW REVIEW COMMITTEE

INTERIM REPORT ON

TAX LEGISLATION

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3rd Floor, 7 Ridgmount Street
London WC1E 7AE
(Tel: +44 (0)171-636 3784)
(Fax: +44 (0)171-323 4780)
(e-mail: mailbox@ifs.org.uk)
(Internet: http://www1.ifs.org.uk/)

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FOREWORD

By the President of the Tax Law Review Committee
The Rt Hon Lord Howe of Aberavon, PC, QC

"Parliament is judged, amongst other things, by the quality of the laws that we produce and by that standard we deserve to be harshly judged". My words from almost twenty years ago[1], as I denounced - even then - the "incoherent drift towards a tax system that is incomprehensible, unrespected, unenforceable - and spinning like a top".

Now, alas - after years in government, almost half of them as Chancellor or Leader of the House of Commons and in a position, or so it might be thought, to do something about all this - I have to confess that nothing has changed. Save that the task of diagnosing the disease and prescribing the remedy has passed into younger and hopefully more vigorous hands. Graham Aaronson and his colleagues have produced, in this first interim report of the TLRC, an excellent description of what is needed. More important than that, they have proved beyond doubt that it *is* possible for tax legislation to be drafted in plain English and in a form which the citizen and his or her advisers can actually understand.

The central responsibility comes back to the legislature itself. In that same talk almost 20 years ago, I described our existing machinery for tax legislation as "about as appropriate to a modern industrial democracy as tally sticks to the international money market" and I concluded that it was only parliamentarians who could change the system. It is democracy itself, I said, that suffers most from "the universal scorn that greets the legislative output of our present system".

It is not for want of trying that the system remains so little changed today. But we did not try hard enough. It is my Presidential hope that this strikingly clear Report will inspire a fresh generation to try again.

1 British Tax Review [1977], page 97: address to the Addington Society on 16 February 1977.

THE TAX LAW REVIEW COMMITTEE

President	Rt Hon Lord Howe of Aberavon PC QC
Chairman	Graham Aaronson QC
Members:	
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ABOUT THE TAX LAW REVIEW COMMITTEE

The Tax Law Review Committee was established by the Institute for Fiscal Studies in the autumn of 1994. We are independent of Government but have received cross-party support. Treasury Ministers and the Revenue departments have been fully consulted and apprised of our work, and they have been wholly supportive and helpful.

Our President is the Rt Hon. Lord Howe of Aberavon PC QC. As Sir Geoffrey Howe, he served as Chancellor of the Exchequer from 1979 to 1983, as Secretary of State for Foreign and Commonwealth Affairs from 1983 to 1989 and as Lord President of the Council, Leader of the House of Commons and Deputy Prime Minister from 1989 to 1990. The Committee is chaired by Graham Aaronson QC, a leading member of the tax bar who has had a varied career which has included running his family's engineering business and tax policy experience having served between 1986 and 1990 as special adviser to the Israeli Treasury on tax reform. Graham Aaronson is chairman of the Revenue Bar Association.

Other members are prominent in the fields of politics, the judiciary, academia, commerce, the professions, government service and public life. As well as Lord Howe, the Rt Hon. Francis Maude (a former Financial Secretary to the Treasury) and Quentin Davies MP are members. So too is Alistair Darling MP, Labour frontbench spokesman on the City and Financial Services. And from the Liberal Democrats there are Baroness Seear, House of Lords spokesman on economic affairs, and Policy Committee member Sir William Goodhart. The judiciary is represented at the highest level with Lords Templeman and Nolan.

Financial support has been provided by the Bank of England, three clearing banks, top public industrial and commercial companies and major legal and accountancy firms.

The establishment of the Tax Law Review Committee is a manifestation of the depth of concern felt by a great many people about the state of our tax system. The Committee intends to keep the tax system under permanent review. We are asking some fundamental questions about whether it is working as intended and if not, why not; how efficiently it is working; and whether the burdens it places on taxpayers and businesses are avoidable. We shall publish reports of our findings periodically; this is the first of those reports giving the Committee's prima facie views on the state of tax legislation in the UK and what needs to be done to make it intelligible to those who have to work with it. We are also currently working on two other research topics. Further reports on the following will be published over the coming months.

Tax appeals. At present, there are two entirely different systems for dealing with appeals against the imposition of the main direct and indirect taxes, and several more covering other taxes and levies. The Committee is researching these to see whether the procedures can be integrated, speeded up and made more cost-effective.

Schedules D and E. As people move with increasing frequency between employment and self-employment, and as modern working arrangements blur the distinctions between the two, the substantive differences in taxation are becoming more apparent. The Committee is looking at the dividing line between self-employment and employment status and at the rules by which taxable income and deductible expenses are calculated.

EXECUTIVE SUMMARY

There have been many very vocal complaints about tax legislation recently. Perhaps this is not surprising given the unprecedented length of the last three Finance Acts. The proposals in the Report may well lead to some shortening as well as simplification of Finance Bills. But the main factor determining their length is the Government's decision as to how many changes it wants to make to the tax code each year, and this is a policy matter outside our remit. Our role is to question whether the Government's policy is being delivered in the most effective and least burdensome way.

We believe something more fundamental is wrong with our tax legislation than the rate at which it is being produced. The style in which it is written has been likened to a puzzle - and one which does not have a picture on the box! It is impenetrable; you cannot see even the broad outline of the picture until you have solved the puzzle. Worse still, there are times when the legislation is wholly incomprehensible. This is unacceptable. It causes taxpayers to incur unnecessary costs in trying to comprehend their rights and obligations, money which would be better spent productively. And it creates uncertainty when they cannot understand their tax position. The money taxpayers spend on tax compliance runs into billions of pounds. How much of that could be saved if the legislation was comprehensible?

We believe simpler, more accessible language *can* be achieved without losing precision. Our main proposals involve plain language drafting of the legislation, explanatory memoranda to assist understanding and interpretation of the legislation, and a pilot to see whether rewriting all our existing legislation in clear terms is worth undertaking.

First proposal - plain language

The language Parliamentary Counsel uses is aimed at the courts: it is framed to be accurate so as to limit the scope for the courts to interpret the legislation other than as intended. But this undervalues clarity and accessibility - 'user friendliness'. We recognise that tax legislation must be accurate. This is paramount. However we believe that legislation could be far more user-friendly without any loss of precision. It should aim to explain, not to mystify.

The basic technique we advocate is plain language, as has been used over the last ten or twenty years to improve the readability of insurance contracts and other legal documents. Plain language involves the use of shorter sentences, clearer structure and (where possible) avoiding the use of jargon or cross references. There is a range of possible approaches. Two examples of legislation redrafted in this style are at appendices 1 and 6. We therefore have no doubt that tax legislation *can* be written in an accessible style, that it *can* be no less accurate than the current drafting style, and that there would be very substantial benefits for taxpayers, practitioners and Government if it *were.*

Legislation written in a wholly new style would represent a very substantial culture change for everyone involved in producing fiscal legislation - draftsmen, policy advisers, MPs and others - as well as for users. But we have no doubt that the present culture *must* change.

Second proposal - explanatory memoranda

We recognise that tax legislation must deal with highly detailed and, frequently, inherently difficult subjects. We cannot, therefore, expect its application to be clear beyond doubt in all circumstances. Moreover, primary legislation cannot set out all the information relevant to its interpretation. But this information needs to be made available somehow. We propose that the Government should publish explanatory memoranda to complement the Finance Bill, containing information relevant to the understanding and interpretation of its provisions. This might include background material, a note of the purpose of each clause and how it would operate, worked examples, answers to difficult points, or any other relevant matter. The explanatory memoranda would be updated for new clauses or significant amendments.

Explanatory memoranda would initially inform the Parliamentary debate. Later, they would be available to and used by the courts as aids to the interpretation of the statutory provisions. So they would have a degree of authority for all users of the legislation - accountants, lawyers, tax inspectors and others - although they would not have the force of the legislation itself.

Third proposal - a pilot of a rewrite

Drafting legislation in more accessible language and supplementing it with helpful explanatory memoranda would make it considerably easier to understand future legislation. But what about existing legislation? It could be left to renew itself gradually as it was changed for other reasons. However this would take many years during which time the situation would be far from satisfactory.

The alternative is to rewrite the existing legislation systematically. This would involve substantial costs for both practitioners and the Revenue departments; it is not a step which should be taken lightly. However, a rewrite would simplify and clarify the language of existing legislation and would also make it easier to draft new provisions in plain language. Moreover it would help to embed the culture change we have referred to. We believe a rewrite is clearly worthwhile as long as the benefits are sufficient to justify the costs.

We recognise that rewriting all or a substantial part of existing tax legislation raises many difficult issues to which careful thought must be given. However the potential benefits that a rewrite promises for improving the legislation merit piloting the rewriting of income tax, corporation tax and capital gains tax. On completion of the pilot project a decision should be taken whether the anticipated benefits do justify the costs. If they do, a full rewrite should be undertaken and consideration given to extending the project to other taxes.

Other matters

We recognise that the draftsman will find a number of factors restrict his opportunity to put these proposals - especially the first one - fully into effect. The most pressing of these is shortage of time. We therefore have some ideas in Chapter 8 for making more time available.

Comments invited

We believe the package of proposals in this interim Report offers a sensible, workable way forward. We invite comments on it, which we shall consider carefully before we produce our final Report on this subject in 1996.

23 November 1995

CHAPTER 1: INTRODUCTION

TERMS OF REFERENCE

1.1. One of the main spurs to the establishment of the Tax Law Review Committee was the widespread perception that tax legislation is not just growing relentlessly but is becoming immensely complex too. "It is a huge, byzantine structure built on shaky and obscure foundations, a baffling baroque maze, a gothic Old Dark House complete with secret rooms, sliding panels, spy holes and trap doors through which the unsuspecting can disappear."[1] So it may come as no surprise that we decided at our first meeting in October 1994 that one of our initial research topics should look at tax legislation.

1.2. We thought it reasonable to assume that these problems resulted from a number of different factors: the increasing sophistication of commercial affairs, taxpayers' desire to pay no more tax than they have to, policy choices and especially measures to make the tax system fairer and to promote social and economic objectives, the administrative and Parliamentary processes for developing and enacting tax legislation, and the judicial approach to its interpretation. An economist might add that income tax, corporation tax and capital gains tax are conceptually complex and that legislative complexity is therefore inevitable. (We discuss the causes of complexity in Chapter 3.)

1.3. However, our terms of reference are to consider whether fiscal legislation is achieving what the Government intends of it in a satisfactory and efficient manner. This does not enable us to deal with tax policy issues. We have therefore focused on the language fiscal legislation adopts and on the use of supporting materials, for the most part assuming that these other factors (in particular, Parliamentary procedure) will remain unchanged.

1.4. This is not to say that other factors are not important. In examining the nature of the problem we have looked to some extent at all these factors: we needed to know how much of the problem was policy or structural rather than linguistic before we could assess the best way to improve matters. And we recognise that "simple" legislation is unlikely to be within our grasp without complementary changes in these other areas. One such change would be simplification of the underlying policy: simpler policy would allow simpler legislation, all other things being equal. However this is a difficult and potentially controversial area since there is a balance between simplicity on the one hand and fairness and a variety of other political objectives on the other. Moreover any policy change would be likely to create winners and losers. Everyone can agree that the tax system should be simpler overall, but how would the losers respond?

WHAT IS WRONG WITH CURRENT LEGISLATION?

1.5. Before recording our researches and conclusions it may be worth summarising the complaints about tax legislation. Each year in advance of the Budget the Chancellor receives

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1 Ernst & Young, "Pruning the Triffid", November 1994.

representations from a wide variety of interest groups representing tax professionals and taxpayers. The matters they raise are diverse, but the one theme which has united almost all of them in the last few years has been the cry that tax legislation is too long and too complex. These demands for simpler legislation were of course behind the "Tim Smith amendment" to the 1995 Finance Bill which became Section 160 Finance Act 1995, requiring the Inland Revenue to lay before Parliament a report on tax simplification by the end of this year.

Volume

1.6. Complaints about tax legislation are not new but they reached new heights with the three longest Finance Bills in history, 312 pages in 1993, 463 pages in 1994 and 380 pages this year. We doubt that anyone knows exactly how many pages of primary legislation now exist for all taxes, but we probably have several thousand covering direct taxes alone and considerably more if legislation concerning indirect taxes is added in. And of course it is not just primary legislation: there are also well over a thousand pages of regulations and tertiary materials, including Statements of Practice, Extra-Statutory Concessions, Press Releases and other interpretative material issued by the Revenue departments; to this are being added thousands of pages of the Revenue's and Customs & Excise's internal guidance under the Open Government initiative. Much of this may be non-statutory but practitioners nevertheless need to be familiar with it.

1.7. This volume of legislative and non-statutory material has been growing for decades. For example, the volume of income tax legislation can be gauged from the periodical consolidations which have taken place over the years. The trend can clearly be seen from the following table:

Act	Pages on enactment	Sections	Schedules
Income Tax Act 1918	180	239	7
Income Tax Act 1952	510	532	25
Income and Corporation Taxes Act 1970	670	540	16
Taxes Management Act 1970	81	119	4
Capital Allowances Act 1968	126	100	12
Capital Gains Tax Act 1979	168 *	160	8
Income and Corporation Taxes Act 1988	1037 *	845	31
Capital Allowances Act 1990	154 *	165	2
Taxation of Chargeable Gains Act 1992	319 *	291	12

1.8. The Income Tax Act 1918 was the first ever tax consolidation act. It contained all the charging provisions (now in the Income and Corporation Taxes Act (ICTA) 1988), the proto-capital-allowance rules (now in the Capital Allowances Act (CAA) 1990) and the management provisions (now in the Taxes Management Act (TMA) 1970) which income tax needed -

* The page-size changed to the current A4 style in 1987. Pages before and after 1987 are not comparable.

capital gains tax and corporation tax would not be invented until almost half a century later[2] - and yet it covered only 180 pages. Of the 239 sections, three-quarters related to management (Commissioners, returns, assessments, etc.).

1.9. By 1952, the length had almost trebled. Moreover, the number of management sections had actually reduced to 77 from 182 in 1918. The growth was in capital allowances (now 77 sections) and in "special provisions" (135 sections, mainly dealing with particular categories of person or activity).

1.10. By the third set of consolidations in 1968/1970/1979, corporation tax and capital gains tax had been introduced and the length had doubled again. Management provisions, which had reduced in the earlier period, were again increasing (by around a half). Capital allowances provisions had also expanded (by one-third). ICTA provisions had grown by 40%, reflecting the introduction of corporation tax. And the total was boosted by capital gains tax, introduced in 1965.

1.11. By 1988/1990/1992 when this legislation was last consolidated, the total number of pages had grown by 50% again. If the change in paper size in 1987 were factored in, the growth in the legislation would be markedly greater. The additional material introduced since the previous consolidation in 1968/1970/1979 is greater than the total length of the legislation had been in 1952. The main areas of growth were capital gains tax (number of pages increased by 90%[3]) and ICTA provisions (55% growth). Management and capital allowances provisions were growing much more slowly.

1.12. Since then, there has been further growth, although we have not sought to quantify this precisely. ICTA 1988 now contains 950 sections and 42 schedules as a result of additions by subsequent Finance Acts. CAA 1990 has expanded to 189 sections and 4 schedules. The Taxation of Chargeable Gains Act 1992 has grown to 312 sections and 17 schedules. TMA 1970 has expanded by nearly half (partly reflecting self-assessment) to 177 sections and 6 schedules.[4] Moreover some new provisions enacted by recent Finance Acts have not been inserted by textual amendment of the main acts. Our preliminary estimates suggest that these could amount to around 10% of the legislation in the main Acts.

1.13. Not only are the numbers of pages of tax legislation increasing remorselessly but the average length of each section has also been on the rise throughout the last 70 years. In 1918 the average section covered less than half a page of the Statute Book. The rate of increase moderated after the 1952 consolidation but the average section has nevertheless increased steadily and has now reached the equivalent of well over twice that figure, taking account of the change in page size. The following table gives the average section length as a percentage of a page.[5]

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2 Profits Tax and its various predecessors had their own legislation.

3 Some (but we would guess less than a quarter) of this growth relates to transfers of provisions relating to the taxation of companies from the Income and Corporation Taxes Act 1970.

4 IFS calculations from Butterworths Yellow Tax Handbook.

5 IFS calculations. 1988/1990/1992 figure adjusted for TMA as at 1990.

Act	% of page	
Income Tax Act 1918	47	
Income Tax Act 1952	81	
1968/1970/1979 Acts	92	
1988/1990/1992 Acts	88	* A4 size, equivalent to at least 105% of the previous size.

1.14. This expansion is not limited to tax legislation. For example, the 1985 Companies Act is two-thirds as long again as the 1948 Act (600 pages, 747 sections and 25 Schedules compared to 360 pages, 462 sections and 18 Schedules).

1.15. Nor is it a purely UK phenomenon; most other countries are also experiencing a similar increase in the volume of their fiscal legislation. For example, the current Canadian Income Tax Act is three times the length it was in 1971. Dutch primary and secondary tax legislation more than doubled in length in the twenty years to 1994 and the most important reference materials quadrupled. The average number of sections in Irish Finance Acts is running at over 80% higher in the 1990s than the 1980s[6].

1.16. So it appears that the forces which are behind this rise in volume of fiscal legislation are both strong and wide.

1.17. The volume of tax legislation means that it is now much more difficult or impossible for new practitioners to acquire a general knowledge of the whole tax field before they take their professional examinations, as was possible 30 years ago. And the pace of change is a major irritation for all practitioners making it difficult for them to keep up to date with the current law. However, these are principally effects of the volume of new policy each year, not of the way the legislation is drafted. Finance Bills would be shorter if fewer changes were made to the tax system each Budget. But legislating for the same changes using less Finance Bill space would not, on its own, be an improvement.

1.18. So the reality is not that users of tax legislation want that legislation to be as short as possible but that they need to be able to comprehend it in the shortest time possible. The complaint about the length of recent Finance Bills is principally that they contain too many chunks of material, not that each discrete chunk is too verbose.

Complexity

1.19. Whilst it is relatively easy to measure the volume of fiscal legislation and to compare it with the volume at other times, measuring the objective complexity of legislation is more difficult. Nevertheless we have found that there is universal acknowledgement amongst those whom we have consulted that fiscal legislation is more complex than it need be. (We have spoken to practitioners, politicians, judges, the Revenue departments and Parliamentary Counsel.)

1.20. It is not just tax legislation which is complex. Several people have told us that other branches of the law are also difficult, among them legislation dealing with social security and

6 Average number of sections per Finance Bill 1980-89 was 91; average for 1990-94 is 167. (IFS calculations from data provided by the Office of the Revenue Commissioners, Dublin.)

local government finance. In its annual report for 1994, the Law Commission criticises the failure to bring criminal law up to date and also says that large parts of trust law and landlord and tenant law are "antique, obscure and impenetrable".[7]

1.21. To say that legislation is complex does not tell us a great deal. What we need to know is why it is complex. Is it complex because it is dealing with complex transactions (subject complexity) or expressing a complex policy (policy complexity)? Is it complex because of some other factor, such as a need to comply with non-tax requirements (legal complexity)? Or is it complex because it has not been expressed as simply and straightforwardly as it could have been (linguistic complexity)? The legislation cannot be criticised unless it can be shown to be more complex than is necessary to give effect to the policy; only linguistic complexity is a genuine cause for complaint as far as the drafting of the legislation is concerned. (There may of course be separate grounds for complaint about other causes of complexity in tax legislation, but as noted at paragraph 1.3 above they are not the subject of this report.)

1.22. Nevertheless, the purpose of language is to communicate information from the speaker/writer to the listener/reader. Statutory language is no different: legislation is first and foremost an exercise in communication. If it fails to communicate its information accurately - or at all - it is not working.

Impenetrability and incomprehensibility

1.23. The language of a tax statute is deliberately tight. The draftsman does not want to leave any possible ambiguity or doubt which might result in the tax not being imposed in circumstances where it was intended that it should be. He aims to achieve this by use of a particular style which avoids narrative passages or any repetition, but expressly links different parts of the text. The result has been likened by some to a jigsaw puzzle - and one without a picture on the box! Frequently, you cannot see even the broad outline of the picture without solving the puzzle. To this extent the legislation is written in an impenetrable style with no obvious way in. The casual reader cannot check briefly that he is outside the scope of the legislation; until he has solved the puzzle he cannot be sure that he has not missed something.

1.24. An example of this may be found in Section 159, Taxation of Chargeable Gains Act 1992. This is drafted in a way which is deceptively easy to understand. The picture seems clear enough, but it is misleading. The true picture only becomes apparent when one crucial piece of the jigsaw into slotted place. That piece is a definition of "chargeable assets" which differs from its normal capital gains tax meaning.

1.25. This style of drafting depends upon the reader being able to solve puzzles. An eminent legal civil servant and commentator, Sir William Dale, put it like this:

> *... when once one understands a United Kingdom Act, one can usually ascertain the answer to one's question. But what time, toil and trouble may be needed to get to the bottom of the Act!*[8]

1.26. But sometimes the puzzle is insoluble and the legislation is then incomprehensible. We have had a number of examples of such incomprehensible legislation cited to us; the foreign

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7 The Law Commission 29th Annual Report 1994, reported in The Times, 16 March 1995.

8 Legislative Drafting: A New Approach, page 82.

exchange gains and losses provisions in Finance Act 1993 were the most frequently mentioned[9].

WHY COMPLEXITY MATTERS

1.27. Complexity matters for two basic reasons. Firstly it increases the costs for taxpayers and Revenue departments alike of running the tax system. Secondly it creates uncertainty which puts a brake on economic activity.

1.28. Our complex tax system imposes a huge burden both on taxpayers and on the Revenue departments which have to administer it. Academic work[10] on these costs suggests that in 1986-87 they were of the order of 1½% of GDP of which over two-thirds is the compliance cost for taxpayers. This is "a very large industry - not far short of agriculture, fishing and forestry".[11] Of the total, 66% of the administrative costs and 72% of the compliance costs related to Inland Revenue taxes, and 17% and 24% respectively to Customs & Excise taxes and duties. 15% of the administrative costs represented the costs of raising local rates; but these took only 2% of compliance costs.

1.29. If these costs remain broadly unchanged as a proportion of GDP, this suggests that at 1995 prices they represent something like £10 billion in total of which over £7 billion is the compliance cost falling on taxpayers; the balance is the administrative cost to central and local government.

1.30. Clearly if tax is to be levied at all, there is an unavoidable minimum of compliance cost for taxpayers and of administrative cost for the Revenue departments. But we have no doubt that incomprehensible legislation adds substantially to these costs. Ultimately both compliance and administrative costs fall upon taxpayers one way or another.

WHO WOULD BENEFIT FROM CLEARER LEGISLATION?

1.31. Tax impacts upon a range of people beginning with the taxpayer with very simple financial affairs through the generalist practitioner to those with specialist knowledge in a particular field. Unrepresented taxpayers will very seldom read fiscal legislation, however straightforward it may be; they will normally refer to guidance issued by the Revenue. Specialists have a good understanding of their area of fiscal legislation and are well equipped to cope with changes in it[12]. Generalist practitioners (into which category would fall most accountants, solicitors, tax departments of multinationals, tax inspectors and Commissioners) cannot have in-depth understanding of the entire corpus of fiscal legislation which may impinge on the wide range of different types of case they deal with. So they need to be able to identify issues and find answers quickly.

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9 Sections 125 to 170, FA 1993.

10 Tax Compliance Costs Measurement and Policy, 1995, edited by Sandford, page 75. We are not aware of any more recent data.

11 Administrative and Compliance Costs of Taxation, 1989, Sandford, Godwin and Hardwick, page 191, where the results were originally reported.

12 However, few are likely to specialise *exclusively* in a narrow field; they need to be generalists too.

1.32. These generalist practitioners would be the main *immediate* beneficiaries if tax legislation were more comprehensible. But everyone should benefit *indirectly*. Businesses of all sizes would see lower professional fees and compliance costs. Small businesses in particular could expect their tax affairs to be dealt with more expeditiously and correctly by their local tax inspector. And all taxpayers would benefit from lower public expenditure if less were spent on administering an excessively complex system.

CHAPTER 1: INTRODUCTION

CHAPTER 2: OTHER COUNTRIES

2.1. In Chapter 1 we looked at what is wrong with UK tax legislation and noted the growth in volume and complexity. We also noted in passing that other countries are experiencing a similar increase in the volume of their fiscal legislation. In this chapter we examine other countries' experiences in a little more detail, in particular Australia and New Zealand which are both engaged on projects to rewrite their income tax legislation in comprehensible language.

2.2. It would of course be dangerous to draw firm conclusions from the experiences of other countries. Their cultures may differ significantly from ours, and they may not have identified the right answers anyway. Although both Australia and New Zealand are currently engaged in significant projects to rewrite their tax laws, they are still at a relatively early stage; how well these projects work out in practice will not be seen for several years yet. Nevertheless, it is useful to consider the lessons we can learn from other countries which have looked at the same questions we are facing. Both Australia and New Zealand are two years or so ahead of us in simplifying their fiscal legislation. The task which they have undertaken is immense; they each have project teams to carry it out, the Australian one comprising almost 50 officials.

Volume and Complexity

2.3. Most other countries seem to have experienced an increase in the volume of their fiscal legislation, just as the UK has done. In the USA the Internal Revenue Code now consists of 1,378 pages, an increase of well over 200% since 1954, with the growth spread across virtually all areas of income tax. Federal income tax regulations ran to 6,439 pages, up by over 450% since 1954. In 1994, the Canadian the Income Tax Act ran to 1,560 pages compared with approximately 500 pages in 1971. Dutch tax legislation grew by over 120% in the twenty years to 1994. Income tax was first introduced in New Zealand in 1891 in a 32-page Act which covered land tax as well. By 1983 it had grown to 773 pages, and in the following decade it doubled in size again. Anecdotally, we have been told that the volume of other countries' legislation has also increased, but we do not have figures. Only in France have we found a different picture. There the length of the Tax Code is barely any longer now than it was thirty years ago.

2.4. It is more difficult to gauge the relative complexity of other countries' tax systems and we have not attempted to do this.

Complaints

2.5. There are complaints about tax in several countries. In the USA there is a major debate about the tax system with various proposals for fundamental reform. But the focus of the debate is on the complexity of the process of completing a tax return and on the tax system's perceived anti-investment bias, not on the way the legislation itself is expressed (although there are, of course, complaints about the legislation).

2.6. In Canada, a recently announced provision drew the response from a professional body that "the Legislation explodes the current provisions into a vast and intricate legislative labyrinth whose breadth and complexity is (sic) almost impossible to intellectually penetrate. Without doubt, the Legislation is the most complex legislation ever ..., attributable, no doubt, to its attempt to provide a specific answer to almost every conceivable possibility ..."[13].

2.7. In Ireland there has been pressure for several years - including questions in the Irish Parliament - for a consolidation of the Irish income tax legislation. This was last consolidated in 1967, since when there have been over thirty Finance and other tax Acts. Given that the Irish do not generally use textual amendment, the pressing need for consolidation is understandable.

2.8. Earlier this year, Sweden's Opposition leader is reported to have said the tax system had "run amok". We are told by practitioners in Germany that "of course taxpayers complain about the tax system". They probably do everywhere else too, but we have no information about other countries.

Responses to Complaints

2.9. So what are other countries doing about tax complexity? In particular, is anyone else looking at the issues we have addressed in this report? The answer is that Australia and New Zealand are both rewriting their income tax legislation to improve its comprehensibility. Several countries are also looking at complexity in one way or another.

<u>AUSTRALIA</u>

2.10. In December 1993 the Australian Government set up a Tax Law Improvement Project (known as TLIP) to re-write income tax legislation over a three-year period.[14] The project was intended to "develop a better structure and arrangement for the law as well as re-expressing it in language that can more easily be understood by its readers".[15]

2.11. The Australian perception of their problems is similar to ours. The tax system is "fundamentally fair, [but] the way in which our laws are expressed leaves a lot to be desired. The law is often very complex, sometimes to the point of being impenetrable for all but the most dedicated tax expert".[16]

2.12. The purpose of TLIP is to restructure, renumber and rewrite the legislation. "The goal is to make significant savings in the costs of compliance by expressing the income tax law more simply. The savings will come from reducing the time and effort that is unnecessarily expended in understanding, interpreting and applying the law."[17]

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13 Commentary of 5 April 1995 by the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants on new rules on "foreclosures and debt forgiveness" contained in Bill C-70 tabled in the Canadian House of Commons on 16 February 1995.

14 The Australian Tax Office regards the three-year period as probably impossible to meet. They are already behind schedule.

15 TLIP Information Paper No. 1, The Broad Framework, page 5.

16 Foreword to TLIP Information Paper No. 1.

17 TLIP Information Paper No. 1, page 4.

Restructuring

2.13. In the rewrite, the legislation has been given a new structure which is described as a 'pyramid'. There are three levels:

- At the top of the pyramid sit the core provisions which "provide a conceptual framework for the workings of the Act".[18] These are the very basic issues such as what income tax is, how the tax due is calculated and when it is due to be paid.
- The second layer of the pyramid is the general provisions which apply across a wide group of taxpayers. They provide the rules for dealing with particular kinds of income and deductions.
- The third layer is specialist topics which affect particular groups of taxpayer. This category includes the rules for taxing partnerships and for dealing with international issues. It also includes the rules for particular industries such as mining and films.

2.14. The rewrite is creating a 'toolbox' of definitions which apply throughout the Act. The intention is that by sign-posting the way through the legislation, taxpayers will always be able to identify with ease the provisions that concern them and will therefore be able to ignore the rest. Unlike New Zealand, however, there is no guarantee that all cross-referencing will be included, so users of the legislation will not have total security that they have not overlooked some relevant provision.

2.15. A further reflection of the pyramid approach of building up the detail of the legislation in layers which move from the general to the specific is that "at the beginning of each 'topic' in the Act, there will be one section which explains the basic principle or purpose of that topic."[19] These purposive statements are known as 'key principles'. They break the rule of English Parliamentary Counsel that the same thing should not be said twice in different language since this is more likely to confuse than clarify. The TLIP team do not see this as a problem; they are trying to create a hierarchy within the legislation. However Australian practitioners have criticised the use of key principles because their role was unclear and hence liable to create confusion.

Renumbering

2.16. One area in which Australia's old legislation was criticised was its numbering system with provisions such as 159GZZZZA(2)(b)(iii)(B). This is being replaced by a two-part numerical system in which all sections will be numbered sequentially (starting from 1) within Divisions. Division numbers run in one sequence throughout the Act. So sections will have numbers such as 6-22 (section 22 of Division 6). Large gaps will be left between allocated numbers in order to leave space for further Parts, Divisions or sections to be added later.

Rewriting

2.17. Three different approaches to drafting the legislation were considered: plain English, general principles drafting (referred to as fuzzy law) and detailed drafting (referred to as black letter law). The conclusion was that there should be a mixture of both general principles drafting and detailed law in the re-write and that it should all be written in plain English.

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18 TLIP Information Paper No. 2, Building the New Law, page 10.
19 TLIP Information Paper No. 2, page 15.

2.18. The language chosen in the rewrite is particularly colloquial. The aim is to reduce the reading age of the legislation from university standard to somewhere around senior school standard. The target audience of the rewritten legislation is generally the high street tax return preparer although some parts of it may be written in more complex style to reflect the fact that their audiences operate at higher levels of expertise.

2.19. For stylistic reasons, different words are sometimes used even though they are intended to mean the same thing. This does not appear to be working well. In one instance in the substantiation provisions the word 'paid' was changed to 'incurred' but the Australian Tax Office has had to give an undertaking that it will be interpreted as if it said 'paid'.

2.20. The TLIP's role is not to look at policy per se but to express the policy better. This aspect is the subject of some disagreement in Australia. A number of practitioners believe it is unproductive to rewrite the legislation without including a policy review. However our impression is that it would have been far too difficult to address both linguistic and policy issues as part of the same process. The policy issues would have soon brought the whole project to a halt.

2.21. There is no guarantee though that the rewrite will not change the effect of the legislation (such a guarantee would effectively give taxpayers two bites at the cherry - they could argue their case by reference to either the new wording or the old wording). Consequently there is a recognition that the law *will* change, albeit unintentionally, because different words are bound to carry different meanings.

2.22. Moreover the TLIP project team regards itself as able to make deliberate changes in the effect of the legislation - although it must identify and justify these. It distinguishes policy with a small 'p', which the project is allowed to address, from Policy with a large 'P' which it cannot. This is justified on the basis that small 'p' policy changes merely enable better ways to be found of realising Policy objectives, especially taking into account deregulation and compliance cost issues.

2.23. However TLIP seems to have had difficulty here in that some parts of the existing legislation were of such complexity that they could not discern either the structure or the significance of particular words. The existing law was just too hard to understand. Consequently they could not determine the policy objectives the legislation was trying to realise.

2.24. The first fruit of the TLIP, the Tax Law Improvement (Substantiation) Act 1995 incorporated numerous changes in "administrative requirements". These changes are mostly fairly small beer in themselves but some clear policy issues are addressed; they range from standardisation of similar requirements to the ability to claim up to $150 for laundry expenses without receipts and the overturning of a legal decision which had held that a hire purchaser of a car was neither owner nor lessee. This therefore gives a flavour of the sort of policy changes which are being made.

2.25. So far, the rewrite has shortened the existing legislation by around 50%, with simplification of the language and of the underlying policy contributing equally to this saving.

2.26. However, in areas where there is considerable case law, the existing language is being retained in order to minimise the loss of precedent. But this is still being placed within the new framework, under the pyramid structure and subject to the 'key principles', so there can be no guarantee that the interpretation of the new legislation will be identical to the old.

Managing the TLIP

2.27. The TLIP project team consists of over forty people headed by Brian Nolan who formerly held a senior position in the Australian Tax Office (equivalent to Deputy Chairman of the Board of Inland Revenue). The senior personnel of the project team include representatives from the Treasury and the Australian National Audit Office, two private sector representatives and a draftsman from the Office of the Parliamentary Counsel.

2.28. There is a consultative committee of senior practitioners which meets monthly to consider papers put to it by the project team.

2.29. One problem faced by TLIP was how to implement such a mammoth project: in stages; or with a single new Act (the "Big Bang" approach)? They decided to proceed in stages, essentially for political reasons: they wanted to demonstrate the advantages of a rewrite early on; and they feared that the whole project would founder if they waited three or more years before producing anything tangible.

Non-tax legislation

2.30. The TLIP is not the only initiative in Australia to improve the comprehensibility of legislation. For example, company law has also be rewritten in a more accessible style. And the Office of the Parliamentary Counsel has developed a Plain English Manual to help draftsmen make their drafts easier to understand. The Manual says that "in this Office, the ability to draft simply is now regarded as one of the essential qualities of a good drafter".[20]

NEW ZEALAND

2.31. A series of reports have been produced in New Zealand and these have culminated in a project to rewrite the Income Tax Act 1976. The rewrite is necessary because:

> *"The current Income Tax Act has not coped well with the demands placed on it in recent years. The numerous and major changes to tax law ... have resulted in the Act's length increasing by some 80 percent. These changes have added to the complexity of the Act. Such complexity has had a number of undesirable effects: the policy intent of the legislation has not been as clear as desirable; compliance costs for taxpayers and their advisers have been higher than necessary; and sometimes the law has had unintended and unforeseen consequences.*
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> *"The policy intent of the current Act's provisions tended to be obscured by the drafting style and by the Act's attempt to provide certainty and precision through the detailed expression of policies in the variety of complex circumstances in which they operate."*[21]

20 Plain English Manual, page 5.

21 Paragraphs 1.3 and 1.5 of "Rewriting the Income Tax Act: objectives, process, guidelines" - New Zealand Government discussion document issued in 1994.

2.32. The rewrite is intended to achieve "great savings in time and money by those who are subject to the legislation and by others, including the courts, who have to apply it".[22] However the potential for cost savings is acknowledged to be limited since tax legislation inevitably imposes some costs. The three reasons cited for this are the complexity of policy objectives, the complexity of the underlying transactions and the need to protect the tax base against the "considerable lengths" some taxpayers will go to to minimise their tax liabilities.[23]

2.33. This inherent complexity of fiscal legislation "means that a key method of reducing the overall costs imposed by our tax system lies in making a complex Act easier to use."[24] "Costs can be reduced by improving the Act's structure, making the interrelationships between the parts of the Act explicit, and adopting a plain language style of drafting."[25]

2.34. The three objectives of the rewrite are that users of the legislation should be able to find the applicable rules, be confident that they have identified all relevant rules and not overlooked anything, and be able to understand the rules once they have found them.

2.35. The re-write is being done in stages:

(a) reorganising the existing legislation into a better structure (*resequencing*);

(b) adding new 'core provisions' (*core provisions phase*); and

(c) progressively reviewing and rewriting the remainder of the Act (*review phase*).

Resequencing

2.36. In the first stage, the Income Tax Act 1994 restructured the existing income tax legislation without changing the law. Prima facie it does no more than a consolidation Act in the UK. (Although New Zealand tax law was consolidated in 1976, "considerable reorganisation of the existing provisions" did not take place then.) But consolidation was regarded as a pre-requisite to the re-writing of the legislation - to make the exercise more manageable and to allow taxpayers to absorb the changes more gradually.

2.37. The new Act is divided into parts which set out all the detailed rules determining, for example, assessable "gross revenue" (Part C), allowable deductions and losses (Part D), tax credits (Part L) and tax payments (Part M).

2.38. Unlike TLIP in Australia, the New Zealand project does not separate out the special rules for particular industries or categories of taxpayer, leaving users of these to look in two (or more) places. Users would find all the rules they needed in the same part of the Act. So, for example, a New Zealand mining company would find all relevant rules within the part of the Act which dealt with business income.

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22 Working Party on the Reorganisation of the Income Tax Act 1976, cited in "Rewriting the Income Tax Act: objectives, process, guidelines", paragraph 1.4.

23 "Rewriting the Income Tax Act: objectives, process, guidelines", paragraph 3.10.

24 "Rewriting the Income Tax Act: objectives, process, guidelines", paragraph 3.1.

25 "Rewriting the Income Tax Act: objectives, process, guidelines", chapter 3.

Core provisions phase

2.39. In the core provisions phase the project goes beyond a mere consolidation. "The core provisions ... provide an overview of the scheme and purpose of the Act and clarify the inter-relationships between different sections of the Act. They specify the obligations imposed by the Act and the key steps that taxpayers must take in order to determine and satisfy those obligations."[26]

2.40. The core provisions are intended to answer three questions which are central to an understanding of the Income Tax Act: who is chargeable, what is subject to tax and how is the tax liability computed and satisfied?

2.41. Draft clauses were released earlier this year.[27] They are organised in a way which reflects the sequence of steps users follow to determine their tax liabilities. They begin with a general statement of their purpose. They also define a number of key terms used in calculating tax liability. And they aim to provide explicit cross-references to the Parts of the Act relevant to each taxpayer's circumstances, thereby increasing certainty and reducing compliance costs for taxpayers as well as preserving the integrity of the Act into the future by preventing provisions being applied for purposes which were not originally intended.

Review phase

2.42. In the third stage, the remainder of the Act will be reviewed and re-written in stages to:

- make policy changes (which were avoided in the resequencing stage);
- introduce purpose sections at the beginning of each Part;
- rationalise and simplify the provisions; and
- use plainer language and improved presentation.

2.43. Drafting guidelines have been developed covering such matters as structure of the Act, purpose clauses, use of definitions, cross-referencing, sentence structure and word choice. Formulae, flowcharts and tables are to be used to assist communication. Unlike TLIP in Australia, there is no attempt to reduce the reading age for the legislation. The New Zealand project team regards the university graduate as the correct target of the legislation. There is therefore no intention to draft in a colloquial style, and no attempt to avoid repetition of the same word or phrase when the same meaning is intended.

2.44. The rewrite is explicitly not a forum to review policy issues, although it is intended that the effect of the existing legislation will be changed. There is a difficult balance here and no attempt is made to define the criteria which determine what is regarded as a 'policy issue'. An advisory panel is being created (see below). Proposals will be regarded as policy issues if *any* member of this panel asks that they be so treated. Once identified as policy issues, the panel will "divert them into the normal tax policy process for decision".[28] They will be given high priority if this is necessary to keep the rewrite moving. This approach is intended to address

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26 Paragraph 1.5 of "Core provisions: Rewriting the Income Tax Act" - New Zealand Government discussion document issued in May 1995.

27 In "Core provisions: Rewriting the Income Tax Act".

28 "Core provisions: Rewriting the Income Tax Act", paragraph 4.1.

the maximum number of concerns at an early stage and thereby minimise the risk of objections to the rewrite proposals at later stages in the process.

Managing the project

2.45. A project team of officials from New Zealand's Inland Revenue Department and Treasury has been established to prepare the new legislation. This is supplemented 'as appropriate' by external advisers. (In New Zealand - as in Ireland - all tax legislation is drafted in-house by Treasury and Inland Revenue Department officials, with only a final quality check by Parliamentary Counsel.)

2.46. As noted above, an advisory panel has been set up with representatives from the main professional bodies as well as from Government. The panel's role is twofold: to identify policy issues and ensure they are passed to the Government for consideration; and to comment on matters of interpretation, style and presentation.[29]

2.47. The project team identifies the policy intent behind the existing legislation and prepares first drafts of each block of legislation. These are shown to the advisory panel. They are then published in a discussion document so that interested parties can comment. Finally a Bill is introduced into Parliament.

OTHER COUNTRIES

2.48. So far as we are aware no other country is doing anything along these lines. However, different solutions to essentially similar problems are being adopted elsewhere.

2.49. In the USA the vogue solution to fiscal complexity is a flat tax[30]. This would make the task of completing a tax return for the average American very much simpler than at present. They would still need to determine their taxable income but the computation of the tax liability would be a simple task of deducting the personal allowance and calculating a fixed percentage of the balance. However, voluminous and complex legislation dealing with the taxability of income and providing the rules for submission of returns and payment of tax would doubtless remain.

2.50. In Ireland a project to consolidate income tax, corporation tax and capital gains tax legislation has begun. This expressly rules out any simplification of the legislation. Even then there is some concern that it may be difficult to get a consolidated Act through Parliament. When the Income Tax Act was consolidated in 1967 opposition to one provision - albeit already on the Statute Book - led to its repeal before the consolidation Bill was passed.

2.51. In Canada virtually all tax legislation is now released in draft for public comment before it is introduced into the Canadian Parliament. This provides an opportunity for any criticisms of the drafting to be voiced whilst there is still time for them to be rectified. We have not yet been able to gauge whether, as a consequence, Canadian tax legislation is more comprehensible.

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29 "Core provisions: Rewriting the Income Tax Act", paragraph 5.4.

30 There is more than one version, but in its most extreme form income above a certain threshold would be taxed at a flat rate of 17% with no deductions or reliefs whatsoever.

CHAPTER 3: CAUSES OF COMPLEXITY

3.1. In his Philip Hardman Memorial Lecture in 1994, Leonard Beighton said that "[u]nless we understand how the matter [i.e. complexity] arises in the first place, we are unlikely to find a solution".[31] He was absolutely right. In this Chapter we look at the factors which, in aggregate, have led us to the current position and which may or may not frustrate attempts to improve the comprehensibility of tax legislation. In Chapter 3 we shall consider further how such factors constrain the ability to put our recommendations into effect and what can be done to resolve these problems.

THE FACTORS

The tax base

3.2. Income tax, it has famously been said, is a tax on income. But what is income? The matter was well stated by a former Director of the IFS when, in 1985, he said:

> *"Economists, as well as accountants, have struggled with definitions of income for long enough, and there are several volumes of tributes to their efforts and their lack of success. Perhaps the best known is that of Hicks. For Hicks, income is what a man can expect to consume during a period and still be as well off at the end of the period as he was at the beginning. This is a valuable concept, but one which is not enormously helpful to the tax collector. How does he establish how well off a man expects to be at the end of the period? And what is the taxman to do if these expectations are unreasonable?*
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> *... income is, in the last analysis, a subjective concept whose size depends on the judgment of the accountants who compile it and the particular purposes for which the measure will be used ... Income, in short, is a necessary concept but one which cannot be given the precision or objectivity that some of its uses might require.*
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> *Foremost among these is its use as a tax base, and the principal source of the bulk of the extensive statutory provisions is successive, not very successful, attempts to give that precision to a concept which intrinsically lacks it."*[32]

The fact that the concept of income is elusive is one reason why the Taxes Acts have grown remorselessly for over 150 years - we keep trying to answer the question as to what are income, profits and gains. Consequently, complexity is fundamental to the calculation of liability to income tax, corporation tax and capital gains tax. And it is responsible for much tax avoidance and for the difficulty of achieving certainty.

3.3. The same is not true of transaction-based taxes - VAT, PAYE, National Insurance Contributions, etc. These have their complexities, but they mainly arise from other features.

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31 "The Finance Bill Process: Scope for Reform?", Second Philip Hardman Memorial Lecture to the Faculty of Taxation.

32 "Is Complexity in Taxation Inevitable?", Deloitte, Haskins & Sells Lecture given by John Kay on 26 February 1985, IFS Working Paper 57.

For example the complexities of VAT are associated largely with its administration, with complexity of the transaction itself (such as the interaction with property law) or where the value of the supply is unclear.

3.4. Our remit does not extend to proposing changes in the tax base - such changes are policy matters for the Government to determine. Nevertheless it is important to recognise the extent to which complexity is inherent in the tax base and the limitation this imposes on the ability to address linguistic complexity.

History

3.5. The UK has had an income tax continuously for over 150 years and the origins of the current income tax system are now very nearly two centuries old. When Addington introduced his income tax in 1803 he adopted the concepts of the source and the schedular system. Over time since then we have effectively moved from taxing sources of income to taxing people. But we have done so by shuffling, little by little, rather than by tackling the issue head on. Consequently we still have the schedular system and other aspects of the original structure.

3.6. In those 150-odd years of income tax's existence there has never been a fundamental rewrite of the legislation[33]; we have had periodical consolidations but these have merely brought together the existing, dispersed legislation into one or more new Acts, in the interests of greater manageability. Each year's Finance Act has built upon the structure left by the previous one so that we now have a huge edifice which bears little resemblance to the original, modest single-storey block from which it has slowly metamorphosed.

3.7. Some of the early drafting was simple but soon demonstrated its inadequacies in dealing with 'real-world' situations. For example, trading profits were taxed without any allowance for depreciation of capital employed.[34] Over the years more and more of the rough edges of the original drafting have come to light, often as cases have come before the courts, and many of these have been the subject of amending legislation. Sometimes this has imposed tax on income which was slipping through the net (for example, post-cessation receipts) but at other times it has conceded relief where none was available previously (for example, capital allowances). This process continues today: for example, sections 90 to 92, Finance Act 1995 concede reliefs for certain expenses paid by former traders or present or former employees.

Common law

3.8. Another aspect of history is that our tax legislation is drafted against a common law background and methods of interpretation. This differs in important respects from the civil law used in continental European countries. Moreover there is not the same concept of precedent. The Renton Committee found that:

> *"... the traditional approach in Europe has been to express the law in general principles, relying upon the courts and the Executive to fill in the details necessary for the application of the statutory propositions to particular cases, in the light of the general intention of the legislature expressed in preambles, recitals and other documents. This approach*

33 The Departmental Committee on Income Tax Codification (1927-1936) produced a complete rewrite but it was never enacted.

34 In re Robert Addie & Sons Ex (S) 1875, 1 TC 1. Deductions for capital expenditure on pit-sinking and depreciation of buildings and machinery were refused.

appears to result in simpler and clearer primary legislation where detail is omitted, but equally it lacks the greater certainty which a detailed legislative application of the principles would provide. Here on the other hand the traditional approach has been to spell out in the statutes themselves the precise way in which the law is to apply in differing circumstances. This gives greater certainty in respect of the circumstances provided for, and it is not necessary to wait for rulings by the courts on particular applications; but it leads to more complex legislation which is less clear to the ordinary reader.[35]

3.9. So a civil law draft does not aim to be comprehensive and therefore it can be drafted in straightforward terms. There is no difficulty in expressing the legislation in terms of general principles even if, as is frequently the case, exceptions to those principles need to be allowed. Administrators and the courts can be left to deal with such hard cases without any steer from the legislation itself.

3.10. Bennion on Statute Law makes the same points and goes on to argue that in the UK we prefer to be ruled by a democratic legislature which passes Acts after full, public debate and which weighs and argues over almost every word in almost every Act. It follows, he says, that there is a technique of statutory interpretation although he adds that many people do not agree.[36]

3.11. Stated in these terms, this is a caricature of both civil and common law drafting, and Renton recognised that the distinctions are in practice "sometimes blurred"[37]. It certainly seems to be true that some continental countries have very short, simple tax law based on bold statements of generalised principle, with the necessary detail being filled in somewhat mysteriously. For example, Spain's personal income tax (*Ley del Impuesto sobre la Renta de las Personas Físicas*) takes up only 30 pages of primary legislation for the most part written in extremely generalised terms. And EU legislation tends to be drafted in - by UK standards - pretty general terms. By contrast, though, the German constitution requires taxing acts to be written in clear and detailed terms, and German practitioners complain that tax legislation is becoming ever more detailed. Although the civil law approach is indeed generally rather different from ours, it appears therefore that there is considerable variation within the heading "civil law drafting".

3.12. Nor is it true to say that almost every word in UK Finance Acts has been weighed and argued over in Parliament. This is certainly the theoretical position. But in practice, much of our tax legislation is hardly scrutinised at all in Parliament. It has become common in the Standing Committee in recent years for particular provisions to be debated in general terms, and sometimes for particular words or phrases to be debated, but for whole blocks of legislation then to be voted to stand part of the Bill with no, or only perfunctory, debate. This is especially true of legislation included in Schedules to the Finance Bill.

3.13. However, Bennion is right to note that the common law background to our legislation and the traditions of Parliamentary scrutiny and of precedent in the courts have led to the development of a very arcane technique of statutory interpretation. This, in turn, has led the draftsman to feel compelled to hammer home his taxing provisions so that there can be no

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35 "The Preparation of Legislation", Cmnd. 6053, paragraph 9.14.

36 Bennion on Statute Law, Third Edition, page 83.

37 "The Preparation of Legislation", Cmnd. 6053, paragraph 9.9.

doubt about their application. Accuracy has acquired a status which transcends any question of clarity or intelligibility.

3.14. This interpretative technique is constantly developing and in recent years has laid more emphasis on Parliament's intentions - the so-called purposive, teleological or schematic approach as contrasted with the literal approach. The beginnings of the movement in this direction probably go back well over twenty years; Lord Diplock remarked upon it as far back as 1975:

> *If one looks back to [House of Lords judgements] on questions of statutory construction over the last 30 years one cannot fail to be struck by the evidence of a trend away from the purely literal towards the purposive construction of statutory provisions.*[38]

But although it may have begun many years ago this trend still seems to be developing: several decisions this year have pushed it a little further.[39] However there is still some way to go before it becomes settled practice for the courts to interpret legislation purposively.

Volume

3.15. It seems clear that complexity feeds on itself. Once a tax system has become complex, even a conceptually simple change may only be achievable by means of a complex provision - because the new legislation has to fit into the conceptual framework and language of the existing body of law. This means we are caught in a spiral in which the existing volume and complexity of our tax legislation demand additional volume and complexity for each new piece of legislation, and so on. Moreover, if a proportion of the existing law needs to be updated annually just for care and maintenance, the larger the Statute Book the more new law is required each year. In this way, this spiral may become self-perpetuating unless something is done to arrest it.

Sophistication of commerce

3.16. It is undoubtedly the case that commerce has changed hugely in the 150 years that income tax has been continuously on the Statute Book. In particular there has been a vast growth in the sophistication of business and financial affairs. In the 1840s, the main commercial activities upon which the tax system impinged were property ownership (including agriculture) and international trade in raw materials and manufactures. Insurance and banking were both rudimentary in comparison with the financial instruments available today and largely domestic rather than international.

3.17. The increased sophistication and mobility of the capital markets and the expansion in world trade have exposed the inherent weaknesses of income tax. So it is hardly surprising that the tax system has had to change, to evolve alongside modern-day commerce.

3.18. The correlation between the sophistication of commerce and legislative complexity is not direct. It is no more difficult to impose tax on "profits or gains" from the manufacture of portable telephones than it was for gas lamps. But it is also the case that new activities have exposed new flaws in the old law, or new manifestations of old flaws. For example, Robert

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38 Carter v Bradbeer [1975] 1 WLR 1204

39 For example, De Rothschild v Lawrenson [1995] STC 623, Chevron UK Ltd v CIR [1995] STC 712 and Melluish v BMI (No. 3) Ltd, House of Lords [1995] STC 964.

Addie & Sons in 1875[40] and Wimpey Waste Management Ltd in 1989[41] both failed to secure a deduction in computing their trading profits for expenditure on capital account, and in both cases the law subsequently had to be changed to right manifest injustices.

3.19. It is practically impossible, where a straightforward statement of general principle has been found wanting, to replace it with another such statement and thereby express precisely what was intended. Instead, the original statement must usually be elaborated by more detailed provisions. The fact that the law has had to keep up with commerce has therefore added to both its volume and its complexity. For example, we now have an entire Capital Allowances Act of nearly 200 sections to deal with what was not originally provided for at all (other than, possibly, through the taxation of "profits and gains"). In more recent years, some of these elaborations have been particularly impenetrable (for example, the foreign exchange gains and losses legislation in FA 1993 - another immense elaboration from the three original words "profits and gains" for traders to a whole code - and the thin capitalisation rules in FA 1995[42]).

Certainty

3.20. One issue which has frequently been raised with us is certainty. The desire for certainty seems universal: taxpayers, practitioners, the Revenue departments, politicians, draftsmen all want it. There are very good reasons for this - uncertainty adds to cost in various ways and makes it difficult for business to operate with confidence. But the desire for what the Renton Committee described as immediate certainty[43] - a clear and accurate legal effect without reference to the courts - has played a large part in making tax legislation complex since, as the examples mentioned in the previous paragraph demonstrate, it has led to ever more information being put into the legislation in the hope of answering in advance the questions which might conceivably arise. Bennion on Statute Law notes that:

> *... the good drafter seeks to word his text so that wherever possible it gives the answer. This makes the text complicated. Even the skilled reader needs help unravelling it. But the answer is there.*[44]

3.21. Unfortunately this is a somewhat over-optimistic view. Immediate certainty is a mirage; it may appear to be within grasp at the cost of one more layer of detail but there is always a further layer below that one waiting to be peeled off. The possible permutations of facts are virtually infinite so that legislation cannot realistically aspire to answer every question. In this sense, complete immediate certainty is unattainable.

Tax avoidance

3.22. We were told an anecdote about a taxpayer who thought it wrong to consider the effect of taxation when taking financial decisions; the Government should decide how much tax it needed to raise and it was the taxpayer's public duty to pay. Not many people are so public-spirited these days and this is therefore not a basis on which Governments can expect to raise revenue. Hence the need for tax legislation to be written in a way which prevents, as far

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40 In re Robert Addie & Sons Ex (S), 1 TC 1.

41 Rolfe v Wimpey Waste Management Ltd, 62 TC 399, [1989] STC 454.

42 Sections 125 to 170 Finance Act 1193 and Section 87 Finance Act 1995.

43 "The Preparation of Legislation", Cmnd. 6053, paragraph 10.4.

44 Bennion on Statute Law, Third Edition, page 1.

as possible, the risk that it will be misused by the would-be avoider, and the need for specific anti-avoidance provisions.

3.23. We noted that, all other things being equal, the reduction in marginal income tax rates over the last 15 years should have reduced the incentive to avoid income tax. However tax avoidance is not just driven by the level of tax rates. Taxpayers routinely avoid 1% or ½% stamp duty when they can and many of the artificial tax avoidance schemes of the 1970s were directed at capital gains tax, which at the time was levied at a nominal rate of 30%. The true position is that the incentive to reduce tax liabilities depends upon a number of factors, including both the tax rate and the tax base. Ultimately, the tax being avoided must justify the costs of taking the necessary steps to avoid it, and the inclination to contemplate those steps may be influenced by people's views of whether or not the tax is "just". Whether there has been any change over time in people's willingness to avoid tax is a question we have not tried to answer.

3.24. Avoidance, or the risk of avoidance, operates to complicate legislation in several ways. Firstly, it leads draftsmen and policy advisers to aim to make their legislation proof to the would-be avoider by drafting so as not to leave potential loopholes. In this way, it acts on all legislation, not just expressly anti-avoidance provisions.

3.25. Secondly, it can add to both length and complexity when the response to a loophole is to introduce a specific anti-avoidance provision. This is especially so if a spiral develops in which the blocking of one loophole is followed by the identification of another which is then blocked, and so on. Just such a spiral was developing in the 1970s until the courts developed the "new approach" in Ramsay and subsequent cases.[45]

3.26. Avoidance also leads to secrecy. Some measures must take effect from the date they are announced in view of the potential consequences otherwise. The difficulty of consulting on such measures, coupled with pressure to enact them as early as possible, may result in legislation which is ineffective and unduly burdensome.

Policy and politics

3.27. Policy often seems to add to the complexity of tax legislation, for several reasons. Apart from explicit tax avoidance provisions, the chosen tax base may need to be protected by specific measures. Thus, employee taxation would be less complex if Schedule E taxed only cash payments, ignoring benefits-in-kind. This would, however, lead to a large erosion in the tax base as earnings were paid in the form of non-cash benefits. Schedule E would also be simplified if it gave no relief for expenses of any kind. However, many people already claim that the existing Schedule E expenses rule is too limited and the disallowance of all expenses would be seen as even less equitable. Other measures designed to give effect to general perceptions of fairness between taxpayers may also dictate additional complexity.

3.28. At a political level, the Chancellor's annual Budget Statement is a theatrical occasion. Chancellors may wish to leave their mark on the tax system and go down in history as "radical reformers" - although few succeed. More prosaically, they generally wish to announce something which will capture the headlines, and they know that if they do not do so the Opposition will make political capital of a "do-nothing" Budget. So even in years when

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45 W T Ramsay Ltd v CIR, 54 TC 101, [1981] STC 174.

significant tax changes are not economically or fiscally necessary, there is political pressure to tinker. This inevitably adds to the length of the legislation and introduces policy complications.

3.29. Ministerial ambitions are fanned both by policy advisers within the Revenue departments, who are seldom at a loss to identify refinements to the areas of the tax system for which they are responsible, and by the professional bodies and other interest groups who put forward lengthy lists of Budget representations each year. Many of these "Budget Starters" fail to find space in the Finance Bill; but too many - originating from both sources - pass through this sieve.

3.30. Ministers also tend to take decisions as late as possible, in order to allow for changes in circumstances. This reduces the time available for drafting the legislation and may lead to the formulation of policy in parallel with, rather than in advance of, drafting the legislation. As a broad proposition, the more hastily it is drafted, the less comprehensible it is likely to be. Ministers' reluctance to take early decisions therefore leads directly to greater complexity.

3.31. There is a limit to what is politically feasible. This was demonstrated most recently by Parliament's refusal to allow the rate of VAT on domestic fuel to be increased to 17½% as the Government had intended. Today's tax system reflects yesterday's political realities. Take a trivial but well-known example: we now have a permanent three-rate VAT[46] contrary to the original intentions of policy-makers and the Government. We have been told that the risk of opening up an existing provision to this sort of effect has, at times, prevented an opportunity being taken to redraft it in less complex terms. Such an opportunity arises when the provision needs to be amended for some other reason. In this case a choice has to be made between making a narrow change just to achieve the altered policy objective, and rewriting the whole provision in a more appropriate and clearer way. The Renton Committee noted this factor.[47]

3.32. One consequence of all this is that tax legislation frequently seems to lack a coherent underlying principle. It is the result of many years' political expediency, not of any rational scheme.

The Courts

3.33. The courts are increasingly using judicial review as a check on the exercise of administrative discretion. There is some suggestion that this may have inclined draftsmen towards placing administrative discretions on firmer statutory footings. This inevitably adds to both length and complexity since, as with legislating Extra-Statutory Concessions mentioned at paragraph 3.49 below, the drafting needs to be proof against mis-interpretation.

3.34. There is a feeling amongst at least some policy advisers that the courts cannot be trusted to reach common sense judgements. This stems from cases in which the court's judgment is perceived not to have been sensible (although not everyone would share this view), such as the Flockton case[48]. This perception inclines the policy adviser, in the search for certainty, to prefer greater detail in legislation and to dislike general principles drafting. The solution to this lies in addressing the cause of poor court decisions. (This strays into the area covered by our Tax Appeals project on which we shall be making recommendations in 1996.)

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46 17.5% on full-rated supplies, 0% on zero-rated supplies and 8% on domestic fuel.

47 "The Preparation of Legislation", Cmnd. 6053, paragraph 17.29.

48 Ian Flockton Developments Ltd, [1987] STC 394.

Parliamentary process

3.35. The form in which Bills, and hence Acts of Parliament, are drafted appears not to have altered significantly since before the First World War (other than the move to A4 page-size in 1987).[49] There has been no attempt to modernise the design of the legislation to take advantage of facilities which were not readily available in the age of the typewriter.

3.36. Bills are required to consist of a Long Title, Clauses and Schedules. Parliament debates the Bill clause by clause. This makes it difficult to alter the layout of the Bill significantly once it has been published. For example, sections 200 to 208 FA 1994 inserted nine new sections (governing the current year basis of assessment under Schedule D) into ICTA 1988. If, for whatever reason, the draftsman had wanted to reorder this material, the Government would have had two, equally unpalatable options. To table nine new clauses at the Committee Stage and withdraw support for the original clauses. Or to table a very large number of amendments to the original nine clauses. Such amendments would be debated sequentially even though in logic they should stand or fall as a package. This procedure is perceived to prevent structural change to the Bill once it has been published, especially at times when the Government wishes to minimise the number of amendments it tables.

3.37. Since income tax is an annual tax, a Finance Bill is needed every year to impose it. This is a vitally important constitutional safeguard since it ensures that the Government must put its Budget before Parliament each year. But it is for debate whether it has allowed Finance Bills to be used as 'Christmas trees' for attaching provisions which would not otherwise have been enacted. Certainly, this has ensured that tax legislation has not had to compete for a share of Parliamentary time.

3.38. Finance Bills use a special Parliamentary procedure which imposes several constraints. Under this procedure, Resolutions are tabled by the Government and when these are passed a Bill must be "brought in and printed".[50] Every clause of this Finance Bill must be covered by a Resolution. The majority of these Resolutions are little more than interesting procedural mechanisms which have little impact upon the legislation. However, some of them (known as PCTA Resolutions) are designed to trigger the Provisional Collection of Taxes Act 1968 so that they can take effect before the Finance Bill receives Royal Assent. A PCTA Resolution must normally use almost exactly the same words as the clause it covers.[51] It ceases to have effect if the clause is rejected by Parliament, and as a consequence it may not be possible to amend a clause without a further Resolution. Ideally, such clauses therefore must be drafted by November when the Resolutions are tabled.

3.39. The Provisional Collection of Taxes Act requires that the Finance Bill must receive its Second Reading "within the next thirty days on which the House of Commons sits" after the Resolutions are passed. However, the Finance Bill must be published earlier than this since a House of Commons rule that two weekends must fall between publication and Second Reading is invariably followed. With printing deadlines to meet, the Finance Bill must be finalised around two weeks after the Budget.

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49 The current style of sections, subsections and indented paragraphs appears to have been introduced between 1850 and 1875, with indented paragraphs gradually gaining in usage thereafter.

50 Section 1, Provisional Collection of Taxes Act 1968. The procedure dates from 1692.

51 There were 67 Resolutions for Finance Act 1994 of which 24 were PCTA Resolutions.

3.40. The Provisional Collection of Taxes Act also requires that Finance Bills receive Royal Assent by 5 May, otherwise the Resolutions lapse. This means that the Report Stage in the Commons - which is the last opportunity to amend the Bill since money Bills cannot be amended in the House of Lords - must take place by approximately early April (depending upon the dates of Easter).

3.41. As noted at paragraph 3.12 above, the Parliamentary scrutiny of fiscal legislation is somewhat haphazard. Politicians, by and large, are interested in politics, not tax law. They tend to focus on the subjects which have a high political profile in preference to technical issues. So whilst some provisions are subjected to close scrutiny, others pass with little or no scrutiny. As Bennion points out (in relation to legislation generally, not just tax law):

> *It is a paradox, if a necessary one, that the people concerned with approving legislation are mostly ill-equipped by training and experience to understand it.*[52]

Parliamentary Counsel

3.42. All primary tax legislation enacted in the last hundred years or more has been drafted by the Office of Parliamentary Counsel. That office must therefore take some responsibility for the criticisms of the legislation as discussed in Chapter 1.

3.43. There has in fact been no shortage of people willing to criticise the draftsmen over the years. For example:

> *The Parliamentary Counsel Office appears, at least to outsiders, to have developed a rigorous, arcane and somewhat inflexible craft-tradition.*[53]

3.44. We consider that some of these criticisms have been unfair. After all, Parliamentary Counsel can only work within the constraints which other aspects of the system impose and with the materials they are supplied with. Three such constraints seem particularly important:

- instructions are frequently delivered far too near to the deadline for publication of the Finance Bill so that Parliamentary Counsel is constantly under severe time pressure;
- those instructions are likely to change as the legislation is drafted so that Parliamentary Counsel is aiming at a moving target[54]; and
- even if the draftsman were minded to draft in plain English, it would be very difficult to do so when the new clause has to slot into existing legislation which is written in the traditional style.

It may be no surprise given this background that the output is less than ideal.

3.45. However we do not accept that this is the full story. We believe that Parliamentary Counsel devotes insufficient attention to the needs of users of the legislation. Following the

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52 Bennion on Statute Law, Third Edition, page 37.

53 "How to do things with rules", by W Twining and D Miers, Second Edition, page 203. (Quoted by Bennion on Statute Law.)

54 One former Parliamentary Counsel thought this problem analogous to being asked initially to build a rowing boat and then later finding the specification changed to an aeroplane. It was unsurprising if the final product had oars protruding from its fuselage.

Renton Committee's recommendation[55] Parliamentary Counsel has made strides to resolve the conflict between the needs of users and of legislators in favour of the former. Consequently, almost all changes in existing legislation are now made by textual amendment. However little has been done to improve the language and structure of tax legislation. Possibly this is because the draftsmen overestimate the abilities of those who have to use the legislation they write. But whatever the cause, user-friendliness has been given less prominence than we believe it deserves.

Time

3.46. Time, or lack of it, aggravates many of the factors outlined above. Nevertheless it is of such importance that we believe it requires separate consideration.

3.47. Lack of time pervades the system. Ministers do not take decisions on tax changes early enough. Policy advisers do not send drafting instructions to Parliamentary Counsel early enough. Parliamentary Counsel does not have enough time to polish his draft. Policy advisers do not have enough time to comment on it. Consultation, where it takes place, frequently does not have sufficient time set aside. Parliament does not have time to scrutinise tax Bills fully within the time-scales required under the Provisional Collection of Taxes Act. There is never enough time after one Bill has received Royal Assent before work has to begin in earnest on the next one.

Europe

3.48. Our commitments in the European Union have made a very substantial impact on indirect taxation from the requirement to introduce VAT on accession to the EEC onwards. Europe's impact on direct tax has so far been less heavy. Recently though it has become rather more significant - we have had several decisions of the European Court of Justice, some amendments of tax law have been necessitated by European non-discrimination rules and several Directives have been adopted - and the European influence may increase further in the future. Regulations and Directives drafted predominantly for civil law jurisdictions - and liable to purposive interpretation by the European Court - have led to some increased complexity whether directly applicable (in the case of regulations) or requiring to be translated into the UK's common law traditions (in the case of Directives).

Other

3.49. The Public Accounts Committee has periodically expressed concern about the use of Extra-Statutory Concessions. But replacing an ESC by non-discretionary legislation invariably adds both length and complexity as the original (more simply expressed) text is redrafted in terms intended to withstand judicial interpretation.

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55 "The Preparation of Legislation", Cmnd. 6053, paragraph 10.3.

CHAPTER 4: PURPOSIVE LEGISLATION

INTRODUCTION

4.1. Much of the debate about the way tax legislation is written has so far turned on whether or not it should be "purposive". There have been articles in the professional press on purposive legislation. Leonard Beighton CB, former Deputy Chairman of the Board of Inland Revenue, floated the idea of purposive legislation at the 1994 Philip Hardman Memorial Lecture. And the Institute for Fiscal Studies and the ICAEW's Tax Faculty jointly held a Purposive Tax Legislation conference in June 1995.

4.2. The first problem in looking at purposive legislation is to define what is meant by the term "purposive". There is a range of ways in which legislation can be written:

(a) *general principles without more.* This would involve the writing of legislation by reference to general concepts without any further elaboration. The detailed application of the legislation in particular cases would be left to the courts. Historically this is how plant and machinery capital allowances have been treated.

(b) *purposive statements with more or less detail.* The general concepts would be supplemented by additional material. This would be illustrative (not exhaustive) of the purpose, which only the courts could expound.

(c) *general principles with supplementary.* This sets out the general concepts but relies on other materials to fill in the detail. For example the taxation of "profits or gains" for which accounting standards supply the detail.

(d) *general framework legislation.* The primary legislation would set out the framework on which the authoritative detail rested. The law would still be drafted in considerable detail; but the detail would be in either regulations or "notices" issued by the Inland Revenue or Customs & Excise and having the force of law. This sort of legislation already exists to govern, for example, personal equity plans and VAT retail schemes.

(e) *purposive statements.* This involves prefacing each part, chapter or section of the Act with a summary of what the detailed legislation which follows is designed to achieve.

(f) *detailed legislation.* This tries to answer questions which will arise in practice. How many, and how likely are the questions to arise, govern how much detail is covered in the legislation.

4.3. Despite this gradation along a range of different meanings of purposive legislation the two main interpretations are:

(i) general principles drafting; and

(ii) the use of purposive statements.

4.4. In this chapter we consider each of these in turn. General principles drafting in particular has its adherents, and its advantages cannot be dismissed lightly. There are many areas of the tax code which already use general principles drafting, and no doubt others could usefully adopt it. But we have concluded that its disadvantages are too great for us to

recommend that this style be relied upon generally. Purposive statements are less radical. We conclude that a clearer view of Parliament's intention would frequently be helpful.

GENERAL PRINCIPLES DRAFTING

4.5. General principles drafting is already employed in some tax legislation, particularly the parts which date back to the time income tax was first introduced. For example, Schedule D taxes the "profits or gains" of trades, professions and vocations, relying in the main on the accountancy profession to produce the detailed rules by reference to which traders can work out what their profits or gains are. Another example is the deductibility of business expenses. These must be spent "wholly and exclusively" for business purposes. Here, notwithstanding a good deal of elaboration about specific types of expenditure, there are no detailed rules of general application. The fundamental question whether an expense passes the wholly and exclusively test is a matter of judgement which is ultimately for the courts to resolve. We doubt that it could be dealt with satisfactorily in any other way.

4.6. But there has been a substantial shift away from general principles drafting in recent Finance Bills. For example, FA 1994 introduced three pages delineating in detail the meaning of the word "plant" which had previously been left to the courts to interpret. To some extent this trend away from the generalised towards the particularised is a natural process: where a generalised provision needs to be altered slightly it is not normally possible to replace it with alternative generalised drafting; instead, more detailed drafting is needed. Over time, the tendency has been for varying degrees of elaboration to be added to original general principles drafting.

The pros and cons

4.7. Legislation drafted in this style has some clear advantages. The Renton Committee said that "the adoption of the 'general principle' approach in the drafting of our statutes would lead to greater simplicity and clarity"[56]. Legislation drafted in this style would certainly be shorter although the totality of primary legislation and supporting materials would not necessarily be. It would deal with the worst examples of incomprehensible legislation - such legislation is invariably drafted in very great detail - as long as the impenetrable detail did not reappear in some other guise. Moreover it would make the broad framework of the legislation clearly visible - at present it is often difficult to see the wood for the trees - and might open up discussion of necessary simplifications of the tax system itself, not just the way it is expressed.

4.8. On the other hand there are disadvantages to this approach. Although the Renton Committee recommended greater use of general principles drafting it accepted that this "to a large extent sacrifices immediate - though not eventual - certainty"[57]. Immediate and absolute certainty is unattainable since there will always be scenarios which the draftsman fails to foresee or cannot foresee, and further levels of subtlety below the level at which he chooses to finish his draft. Nevertheless we accept that a detailed provision will very frequently offer greater immediate certainty than one based on general principles. The Renton Committee recognised that this loss of immediate certainty was unlikely to be acceptable in fiscal and certain other categories of legislation; we agree.

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56 "The Preparation of Legislation", Cmnd. 6053, paragraph 10.13.

57 "The Preparation of Legislation", Cmnd. 6053, paragraph 10.13.

4.9. Nevertheless, detailed drafting does not offer immediate certainty if it is so incomprehensible that it cannot be understood by those who have to work with it. Moreover, legislation which includes excessive layers of detail risks failing to achieve Parliament's intentions precisely because it is so detailed. Taxpayers who would fit the underlying principle of a relief and would be granted it by reference to legislation drafted in general principles may fail to surmount all of the hurdles set out in the detailed rules. Of course what is true of reliefs is also true of taxing provisions. A taxpayer who can bring himself within the detail of a provision may be relieved from tax even though he clearly does not satisfy the underlying principle of the relief. In this way an avoidance opportunity is created.

Alternative sources of certainty

4.10. We have considered whether certainty could be obtained otherwise than from the primary legislation. There are three possibilities:

(i) the general principles expressed in the primary legislation could be elaborated by regulations;

(ii) the Revenue departments could issue guidance or authoritative notices; or

(iii) the task could be devolved to the courts.

4.11. In many ways the idea of expressing general principles in the primary legislation and filling in the detail through regulations is attractive. It would give time to get the detail right, as long as it was acceptable to enact the primary legislation before drafting of the regulations had been finalised. It would help avoid the problem of the detail obscuring the broader picture. And it would enable the detailed provisions to be changed more easily to reflect changes in commercial practice. Regulations are already used in direct tax; and they are very widely used in indirect tax. For example, the coverage of VAT can be widened by regulation.[58] The major drawback is that Parliamentary scrutiny of regulations is little more than cursory.[59] We are prepared to accept that an alternative process of scrutiny could be established - possibly involving a committee of tax experts to consider and propose amendments to draft regulations, with Parliament having the final word where consensus could not be found. But we detect a very strong reluctance in many quarters to any increase in the use of regulations.[60] We therefore do not believe the climate is right for such an innovation.

4.12. There is a place for guidance produced by the Revenue departments. We already have a plethora of different materials - Extra-Statutory Concessions, Statements of Practice, Press Releases, internal manuals, Revenue Interpretations, etc. There may be an argument for the establishment of a pre-transaction ruling system; the Inland Revenue issued a Consultative Document on 9 November 1995.[61] But such guidance is not authoritative in the courts, it is only the Revenue department's view of the law.

4.13. General principles law might alternatively empower the Revenue departments to elaborate the detail, which would then become the law. Customs & Excise already have such

58 For example, 'clarification' of the borderline of the zero-rating of public transport - raising £45 million in a full year - was done by regulation (VAT (Transport) Order 1994, SI 1994/3014).

59 Parliament cannot amend regulations, it can only either approve or reject them in toto.

60 For example, see Christopher Booker in The Daily Telegraph, 30 September 1995.

61 "Pre-Transaction Rulings".

powers, for example to issue notices detailing the VAT retail schemes. However the use of such powers would be even less acceptable than increased use of regulations. We do not therefore recommend this approach.

4.14. Devolving the task of filling in the details in particular cases to the courts is sometimes the only way forward. We instanced at paragraph 4.5 above the deductibility of business expenses which could not sensibly operate in any other way. However if immediate certainty is required, this is no solution at all.

Conclusions on general principles drafting

4.15. Our conclusion is that there is no single correct legislative approach. General principles drafting may very well be appropriate for some provisions where the principle can be stated with sufficient clarity to avoid uncertainty. In other cases, legislation of varying degrees of detail may be supplemented by secondary legislation, guidance issued by the Revenue departments or left to judicial development. It is a matter of balance and where best to draw the line. The courts' increasing preference for purposive interpretation of statutes which we note in Chapter 3 may give draftsmen comfort to move the balance a little away from very detailed drafting. However we do not recommend the use of general principles drafting as a solution of general application.

PURPOSIVE STATEMENTS

4.16. The second meaning of purposive legislation relates to the use of statements of purpose. This involves prefacing each part, chapter or section of the Act with a summary of what the detailed legislation which follows is designed to achieve. This type of purposive legislation differs from general principles drafting in that the statements of purpose would supplement rather than replace the detailed provisions. In some ways this approach resembles the recitals which precede European law and also the preambles which these days appear in the UK only in private Acts. Australia is using a slight variation on purposive statements - summaries of provisions, called 'key principles' - in the rewrite of its income tax legislation.

4.17. Those who advocate the use of purposive statements believe they would help to improve the general quality of drafting by directing the mind of the drafter to the central points early on, render at least some of the detail unnecessary, and at a later stage aid the resolution of doubts and ambiguities in the detailed legislation. We have no doubt that these objectives are well worthwhile.

4.18. Bennion on Statute Law expresses the view that "the pragmatic British are chary of statements of principle. They distrust them because they almost invariably have to be qualified by exceptions and conditions to fit them for real life. What is the use of a principle that cannot stand on its own?"[62] We have certainly found in rewriting roll-over relief that the *existing* legislation cannot readily be encapsulated in a simple statement of purpose. We suspect this is true of a large part of our tax legislation; much of it is a series of more or less arbitrary but politically expedient rules from which no clear underlying principle can be extracted. However, against this, *future* legislation might be capable of being drafted in this way if statements of purpose were included from the outset.

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62 Bennion on Statute Law, Third Edition, page 25.

4.19. In a specific recommendation for fiscal legislation, the Renton Committee said that "the scope of a charge or relief should be stated clearly in general terms at the beginning of the section or group of sections dealing with it".[63] However this is capable of two different interpretations. If, on the one hand, it means that sections should be organised so that the basic proposition appears at the beginning with issues of greater detail left for later subsections, it does not take one very far since this is already done. But if, on the other hand, it means that a purposive statement should be included ahead of the detail, it is not a recommendation which has been acted upon. Purposive statements rarely appear in UK fiscal legislation, although they have been used in a few anti-avoidance contexts.[64]

4.20. Parliamentary Counsel has told us that opening with a statement of the legislative purpose risks saying the same thing twice, a cardinal sin for a draftsman since it risks introducing conflict and hence grounds for argument. We are not convinced that saying the same thing twice would be a bad thing, although we accept that a rule would be needed to allow any apparent conflicts to be resolved - for example by making the purposive statements non-authoritative or providing that the detail prevails if there is a conflict. For this reason we have concluded that the same effect can be achieved by a better route. In Chapter 6 we propose the establishment of explanatory memoranda. These could give at least as much information about the purpose of a statutory provision as an additional subsection in the primary legislation itself. And they need be no less authoritative (bearing in mind the rule mentioned above) if our recommendation that they should be available to the courts as aids to statutory interpretation is accepted.

4.21. We have therefore concluded, as did the Hansard Society,[65] that statements of purpose - or of "key principles" on the Australia model - within the primary legislation are not essential, although we add for the avoidance of doubt that the draftsman should use such statements where he finds it helpful to do so.

ANTI-AVOIDANCE LEGISLATION

4.22. We recognise that there is a question whether different considerations should apply in the case of anti-avoidance legislation. We intend to look at the whole issue of tax avoidance as a separate research topic. In the meantime we leave this question open but will return to it in a future report.

CONCLUSIONS

4.23. Purposive drafting has been the totem around which the public debate on the intelligibility of tax legislation has so far danced. We have no doubt that there are areas of tax law where detailed rules could be replaced by a statement of principle without significant loss of certainty (and conceivably with increased certainty) or where a statement of the purpose of the legislation would be beneficial. Where they are identified, these forms of drafting should be used. However our instinct is that they are the exception rather than the rule.

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63 "The Preparation of Legislation", Cmnd. 6053, paragraph 17.11.

64 See, for examples, sections 739(1) and 776(1) ICTA 1988.

65 "Making the Law", The Report of the Hansard Society Commission on The Legislative Process, paragraph 242

CHAPTER 4: PURPOSIVE LEGISLATION

CHAPTER 5: LANGUAGE

WHAT IS WRONG WITH STATUTORY LANGUAGE?

5.1. We noted in Chapter 1 that the language of a tax statute is deliberately drafted in a way which, it is hoped, will avoid any possible ambiguity, but that the result is a puzzle which the reader has to solve.

5.2. Complaints about legislation are as old as legislation itself. Oliver Cromwell famously aspired to reduce the laws of England to the size of a pocket-book. The language of fiscal language has long been a bone of contention too. The Departmental Committee on Income Tax Codification (1927-1936) said:

> *... to expect from us a codification of the law of income tax which the layman could read and easily understand was a vain hope, which only the uninstructed could cherish ... Income tax legislation must, by its very nature, be abstract and technical, and can never be easy reading.*[66]

The Royal Commission on the Taxation of Profits and Income (1952-1955) concluded that tax law could not be made intelligible to ordinary taxpayers, although it could be less obscure.[67]

5.3. The Renton Committee examined the criticisms of legislation generally and found that "the legislative output of Parliament is often incomprehensible even to those who are most familiar with the subject matter of the legislation". They quoted from the National Insurance Act 1946:

> *"For the purposes of this Part of the Schedule a person over pensionable age, not being an insured person, shall be treated as an employed person if he would be an insured person were he under pensionable age and would be an employed person were he an insured person."*

They concluded that "any enactment of this type is liable to be provocative, and the more so the more skilfully it is compressed"[68]. They went on to suggest changes in sentence structure; use of indentation; use, highlighting and indexing of definitions; arrangement of provisions; use of cross-references and mathematical formulae; typography; and "shoulder notes"[69]. But "the most important technique, if the least tangible, is simplicity of vocabulary and syntax".[70]

FOR WHOM IS STATUTORY LANGUAGE WRITTEN?

5.4. Selection of the appropriate vocabulary and syntax depends crucially upon the audience. A letter to a six-year-old child discussing an increase in the price of sweets should look very different from one to a professor of economics, even though the subject of both

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66 Cmnd. 5131, paragraph 26.
67 Cmnd. 0474, paragraph 1080.
68 "The Preparation of Legislation", Cmnd. 6053, paragraph 6.3.
69 "The Preparation of Legislation", Cmnd. 6053, Chapter XI.
70 "The Preparation of Legislation", Cmnd. 6053, paragraph 11.2.

letters is inflation. So for whom should tax legislation be written? What is the target audience? There are a number of possibilities:

- the departmental officials to whose instructions Parliamentary Counsel writes it;
- Parliament which must approve the legislation if it is to become law[71];
- taxpayers who must abide by it;
- tax practitioners who use it in their everyday work; and
- the courts which may ultimately be called upon to adjudicate upon disputes as to the meaning of the legislation and its application to the facts of a particular case.

5.5. The Renton Committee had the following to say on this subject:

We do not dissent from the Codification Committee's and the Royal Commission's view that the layman is never likely to be able to read and understand all fiscal legislation. We accept that over much of this field the legislative audience after enactment is to be regarded as consisting mainly of those - businessmen, lawyers, accountants, and members of the judiciary - who are professionally concerned with the subject, and that to a large extent the objective can only be the limited one of making fiscal legislation more readily intelligible to that audience ... On the other hand many of the more complicated situations dealt with in the legislation are unlikely to occur in the affairs of the great majority of taxpayers, and we think it should be possible for the basic provisions affecting that majority to be framed in relatively simple terms, so as to be capable of being understood by them at any rate with the help of the explanatory material prepared for their guidance by the Inland Revenue.[72]

5.6. We agree with this although some elaboration is needed. The group of people who are professionally involved in tax is not homogeneous: rather, there is a spectrum from those who act in the most straightforward cases, often without any professional qualification, through to those who specialise in the most complex areas of tax law. The Australians are seeking to pitch their rewrite of their income tax legislation at the level of the High Street tax agent with no professional qualifications. We believe that this goes too far and confuses legislation with explanatory materials. There will always be a role for explanations and interpretation whether produced by the Revenue departments or the commercial publishers. Accordingly, legislation need not be written as explanatory material.

5.7. Nevertheless we believe that legislation should be written in a linguistic style which, as far as possible, is capable of being understood by accountants, lawyers, tax inspectors and other professionally qualified users.

5.8. This means that the needs of users should be given far greater importance by Parliamentary Counsel. We consider that the draftsman should accord equal importance to clarity and accessibility as to accuracy, even though we recognise, as did the Renton Committee[73], that clarity and accessibility must in the final resort take second place to accuracy

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71 As Lord Thring, the original Parliamentary Counsel, is quoted as saying, "Bills are made to pass as razors are made to sell".

72 "The Preparation of Legislation", Cmnd. 6053, paragraph 17.9.

73 "The Preparation of Legislation", Cmnd. 6053, paragraph 11.5.

and precision. However this choice should be just that, a final resort, and not the normal state of affairs.

A DIFFERENT LEGISLATIVE STYLE

5.9. We believe there is a strong prima facie case for concluding that tax legislation *can* be written in clearer, more accessible and more comprehensible terms without losing its accuracy. In short, it can be more user-friendly.

5.10. We have undertaken two exercises to redraft existing pieces of legislation:

- capital gains tax roll-over relief[74], and
- the new relief for post-cessation expenditure[75].

The redrafted legislation is at appendices 1 and 6.

5.11. In undertaking these redrafts our intention has been to show only that legislation does not need to be written in the current style; that it is possible to draft in different styles which afford greater clarity and ease of comprehension. We aim to show what the current legislation might have looked like if the needs of users had been given sufficient prominence when it was drafted. It follows that we are not putting them forward as the way the legislation would be drafted now if the draftsman were to begin again with a blank sheet of paper. In particular, we recognise that it would probably not be acceptable to introduce legislation which needed to be supported by Extra-Statutory Concessions. Our roll-over relief redraft has three ESCs, a reduction from the seven currently operated by the Inland Revenue.[76]

5.12. The roll-over relief redraft is the more radical of the two; the rewritten primary legislation and statement of practices and concessions (appendix 3) should be considered together. Our aim has been broadly to develop a clearer and more user-friendly structure whilst maintaining the effect of the current legislation, concessions and practices. We have taken the opportunity to update the primary legislation by bringing into it some current concessions and practices. We have also changed the effect of the existing legislation in some minor ways. These changes are listed at appendix 5.

5.13. The redraft of post-cessation expenditure relief is much shorter. It is also far more faithful to the original wording, but it changes the structure and shortens the sentences in order to improve comprehensibility.

5.14. We are aware that our two redrafts are not the only exercises of this type which are being undertaken. The Special Committee of Tax Law Consultative Bodies is rewriting the Rent a Room legislation[77] and we believe that the Inland Revenue is also rewriting a block of legislation.

5.15. In our opinion, these redrafts demonstrate two things. Firstly that it is possible to write tax legislation in a more user-friendly style, even when it deals with a highly detailed subject

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74 Sections 152 to 159 and 175, Taxation of Chargeable Gains Act 1992.

75 Section 109A, Income and Corporation Taxes Act 1988, inserted by section 90 Finance Act 1995.

76 Inland Revenue booklet IR1, concessions D15, D16, D22, D23, D24, D25 and D45.

77 Schedule 10, Finance (No. 2) Act 1992.

(roll-over relief currently occupies nine sections, seven concessions, five statements of practice, two press releases and five Revenue interpretations). As we have noted above, in the final resort accuracy and precision are more important than simplicity of linguistic style and therefore the key test is whether the redrafts achieve their objectives with sufficient precision. We are not aware of any way in which they fail to do so.

5.16. Secondly we believe the redrafts show there is a range of different styles which can be adopted. We express no view as to the correct style for any particular provision other than to note that it is unlikely that a single style will be appropriate for all circumstances.

5.17. We should be interested to receive comments on any aspect of the redrafts, and especially on the variations in drafting styles which we have illustrated and also on whether this type of approach would seem satisfactory for a general rewrite of tax legislation.

5.18. We should record that these two redrafts have been produced with the benefit of three very considerable advantages, none of which was available to the original draftsman. Firstly they have not been subject to any real time pressures, other than the need to finish them for the publication of this report. The original draftsman would have been under a far tighter constraint to ensure they were ready in time for inclusion in the Finance Bill. Secondly they begin from a fixed reference point - the existing legislation - whereas the original draftsman probably had to accommodate changes in the instructions as he was developing his draft. Thirdly, in the case of roll-over relief, we have thirty years of experience of the legislation and the practical issues to which it gives rise.

FURTHER COMMENTS ON THE REDRAFTS

5.19. In redrafting roll-over relief and post-cessation expenditure relief we have adopted several features which we think it worth mentioning specifically.

Introductions

5.20. In Chapter 4 we conclude that purposive legislation (in the sense of general principles drafting) is unlikely to be the way forward on a general basis. We believe there may be a role, however, for limited use of purposive statements to 'set the scene' for specific provisions. We have therefore included introductory statements in our roll-over relief redraft, both in section 1 and also in section 5.

5.21. We believe the introductions are valuable from the perspective of the user since they offer a gentle lead-in to the detail which follows. The introduction in section 1 of the roll-over relief redraft is self-evidently not comprehensive and we therefore believe it would not lead to any difficulty of interpretation. The redraft of post-cessation expenditure relief is slightly different in that it contains some of the basic conditions for relief. However it is also drafted in a way which leads in to the subsections which follow.

Sentences

5.22. In both redrafts we have deliberately kept the sentences short. The average sentence length in the rewrite of post-cessation expenditure relief is 21½ words. We have used roughly the same number of words as the original but we believe the readability is greatly improved.

5.23. Moreover this is not simply a question of style. The existing provisions are both very terse; they pack in a large amount of information, especially in their opening sentences. We have deliberately expanded the language in places in order to aid comprehension.

5.24. For example the original opening sentence of the post-cessation expenditure relief was as follows:

> *Where in connection with a trade, profession or vocation formerly carried on by him which has been permanently discontinued a person makes, within seven years of the discontinuance, a payment to which this section applies, he may, by notice given within twelve months from the 31st January next following the year of assessment in which the payment is made, claim relief from income tax on an amount of his income for that year equal to the amount of the payment.*

In the redraft this single sentence of 80 words is replaced by six sentences of between 13 and 33 words each in subsections (1.), (3.), (13.) and (14.). The total number of words used is increased to 142, but we believe the meaning can be understood more quickly. The original provision has therefore been recast as follows:

> *(1.) This section applies to a person who formerly carried on a trade, profession or vocation which has been permanently discontinued. It provides income tax relief on certain amounts paid by such a person in connection with the former trade, profession or vocation, and on certain debts.*
>
> *(3.) The relief applies to certain amounts paid and certain debts written off within seven years of the discontinuance of the former trade, profession or vocation.*
>
> *(13.) Relief may be claimed under this section by notice given in writing within twelve months from the 31st January next following the year in which the payment is made or treated as made.*
>
> *(14.) Relief from income tax is given on an amount of the claimant's income equal to the amount of the payment for which relief is available. The relief is given for the year in which the payment is made.*

5.25. In our view, the objective should not be to convey information in the smallest number of words possible - this is a recipe for incomprehensibility and impenetrability. We believe that the objective should be to enable the user to understand the message in the shortest time possible. We would therefore rather see longer, less compressed legislation if it could be understood after fewer readings so that the time taken in understanding it was shorter. Taxpayers do not pay their professional advisers for the number of words they read; they pay for the time it takes them to comprehend them.

Structure

5.26. Both our redrafts seek to give the legislation a logical structure with the conditions for the relief grouped together and kept separate from the mechanics of how the relief is given. The aim is to build up the legislation in coherent blocks. This contrasts with the original legislation in which the attempt, noted above, to pack as much as possible into the first subsection leads to a mixing of these elements thereby overwhelming the reader with detail at the beginning.

5.27. For example, the current roll-over relief legislation begins in section 152(1) Taxation of Chargeable Gains Act 1992 by stating some of the conditions required to obtain relief and also deals with claims and the effect of the claim. Our redraft gives prominence to the primary conditions which every claimant must satisfy. It deals in a separate section with how the relief operates. Subsequently it covers particular situations which may affect only a limited number of claimants.

Subsection side notes

5.28. We agree with a former Parliamentary Counsel that "the lack of marginal notes to subsections is a serious handicap to comprehension".[78] We have added such notes in the form of abbreviated summaries to each subsection. They appear as marginal notes in the roll-over relief redraft and in an alternative format in the redraft of post-cessation expenditure relief. We believe the main purpose of such summaries would be to help users navigate through the legislation. They would have the same status as headnotes and marginal notes to sections.

Definitions

5.29. There is scope for much confusion in the use of definitions. We referred at paragraph 1.24 to a particularly bad example of a misleading definition in the current roll-over relief legislation. Section 159 Taxation of Chargeable Gains Act 1992 prevents roll-over relief being claimed unless the New Assets are "chargeable assets" when they are acquired. This term does not have its ordinary capital gains tax meaning but is specially defined in subsection (4), and then only by cross-reference to another section. The true meaning of "chargeable assets" - and hence of the whole section - only becomes clear once these pieces of the puzzle have been found.

5.30. In both redrafts we have tried to avoid this trap. Defined words are italicised the first time they appear. This puts the reader on notice that he should be looking for a definition elsewhere in the legislation. Moreover in the roll-over relief redraft they are grouped together in their own interpretation section, which helps to avoid cluttering up the main text. We recognise that further consideration would need to be given as to when to italicise defined words which apply more generally. It may be insufficient to italicise them only when they first appear in an Act.

5.31. The Renton Committee considered the suggestion that definitions should be italicised but stood back from expressing a view.[79] It was concerned that "this might merely be a distraction, particularly if several kinds of type were used for this and other purposes" - distinctive types for amendments and for EU legislation had also been suggested - and they recommended that the Statute Law Commission should study the issue. We agree that it could be counter-productive to use several kinds of type in this way. However we are proposing only one such use. We do not consider that this would be a distraction; it is a technique which is already used successfully by commercial publishers.

5.32. We acknowledge the argument that defined terms are not always easily identified so that Parliamentary Counsel would not know where to draw the line and confusion would result. However, users would be well aware that the words of a statute take their meaning

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78 Bennion on Statute Law, Third Edition, page 44.

79 "The Preparation of Legislation", Cmnd. 6053, paragraphs 11.18 and 11.21.

from their surroundings so they should be on guard against accepting the literal meaning of any word without further enquiry. Accordingly we do not agree with this objection.

Cross references and interlinkages

5.33. Both Australia and New Zealand considered the use of cross references as part of their redrafts of their income tax legislation. The New Zealand approach was to aim to make all cross references explicit so that a taxpayer could rely on not needing to look elsewhere in the legislation if there was no cross reference. The Australian rewrite aims to include as many cross-references as possible, but there is no guarantee that they will all be included. So the Australian taxpayer cannot be sure that he has nowhere else to look.

5.34. We have included cross references within our redraft of roll-over relief where these help the user by pointing out that he needs to be aware of another provision. For example, we have put the main qualifying conditions in section 2 but included signposts to other sections which might be relevant. By contrast we have not made each and every subsection expressly 'subject to' others. In our view it cannot seriously be doubted that a claimant who meets the conditions of subsection 2(1) must also satisfy the conditions in subsections 2(2) and (3) even though subsection (1) is not expressly 'subject to' those subsections. Nor, given their proximity, do we believe that users need to be referred to these additional conditions.

5.35. Presumably the intended advantage of cross references is that they save space. By adopting a different approach to the one currently used by section 159 TCGA 1992 - see paragraph 5.29 above - we have been able to avoid the cross reference referred to and still shorten the legislation.

Design

5.36. The typographical design of tax legislation has not been modernised to take advantage of the possibilities afforded by modern word processing and printing techniques. The current design has changed little since Queen Victoria was alive. It ought to be brought out of the Nineteenth Century before we move into the Twenty-first.

5.37. The typography used in our roll-over relief redraft has been developed by a company which specialises in design and typography, Banks & Miles London Ltd. We believe that this work shows that there is considerable scope for altering the design of tax legislation to complement the language. We intend, before our final report on this subject, to take this question of design further and examine whether additional features need to be incorporated to achieve compatibility with new electronic data delivery media such as CD-ROM and whatever replaces it in the future.

Worked examples

5.38. We have considered whether our redrafts should include worked examples to illustrate the operation of the legislation, and we believe the arguments are finely balanced. (We have no doubt that such worked examples are needed and that if they are not included in the legislation they should form an important part of the explanatory memoranda we discuss in Chapter 6.)

5.39. There are several instances of worked examples being included in primary legislation. These include sections 2(3) and (4) of the Occupiers Liability Act 1953, section 2(2) of the

Race Relations Act 1968, section 29(2) of the Sex Discrimination Act 1975 and section 188 and Schedule 2 of the Consumer Credit Act 1974.[80]

5.40. If examples were included they would need to be expressly made subordinate to the text they sought to exemplify - otherwise there would be a risk of conflict between the text and the examples. The Inheritance Tax (Double Charges Relief) Regulations 1987[81] include precisely the type of examples we envisage, and practitioners have told us they find them extremely useful. Article 9 of the regulations provides that "in the event of any conflict between the [examples] and the Regulations, the Regulations shall prevail". The Capital Gains Tax (Parallel Pooling) Regulations 1986[82] provide another instance of the use of examples.

5.41. Parliamentary Counsel has explained to us that such examples are not normally included in primary legislation because of the risk of creating conflict and that even the express provision that the text prevails would be insufficient to dispel this risk. However if they were included in explanatory memoranda a residual risk would remain. We believe the risk is worth accepting for the benefits worked examples would offer practitioners.

5.42. Because we believe the arguments are finely balanced, we have used our redrafts to illustrate both approaches. In the roll-over relief redraft we have included the worked examples in Schedule 2 of the primary legislation (see Appendix 1). This has the advantage that signposts can be included in the sections themselves which we believe would assist users. By contrast, the worked examples for the redraft of post-cessation expenditure relief are in the explanatory memorandum at Appendix 8. We would welcome views on which of these two approaches should be adopted generally.

FURTHER WORK

5.43. We said in paragraph 5.9 above that there was a strong prima facie case that tax legislation *can* be more user-friendly without sacrificing the accuracy for which Parliamentary Counsel strives. We believe that our own and the Special Committee's work on legislation has demonstrated that this is so. However our purpose in publishing the drafts is to seek comments, which we shall consider with a view to publishing revised drafts in our final Report on this subject.

CONCLUSION

5.44. In this chapter we have sought to show why we believe that user-friendly drafting without loss of accuracy is both possible and essential. We need to break away from the artificial elegance and excessive terseness of the traditional drafting style. The objective of legislative drafting should be clear: it should be to *explain to* taxpayers, where necessary through their professional advisers, what their rights and obligations are, and to explain to the Revenue departments and the courts what is required of them.

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80 Cited by Bennion on Statute Law, Third Edition, page 127.

81 SI 1987/1130.

82 SI 1986/387.

CHAPTER 6: EXPLANATORY MEMORANDA

THE NEED FOR EXPLANATORY MEMORANDA

6.1. Users of complex legislation have three ways of coping. Firstly, they can ignore it. This is not an answer that we can recommend, although eminent practitioners have told us that some legislation is so incomprehensible that neither the Revenue nor those it affects can understand it and they therefore reach pragmatic agreements independent of the legislation. Secondly, they can study the legislation until they believe they understand it - the "wet towel" approach. Often this may be the only solution, but it is an expensive one which our other recommendations are intended to address. Thirdly, they can rely on material which explains the legislation in clear, comprehensible terms. This approach may, of course, be used to assist the early stages of the "wet towel" process. A map is useful to speed the process of familiarisation with a new location even if total accuracy can only be gained by walking the area on foot.

6.2. There is already a great deal of explanatory material available, ranging from commercial publications through to the Inland Revenue's internal manuals. Some of this is authoritative - there are now over a hundred years' worth of court decisions published as Tax Cases - but the vast majority is no more than the opinion of the person who wrote it and may turn out to be incorrect.

6.3. We believe there is a need for an additional form of explanatory material which would be more authoritative than this existing material. This would be an explanatory memorandum published when the legislation was first enacted. It would be available to the courts as an aid to interpretation of the legislation, and practitioners could therefore rely upon it as authoritative guidance. In this regard our proposal is similar to that of the Hansard Society in 1992.[83] Explanatory memoranda are already routinely produced for all Bills other than the Finance Bill and for all Statutory Instruments, and the Treasury publishes its Notes on Clauses which give some (very limited) information about each clause of the Finance Bill on publication. Explanatory memoranda would not therefore be a radical departure. But they would be developed in important respects to enable them to serve a more useful purpose.

6.4. We accept that more comprehensible legislation is the first priority. However we reject the argument that explanatory memoranda will not be needed. More comprehensible legislation may reduce substantially what the explanatory memoranda need say. However we believe that there are two reasons why they will still be required. Firstly, we recognise that the draftsman will not be able, in the frenzied rush typical of the run-up to the publication of the Finance Bill, to draft as clearly as we would like. We consider in Chapter 8 how more time might be made available for drafting, but we do not expect the problem will be eliminated.

[83] "Making the Law", The Report of the Hansard Society Commission on The Legislative Process, paragraphs 235 to 252.

6.5. Secondly, however well tax legislation is written there is likely to be an inherent, irreducible level of complexity so that there will always be room for debate as to its exact interpretation - this is the nature of the English language. So there will be a need for explanatory memoranda to guide users of legislation. Because language is imprecise, saying things in several different ways aids comprehension. It does so by narrowing the meaning since fewer cases will fit all the different modes of expression. This is how we convey a difficult point in ordinary conversation; explanatory memoranda would fulfil this role.

Effect on the Courts

6.6. We believe the courts would welcome an additional source of guidance such as this. Judges have as much difficulty with the incomprehensibility and impenetrability of tax legislation as other practitioners do. While judges are well-used to dealing with difficult points of statutory interpretation, they do so with the benefit of argument on behalf of the taxpayer and the Revenue department. We believe that that argument and the judge's task would be elucidated by explanatory memoranda.

6.7. The courts would be able, if they wished, to use the explanatory memoranda simply as a "map" to assist the initial stages of the interpretation process - an aid to understanding - in the same way that any user of tax legislation could. The explanatory memoranda would require no special status for this; they would not need to be regarded as any more or less authoritative than any other explanatory materials. In most cases, the courts will find that the legislation is unambiguous and whatever materials the judges use in reaching this conclusion amount to no more than background reading.

6.8. However, it is inevitable that in some cases the legislation will be found to be difficult or ambiguous. In these cases different considerations apply. As we noted in Chapter 3, recent court judgements have increasingly adopted a purposive approach to statutory interpretation, but by reference to the courts' own inference as to the legislative purpose. The Hansard Commission commented that "virtually every other legal system in the world permits the court to gather from sources other than the words of the statute the intention underlying the enactment".[84] We believe that explanatory memoranda should be used to help the courts *discover* the statutory purpose. In such cases they would be more than the aids to understanding discussed in paragraph 6.7 above; they would become an aid to interpretation.

6.9. We note in passing that purposive interpretation is not the same as purposive legislation. The latter concerns the way the legislation is drafted; the former deals with the techniques employed by the courts in interpreting the legislation, irrespective of how it is drafted. As noted above, we believe explanatory memoranda have a role to play in understanding and interpreting the legislation.

6.10. We believe it would require legislation for explanatory memoranda to be accorded this status as an aid to interpretation. We recommend that such legislation be introduced. This would extend the rule in Pepper v Hart[85] which already allows the courts to consider certain Parliamentary materials. The new rule would entitle the courts to have regard to the explanatory memorandum in interpreting any provision. The essential principle would be the

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84 "Making the Law", The Report of The Hansard Society Commission on The Legislative Process, paragraph 235.

85 [1992] STC 898; [1992] WLR 1032; [1993] 1 All ER 42.

same as that in Pepper v Hart: that in interpreting legislation the courts should be able to have regard to any explanation which Ministers had put before Parliament when asking it to pass that legislation.

6.11. Where there was more than one possible interpretation of the provision, we believe the courts would prefer one which was consistent with the explanatory memorandum if such an interpretation existed. If an explanatory memorandum was in conflict with the legislation and it was impossible to find an interpretation consistent with it, the courts would have no alternative but to conclude that Parliament had failed to enact what the explanatory memorandum said it was being asked to enact. Hence they would disregard the explanatory memorandum. In this way the explanatory memoranda would have no authority other than as aids to construction.

6.12. In interpreting any enactment it would, of course, be for the courts to decide what weight to give to the relevant explanatory memorandum. The courts already make these judgements successfully when called upon to consider Parliamentary statements under Pepper v Hart.

6.13. We expect that explanatory memoranda would largely supersede Hansard as the courts' main interpretative tool. It would be for consideration whether Pepper v Hart should be reversed so that Hansard was no longer available to the courts for the interpretation of tax legislation where an explanatory memorandum was available. This would raise a number of issues, in particular a mechanism might be needed to enable the explanatory memoranda to be revised or expanded, where necessary, to take account of relevant Ministerial statements. However whilst Pepper v Hart remained, it would be for the courts to balance the words of the explanatory memorandum against those of any such Hansard statement open to them.

Effect on Parliament

6.14. If explanatory memoranda are to have a higher status in the courts than other explanatory materials - as we propose - the basis for such higher status must be clearly established. They would not represent the will of Parliament as such - only legislation can do so. They would be available to members of the Finance Bill Standing Committee, and there is an argument that the Committee should consider and if necessary amend them. However, we do not believe that MPs would wish to take on this additional task which would be likely to more than double the amount of material the Standing Committee has to debate, line by line, each year. We make no such recommendation.

6.15. Nevertheless, explanatory memoranda would be available to Parliament when it enacted its legislation so that it could be said to have passed that legislation with full knowledge of their contents. Consequently, the explanatory memoranda would inform the Parliamentary debate by illuminating the purpose and effect of the legislation. If MPs did not agree with that purpose and effect they could amend or reject the primary legislation.

THE PRODUCTION OF EXPLANATORY MEMORANDA

Contents

6.16. We recommend that there should be an explanatory memorandum for each clause or block of clauses. The precise form and content of the explanatory memorandum would depend upon the subject matter but it could contain such matters as:

- an explanation of the overall purpose of that clause or block of clauses and of the part it or they played in the broad scheme of taxation;
- a statement of how each clause and sub-clause was intended to operate;
- any necessary explanations of the wording adopted, including the reasons for any unusual or complicated drafting where appropriate; and
- worked examples where these would assist understanding.

6.17. However, we recommend that explanatory memoranda should not be used as a way of allaying concerns about legislation through statements as to how the Revenue departments would *in practice* apply it or exercise their powers. They should simply state its scope.

6.18. The explanatory memoranda would be written in plain English. Whilst it would be impossible to try to cover all possible scenarios, they might give sufficient illustration to answer at least some actual cases.

6.19. Notwithstanding the above, we believe that it would be undesirable for explanatory memoranda to follow a pre-set pattern in every case. Some very complex legislation - such as the foreign exchange gains and losses legislation - would justify long and copious explanatory memoranda. But other, more straightforward legislation would require something much shorter. And the purpose and effect of some legislation, particularly minor amendments of existing legislation, might be so self-evident that no explanatory memorandum was needed at all.[86] It would in each case be for the Government to judge the amount of material which was justified by the nature of the legislation and the likely needs of its users.

6.20. Moreover we are acutely conscious of the danger of explanatory memoranda being so comprehensive that they become enormously lengthy and thereby become a burden on practitioners. We believe that this does not need, and should not be allowed, to happen. The guiding principle should be to include helpful material only, that is material which clarifies the legislation or explains its purpose. Where the Government judges that no such material is needed the explanatory memorandum should be silent.

6.21. We also note that different users will have different needs. For example, a tax specialist with a particular interest in, say, mergers and acquisitions will want to go into the tax aspects of this in great detail. However the generalist practitioner could be more hindered than helped by a further great mass of material. The primary market for explanatory memoranda should be those generalist practitioners who deal with the subject matter of the legislation. A balance will need to be drawn between brevity and comprehensiveness.

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[86] Minor amendments the effect of which was self-evident (see, for example, Section 110 FA 1993) would fall into the last category.

Origination

6.22. We recommend that the explanatory memoranda should be written by the officials within the Inland Revenue and Customs & Excise responsible for instructing Parliamentary Counsel on those parts of the Finance Bill covered by the memorandum in question. In the Inland Revenue this will be the policy advisers; in Customs & Excise it will be the Solicitors who instruct Parliamentary Counsel on administrators' instructions to them. Alternatively, the explanatory memoranda could be written by Parliamentary Counsel. It might be argued that this would be ideal in that the draftsman is best placed to explain how his legislation is intended to operate. On the other hand, there is value in someone different writing the explanation, with Parliamentary Counsel cross-checking. Accordingly we do not recommend that explanatory memoranda be the responsibility of Parliamentary Counsel.

6.23. Nevertheless, all explanatory memoranda should be seen and approved by Parliamentary Counsel. Of necessity, all explanatory memoranda would be seen and authorised by the Minister responsible for the passage of the legislation through Parliament.

6.24. Ideally the explanatory memoranda would be published at the same time as the Finance Bill. This would enable MPs and practitioners the maximum time to consider their contents in conjunction with the Bill before it went into Committee.

6.25. We foresee that this ideal might not be achievable in practice without significant detriment to the content of the explanatory memoranda since the more time there is to produce them the more helpful they are likely to be. We have no doubt that if our choice lies between early but bland and uninformative memoranda and later but useful memoranda, the latter is far preferable. We therefore accept that if the Government cannot publish the sort of helpful memoranda we wish to see in early January with the Finance Bill, it should have flexibility to publish them when it chooses, subject to this being in good time for the Committee Stage debates. This would allow up to two months' extra time for preparation of the memoranda for clauses which are debated towards the end of the Committee Stage. Within this flexibility, the explanatory memoranda should be published as early as possible.

Amendments

6.26. The original explanatory memoranda would begin to depart from the text of the Bill as it was amended in Parliament. A mechanism would therefore be needed to ensure that they kept pace with amendments. Of course many Government amendments would be minor or self-explanatory or would have no effect on the explanatory memoranda. For these, no change in the associated explanatory memoranda would be needed. But other Government amendments, and in particular the tabling of new clauses, would necessitate a new explanatory memorandum or a substantial alteration to the original one.

6.27. It would be for the Government to judge when a new or revised explanatory memorandum was justified by a Government amendment to the Finance Bill.

6.28. Ideally, a non-governmental amendment would always be accompanied by its own explanatory memorandum, prepared by the promoter of the amendment.

6.29. Despite this ideal, there could not realistically be a requirement that all such non-governmental amendments be accompanied by an explanatory memorandum. This would

involve an absolute Parliamentary rule that a bare amendment tabled without an explanatory memorandum would not be considered, which would be unlikely to be acceptable to Parliament. Nevertheless, in the longer term the tabling of an explanatory memorandum with every non-governmental amendment might become the norm if the Opposition and backbenchers followed an example set by the Government. The chairman of the Finance Bill Standing Committee might request adherence to such a practice. We do not believe this would put undue strain on MPs who very frequently have access to advice provided by one or other of the professional bodies.

Supplementary memoranda

6.30. There may be circumstances in which the Government would wish to publish supplementary explanatory memoranda. Three situations may be foreseen:

- a point might be raised in the Committee Stage debate which can best be clarified by such a memorandum;
- issues may be raised by practitioners or the professional bodies which it would be useful to place on the Parliamentary record; for example, if the explanatory memoranda list circumstances which will qualify for a particular treatment, other similar circumstances may be identified; or
- a non-governmental amendment may be accepted but the Government wishes to place on the Parliamentary record that an explanatory memorandum which accompanied it is not accurate.

6.31. Of course all these could be dealt with through other media such as a Statement of Practice. However this does not have the advantages of a Parliamentary statement. Consequently we see merit in allowing the Government to table a supplementary memorandum, whenever it thought it appropriate to do so, to cope with these situations. Of course, such a memorandum would have to be made available to Parliament in good time. It would not normally be available before the Committee Stage but would have to be published for the Report Stage, at the latest.

Late amendments

6.32. We recognise that a Government amendment may in very exceptional and unavoidable circumstances be tabled so late that there is insufficient time for preparation of an explanatory memorandum. We see no difficulty with this. We do not believe that the value of explanatory memoranda would be undermined because they would thereby be incomplete. The very occasional lack of an explanatory memorandum would not detract from the benefits of having them for the great majority of provisions where they would be useful. The best should not be the enemy of the good.

CONSOLIDATION

6.33. It would be possible to stop at this point and leave the explanatory memoranda without any further development. They could simply be left as presented to Parliament. However, various people have indicated to us that this would not be particularly helpful since users would need to reconstruct the picture of the legislation's passage through Parliament - its legislative history - to work out which explanatory memoranda were relevant, and then

establish which parts remained from the original, which had been jettisoned along the way and how the new, revised or supplementary memoranda could be married with the old. It would therefore be desirable to have a mechanism by which the explanatory memoranda could be consolidated. Our preference is to leave this to the commercial publishers. We explain below why we do not recommend other approaches.

Report Stage update

6.34. One approach would be for the Revenue departments to produce a consolidated memorandum covering the whole Bill after the Committee Stage but in time for the Report Stage. This would merge the original explanatory memoranda published with the Finance Bill and the explanatory memoranda which accompanied amendments made at the Committee Stage. The main advantage of this approach is that it would be presented to Parliament before irrevocable decisions had been taken and hence its status in the courts as an aid to interpretation would be secure. Anything produced later would not satisfy this criterion since the Third Reading normally follows immediately after Report, and there is, of course, no opportunity for the Finance Bill to be amended in the House of Lords.

6.35. However, such an update would take no account of amendments made at Report Stage, which in some years can be numerous. And despite its theoretical status there is in practice no real opportunity to amend the Bill save to the extent that the Government proposes amendments. Moreover it would place considerable strain on Inland Revenue resources since the interval between the end of the Committee Stage and the beginning of the Report Stage is only around a fortnight. We do not therefore believe this is the right solution.

Independent Committee

6.36. We have considered whether an update taking into account all amendments passed by Parliament at both the Committee and Report Stages could be prepared by the clerk to the Standing Committee after the Finance Bill had received Royal Assent. He would need to draw upon the original material produced by the proposers of the legislation as well as points made during the Parliamentary debates. A clerk who was not a tax expert would also need to call upon assistance from somewhere, and he might need to issue drafts for comment. A final explanatory memorandum produced in this way might still be regarded as a Parliamentary material such that it could be available to the courts - although the point is certainly not free from doubt. However, this system would be very bureaucratic and would be undermined by the clerk's lack of expertise in taxation matters. Moreover, we understand that Parliament would be likely to oppose it: firstly because it would not be regarded as part of the clerk's duties - Bills are not Parliament's property, they are the property of the sponsoring MP or the Government; and secondly because material produced after the Report Stage would be for the benefit of practitioners and the courts, not MPs. We do not recommend this solution.

6.37. It has also been suggested to us that the task of updating the explanatory memoranda could be entrusted to a committee of experts comprising representatives both from the professional bodies and from the Revenue departments. The advantage would be that it would have both the standing and the expertise to produce updated explanatory memoranda after the Finance Bill had received Royal Assent. However, such a committee would be unaccountable and potentially bureaucratic and costly. We do not believe that the case for establishing such a committee of experts has been made.

6.38. The overriding difficulty with any form of independent Committee is that it would be caught between two conflicting pressures. If it sought to interpret the raw material it began with, its product could not have any authoritative status in the courts - unless a procedure were developed under which Parliament debated and voted on the consolidated explanatory memoranda, which we do not believe is feasible. But if it merely consolidated without further elaboration it would add no useful value.

Notes on Sections

6.39. We would expect that the explanatory memoranda would routinely come to be included in handbooks of UK tax legislation, including Butterworths Yellow and Orange Tax Handbooks and the CCH Handbooks. This is our preferred solution.

6.40. If there were any doubt about this, we believe the Revenue departments should produce such a volume. This might be called *Notes on Sections* by analogy with the current Notes on Clauses and could be published after the Finance Bill had received Royal Assent. The Notes on Sections would do no more than bring together in one handy reference book all the relevant explanatory memoranda for the year's Finance Act. However they would have no greater status before the courts as an aid to interpretation than the original explanatory memoranda. The Notes on Sections could omit those parts of the original explanatory memoranda which had been superseded by later amendment of the Bill, but not those which had merely been added to. Explanatory memoranda for failed amendments would not be included.

6.41. If the Revenue departments published the Notes on Sections themselves they would be in a position to include additional material or clarify original material. We believe, however, that this would be undesirable. Even if this material was clearly distinguished there would be scope for confusion. Any additional material the Revenue departments want to publish should be issued separately.

EXISTING LEGISLATION

6.42. The above has addressed the question of explanatory memoranda for new legislation but there remains the issue of how to deal with existing legislation. Explanatory memoranda do not exist for this. Even if the rate of production of tax legislation continued at the same pace as in the recent past, it could take at least a decade before explanatory memoranda covered half the corpus of tax law, and some of it could never be expected to be covered.

6.43. One possibility would be for the Revenue and Customs to begin a programme of filling in the gaps with explanatory memoranda covering existing legislation. Another would be for opportunities to be taken as existing legislation is amended to produce explanatory memoranda covering the unamended as well as the new legislation. Whilst such material might be desirable in itself (depending upon what information is already available in the form of Statements of Practice or the Revenue's and Customs & Excise's internal manuals), it could not be given the same status as the explanatory memoranda proposed above; it would not be contemporaneous material available to Parliament when it passed the legislation and could not therefore be authoritative before the courts. We do not therefore believe there is any real point in producing explanatory memoranda for existing legislation.

6.44. We discuss at paragraphs 7.34 and 7.35 the role for explanatory memoranda if the legislation were to be rewritten.

SECONDARY LEGISLATION

6.45. This Chapter has so far looked at explanatory memoranda from the perspective of primary legislation. However it would in principle be desirable to have similar material available to assist understanding and interpretation of secondary legislation.

6.46. There are, though, difficulties with secondary legislation, stemming from the Parliamentary procedure which does not permit amendments. We are still considering the consequences of these.

EXAMPLES

6.47. We have developed explanatory memoranda for our redrafts of roll-over relief and post-cessation expenditure relief. These are at Appendices 4 and 8. They show what the explanatory memoranda might have looked like had these redrafts been clauses in a Finance Bill. We would welcome comments on any aspect of these explanatory memoranda, and in particular on whether they achieve the right balance between brevity and comprehensiveness.

CHAPTER 6: EXPLANATORY MEMORANDA

CHAPTER 7: REWRITING EXISTING LEGISLATION

7.1. In previous Chapters we have concentrated on the ways in which tax legislation could be better expressed and supported *in the future*. But what about the thousands of pages which are already on the Statute Book? How do we deal with these? In this Chapter we review the options:

- to allow a process of natural renewal gradually to replace old-style legislation with the new style as it is amended for other reasons;
- to select and systematically rewrite those areas of the old legislation which would benefit from being rewritten, leaving remaining areas to be renewed naturally; or
- to embark upon a systematic rewrite of *all* the old legislation.

7.2. We conclude that natural renewal does not offer a sensible way forward and recommend that a systematic rewrite should be piloted. In Chapter 5 we argued that it was possible for tax legislation to be drafted in much more accessible language without sacrificing precision. However, we also acknowledge at paragraph 3.44 that it is not easy for the draftsman to achieve the degree of comprehensibility which we would like to see. There are several reasons:

- he is aiming at a moving target, the instructions expanding and changing as the legislation is developed[87];
- he is often under very severe time pressure; and
- he usually has to link his draft into the existing legislation which is, of course, drafted in the old style.

Our proposals in Chapter 8 address the first two of these issues. A systematic rewrite would address the third. It would also provide a standard against which the comprehensibility of future Finance Bills could be measured, which should be of help to the draftsmen.

SYSTEMATIC REWRITE OR NATURAL RENEWAL?

Natural renewal

7.3. The apparently easier of the potential approaches mentioned at paragraph 1 above is to allow the problem of the existing legislation to take care of itself. With one Finance Bill a year, there could be a steady stream of new-style legislation replacing the existing legislation as it came up for amendment for other reasons. This approach has the advantage of placing the least additional pressure on the system. The Revenue departments would need relatively little additional resource since they would only be reviewing what was being reviewed in the ordinary course of events, albeit more fundamentally. Parliamentary Counsel would only be

[87] This is unsatisfactory where it results from ill-thought-out instructions. However we cannot hope to eradicate the phenomenon since it is part of the function of Parliamentary Counsel to question the instructions he is given.

asked to rewrite blocks of legislation which they would be rewriting anyway. And Parliament would be asked to scrutinise only the minimum amount of new legislation. Practitioners would find the flow of new material no less manageable than currently.

7.4. Within this model, two approaches can be identified. Firstly, to write genuinely new provisions in the new style but to allow existing provisions, even when amended, to remain in the old style. This is the minimalist option. It would create a hybrid system of legislative drafting which could persist indefinitely. Moreover it would require the draftsman to use two different drafting styles side by side in his day-to-day work.

7.5. Secondly, where a small amendment of an existing provision was required, the entire provision could be rewritten in the new style. This would involve some additional work for all concerned compared with the minimalist approach and would self-evidently lengthen the Finance Bill. Some people may therefore see this as an unwelcome development, that Finance Bills are already too long. However there is no way of addressing the issue of existing legislation without increasing the amount of new legislation in the short term. A hybrid system of tax legislation would be created even though the draftsman would work entirely in the new style. The old-style legislation would eventually be largely if not wholly replaced by provisions drafted in the new style. It could also be very difficult administratively for the Revenue departments as they would be expected to undertake major legislative revisions as a consequence of Ministerial decisions to make minor policy changes; the workload would be unpredictable and hence difficult to manage. And this problem would be likely to lead to a significant reluctance to make small but necessary policy changes.

7.6. Both these approaches also lack any clear completion date. We have concluded therefore that the prospect of a mixture of old and new drafting styles with no end in sight points strongly to proceeding with a partial or full systematic rewrite, provided that we can be satisfied that the costs of that exercise are justified by the benefits.

Partial or full systematic rewrite

7.7. A full systematic rewrite would not avoid entirely the problems we have mentioned, but it would be possible to see an end to them. There would be considerable additional work for the Revenue departments in the short term, but it would be predictable and manageable. Ordinary Finance Bill policy changes could take place in parallel. Once it had been completed - much sooner than natural renewal could achieve - there would be no hybrid legislative style.

7.8. A variation on a full rewrite is to select and rewrite only certain areas of tax legislation - a partial rewrite. This might involve a choice between different taxes - for example, rewriting income tax, corporation tax and capital gains tax but not VAT or Inheritance Tax. Or it might involve a more selective approach under which particular Parts or sections of the existing legislation were rewritten, although this would not address the problem of a persistent hybrid style of drafting. Both Australia and New Zealand are rewriting their income tax, corporation tax and capital gains tax legislation.

7.9. A systematic rewrite - either full or partial - would have a further advantage. Making the break from the existing style of legislative drafting to the new style we are proposing will involve a very substantial culture change for everyone involved in producing fiscal legislation - draftsmen, policy advisers, consultative bodies - as well as for users. At present the culture

produces legislation which, as we have said, is complex, incomprehensible and impenetrable. That culture must change. But it will require everyone concerned, particularly the draftsmen, to adopt a different mental approach from the one they are used to. We believe a systematic rewrite would help to bring about that change.

7.10. A systematic rewrite would not, though, be an easy option. A number of issues which would need to be resolved are discussed at paragraph 7.17 onwards.

7.11. Any change in the way the existing legislation is drafted will impose costs on taxpayers, practitioners and the Revenue departments. These costs will include the direct costs of passing legislation through Parliament and of rewriting reference books, familiarisation and retraining, and the indirect costs during the transition of uncertainty and the opportunity cost of time spent on non-productive work. Depending upon the nature of the rewrite they might also include the loss of at least part of the body of precedent which, in the case of income tax, has taken over one hundred years to construct. Any rewrite should, in our view, minimise such loss by retaining words and phrases which have been judicially interpreted whenever possible.

7.12. Equally, a rewrite would offer significant benefits, as noted at paragraph 1.27 onwards, for all taxpayers and users of tax legislation. Whether a rewrite - either full or partial - should be undertaken boils down to a very simple question: Do the long-term benefits justify the short-term costs?

7.13. The answer to this question depends in part upon what is being rewritten and how. Many of the direct costs of rewriting legislation can be identified and estimated. Other costs - for example, the costs of retraining and loss of precedent - are less easily measured. Against these costs, it is impossible to quantify the benefits of improved legislation.

A pilot project

7.14. The easy way out is to conclude that the benefits of a rewrite are not proven and a rewrite is not worthwhile. But in our view that would be unnecessarily pessimistic. It would close the door to a good part of the benefits our other recommendations are designed to achieve. We believe that it is possible to reach a proper judgement on whether the long-term benefits of a rewrite justify the short-term costs and that the best way of making this judgement is to pilot a rewrite of a selected part of the legislation.

7.15. We therefore recommend that a pilot be established for a project to rewrite systematically the income tax, corporation tax and capital gains tax legislation. A pilot offers the opportunity to assess and point the way forward on the various issues which we discuss at paragraph 7.17 onwards. The outcome of the pilot would be published for comment by taxpayers, practitioners and others. If that outcome and the comments on it were favourable, the project to rewrite direct tax legislation would proceed.

7.16. A pilot would complement the full project because no systematic rewrite of that legislation could be undertaken as a single exercise; it would have to be broken down into tranches. If a favourable judgement is reached at the conclusion of the pilot, that pilot would form the first tranche of the larger project that would then proceed to rewrite income tax, corporation tax and capital gains tax. If the pilot is successful, it should also become clearer whether a full rewrite should extend to other taxes - VAT, Excise Duties, Inheritance Tax,

National Insurance Contributions, etc. - and if not, which of them should be included in a partial rewrite. We note in this regard that Customs & Excise are engaged on a project - known as LEGIS - to align similar provisions in different taxes and consolidate all their legislation, probably in a single Act. This project is due for completion in 1998.

ISSUES ARISING ON A REWRITE

7.17. The remainder of this Chapter looks at some of the issues which will arise on a rewrite of the legislation. We have not reached firm conclusions on these; on some of them we have reached no conclusion at all. Some of them probably cannot be resolved before the pilot we suggest has begun. We intend to reflect further on these issues and will return to them in our final Report on this topic in 1996.

7.18. The following issues are set out in no particular order.

7.19. We need to decide how long the rewrite should take. This in turn depends upon what is to be rewritten. The balance is between minimising the transition to improved legislation and ensuring sufficient time to secure that improvement. Australia's Tax Law Improvement Project aims to rewrite the Australian direct tax legislation in three years (but is unlikely to finish on time); New Zealand is taking five years, also to rewrite its direct tax legislation. The Republic of Ireland expects to take four to five years merely to *consolidate* its income tax, corporation tax and capital gains tax legislation. The shorter the period taken, the greater the resources which would need to be devoted to the project and the more acute would be the indigestion caused by the rate of production of new legislation. It seems likely that a rewrite of income tax, corporation tax and capital gains tax alone would need to take something like five or six years.

7.20. We envisage that there would need to be a team drawn from various disciplines (Revenue departments, lawyers, accountants, draftsmen, possibly experts in plain English, design, information technology) although not all of them would necessarily need to be engaged full-time or for the whole time the team was in existence.

7.21. If the rewrite was to extend beyond income tax, corporation tax and capital gains tax, and especially if it encompassed indirect taxes or National Insurance Contributions which are outside the care and management of the Inland Revenue, it might be more manageable to have more than one project separately managed, and hence more than one team. But if there were to be more than one project, close liaison would be needed.

7.22. How should this team (or teams) be managed? Should it report to senior management of the Revenue departments, to a separate body with both private sector and Revenue department staff, to Parliamentary Counsel or to an independent Commission (such as the Law Commission)? We see advantages in the project team reporting to a steering group on which:

- Ministers, through senior Revenue officials, and
- the professions and taxpayers

would be represented. The steering group should be fairly small. However, if the full rewrite proceeds, we believe the overriding requirement is to ensure the success of the project through the enactment of new legislation. This will require strong commitment to the project from

Ministers and Treasury officials as well as cross-party support within Parliament. The control of the project, and the make-up of the steering group, should be determined with this criterion firmly in mind.

7.23. We see a good case for suspending the current arrangements under which Parliamentary Counsel is given instructions explaining the policy objective and translates these into legislative form. In a rewrite the instructions would for the most part be clear: to reproduce the effect of the existing legislation. The main function of the rewrite would be to improve the clarity, comprehensibility and accessibility of the legislation. Parliamentary Counsel would have a major role to play in this, but one or more draftsmen could form part of the project team, as in the Australian project, rather than maintaining their current arm's-length relationship with the Revenue departments. This would enable them to take a wider part in the development of the project.

7.24. How many Bills would be needed? If VAT and other duties under the care and management of Customs & Excise were included in the rewrite it would almost certainly make sense to have at least two Bills (one for direct taxes, the other for indirect taxes), possibly more. Another would be needed if National Insurance Contributions were included. But should the present arrangements by which the income tax, corporation tax and capital gains tax legislation is split into four Acts[88] be continued, or would more or fewer Acts be preferable? This question has been considered recently in Ireland where the consolidation of the Irish income tax, corporation tax and capital gains tax legislation will be contained in a single Act. There, the benefits of avoiding the duplication of work caused by the need to update cross-references in previous consolidation Acts with each new consolidation Act are thought to justify the difficulties of producing a single omnibus Taxes Act.

7.25. Should a rewrite be achieved in one step, or should the existing legislation be restructured and renumbered first? Australia has adopted a one-step rewrite. New Zealand firstly restructured and renumbered its legislation and inserted some new material; it is now going on to rewrite the legislation in its chosen style.

7.26. Whenever legislation is rewritten in different words the possibility of changing its effect cannot be ruled out. But should deliberate changes be allowed and if so how significant should they be? They could not be limited to the very minor changes which are permissible in a consolidation Act since the rewrite would certainly make more substantial changes than that[89]. There is no conceptual reason why any limitation should be placed on the degree of change, but in practice the rewrite project would quickly become mired in controversy if it tried to make both linguistic changes and major policy changes simultaneously. It would therefore be better for major policy changes to be made entirely separately from the rewrite project, as part of the ordinary Budget process as they are currently, with enactment in the annual Finance Bill. We recognise, however, that there would need to be careful co-ordination between the rewrite project and the ordinary Budget process if areas of the Act which were being rewritten were also subject to more fundamental policy review.

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88 Taxes Management Act 1970, Income and Corporation Taxes Act 1988, Capital Allowances Act 1990 and Taxation of Chargeable Gains Act 1992.

89 Consolidation is a process of combining the texts of two or more Acts into a coherent whole without altering the essential wording. At minimum, a rewrite would certainly alter the essential wording but with the aim of leaving the effect unchanged. Our experience of rewriting roll-over relief suggests it would be virtually impossible to avoid going further than this and changing the effect is some areas.

7.27. But should minor changes - changes in policy with a small p - be allowed? If the rewrite were to stick slavishly to the original effect of the legislation a large part of the opportunity for simplification would be lost. We therefore believe that strict reproduction of the existing effect of the legislation cannot be required. It follows that at least some small changes in policy must be allowed. We envisage that these would be designed mainly to iron out the anomalies and inconsistencies in existing legislation which a rewrite would highlight. In this, there is a balance to be struck between achieving clearer legislation and, at the same time, generating so much change (albeit in minor policy matters) that it adds significantly to the costs of implementing the rewrite and, potentially, loses the support of taxpayers who have already had to get to grips with a large amount of new legislation in recent years. Accordingly, should only changes which simplify the legislation be permitted? After all, the purpose of the rewrite would be to improve the comprehensibility of the legislation. It is likely that a number of minor issues would be thrown up, many of which might be deserving cases but which would add to the length and complexity of the legislation. Several such issues arose on our own redraft of the capital gains tax roll-over relief provisions.

7.28. Our redraft of the roll-over relief provisions also illustrates the large amount of existing concession, Revenue practice and explanatory material which exists in respect of current legislation. Decisions will be needed on how much of this should be incorporated into the legislation. We also recognise that among the most complex tax provisions are those dealing with tax avoidance. The pilot project will need to consider how such legislation can be written in simpler and clearer terms without prejudicing its principal purpose to prevent avoidance.

7.29. It would be important for the rewritten material to command widespread support. Without such support there would be a danger of controversy arising over the re-enactment of existing provisions. This occurred in Ireland when income tax legislation was consolidated in 1967, the President refusing to sign the Bill into law until a particular provision was repealed. Such an impasse could cause the rewrite to stall or even be abandoned.[90] This sort of support could be generated through full consultation with all interested parties and the release of the new legislation in draft for public comment, as well as by having an independent steering group.

7.30. Parliament would need to find a way of handling the new legislation and this would probably require the creation of some sort of special procedure. There would be many thousands of pages in a relatively short period, most of which (subject to the previous paragraph) would be little more than a restatement of existing law although there would be no guarantee that its effect would not be changed accidentally. For this reason the current consolidation procedure would not be available. There are several possible solutions. One would be to include the new legislation in Finance Bills. This would maintain the number of tax Acts (excluding consolidations) at one each year[91] but would make these Bills very long indeed and they would need to go through the full Parliamentary procedure. This might not create too many difficulties if the rewritten legislation were non-controversial and required

90 This would be ironical in that if, as in Ireland in 1967, the controversy concerned an existing provision which was being re-enacted unchanged, abandonment of the rewrite would leave that provision on the Statute Book.

91 It is twenty years since there was last more than one Finance Bill in a year, except when a general election has caused part of the Government's programme to be lost and this been reintroduced, or a new Government's programme introduced, as a Finance (No. 2) Bill after the election.

relatively little Parliamentary scrutiny because it had been the subject of full consultation and had received the steering group's approval.

7.31. The alternative would be to introduce separate Bills. This would require additional Parliamentary time which might not be available; there is constant pressure on Parliamentary time for Government Bills. However, Bennion on Statute Law refers to a special procedure which, whilst we have not researched the point, might be used:

> *Where the amendments required are too substantial [for the normal] procedure to be employed, the practice is to set up an ad hoc expert committee. The Highways Act 1959 was produced in this way. ...*
>
> *Although there is nothing to prevent members from putting down amendments to Bills in [this category], it is expected that they will not use this opportunity to attempt substantial changes to the law. Otherwise the special virtue of a consolidation Bill, namely that it does not take up Government time, would be lost. To facilitate this, Bills in [this] category may be sent first to an* ad hoc *Joint Select Committee. This happened with Bills for the Local Government Act 1933, the Public Health Act 1936, the Customs & Excise Act 1952 and the Highways Act 1959.*[92]

It might be possible to use a variation on this under which rewritten Bills were referred first to a specially-created independent review body which would report on the proposed legislation prior to its introduction into Parliament. The review body would be comprised of tax practitioners and hence represent a formalised consultation. The Bills would then be sent to an ad hoc Select Committee of the House of Commons only (being Money Bills, the Committee could not include members of the House of Lords). We have not investigated whether this procedure would be available; it would probably depend upon the extent to which the new legislation altered the effect, rather than merely the presentation, of the law.

7.32. If this special procedure was not available, the new legislation might still be introduced as a consolidation Bill if it were possible to make pre-consolidation amendments, although we find it difficult to see how this would work given the substantially different drafting styles which would be involved. Moreover a disadvantage of using a consolidation Bill would be that it would not break the link with the past. In any dispute about interpretation of the new legislation, reference would be made back to the old law. We believe it would be important not to allow such reference back. We suspect therefore that it will not be possible to use a consolidation Bill.

7.33. Should the new legislation be phased in as it became ready so that it co-existed with some of the old legislation for a period, or should it be brought in from an appointed day - the 'Big Bang' approach? Either way, the Parliamentary procedure need not be affected. The legislation could be enacted over a period of years as it was written, but be given simultaneous commencement dates. However tax legislation is continuously under review; the rewrite would not suspend ordinary Finance Bill business. It could be awkward to have two sets of legislation on the Statute Book - even if only one set was in force at any one time - with the result that such ordinary changes in the law would have to be incorporated into both the old and the new legislative texts.

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92 Bennion on Statute Law, Third Edition, page 70.

7.34. Should explanatory memoranda (as discussed in Chapter 6) be produced? As we note at paragraph 7.26 above, a rewrite would inevitably change the effect of the legislation in some areas. We believe these intentional changes would need to be identified and publicised in some way. Explanatory memoranda could be an appropriate medium.

7.35. Whether the explanatory memoranda for the new legislation should go further and explain areas which were not changing would depend upon the mechanism by which the rewritten law was enacted. If the rewritten legislation were dealt with as a consolidation, we believe it would be inappropriate for explanatory memoranda to be produced. Parliament does not debate or amend consolidation Bills. But if the rewritten legislation were fully debated in Parliament, explanatory memoranda could usefully be provided.

SUMMARY

7.36. In this Chapter we have looked at the options for dealing with the existing body of tax law, assuming that our recommendations for a change in the style of tax legislation to improve its clarity and comprehensibility are accepted. The Chapter first examined the option of allowing current legislation to wither on the vine, naturally renewing as and when changes are made to it for other reasons. But we do not regard this as satisfactory since it would be entirely open-ended - and for some parts of the legislation never-ending - as well as introducing distortions into the normal policy-making process. We recommend the alternative approach of systematically rewriting tax legislation, beginning with a pilot to confirm that the costs are justified by the benefits.

7.37. The Chapter went on to review some of the issues which would arise on a rewrite. We would welcome comments on any of these issues.

CHAPTER 8: CONSTRAINTS

INTRODUCTION

8.1. In Chapter 3 we looked at the various factors which have led to complex tax legislation and we now develop these themes as we consider the factors which make it difficult or even impossible to devise practical recommendations which can be implemented.

8.2. We make three principal recommendations in this report: more user-friendly language; explanatory memoranda; and the piloting of a rewrite of the corpus of tax legislation. The constraints on practical proposals mainly affect the first of these but we add some comments on the other two at the end.

USER-FRIENDLY LANGUAGE

8.3. In Chapter 5 we argued that there is a strong prima facie case that tax legislation *can* be more user-friendly without sacrificing accuracy. The two pieces of legislation we have redrafted (appendices 1 and 6) and the Rent a Room redraft which the Special Committee of Tax Law Consultative Bodies has developed indicate the sort of style we have in mind. But we also recognised that there is a very substantial difference between, on the one hand, the relaxed time-scale within which we produced our redrafts and the fixed reference points from which they started and, on the other hand, the hurly-burly of preparation for the Finance Bill under which conditions the draftsman has to operate.

8.4. There are in fact a large number of constraints on the draftsman's ability to produce clear, comprehensible, accessible legislation. Some of these - the desire for certainty and the sophistication of commercial affairs - are effectively givens which cannot be altered. Others could change in theory, but it is beyond our remit to suggest that they should do so. In this category we include the tax base and tax avoidance, policy and politics, the common law and Europe.

8.5. The constraints which we are able to address are therefore limited. They mainly concern time factors.

Lack of time

8.6. Lack of time is by far the most important constraint on Parliamentary Counsel's ability to produce good legislation. As we noted in Chapter 3, it pervades the system. We have therefore considered a number of proposals for making more time available.

8.7. Firstly, lack of time boils down to trying to do too much with too few resources. If the amount of new legislation cannot be reduced - and we accept that that is a matter for the Government - sufficient resources need to be made available to cope properly with the pressures. As the Hansard Society Commission put it, "the kitchen should be big enough and

properly equipped to satisfy the legislative appetite".[93] If this requires an increase in the number of draftsmen, so be it - additional funding should be provided to enable extra draftsmen to be recruited. We recognise that there is severe pressure on public finances but to skimp on drafting resources is a false economy: the costs to taxpayers and Revenue departments of operating with badly drafted legislation far outweigh any savings from under-resourcing the Parliamentary Counsel Office.

8.8. Secondly, Parliament does not have enough time to scrutinise tax legislation adequately. One of the reasons for this is that tax legislation passes through Parliament so quickly. The Finance Bill is generally presented to Parliament in the first half of January and the Second Reading Debate follows less than a fortnight later. The Committee Stage occupies February and March and then (depending on the date of Easter) the Report Stage and Third Reading follow within a couple of weeks of the end of the Committee Stage. The Bill still has to pass through the House of Lords and receive Royal Assent by 5 May, but being a Money Bill it cannot be amended after it has passed its Report Stage in the House of Commons. So from introduction to finalization of the text takes around three months.

8.9. This very tight time-scale is dictated by the Provisional Collection of Taxes Act ('PCTA'), an important constitutional safeguard. The PCTA allows tax changes to be made with immediate effect on the strength of Resolutions passed by the House of Commons at the conclusion of the Budget Debate. But those changes must be ratified by a Bill which is given a Second Reading within thirty sitting days and receives Royal Assent by 5 May.

8.10. One proposal which has been considered in the past is to separate from the Finance Bill those measures which do not require a PCTA Resolution[94] and which could be introduced in a second, technical Bill. Governments have always rejected this proposal in the past. The theoretical advantage is that it would allow technical issues to be considered at a more leisurely pace. However the major disadvantage in practice is that it would take up additional time on the floor of the House of Commons, and we doubt that this would available.

8.11. We have considered whether the PCTA should be amended either to allow more time between the Budget and the publication of the Finance Bill or to allow more time for debate by extending the 5 May deadline for Royal Assent. We have concluded that there would be insufficient benefits to justify either recommendation. A short extension before the publication of the Finance Bill would be unlikely to make a noticeable impact on the quality of the legislation; it would more likely be swallowed up by the ordinary processes of drafting. A long extension would be unacceptable from a constitutional perspective and might not in any case achieve very much since, as we noted at paragraph 3.36 substantial changes to the legislation cannot easily be made after the Bill has been presented. Extending the 5 May deadline would be unlikely to result in much improvement for the same reason.

8.12. We therefore believe that the point at which additional time needs to be made available is before the Bill has been published, at a time when the draft legislation can be amended, perhaps substantially, without the formality of the Parliamentary process.

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93 "Making the Law", The Report of The Hansard Society Commission on The Legislative Process, paragraph 52. See also paragraph 205.

94 See paragraph 3.38 for the distinction between ordinary Resolutions and PCTA Resolutions.

8.13. More time would be available if Ministers took decisions earlier. However it is the nature of politics that decisions are made on less than full information. It is therefore often preferable to defer taking them until as late as possible when as much as possible of the picture will be visible. Nevertheless, Ministers need to balance against this the need for sufficient time to be available for formulating policy and drafting legislation, and the likelihood that a late decision will result in less than satisfactory legislation. We therefore recommend that, wherever possible, Ministers should take early decisions on tax changes.

8.14. An alternative approach is for Parliamentary Counsel to draft clauses provisionally, subject to later Ministerial confirmation. Draftsmen and policy advisers alike see this as a second-best solution since it risks effort being wasted on instructing for and drafting legislation which is not ultimately used, and there is also a likelihood of the instructions changing substantially once the decision has been made. Nevertheless provisional drafting does take place. We make no recommendation as to the degree to which it should be employed; this calls for the exercise of professional judgement by policy advisers and draftsmen.

8.15. Coupled with the problem of late decisions is the tendency to keep them secret until Budget Day. Some decisions need to be confidential because of the scope for forestalling or of adverse effects on the economy if they are made public too early. But others would benefit from earlier announcement or from an acceptance that they need not be enacted immediately, in the Finance Bill which follows the Budget Statement.

Consultation - proposals

8.16. Openness allows consultation. Consultation is now a fairly common exercise in advance of the introduction of many new policies, but it was not always so. Although consultation exercises have taken place for many years, there has been a considerable expansion of both the breadth and depth of consultation over the last few years. Both the Inland Revenue and Customs & Excise now consult far more frequently than they used to, and they work far more closely with those whom they consult and are far more open with them when they do so. We welcome this although we note that most consultation is on policy, not on drafting of clauses.

8.17. Full consultation - on both policy and drafting - can bring significant advantages both for the Revenue departments and for taxpayers. Revenue departments can test their ideas before they become committed to them, they may identify better policy options, and loopholes and ambiguities in the draft clauses may be spotted and more easily rectified. Taxpayers benefit if the legislation is less open to abuse but is more tuned to their needs and hence less burdensome. Everyone benefits if the clarity and comprehensibility of the legislation are improved.

8.18. Consultation can, though, have a negative aspect. It can be seized upon as an opportunity for interest groups to press for special privileges. If Ministers accede to these demands, and additional anti-avoidance rules then have to be built in to prevent these privileges being abused, the legislation becomes more complex.

8.19. We would like to see a clear distinction drawn between consultation on policy and consultation on drafting. Both are valuable. When clauses are released for consultation the Revenue departments should make it plain that they welcome specific comments on the

drafting and suggestions for improvements. Moreover the draft clauses should not be regarded as set in stone. We were told by Parliamentary Counsel that by the time they are finalised they have often developed substantially from the first draft and in this process comprehensibility has been eroded. Where this happens we believe there should be a willingness to rewrite them from scratch in a more user-friendly style. But this can only happen if sufficient time is available, and in turn this means either that draft clauses need to be exposed earlier or that their enactment would need to be deferred until a later Finance Bill.

8.20. We recommend that such consultation should be entirely open wherever possible. We are aware, for example, that draft Finance Bill clauses have been exposed in confidence to representatives on various consultative bodies, such as the working group set up to look at the settlement provisions (which led to changes in the last Finance Act[95]). However, we believe that such clauses would benefit from wider public exposure. There should be no reluctance to publish clauses just because they are in draft and may change. The essence of consulting on draft legislation is to lead to beneficial change.

8.21. As part of a full consultation process, we recommend that the draftsman should be available to discuss drafting points with those who are consulted.

8.22. Early consultation on policy would often be the best way to identify appropriate policies. We have been told of a specific case in which early consultation on policy would have improved the legislation. There was no consultation before the Insurance Premium Tax was introduced, Budget secrecy prevailing. It was only after the Finance Bill had been published that an incorrect assumption about the commercial arrangements made by insurers came to light, very late in the day to alter the policy and too late to enable the structure of the legislation to be redrafted in the most user-friendly way.

8.23. We would also like to see consultation at a much earlier stage than is currently offered. Such 'pre-consultation' could assist the Revenue departments to identify avoidance opportunities at an early stage and to formulate effective responses. Consultation on self-assessment shows that it is possible for policy advisers and practitioners to work closely together to mutual advantage.

Consultation - a question

8.24. We also have one further idea on which we would welcome comments.

8.25. In Canada almost all tax legislation is now published as draft clauses several months before it is introduced into Parliament. We have been told by the Canadian Department of Finance that the legislation ultimately tabled in Parliament is consequently almost always the better for having been released in draft. There is also a presumption in favour of consultation in the UK, but we should like to see this go further. We should like to recommend that it be common practice for tax legislation (other than Budget changes to rates and allowances, the drafting of which does not normally cause difficulty) to be published in draft before it appears in the Finance Bill.

8.26. However we recognise that more time would need to be made available for this to be feasible.

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95 Section 74 and Schedule 17, FA 1995.

8.27. New Canadian provisions take effect from the date of announcement, however long the consultation and enactment processes take. This is a necessary consequence of such full consultation if delays in implementation of new proposals, and also forestalling, are to be avoided. The disadvantage of this procedure is self-evident: it is legislation by announcement. We have been told though that this is a price Canadian taxpayers and practitioners are prepared to pay for a real opportunity to shape the final legislation. Of course, Budget Day press releases in the UK are also legislation by announcement, but the delay before enactment in Canada can be much longer - up to 18 months - as a result of the consultation process.

8.28. Such an approach could be adopted in the UK. Draft clauses could be released - either in the Budget or at other times. Consultation could then follow on both policy and drafting. Any significant changes could be announced by further press notice. The draft legislation could be rewritten from scratch and republished if this was necessary to achieve comprehensibility. The finalised legislation could then be included in the following year's Finance Bill but with effect from the time of the original release or, where consultation had led to changes being made, from the time of their announcement.

8.29. The advantage of such a procedure would be the increased opportunity for taxpayers and practitioners to shape both the policy and more importantly the drafting of the legislation. The disadvantage would be delay and uncertainty, and these could incline people to delay taking major business decisions in areas affected by new legislative proposals. If this happened, policy changes could be slower to take effect.

8.30. We would welcome comments on whether, as long as full details were published as draft clauses, the delay and uncertainty between implementation and enactment would be a price worth paying for an opportunity to achieve more comprehensible legislation.

EXPLANATORY MEMORANDA

8.31. In Chapter 6 we recommend that explanatory memoranda should be produced to explain each clause of the Finance Bill. We recognise that this would be an additional task falling upon the Revenue departments - and also upon Parliamentary Counsel and Ministers who would need to check and approve them - and that time would need to be made available for it. To this extent, shortage of time would again be a constraint.

8.32. However, much of the material we would like to see in explanatory memoranda is already produced for other purposes (for example, as part of the instructions to Parliamentary Counsel) or is produced as Notes on Clauses in a different and much less helpful form. Moreover there is room for considerable flexibility: we have said at paragraphs 6.19 and 6.25 that the Government should judge what goes into the explanatory memoranda and when they are published (subject to the requirement that they be available in time for the Committee Stage debates).

8.33. We do not therefore believe that there are major constraints on publishing explanatory memoranda.

8.34. It is though worth mentioning here that one purpose of explanatory memoranda would be to help the courts to identify the purpose of a particular enactment. We noted at paragraph

3.14 that the courts were adopting an increasingly purposive approach to statutory interpretation but that there is still some way to go before they can be relied upon to do so. There may be a case for introducing a statutory provision to reinforce the courts' willingness to interpret legislation purposively. Australia introduced such a provision in 1981 and, whilst opinions differ as to the causes, it is generally accepted that Australian courts now give greater weight to the statutory purpose than they did previously.

A REWRITE OF TAX LEGISLATION

8.35. In Chapter 7 we recommend that as well as improving the user-friendliness of future tax legislation the advantages of a rewrite of existing legislation should be tested by means of a pilot exercise.

8.36. Such a rewrite would remain constrained by those factors which we list in paragraph 8.4 above as givens or beyond our remit. But it would not be hidebound by the existing legislation, nor by the same time pressures which affect the Finance Bill draftsmen or the policy developing with the drafting of the legislation.

8.37. A rewrite would also bring major benefits for subsequent new legislation. If it could sweep away much of the existing impenetrable language which so constrains the draftsman, it would make it possible for new legislation to be far more user-friendly. It would also assist the culture change which the draftsmen will need to undergo in order to be able to produce legislation in this style.

CHAPTER 9: OTHER ISSUES

9.1. Two other issues arise which have not been mentioned in previous chapters. These are firstly the structure of the legislation and the numbering of sections and secondly the application of our proposals in Scotland where the legal system differs from England and Wales.

STRUCTURE

9.2. In rewriting their income tax acts, both Australia and New Zealand are creating new structures. At present, their legislation is a mish-mash which has built up over nearly 60 and 20 years respectively. Over the years, new provisions have been inserted into Australia's Income Tax Act 1936 and New Zealand's Income Tax Act 1976 with insufficient thought for where they belong. Both countries are therefore reordering their provisions[96] in the hope of producing a logical structure which will enable relevant provisions to be found where they are expected. A taxpayer would therefore know where to look in the Act and would find all provisions relevant to his circumstances.

9.3. Arguably, the UK's income tax legislation also lacks structure. With the exception of the settlements legislation in Part XV ICTA 1988, and possibly Part XVII on avoidance, few people refer to income tax (or corporation tax or capital gains tax) legislation by anything other than section numbers. However, the structure of the UK's direct tax legislation is complicated by the schedular system. We have not yet given any thought to whether a new structure would be preferable or, if so, what it should be. This is though an issue which would need to be addressed by the pilot project to rewrite tax legislation.

9.4. We have not given any thought to the structures of other taxes although, being shorter, the structure of their legislation is less likely to cause difficulty.

NUMBERING

9.5. Australia and New Zealand have also adopted new numbering systems for their income tax legislation. Australian legislation had reached the point where the section numbers were almost impossible to differentiate let alone remember. Inserting new material into the 1936 Act produced numbers like 159GZZZZA(2)(b)(iii)(B). Australia will use a two-component system to designate both Division and section; section numbers will begin at 1 within each Division. So a section might be known as 17-24. New Zealand is using an alpha-numeric system designating Part, sub-part and section numbers. A New Zealand section might be known as GC 15.

9.6. Periodical consolidation has enabled the UK to avoid these problems. The worst we have in direct tax legislation are section 432ZA Income and Corporation Taxes Act 1988 and

96 New Zealand has done so already.

section 164MA Taxation of Chargeable Gains Act 1992. In indirect tax the situation is better still. However, frequent consolidation has the disadvantage that section numbers change and have to be relearnt each time. And the UK approach of selective textual amendment means that we have legislation spread between consolidated Acts and Finance Acts.

9.7. As long as periodical consolidations continue to be produced, the grounds for altering the present numbering system do not appear strong. However, we would welcome views on both the structure and numbering of legislation. We shall return to this subject in our final Report next year.

SCOTLAND

9.8. The application of UK tax law in Scotland has at times been a controversial subject. Tax liability frequently sits upon the underlying law. For example, capital gains tax arises on disposals of assets; whether (and, if so, when) a disposal has occurred may depend upon property, company or trust law which are not the same in Scotland as in England and Wales.[97] At times, it has been argued to us, tax policy-makers and draftsmen have not recognised these differences and as a result the tax legislation has applied with different effect in Scotland than in England and Wales.

9.9. We have not sought to discover whether this is a valid criticism. However, we accept that tax legislation should prima facie apply uniformly across the whole of the United Kingdom. If a differential impact arises it must either be deliberate or accidental. The former would be a policy matter and hence outside our remit. The latter will be less likely to occur if the recommendation in Chapter 8 that there should be consultation on technical issues is implemented.

9.10. If, as we recommend in Chapter 7, a pilot project to rewrite legislation is established, it will be important to put in place adequate arrangements for identifying and dealing with these issues.

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[97] In principle, the interface with other jurisdictions may also be difficult, but the problem is most acute with the interaction between English and Scots law.

CHAPTER 10: SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

10.1. In this Chapter we summarise the conclusions and recommendations reached in previous Chapters, and the points on which we shall welcome comments.

General principles drafting

10.2. (*Paragraph 4.8*) General principles drafting to a large extent sacrifices immediate certainty. This is unacceptable in fiscal legislation.

10.3. (*Paragraph 4.11*) It could be attractive to have shorter primary legislation based on general principles, with detail supplied by regulations if an alternative process of scrutiny for the regulations could be established. But we do not believe the climate is right for such an innovation.

10.4. (*Paragraph 4.15*) General principles drafting may be appropriate for some provisions where the principle can be stated with sufficient clarity to avoid uncertainty. However we do not recommend its use as a solution of general application.

Statements of purpose

10.5. (*Paragraph 4.21*) Statements of purpose within the primary legislation are not essential. But the draftsman should use them where they are helpful.

10.6. (*Paragraph 4.22*) We intend to look at the issue of tax avoidance, and the use of purposive anti-avoidance legislation, as a separate research topic.

Language

10.7. (*Paragraphs 5.6 and 5.7*) The legislative audience after enactment is tax professionals. Legislation should be written in a linguistic style which, as far as possible, is capable of being understood by accountants, lawyers, tax inspectors and other professionally qualified users.

10.8. (*Paragraph 5.8*) The needs of users should be given far greater importance by Parliamentary Counsel who should accord equal importance to clarity and accessibility as to accuracy, even though clarity and accessibility must in the final resort take second place to accuracy and precision.

10.9. (*Paragraphs 5.9 and 5.15*) Tax legislation *can* be clearer, more accessible and more comprehensible without losing accuracy, even when it deals with a highly detailed subject.

10.10. (*Paragraph 5.16*) There is a range of different styles which can be adopted. It is unlikely that any single style will be appropriate for all circumstances.

10.11. (*Paragraph 5.17*) We should be interested to receive comments on any aspect of our redrafts of roll-over relief and post-cessation expenditure relief (appendices 1 and 6), and especially on the variations in drafting styles which we have illustrated and also on whether this type of approach would seem satisfactory for a general rewrite of tax legislation.

Aspects of drafting technique

10.12. (*Paragraph 5.25*) The objective should not be to convey information in the smallest number of words possible, but to enable the user to understand the message in the shortest time possible. Longer, less compressed legislation is preferable if it can be understood after fewer readings so that the time taken in understanding it is shorter.

10.13. (*Paragraph 5.28*) Marginal notes to subsections should be provided to help users navigate through the legislation.

10.14. (*Paragraph 5.30*) Defined words should be italicised when they first appear. Further consideration should be given as to when to italicise defined words which apply generally.

10.15. (*Paragraph 5.36*) The typographical design of tax legislation should be modernised.

10.16. (*Paragraphs 5.38 to 5.43*) Worked examples should be provided to illustrate the operation of the legislation. We would welcome views on whether the worked examples should be in the primary legislation or the explanatory memoranda. If they are included in the primary legislation, they should be subordinate to the text they exemplify.

Explanatory memoranda

10.17. (*Paragraph 6.3*) There is a need for an additional form of explanatory material which would be more authoritative than existing material. Explanatory memoranda should be published when the legislation is first enacted.

10.18. (*Paragraph 6.4*) The first priority is more comprehensible legislation, but this will not remove the need for explanatory memoranda.

10.19. (*Paragraphs 6.8 and 6.10*) Legislation should be introduced to enable the courts to use explanatory memoranda as aids to interpretation in difficult or ambiguous cases.

10.20. (*Paragraph 6.19 and 6.20*) The Government should judge the amount of material which each explanatory memorandum needs to contain in the light of the nature of the legislation and the likely needs of its users. They should not be so comprehensive that they become enormously lengthy and a burden on practitioners. The primary market for explanatory memoranda should be those generalist practitioners who deal with the subject matter of the legislation.

10.21. (*Paragraph 6.22 and 6.23*) The explanatory memoranda should be written by the officials within the Revenue departments. They should be approved both by Parliamentary Counsel and by Ministers.

10.22. (*Paragraph 6.24 and 6.25*) If possible, the explanatory memoranda should be published at the same time as the Finance Bill. But if useful memoranda cannot be produced this early, the Government should have flexibility to publish them later, but in good time for the Committee Stage debates. Within this flexibility, the explanatory memoranda should be published as early as possible.

10.23. (*Paragraph 6.26 and 6.27*) Substantial Government amendments, and in particular the tabling of new clauses, would necessitate a new or revised explanatory memorandum. The Government should judge when to provide one.

10.24. (*Paragraph 6.29*) In the longer term, the tabling of an explanatory memorandum with every non-governmental amendment should become the norm.

10.25. (*Paragraph 6.31*) The Government should publish supplementary explanatory memoranda, whenever it thinks it appropriate to do so. But these should be made available to Parliament in good time for the Report Stage, at the latest.

10.26. (*Paragraph 6.33, 6.39 and 6.40*) It would be desirable to have a mechanism by which the explanatory memoranda could be consolidated once the Finance Bill received Royal Assent, bringing together in one handy reference book all the relevant explanatory memoranda for the year's Finance Act. We would prefer this consolidation to be done by commercial publishers. If they did not, the Revenue departments should do so.

Rewriting existing legislation

10.27. (*Paragraph 7.11 to 7.13*) A rewrite of existing legislation would impose costs on taxpayers, practitioners and the Revenue departments. Equally, a rewrite would offer significant benefits. Whether a rewrite - either full or partial - should be undertaken depends upon whether the long-term benefits justify the short-term costs. The answer to this depends in turn upon what is being rewritten and how. Many of the costs can be identified and estimated, but it is impossible to quantify the benefits.

10.28. (*Paragraph 7.14*) Nevertheless, it will be possible to reach a proper judgement on whether then long-term benefits of a rewrite justify the short-term costs. The best way of making this judgement is to pilot a rewrite of a selected part of the legislation.

10.29. (*Paragraph 7.15*) Such a pilot should be established for a project to rewrite systematically the income tax, corporation tax and capital gains tax legislation. The outcome of the pilot should be published for comment. If the comments are favourable, the project to rewrite direct tax legislation should proceed.

10.30. (*Paragraph 7.16*) A rewrite would have to be broken down into tranches. The pilot should form the first tranche of the larger project. It should also clarify whether a full rewrite should extend to other taxes - VAT, Excise Duties, Inheritance Tax, National Insurance Contributions, etc. - and if not, which of them should be included in a partial rewrite.

10.31. (*Paragraph 7.19*) It seems likely that a rewrite of income tax, corporation tax and capital gains tax alone would need to take something like five or six years.

10.32. (*Paragraph 7.20 to 7.22*) There should be a project team drawn from various disciplines. It might be more manageable to have more than one project separately managed, and hence more than one team; but close liaison would be needed. The project team should report to a steering group with both Revenue and private sector representation. The control of the project, and the make-up of the steering group, should be determined with the overriding requirement to ensure enactment of new legislation in mind.

10.33. (*Paragraph 7.26 and 7.27*) On a rewrite, changes in the effect of the legislation could not be ruled out. Major policy changes should be made separately, but with careful co-ordination between the rewrite project and the ordinary Budget process. Small changes in policy, designed mainly to iron out the anomalies and inconsistencies in existing legislation which a rewrite would highlight, should be allowed. A balance should be struck between achieving clearer legislation and generating so much change that it adds significantly to the costs of implementation.

10.34. (*Paragraph 7.29*) The rewritten material should command widespread support. There should be full consultation. New legislation should be released in draft for public comment.

10.35. (*Paragraph 7.30*) Parliament should find a way of handling the new legislation.

10.36. (*Paragraph 7.34*) Changes in the effect of the legislation should be indicated.

10.37. (*Paragraph 7.35*) If the rewritten legislation were fully debated in Parliament, full explanatory memoranda should be provided.

Constraints

10.38. (*Paragraph 8.4 and 8.6*) There are a large number of constraints on the draftsman's ability to produce comprehensible legislation. Lack of time is by far the most important.

10.39. (*Paragraph 8.7*) Lack of time boils down to trying to do too much with too few resources. If this requires an increase in the number of draftsmen, additional funding should be provided.

10.40. (*Paragraph 8.12*) The point at which additional time needs to be made available is before the Bill has been published.

10.41. (*Paragraph 8.13*) Wherever possible, Ministers should take early decisions on tax changes.

10.42. (*Paragraph 8.15*) Some decisions which are kept secret until Budget Day would benefit from earlier announcement or from an acceptance that they need not be enacted immediately.

10.43. (*Paragraph 8.19 to 8.23*) There should be a clear distinction between consultation on policy and consultation on drafting. Comments on drafting should be welcomed. Where necessary, there should be a willingness to rewrite draft clauses from scratch in a more user-

friendly style. Consultation should be entirely open wherever possible. As part of a full consultation process, the draftsman should be available to discuss drafting points with those who are consulted. Consultation on policy should take place sufficiently early.

10.44. (*Paragraph 8.27 to 8.30*) In Canada, draft clauses are released for consultation and take effect immediately although they will not be enacted until later. This enables the ultimate legislation to be more comprehensible. We would welcome views on whether this would be acceptable in the UK. Would the delay and uncertainty between implementation and enactment be a price worth paying for an opportunity to achieve more comprehensible legislation?

10.45. (*Paragraph 8.35*) There may be a case for introducing a statutory provision to reinforce the courts' willingness to interpret legislation purposively.

Other issues

10.46. (*Paragraph 9.7*) We would welcome views on both the structure and numbering of legislation.

10.47. (*Paragraph 9.9*) If a pilot project to rewrite legislation is established, adequate arrangements should be made to ensure that the legislation applies uniformly across the whole of the United Kingdom.

COMMENTS

10.48. As well as the specific areas on which we have asked for comments, we would welcome comments on any matter covered in this report. Comments should be addressed to:

Chris Davidson
Tax Law Review Committee Secretariat
Institute for Fiscal Studies
7 Ridgmount Street
London WC1E 7AE

to arrive, if possible, by 28 February 1996.

CHAPTER 10: SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Appendix 1: Roll-over relief

1 Introduction

Purpose 1.1 The purpose of this legislation is to defer payment of tax where specified types of assets used in business produce a gain on disposal and where other assets of a specified type are acquired for use in business. The following sections explain how that purpose is achieved.

Name; roll-over relief to be claimed 1.2 This tax relief is called roll-over relief and is available only if it is claimed.

Definitions 1.3 Definitions are in section 9. The first time a defined word is used it appears in *italics.*

Examples 1.4 Schedule 2 gives, for illustrative purposes only, examples of the way in which roll-over relief operates. Therefore if there is conflict between the examples and the legislation, the legislation prevails.

2 Qualifying for roll-over relief

Primary conditions to be satisfied 2.1 A person is entitled to claim roll-over relief if:

A he disposes of an *Eligible Asset*; and

B he applies all or part of the *Disposal Proceeds* in acquiring another Eligible Asset; and

C the *time of disposal* and the *time of acquisition* are within the time limits specified in section 4.

Old Asset: use 2.2 The *Old Asset* must have been used throughout the *Period of Ownership* solely for the purposes of a *Qualifying Activity* carried on by the person making the disposal. Modifications to this condition are set out in sections 5 and 8.

New Asset: use 2.3 The *New Asset* must be acquired solely for the purposes of a Qualifying Activity carried on by the person making the acquisition. It must be taken into such use promptly after its acquisition. Modifications to this condition are set out in sections 5 and 8.

New Asset: exclusion if acquired for gain 2.4 The purpose of acquiring the New Asset must be for use in a Qualifying Activity and the New Asset must not be acquired wholly or partly for the purpose of realising a gain from its disposal.

Partial reinvestment of Disposal Proceeds 2.5 If only part of the Disposal Proceeds is reinvested but all other conditions are satisfied, then restricted relief is given under section 6 below.

Depreciating Assets 2.6 If all or part of the Disposal Proceeds are reinvested in a *Depreciating Asset* then section 7 applies.

3 Operation of roll-over relief

Time limits for claim

3.1 A claim to roll-over relief must be made in writing not later than 6 years from the end of the *Chargeable Period* in which the disposal of the Old Asset or the acquisition of the New Asset occurs, whichever is the later.

Consequences of claim

3.2 If a roll-over relief claim is made, the tax treatment is as follows:

A the *Acquisition Cost* of the New Asset is reduced by the chargeable gain made on the disposal of the Old Asset; and

B the chargeable gain made on the disposal of the Old Asset is reduced to nil.

Where there is partial reinvestment of the Disposal Proceeds the tax treatment is modified under section 6.

An example is set out in paragraph 1 of Schedule 2.

Pre-1965 acquisition

3.3 If a person:

A acquired the Old Asset before 6 April 1965; and

B sub-section 35(3) of *the Act* applies: and

C he has not made a rebasing election under paragraph 17 of Schedule 2 of the Act

the reduction made in sub-section 3.2 A is the amount of the chargeable gain as calculated in paragraph 16 of Schedule 2 of the Act and not the whole of the gain.

Effect of claim on other parties

3.4 No other party to the disposal or acquisition is affected by a roll-over relief claim.

Other reliefs: priority

3.5 A person may choose to claim roll-over relief either before or after any other relief relating to chargeable gains in respect of the same disposal.

Transaction where some assets are not Eligible Assets

3.6 If several assets are acquired or disposed of for a single consideration and only some of those assets are Eligible Assets, then a reasonable apportionment of the consideration is made.

More than one New Asset: allocation

3.7 All or part of the Disposal Proceeds may be applied in the acquisition of more than one New Asset at any time or times within the time limits set out in section 4. A person may decide how the reduction made in sub-section 3.2 A is allocated between the Acquisition Costs of such New Assets.

An example is set out in paragraph 7 of Schedule 2

4 Time limits

When New Asset to be acquired

4.1 A person must acquire the New Asset or enter into an unconditional contract to acquire the New Asset not earlier than 12 months before, or later than 3 years after, the disposal of the Old Asset. These time limits may be relaxed at the discretion of the *Board*.

Delayed acquisition: provisional relief

4.2 When an unconditional contract for the acquisition of the New Asset is made within the time limits, roll-over relief is granted on a provisional basis without waiting to ascertain whether the New Asset is acquired in pursuance of the contract. When that fact is ascertained, all necessary adjustments to the tax liability shall be made without any time limits.

5 Modifications of requirements relating to use and acquisiton of assets

Note that this section represents a simplification of sub-sections 152(6) and (7). Those sub-sections are followed more closely in the redraft in the annex.

Purpose and scope of modifications

5.1 This section modifies the conditions set out in section 2 and the tax treatment under section 3 is modified accordingly. One or more of these modifications may apply in any particular case.

Old Assets: partial qualifying use

5.2 A person is entitled to claim roll-over relief if the Old Asset was not used throughout the Period of Ownership solely for the purposes of a Qualifying Activity but all other conditions are satisfied. In such a case, a reasonable apportionment of the Disposal Proceeds is`made taking into account:

A the relative length of time for which the Old Asset was and was not so used; and

B where part of the Old Asset was and part of the Old Asset was not so used, the proportionate value of each part.

Roll-over relief applies as if the part of the Old Asset which was used in a Qualifying Activity or which represents the time it was so used (or both) were a separate asset from the part which was not so used.

An example is set out in paragraph 2 of Schedule 2.

New Assets: partial qualifying use

5.3 A person is entitled to claim roll-over relief where only part of the New Asset is used promptly on acquisition for the purposes of a Qualifying Activity but all other conditions are satisfied. In such a case a reasonable apportionment of the Acquisition Cost is made as if the proportionate value of the part so used were a separate asset from the part not so used.

An example is set out in paragraph 3 of Schedule 2.

New Asset not used promptly

5.4 If the New Asset or part of the New Asset is not on acquisition used promptly for the purposes of a Qualifying Activity because it is to be improved or altered before being brought into such use, the period between acquisition and such use shall nevertheless be treated as use in a Qualifying Activity if the New Asset or (as the case may be) part of the New Asset:

A is improved or altered as soon as practicable after acquisition; and

B is then used in a Qualifying Activity; and

C is not let or used for any other purpose in the interim period.

For the purposes of satisfying the conditions in this sub-section, land and buildings are treated as one asset.

Investment in or improvement of Old Asset

5.5 This sub-section applies if a person:

A applies all or part of the Disposal Proceeds:

(i) as capital expenditure in the improvement of an Eligible Asset; or

(ii) in the acquisition of a further interest in an Eligible Asset

B and in either case the Eligible Asset is used promptly after that expenditure is incurred for the purposes of a Qualifying Activity.

In such a case, the person is entitled to claim roll-over relief as if that expenditure had been incurred in the acquisition of a New Asset.

6 Partial reinvestment

If only part of the Disposal Proceeds is applied in acquiring the New Asset or New Assets, roll-over relief is restricted so that for every £1 not reinvested in New Assets, £1 of the chargeable gain is left chargeable.

The Acquisition Costs of the New Assets are reduced by the part of the chargeable gain which qualifies for roll-over relief and the claimant may decide how the reduction is allocated between the Acquisition Costs of the New Assets.

If the amount not reinvested in the New Assets is greater than the amount of the chargeable gain, no roll-over relief is due.

Examples are set out in paragraphs 4, 5, 6 and 7 of Schedule 2.

7 Reinvestment in depreciating assets

Investment in Depreciating Assets: modified rules

7.1 If the New Asset is a Depreciating Asset relief is given as follows.

A calculation is made of the amount of the gain in respect of which roll-over relief is due. This gain ('the held-over gain') does not reduce the Acquisition Cost of the New Asset but is deferred and accrues on the Chargeable Occasion.

The Chargeable Occasion means the earliest of the following events:

A the disposal of the Depreciating Asset;

B the person ceasing to use the Depreciating Asset for a Qualifying Activity except by reason of his death;

C the expiry of 10 years from the acquisition of the Depreciating Asset.

An example is set out in paragraph 8 of Schedule 2.

Death wipes out held-over gain

7.2 Where an individual dies before the Chargeable Occasion has occurred, then:

A the held-over gain never becomes chargeable; and

B sub-section 62(1) of the Act applies so that the Depreciating Asset is acquired on death by the deceased's personal representatives at market value.

Investment in second New Asset after investment in Depreciating Asset

7.3 Where sub-section 7.1 has applied but before or at the same time as the Chargeable Occasion occurs the person:

A acquires an Eligible Asset ('the second New Asset') which is not a Depreciating Asset and which satisfies the condition in sub-section 2.3; and

B claims roll-over relief within six years from the end of the Chargeable Period in which he acquires the second New Asset;

then:

(i) if the Acquisition Cost of the second New Asset is not less than the Disposal Proceeds from the Old Asset, sub-section 7.4 applies; or

(ii) otherwise, sub-section 7.5 applies.

Consequences: full reinvestment

7.4 Where this sub-section applies:

A the held-over gain is reduced to nil; and

B the Acquisition Cost of the second New Asset is reduced by the held-over gain.

An example is set out in paragraph 9 of Schedule 2.

Consequences: partial reinvestment

7.5 Where this sub-section applies:

A the held-over gain is reduced to the amount not reinvested in the second New Asset; and

B the Acquisition Cost of the second New Asset is reduced by the amount by which the held-over gain is reduced under sub-section 7.5 A.

An example is set out in paragraph 10 of Schedule 2.

Interpretation

7.6 This sub-section applies where there is reinvestment in more than one second New Asset. The Acquisition Cost of the second New Asset in sub-section 7.3(i), but not in sub-sections 7.4 B or 7.5 B, means the sum of those Acquisition Costs and in sub-section 7.5 A the amount not reinvested in the second New Asset is interpreted accordingly.

8 Special categories

INDIVIDUALS

Individual disposes of Old Asset used by company

8.1 An individual who would otherwise be entitled to claim roll-over relief but does not qualify for relief only because he does not personally carry on a Qualifying Activity in which the Old Asset was used, is entitled to claim relief if:

A the Old Asset was used (whether or not for consideration) throughout the Period of Ownership in a Qualifying Activity carried on by a *Qualifying Company*; and

B the New Asset is used promptly on acquisition for the purposes of a Qualifying Activity carried on by the same Qualifying Company.

The modifications in section 5 apply.

COMPANIES

Groups: treatment as a single trade

8.2 For the purposes of roll-over relief, all Qualifying Activities carried on by members of a group are treated as a single trade.

Transfers of assets within group

8.3 Transfers of assets between members of a group do not qualify as the acquisition of Eligible Assets if such transfers are treated by the Act as giving rise to neither a gain nor a loss.

Groups: disposals and acquisitions not by same company

8.4 Roll-over relief may be claimed where a company disposes of an Old Asset whilst it is a member of a group and the acquisition of the New Asset is by a company which at the time of the acquisition:

A is a member of the same group; and

B is not a dual resident investing company.

The claim must be made by both companies. All other conditions for roll-over relief must be satisfied.

Groups: companies not carrying on Qualifying Activity

8.5 A company which disposes of an Old Asset or acquires a New Asset is entitled to claim roll-over relief where it is a member of a group but not itself carrying on a Qualifying Activity (if all other conditions are satisfied) if the Old Asset and the New Asset are used solely for the purposes of a Qualifying Activity carried on by another member or members of the same group.

The modifications in section 5 apply.

Groups: Depreciating Assets

8.6 Where a company which is a member of a group claims roll-over relief on the acquisition of a Depreciating Asset, the following rules apply:

A sub-section 7.1 applies as if all members of the group at any time in the period between the acquisition of the Depreciating Asset and the date when the held-over gain accrues were the same person;

B the held-over gain accrues under sub-section 7.1 to the member holding the Depreciating Asset at the time it accrues.

NON-RESIDENCE

Non-residents trading in the UK

8.7 A person who at the time of the disposal of an Old Asset used in a Qualifying Activity carried on in the UK:

A is not resident or not ordinarily resident in the UK; or

B is treated as not resident or not ordinarily resident in the UK for the purposes of any double taxation agreement

cannot claim roll-over relief unless either:

(i) the New Asset is acquired after the disposal of the Old Asset and immediately after such acquisition he is resident or ordinarily resident in the UK or is treated as such for the purposes of any double taxation agtreement; or

(ii) the New Asset is situated in the UK and used for the purposes of a Qualifying Activity carried on in the UK through a branch or agency.

Non-resident companies

8.8 A company which ceases to be resident in the UK between the disposal of the Old Asset and the subsequent acquisition of the New Asset cannot claim roll-over relief unless the New Asset is situated in the UK and used for the purposes of a Qualifying Activity carried on in the UK through a branch or agency.

Non-resident trustees

8.9 If between the disposal of the Old Asset and the subsequent acquisition of the New Asset trustees of a settlement become neither resident nor ordinarily resident in the UK are regarded for the purposes of any double taxation relief as resident in a territory outside the UK, they cannot claim roll-over relief unless the New Asset is situated in the UK and used for the purposes of a Qualifying Activity carried on in the UK through a branch or agency.

9 Interpretation

9.1 *Acquisition Cost* means the consideration which a person gives or is deemed to give wholly and exclusively for the acquisition of a New Asset including incidental costs of acquisition.

9.2 *Board* means the Commissioners of Inland Revenue.

9.3 a *Chargeable Period* means a year of assessment or in the case of a company its accounting period.

9.4 *Depreciating Asset* means an asset which has a predictable life of 60 years or less and includes all plant and machinery. It also includes leasehold land where the lease has 60 years or less to run and any buildings on that land. However, freehold land, including buildings on freehold land, cannot be Depreciating Assets.

9.5 *Disposal Proceeds* means a sum equivalent to:

A the consideration to which a person is entitled; or

B the consideration to which a person is deemed to be entitled;

on a disposal of the Old Asset after allowing for incidental costs of disposal.

9.6 *Eligible Asset* means an asset, assets or an interest in an asset or assets within any of the categories of assets specified in Schedule 1.

9.7 *New Asset* means the Eligible Asset acquired or deemed to be acquired as described in sub-section 2.1 B .

9.8 *Old Asset* means the Eligible Asset disposed of or deemed to be disposed of as described in sub-section 2.1 A.

9.9 *Period of Ownership* means the period beginning with the claimant's acquisition of the Eligible Asset (or 31 March 1982 if later) and ending with the claimant's disposal of the Eligible Asset.

9.10 *Qualifying Company* means any company in which the claimant is entitled to exercise not less than 5% of the voting rights.

9.11 *Qualifying Activity* means one or more trades (and whether two or more trades are carried on successively or at the same time by a person they shall be treated as a single trade) and the word 'trade' shall be deemed to include any of the following:

A the discharge of the functions of a public authority;

B the occupation of woodlands where the woodlands are managed by the occupier on a commercial basis and with a view to the realisation of profits;

C a profession, vocation, office or employment;

D the activities of a company or body of persons (and the term body of persons shall exclude settlements but include associations and statutory bodies) whose activities are wholly or mainly carried on otherwise than for profit.

Trade includes any activity which is treated as a trade for the purposes of income tax.

9.12 *The Act* means Taxation of Chargeable Gains Act 1992

9.13 *Time of acquisition* for roll-over relief purposes is the date when a person obtains possession of an asset.

9.14 *Time of disposal* for roll-over relief purposes is the date when an asset is conveyed or transferred.

Other words and expressions not specifically defined have the same meanings as they have when used elsewhere in the Act.

Schedule 1

The categories of assets (which may be added to from time to time by the Treasury by order made by statutory instrument, subject to annulment by a resolution of the House of Commons) are as follows:

HEAD A

1 Any building or part of a building and any permanent or semi-permanent structure in the nature of a building, occupied (as well as used) only for the purposes of a Qualifying Activity.

2 Any land occupied (as well as used) only for the purposes of a Qualifying Activity.

Assets within Head A are not Eligible Assets where the Qualifying Activity is:

A dealing in or developing land unless a profit on the sale of such land would not form part of trading profits; or

B providing services for the occupier of land in which the claimant has an interest.

Where use is required in a Qualifying Activity, in the case of assets within Head A the requirement for use is deemed to include the requirement for occupation in a Qualifying Activity.

A person who is a lessor of tied premises (as defined in sub-section 98(2) of ICTA 1988) is treated as if he occupied (as well as used) those tied premises solely for the purposes of the Qualifying Activity.

HEAD B

Fixed plant or fixed machinery which does not form part of a building or part of a permanent or semi-permanent structure in the nature of a building.

Ships, aircraft and hovercraft.

Satellites, space stations and spacecraft (including launch vehicles).

Goodwill.

Milk and potato quotas.

Ewe and suckler cow premium quotas.

Schedule 2

Indexation is ignored in the examples unless otherwise stated. In each example the claimant carries on a Qualifying Activity and claims roll-over relief within the statutory time limits. Unless otherwise stated the Old Asset is used (and in the case of land occupied) solely for the purposes of the Qualifying Activity throughout the Period of Ownership and the New Asset is taken into use (and in the case of land occupied) promptly on acquisition solely for the purposes of the Qualifying Activity.

see sub-section 3.2

Paragraph 1 - Basic rules on how relief operates

1984	A buys land (the 'Old Asset') for £70,000.
1993	A sells the Old Asset for £100,000. Chargeable gain is £30,000.
1995	A buys another piece of land (the 'New Asset') for £180,000.

The Disposal Proceeds have been fully reinvested, so no CGT is due on the disposal of the Old Asset. The Acquisition Cost of the New Asset is reduced as follows:

	£
Acquisition Cost of New Asset	180,000
Chargeable gain on sale of Old Asset	(30,000)
CGT base cost of New Asset	150,000

see sub-section 5.2

Paragraph 2 - Old Asset: only partial qualifying use

1980	B buys a property for £45,000 for use as a private house.
1992	B spends £2,000 to convert part of the house, which he then occupies and uses for the purposes of a Qualifying Activity.
1997	B sells the whole property for £180,000.
1998	B buys a shop (the 'New Asset') for £25,000.

On a reasonable apportionment, one-third of the value of the property was used for the purposes of the Qualifying Activity. The Period of Ownership (since periods prior to 1982 are excluded) is 15 years; use for the purposes of the Qualifying Activity lasted 5 of these years. One-ninth of the house (1/3 x 5/15) is treated as a separate asset.

The chargeable gain on the part of the property used for the Qualifying Activity is therefore as follows:

	£	£
Disposal Proceeds 180,000 x 1/9		20,000
Acquisition Cost 45,000 x 1/9	5,000	
Cost of conversion	2,000	(7,000)
Chargeable gain		13,000

The Disposal Proceeds (£20,000) have been fully reinvested so no CGT is due on the chargeable gain arising from the disposal of the part of the Old Asset used for the purposes of a Qualifying Activity. (Roll-over relief is not due in respect of the remainder of the gain.)

The Acquisition Cost of the New Asset is reduced as follows:

	£
Acquisition Cost of New Asset	25,000
Chargeable gain on sale of Old Asset	(13,000)
CGT base cost of New Asset	12,000

see sub-section 5.3

Paragraph 3 - New Asset has non-qualifying use

1996	C sells a fixed machine (the 'Old Asset') for £10,000 and makes a chargeable gain of £2,000.
1998	C buys a property (the 'New Asset') for £20,000

One room in the New Asset is used for non-qualifying purposes; the remainder is used as a shop, a Qualifying Activity. On a reasonable apportionment of the Acquisition Cost, 90% of the value of the New Asset is used for the purposes of the Qualifying Activity. Thus, 90% of the New Asset is treated as a separate asset with its Acquisition Cost £18,000 (that is, £20,000 x 90%).

The Disposal Proceeds (£10,000) have been fully reinvested so no CGT is due on the disposal of the Old Asset. The Acquisition Cost of the part of the New Asset used for the purposes of the Qualifying Activity is reduced as follows:

	£
Acquisition Cost of part of New Asset	18,000
Chargeable gain on the sale of Old Asset	(2,000)
CGT base cost of this part of New Asset	16,000

The CGT base cost of the other part of the New Asset remains £2,000 (20,000 minus 18,000)

see section 6

Paragraph 4 - only part of proceeds reinvested

1982	D buys goodwill (the 'Old Asset') for £40,000
1990	D sells the Old Asset for £150,000 (chargeable gain £110,000) and buys other goodwill (the 'New Asset') for £90,000

The Disposal Proceeds have not been fully reinvested. Roll-over relief is restricted as follows:

	£
Disposal Proceeds of Old Asset	150,000
Acquisition Cost of New Asset	(90,000)
Disposal Proceeds not reinvested	60,000
Chargeable gain on sale of Old Asset	110,000
Disposal Proceeds not reinvested	60,000
Chargeable gain eligible for roll-over relief	50,000

CGT remains payable on chargeable gain of £60,000.
The Acquisition Cost of the New Asset is reduced as follows:

	£
Acquisition Cost of New Asset	90,000
Chargeable gain eligible for roll-over relief	(50,000)
CGT base cost of New Asset	40,000

see section 6

Paragraph 5 - Disposal Proceeds from Old Asset owned prior to 1965 only partially reinvested

April 56	E buys an office building (the 'Old Asset') for £150,000.
March 82	Old Asset worth £200,000.
April 96	E sells Old Asset for £950,000, gain £800,000
May 96	E buys New Asset for £850,000.

	£
Disposal Proceeds of Old Asset	950,000
Acquisition Cost of New Asset	850,000
Disposal Proceeds not reinvested	100,000
Chargeable gain on sale of Old Asset	800,000
Less time apportionment (800,000 x 9/40)	(180,000)
Chargeable gain by time apportionment since this is less than chargeable gain on March 1982 value	620,000
Non-invested proceeds	(100,000)
Chargeable gain eligible for relief	520,000
Acquisition Cost of New Asset revised to:	
Acquisition Cost	850,000
Less chargeable gain eligible for roll-over relief	(520,000)
CGT base cost of New Asset	330,000

CGT remains payable on £100,000

see section 6

Paragraph 6 - Amount not reinvested exceeds chargeable gain on Old Asset

1990	F buys milk quota (the 'Old Asset') for £140,000
1995	F sells the Old Asset for £250,000 (chargeable gain £110,000) and buys potato quota (the 'New Asset') for £125,000

No roll-over relief is available. The amount not reinvested is:

	£
Disposal Proceeds of Old Asset	250,000
Acquisition Cost of New Asset	125,000
Not reinvested	125,000

This is more than the chargeable gain, so the restriction in section 6 reduces roll-over relief to nil and the CGT base cost of New Asset remains £125,000.

see sub-section 3.7 and section 6

Paragraph 7 - Further reinvestment of Disposal Proceeds in more than one New Asset

If, in the example in paragraph 6, F went on to purchase further milk quota in 1996, reinvesting a further £125,000, then full roll-over relief can be claimed on the sale of the Old Asset. Under sub-section 3.7, F has a choice on how the rolled-over gain is allocated between the respective Acquisition Costs of the potato quota and the milk quota. He may allocate it in any of the folowing ways:

		Acquisition Cost of potato quota	Acquisition Cost of milk quota
A	all against the potato quota	125,000	125,000
	less chargeable gain	(110,000)	
	CGT base costs	15,000	125,000
B	all against the milk quota	125,000	125,000
	less chargeable gain		(110,000)
	CGT base costs	125,000	15,000
C	in equal proportions	125,000	125,000
	less chargeable gain	(55,000)	(55,000)
	CGT base costs	70,000	70,000
D	in unequal proportions	125,000	125,000
	less chargeable gain	*(20,000)	*(90,000)
		105,000	35,000

• or any other two positive figures totalling £110,000.

see sub-section 7.1

Paragraph 8 - New Asset is a Depreciating Asset

1989	G buys freehold offices (the 'Old Asset') for £170,000.
1995	G sells the Old Asset for £250,000 (chargeable gain £80,000).
1January1997	G buys fixed plant (the 'New Asset', a Depreciating Asset) for £280,000.

The Disposal Proceeds have been fully reinvested so no CGT is due on the disposal of the Old Asset. However, as the New Asset is a Depreciating Asset, the chargeable gain of £80,000 is held over and will become chargeable on the earliest of:

A the date G disposes of the fixed plant;

B the date G ceases to use the fixed plant for the purposes of a Qualifying Activity; and

C 1 January 2007

see sub-section 7.4

Paragraph 9 - Non-depreciating New Asset acquired after Depreciating Asset - full reinvestment

The facts are as in paragraph 8. G continues to own the fixed plant and to use it in a Qualifying Activity.

2003	G buys a freehold building ('second New Asset') for £350,000.

The held-over gain of £80,000 is reduced to nil. The Acquisition Cost of the second New Asset is reduced by £80,000 to £270,000.

see sub-section 7.5

Paragraph 10 - non-depreciating New Asset acquired after Depreciating Asset but not full reinvestment

The facts are as in paragraph 8. G continues to own the fixed plant and to use it in a Qualifying Activity.

2003	G buys a freehold building (the 'second New Asset') for £240,000

The Acquisition Cost of the second New Asset (£240,000) is less than the Disposal Proceeds of the Old Asset (£250,000). The held-over gain is reduced to the amount not reinvested, £10,000 (£250,000 minus £240,000), a reduction of £70,000 (£80,000 minus £10,000).

The Acquisition Cost of the second New Asset is reduced by £70,000 to £170,000. The held-over gain of £10,000 will crystallise on the earliest event specified in paragraph 8 above unless on or before this date G acquires a further New Asset which is not a Depreciating Asset and makes a further claim under sub-section 7.3.

Land and buildings only partly used

5.2 If only part of an asset within Head A of Schedule 1 is used and occupied for a Qualifying Activity either:

A in the case of an Old Asset for any substantial time during the Period of Ownership; or

B in the case of a New Asset on acquisition

then roll-over relief applies as if the part which is so used and occupied for a Qualifying Activity were a separate asset from the part which is not. A reasonable apportionment of the Disposal Proceeds shall be made having regard to the proportionate value of each part.

Old Asset: periods of non-qualifying use

5.3 If the Old Asset was not used in a Qualifying Activity throughout the Period of Ownership, then roll-over relief applies as if the part of the Old Asset representing the time it was used in a Qualifying Activity were a separate asset. A reasonable apportionment of the Disposal Proceeds shall be made taking into account the relative length of time for which the Old Asset was and was not so used.

New Asset: non-qualifying use

5.4 If promptly on acquisition the New Asset is used virtually entirely in a Qualifying Activity, then any use which is not for the purposes of a Qualifying Activity shall be ignored.

[5.4 of main text becomes 5.5 here.]

APPENDIX 2: ROLL-OVER RELIEF ORIGINAL LEGISLATION

PART V

TRANSFER OF BUSINESS ASSETS

CHAPTER I

GENERAL PROVISIONS

Replacement of business assets(a)

Roll-over relief. [1979(C) s.115(1), (2)]

152.—(1) If the consideration which a person carrying on a trade obtains for the disposal of, or of his interest in, assets ("the old assets") used, and used only, for the purposes of the trade throughout the period of ownership is applied by him in acquiring other assets, or an interest in other assets ("the new assets") which on the acquisition are taken into use, and used only, for the purposes of the trade, and the old assets and new assets are within the classes of assets listed in section 155, then the person carrying on the trade shall, on making a claim as respects the consideration which has been so applied, be treated for the purposes of this Act—

(a) as if the consideration for the disposal of, or of the interest in, the old assets were (if otherwise of a greater amount or value) of such amount as would secure that on the disposal neither a gain nor a loss accrues to him, and

(b) as if the amount or value of the consideration for the acquisition of, or of the interest in, the new assets were reduced by the excess of the amount or value of the actual consideration for the disposal of, or of the interest in, the old assets over the amount of the consideration which he is treated as receiving under paragraph (a) above,

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(a) *See—*
1992(C) s.241—*furnished holiday lettings.*
1992 (No.2) s.77 *and* Sch.17 para.3—ss.152 *to* 156 *to apply to disposals by Northern Ireland Electricity or a successor company.*
1994 s.252 *and* Sch.24 para.6—*application of* ss.152–160 *in relation to certain schemes under* Railways Act 1993 (c.43).
1994 Sch.25 para.3—*application of* ss.152–156 *in relation to disposals by Northern Ireland Airports Ltd.*
Agriculture Act 1993 (c.37) Sch.2 para.6—ss.152–156 *to apply to disposals of assets by a milk marketing board prior to vesting day under an approved scheme.*

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Roll-over relief—(*cont.*).

but neither paragraph (a) nor paragraph (b) above shall affect the treatment for the purposes of this Act of the other party to the transaction involving the old assets, or of the other party to the transaction involving the new assets(a).

(2) Where subsection (1)(a) above applies to exclude a gain which, in consequence of Schedule 2, is not all chargeable gain, the amount of the reduction to be made under subsection (1)(b) above shall be the amount of the chargeable gain, and not the whole amount of the gain.

[1979(C) s.115(3)]

(3) Subject to subsection (4) below, this section shall only apply if the acquisition of, or of the interest in, the new assets takes place, or an unconditional contract for the acquisition is entered into, in the period beginning 12 months before and ending 3 years after the disposal of, or of the interest in, the old assets, or at such earlier or later time as the Board may by notice allow.

(4) Where an unconditional contract for the acquisition is so entered into, this section may be applied on a provisional basis without waiting to ascertain whether the new assets, or the interest in the new assets, is acquired in pursuance of the contract, and, when that fact is ascertained, all necessary adjustments shall be made by making assessments or by repayment or discharge of tax, and shall be so made notwithstanding any limitation on the time within which assessments may be made.

[1979(C) s.115(4)–(7)]

(5) This section shall not apply unless the acquisition of, or of the interest in, the new assets was made for the purpose of their use in the trade, and not wholly or partly for the purpose of realising a gain from the disposal of, or of the interest in, the new assets.

(6) If, over the period of ownership or any substantial part of the period of ownership, part of a building or structure is, and part is not, used for the purposes of a trade, this section shall apply as if the part so used, with any land occupied for purposes ancillary to the occupation and use of that part of the building or structure, were a separate asset, and subject to any necessary apportionments of consideration for an acquisition or disposal of, or of an interest in, the building or structure and other land.

(7) If the old assets were not used for the purposes of the trade throughout the period of ownership this section shall apply as if a part of the asset representing its use for the purposes of the trade having regard to the time and extent to which it was, and was not, used for those purposes, were a separate asset which had been wholly used for the purposes of the trade, and this subsection shall apply in relation to that part subject to any necessary

(a) *See* s.198—Oil Taxation Acts—*replacement of business assets used in connection with oil fields.*

apportionment of consideration for an acquisition or disposal of, or of the interest in, the asset.

Roll-over relief —(*cont.*).

(8) This section shall apply in relation to a person who, either successively or at the same time, carries on 2 or more trades as if both or all of them were a single trade.

(9) In this section "period of ownership" does not include any period before 31st March 1982.

[1979(C) s.115(7A); 1988(F) Sch.8 9]

(10) The provisions of this Act fixing the amount of the consideration deemed to be given for the acquisition or disposal of assets shall be applied before this section is applied.

[1979(C) s.115(8), (9)]

(11) Without prejudice to section 52(4), where consideration is given for the acquisition or disposal of assets some or part of which are assets in relation to which a claim under this section applies, and some or part of which are not, the consideration shall be apportioned in such manner as is just and reasonable.

Assets only partly replaced. [1979(C) s.116]

153.—(1) Section 152(1) shall not apply if part only of the amount or value of the consideration for the disposal of, or of the interest in, the old assets is applied as described in that subsection, but if all of the amount or value of the consideration except for a part which is less than the amount of the gain (whether all chargeable gain or not) accruing on the disposal of, or of the interest in, the old assets is so applied, then the person carrying on the trade, on making a claim as respects the consideration which has been so applied, shall be treated for the purposes of this Act—

(a) as if the amount of the gain so accruing were reduced to the amount of the said part (and, if not all chargeable gain, with a proportionate reduction in the amount of the chargeable gain), and

(b) as if the amount or value of the consideration for the acquisition of, or of the interest in, the new assets were reduced by the amount by which the gain is reduced (or as the case may be the amount by which the chargeable gain is proportionately reduced) under paragraph (a) of this subsection,

but neither paragraph (a) nor paragraph (b) above shall affect the treatment for the purposes of this Act of the other party to the transaction involving the old assets, or of the other party to the transaction involving the new assets(**a**).

(2) Subsections (3) to (11) of 152 shall apply as if this section formed part of that section.

(**a**) *See* s.198—Oil Taxation Acts—*replacement of business assets used in connection with oil fields*.

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S.154

New assets which are depreciating assets.
[1979(C) s.117(1), (2); 1990 s.40(2)]

154.—(1) Sections 152, 153 and 229 shall have effect subject to the provisions of this section in which—

(a) the "held-over gain" means the amount by which, under those sections, and apart from the provisions of this section, any chargeable gain on one asset ("asset No.1") is reduced, with a corresponding reduction of the expenditure allowable in respect of another asset ("asset No.2"), and

(b) any reference to a gain of any amount being carried forward to any asset is a reference to a reduction of that amount in a chargeable gain coupled with a reduction of the same amount in expenditure allowable in respect of that asset.

(2) If asset No.2 is a depreciating asset, the held-over gain shall not be carried forward, but the claimant shall be treated as if so much of the chargeable gain on asset No.1 as is equal to the held-over gain did not accrue until—

(a) the claimant disposes of asset No.2, or

(b) he ceases to use asset No.2 for the purposes of a trade carried on by him, or

(c) the expiration of a period of 10 years beginning with the acquisition of asset No.2,

whichever event comes first(**a**).

[1979(C) s.117(2A), (3); 1990 s.40(3), (4)]

(3) Where section 229 has effect subject to the provisions of this section, subsection (2)(b) above shall have effect as if it read—

"(b) section 232(3) applies as regards asset No.2 (whether or not by virtue of section 232(5)), or".

(4) If, in the circumstances specified in subsection (5) below, the claimant acquires an asset ("asset No.3") which is not a depreciating asset, and claims under section 152 or 153—

(a) the gain held-over from asset No.1 shall be carried forward to asset No.3, and

(b) the claim which applies to asset No.2 shall be treated as withdrawn (so that subsection (2) above does not apply).

[1979(C) s.117(4)–(6)]

(5) The circumstances are that asset No.3 is acquired not later than the time when the chargeable gain postponed under subsection (2) above would accrue and, assuming—

(**a**) *See* Electricity Act 1989 (c. 29) s.90 *and* Sch.11 para.3 (*as amended by* 1992(C) Sch.10 para.20)—*application of* s.154 *to claims made by successor companies* (*with effect on and after* 31 *March* 1990 *by virtue of* S.I.1989 No.117 (C. 4) (*not reproduced*)).

New assets which are depreciating assets—(*cont.*).

(a) that the consideration for asset No.1 was applied in acquiring asset No.3, and

(b) that the time between the disposal of asset No.1 and the acquisition of asset No.3 was within the time limited by section 152(3),

the whole amount of the postponed gain could be carried forward from asset No.1 to asset No.3; and the claim under subsection (4) above shall be accepted as if those assumptions were true.

(6) If part only of the postponed gain could be carried forward from asset No.1 to asset No.3, and the claimant so requires, that and the other part of the postponed gain shall be treated as derived from 2 separate assets, so that, on that claim—

(a) subsection (4) above applies to the first-mentioned part, and

(b) the other part remains subject to subsection (2) above.

(7) For the purposes of this section, an asset is a depreciating asset at any time if—

(a) at that time it is a wasting asset, as defined in section 44, or

(b) within the period of 10 years beginning at that time it will become a wasting asset (so defined).

Relevant classes of assets. [1979(C) s.118; 1988(F) s.112]

155. The classes of assets for the purposes of section 152(1) are as follows(**a**).

CLASS 1

Assets within heads A and B below.

Head A

1. Any building or part of a building and any permanent or semi-permanent structure in the nature of a building, occupied (as well as used) only for the purposes of the trade

2. Any land occupied (as well as used) only for the purposes of the trade.

Head A has effect subject to section 156.

Head B

Fixed plant or machinery which does not form part of a building or of

(**a**) *See* s.193—*oil licences.*

a permanent or semi-permanent structure in the nature of a building.

CLASS 2

Ships, aircraft and hovercraft ("hovercraft" having the same meaning as in the Hovercraft Act 1968).

1968 c.59.

CLASS 3

Satellites, space stations and spacecraft (including launch vehicles).

CLASS 4

Goodwill.

CLASS 5

Milk quotas (that is, rights to sell dairy produce without being liable to pay milk levy or to deliver dairy produce without being liable to pay a contribution to milk levy) and potato quotas (that is, rights to produce potatoes without being liable to pay more than the ordinary contribution to the Potato Marketing Board's fund).

[CLASS 6

Ewe and suckler cow premium quotas (that is, rights in respect of any ewes or suckler cows to receive payments by way of any subsidy entitlement to which is determined by reference to limits contained in a Community instrument)(**a**).]

Assets of Class 1.
[1979(C) s.119]

156.—(1) This section has effect as respects head A of Class 1 in section 155.

(2) Head A shall not apply where the trade is a trade—

(a) of dealing in or developing land, or

(b) of providing services for the occupier of land in which the person carrying on the trade has an estate or interest.

(3) Where the trade is a trade of dealing in or developing land, but a profit on the sale of any land held for the purposes of the trade would not form part

(**a**) 1993 s.86(1), (4) *in relation to acquisitions or disposals on or after* 1 *January* 1993. (*Class* 6 *is numbered Class* 5 *of* 1979(C) s.118 *for accounting periods of a company which began before* 6 *April* 1992.)

of the trading profits, then, as regards that land, the trade shall be treated for the purposes of subsection (2)(a) above as if it were not a trade of dealing in or developing land.

Assets of Class 1 —(*cont.*).

(4) A person who is a lessor of tied premises shall be treated as if he occupied (as well as used) those tied premises only for the purposes of the relevant trade.

This subsection shall be construed in accordance with section 98(2) of the Taxes Act (income tax and corporation tax on tied premises).

Trade carried on by family company: business assets dealt with by individual. [1979(C) s.120; 1985 s.70(9)]

157. In relation to a case where—

(a) the person disposing of, or of his interest in, the old assets and acquiring the new assets, or an interest in them, is an individual, and

(b) the trade or trades in question are carried on not by that individual but by a company which, both at the time of the disposal and at the time of the acquisition referred to in paragraph (a) above, is his [personal company(a)], within the meaning of Schedule 6,

any reference in sections 152 to 156 to the person carrying on the trade (or the 2 or more trades) includes a reference to that individual.

Activities other than trades, and interpretation. [1979(C) s.121]

158.—(1) Sections 152 to 157 shall apply with the necessary modifications—

(a) in relation to the discharge of the functions of a public authority, and

(b) in relation to the occupation of woodlands where the woodlands are managed by the occupier on a commercial basis and with a view to the realisation of profits, and

(c) in relation to a profession, vocation, office or employment, and

(d) in relation to such of the activities of a body of persons whose activities are carried on otherwise than for profit and are wholly or mainly directed to the protection or promotion of the interests of its members in the carrying on of their trade or profession as are so directed, and

(e) in relation to the activities of an unincorporated association or other body chargeable to corporation tax, being a body not established for profit whose activities are wholly or mainly carried on otherwise than for profit, but in the case of assets within head A of class 1 only if they are both occupied and

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(a) 1993 s.87 *and* Sch.7 para.1(1) *in relation to any disposals made on or after* 16 *March* 1993. *Previously* "family company".

Activities other than trades, and interpretation —*(cont.)*.

used by the body, and in the case of other assets only if they are used by the body,

as they apply in relation to a trade.

(2) In sections 152 to 157 and this section the expressions "trade", "profession", "vocation", "office" and "employment" have the same meanings as in the Income Tax Acts, but not so as to apply the provisions of the Income Tax Acts as to the circumstances in which, on a change in the persons carrying on a trade, a trade is to be regarded as discontinued, or as set up and commenced.

(3) Sections 152 to 157 and this section shall be construed as one.

Non-residents: roll-over relief. [1988(F) s.129]

159.—(1) Section 152 shall not apply in the case of a person if the old assets are chargeable assets in relation to him at the time they are disposed of, unless the new assets are chargeable assets in relation to him immediately after the time they are acquired.

(2) Subsection (1) above shall not apply where—

(a) the person acquires the new assets after he has disposed of the old assets, and

(b) immediately after the time they are acquired the person is resident or ordinarily resident in the United Kingdom.

(3) Subsection (2) above shall not apply where immediately after the time the new assets are acquired—

(a) the person is a dual resident, and

(b) the new assets are prescribed assets.

(4) For the purposes of this section an asset is at any time a chargeable asset in relation to a person if, were it to be disposed of at that time, any chargeable gains accruing to him on the disposal—

(a) would be gains in respect of which he would be chargeable to capital gains tax under section 10(1), or

(b) would form part of his chargeable profits for corporation tax purposes by virtue of section 10(3)(a).

(5) In this section—

"dual resident" means a person who is resident or ordinarily resident in the United Kingdom and falls to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the United Kingdom; and

"prescribed asset", in relation to a dual resident, means an asset in respect of which, by virtue of the asset being of a description

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(a) *See* Sch.7B paras.1, 6 *for modification in the case of overseas life insurance companies.*

specified in any double taxation relief arrangements, he falls to be regarded for the purposes of the arrangements as not liable in the United Kingdom to tax on gains accruing to him on a disposal.

Non-residents: roll-over relief—(*cont.*).

(6) In this section—

(a) "the old assets" and "the new assets" have the same meanings as in section 152,

(b) references to disposal of the old assets include references to disposal of an interest in them, and

(c) references to acquisition of the new assets include references to acquisition of an interest in them or to entering into an unconditional contract for the acquisition of them.

(7) Where the acquisition of the new assets took place before 14th March 1989 and the disposal of the old assets took place, or takes place, on or after that date, this section shall not apply if the disposal of the old assets took place, or takes place, within 12 months of the acquisition of the new assets or such longer period as the Board may by notice allow.

Dual resident companies: roll-over relief. [1989 s.133]

160.—(1) *Where a company is a dual resident company at the time it disposes of the old assets and at the time it acquires the new assets, and the old assets are not prescribed assets at the time of disposal, section* 152 *shall not apply unless the new assets are not prescribed assets immediately after the time of acquisition.*

(2) *In this section—*

"dual resident company" means a company which is resident in the United Kingdom and falls to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the United Kingdom; and

"prescribed asset", in relation to a dual resident company, means an asset in respect of which, by virtue of the asset being of a description specified in any double taxation relief arrangements, the company falls to be regarded for the purposes of the arrangements as not liable in the United Kingdom to tax on gains accruing to it on a disposal.

(3) *In this section—*

(a) *"the old assets" and "the new assets" have the same meanings as in section* 152,

(b) *references to disposal of the old assets include references to disposal of an interest in them, and*

Replacement of business assets by members of a group.
[1970 s.276(1); 1987 (No.2) s.64(4)]

175.—(1) Subject to subsection (2) below, for the purposes of sections 152 to 158 all the trades carried on by members of a group of companies shall, for the purposes of corporation tax on chargeable gains, be treated as a single trade (*unless it is a case of one member of the group acquiring, or acquiring the interest in, the new assets from another or disposing of, or of the interest in, the old assets to another*)(a)(b).

[1970 s.276(1A); 1987 (No.2) s.64(4); 1990 s.65(3)]

(2) Subsection (1) above does not apply where so much of the consideration for the disposal of the old assets as is applied in acquiring the new assets or the interest in them is so applied by a member of the group which is a dual resident investing company *or a company which, though resident in the United Kingdom*—

(a) *is regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the United Kingdom, and*

(b) *by virtue of the arrangements would not be liable in the United Kingdom to tax on a gain arising on a disposal of, or of the interest in, the new assets occurring immediately after the acquisition*(c);

and in this subsection "the old assets" and "the new assets" have the same meanings as in section 152.

[(2A) Section 152 shall apply where—

(a) the disposal is by a company which, at the time of the disposal, is a member of a group of companies,

(b) the acquisition is by another company which, at the time of the acquisition, is a member of the same group, and

(a) *Words repealed by* 1995 Sch.29 Pt.VIII(4) *where the acquisition of, or the interest in, the new assets is on or after* 29 *November* 1994.

(b) *See* s.198—Oil Taxation Acts—*modification of the operation of* s.175 *in connection with the replacement of business assets used in connection with oil fields.*

(c) *Repealed by* 1994 s.251(1), (8) *and* Sch.26 Pt.VIII(1) *where the disposal of the old assets or the acquisition of the new assets is made on or after* 30 *November* 1993.

Replacement of business assets by members of a group —(*cont.*).

(c) the claim is made by both companies,

as if both companies were the same person(**a**).

(2B) Section 152 shall apply where a company which is a member of a group of companies but is not carrying on a trade—

(a) disposes of assets (or an interest in assets) used, and used only, for the purposes of the trade which (in accordance with subsection (1) above) is treated as carried on by the members of the group which carry on a trade, or

(b) acquires assets (or an interest in assets) taken into use, and used only, for those purposes,

as if the first company were carrying on that trade(**b**).

(2C) Section 152 shall not apply if the acquisition of, or of the interest in, the new assets—

(a) is made by a company which is a member of a group of companies, and

(b) is one to which any of the enactments specified in section 35(3)(d) applies(**c**).]

[1970 s.276(2)] (3) Section 154(2) shall apply where the company making the claim is a member of a group of companies as if all members of the group for the time being were the same person (and, in accordance with subsection (1) above, as if all trades carried on by members were the same trade) and so that the gain shall accrue to the member of the group holding the asset concerned on the occurrence of the event mentioned in section 154(2).

[1990 s.65(6)] (4) Subsection (2) above shall apply where the acquisition took place before 20th March 1990 and the disposal takes place within the period of 12 months beginning with the date of the acquisition or such longer period as the Board may by notice allow with the omission of the words from "or a company" to "the acquisition".

(**a**) 1995 s.48(1), (3), (4). Subs.(2A) *deemed always to have had effect (also for corresponding earlier enactments) and* subs. (c) *applies only where a claim is made on or after* 29 *November* 1994.

(**b**) Subs.(2B) *inserted by* 1995 s.48(1), (5) *where the disposal or acquisition is on or after* 29 *November* 1994.

(**c**) Subs.(2C) *inserted by* 1995 s.48(1), (5) *for acquisitions on or after* 29 *November* 1994.

APPENDIX 3: STATEMENT ON ROLL-OVER RELIEF

This statement explains the basis on which the Board of Inland Revenue will apply the roll-over relief provisions as set out in sections 1-9 of the redraft in certain situations. Where an Extra-Statutory Concession has been granted, this has been asterisked. An Extra-Statutory Concession is a relaxation which gives taxpayers a reduction in tax liability to which they would not be entitled on a strict application of the law. A concession will not be given in any case where an attempt is made to use it for tax avoidance.

Otherwise this statement represents the Board's interpretation of how the legislation is to be applied in practice. It does not affect the taxpayer's right to argue for a different interpretation, if necessary in an appeal before the Special or General Commissioners.

Circumstances covered by this statement:

1. Eligible Assets owned by an employee or office-holder but used by the employer.

2. Partners let Eligible Assets to the partnership.

*3. Partners receive Eligible Assets on dissolution of the partnership.

4. Land: compulsory purchase and lease-back.

*5. Non-profit making associations use Eligible Assets owned by a company.

6. Holiday lettings: longer term lets.

7. Gap between trades: the meaning of "successively".

*8. Sale and repurchase of the same Eligible Asset.

*9. Options over land.

10. Representative occupation of land/buildings by an employee.

11. Requirements of a claim for roll-over relief.

APPENDIX 3: STATEMENT ON ROLL-OVER RELIEF

1. Eligible Assets owned by an employee or office-holder but used by the employer

The definition of Qualifying Activity in section 9 includes an office or employment. If an employee or office-holder owns land or buildings which are made available to the employer for general use in the employer's trade, then the employee will be treated as satisfying the condition for occupation of land provided no consideration is given by the employer for the land or buildings being made available and the employer does not occupy them under any lease or tenancy.

The employee will be treated as satisfying the condition requiring the Eligible Asset (whether or not land or buildings) to be used in a Qualifying Activity if the employee uses or operates those assets in the course of performing his duties of employment or office, as directed by the employer.

Roll-over relief will be available on the disposal of such assets by the employee or office-holder even if he reinvests in New Assets which are not used by the employer but are used in another Qualifying Activity carried on by the employee or office-holder.

2. Partners let Eligible Assets to the partnership

A partner who owns Old Assets which are let (whether or not for consideration) to a partnership of which he is a member and which are used for the purposes of a Qualifying Activity carried on by the partnership, can claim roll-over relief on disposal of the Old Assets. The New Assets acquired by the partner do not need to be used by the partnership provided the partner uses the New Asset(s) in a Qualifying Activity and all other conditions are satisfied.

*3. Partners receive Eligible Assets on dissolution of the partnership

A partner who receives Eligible Assets on a partition of partnership assets which were used in a Qualifying Activity carried on by the partnership, will by concession be treated as acquiring a New Asset for the purposes of roll-over relief, provided the partnership is dissolved immediately after the partition.

4. Land: compulsory purchase and lease-back

Where a statutory authority acquires land from a claimant by compulsory purchase for the purposes of development and then immediately grants the claimant a lease of the same land until the authority is ready to commence building, the strict time limits set out in section 4 for the acquisition of the New Asset in relation to the disposal of the Old Asset (i.e. the compulsory purchase of the land) may not be satisfied.

The Board will exercise its discretion under the legislation to extend the time limits for acquisition of the New Asset to three years after the Old Asset (i.e. the land) ceases to be used by the claimant in his Qualifying Activity, provided that he has a clear and continuing intention to use the Disposal Proceeds in acquiring a New Asset which is to be used in a Qualifying Activity.

Protective assessments may be raised if the lease to the vendor extends beyond the statutory six-year time-limit for making assessments.

***5. Non-profit making associations use Eligible Assets owned by a company**

Roll-over relief for the replacement of Eligible Assets extends to unincorporated associations not established for profit whose activities are wholly or mainly carried on otherwise than for profit. In cases where the Eligible Assets are owned by a company in which at least 90% of the shares are held by or on behalf of such an association or its members, by concession the relief will be available on a disposal by the company provided all other conditions are satisfied.

6. Holiday lettings: longer term lets

Roll-over relief is available on the disposal of property which has been let commercially as furnished holiday accommodation if it meets the conditions set out in sections 503 and 504 ICTA 1988.

Many people in holiday areas let their properties out during the main holiday period on a short term basis, but during the quieter part of the year let them out on longer terms. Provided the conditions for holiday lettings satisfy the requirements of sections 503 and 504, the longer lettings will not preclude or restrict roll-over relief when the property is later disposed of. Therefore, no apportionment will need to be made under subsection 5.2.

7. Gap between trades: the meaning of "successively"

Under subsection 9.11, two or more trades or other activities listed in that subsection are treated as a single trade - and hence as a single Qualifying Activity - if they are carried on either at the same time or successively. Where a taxpayer ceases one activity and begins another, there will often be an interval between them. It may then be important to establish whether the two activities have been carried on "successively".

The Board will regard such activities as having been carried on successively within the meaning of subsection 9.11 where this interval is not more than three years.

If an Old Asset is disposed of during this interval, roll-over relief is still available, with an apportionment under subsection 5.2 as appropriate. If the New Asset is acquired in the interval, the gain can still be rolled over provided:

(a) the New Asset is not used or leased for any purpose in the period before the new activity commences; and

(b) the New Asset is taken into use for the activity on its commencement.

Where the Old Asset is disposed of by a member of a group which then ceases to carry on a trade or the New Asset is acquired by a second company in the group before it has started to carry on a trade, the same treatment applies.

***8. Sale and repurchase of the same Eligible Asset**

Where a person sells an Old Asset and for purely commercial reasons subsequently repurchases the same asset, that asset by concession will be regarded as a New Asset. Without this concession roll-over relief would not be available since subsection 2.1B requires the purchase of *another* Eligible

Asset and subsection 5.5 only modifies this rule for the improvement or alteration of, or the acquisition of a further interest in, an existing Eligible Asset.

*9. Options over land

An option over land is an equitable interest in the land. For capital gains tax purposes, however, the grant of an option is treated as a disposal of a separate asset, namely the option itself, not a disposal of the underlying land.

However, provided roll-over relief would be due on the disposal of the underlying land (i.e. the land is used and occupied for the purposes of a Qualifying Activity carried on by the claimant) and the land is the subject of the option, by concession roll-over relief is also available in respect of the gain which arises on the grant of the option.

10. Representative occupation of land/buildings by an employee

Schedule 1 makes it clear that land and buildings must be occupied as well as used for the purposes of a Qualifying Activity. Occupation may be an issue where a trader provides accommodation for his employees since in these circumstances the occupation test is only satisfied when the employees are in representative occupation.

Representative occupation means that the employee's occupation is either essential to the performance of his duties or enables him to perform them better and is required by his contract of employment.

11. Requirements of a claim for roll-over relief

A claim for roll-over relief should be made in writing specifying all the following matters:

(a) the identity of the claimant;

(b) the assets which have been disposed of;

(c) the date of disposal of each of those assets;

(d) the consideration received for the disposal of each of those assets;

(e) the assets which have been acquired;

(f) the date of acquisition of each of those assets or the dates on which unconditional contracts for the acquisition of each of those assets were entered into;

(g) the consideration given for each of those assets; and

(h) the amount of consideration received for the disposal of each of the specified assets which is reinvested in the acquisition of each replacement asset.

Where the claim for relief is made under subsection 8.4 (which concerns transactions between members of a group), the claim must be made jointly by the two companies involved.

APPENDIX 4: EXPLANATORY MEMORANDUM ON ROLL-OVER RELIEF

A. INTRODUCTION

General note on the relief

1. Roll-over relief enables traders and others engaged in certain *Qualifying Activities* to defer the incidence of capital gains tax arising from the sale or other disposal of certain business assets ("*Old Assets*") if the *Disposal Proceeds* are reinvested in other business assets ("*New Assets*") or in improving or acquiring a further interest in existing business assets for use in the Qualifying Activity.

2. "Old Assets", "New Assets", "Qualifying Activity" and "Disposal Proceeds" are defined terms found in section 9 of the legislation. Where defined terms first appear in this note or in the legislation they are put in italics. Sections J and K of this memorandum, which give further details on the meaning and implications of definitions, should always be read when referring to this memorandum.

3. The basic concept of the relief is that instead of paying tax on the gain accruing on a disposal of the *Old Asset*, the trader may elect to have the gain carried forward to reduce the *Acquisition Cost* of the New Asset. The process can be repeated on a subsequent sale of the New Asset if further New Assets are acquired with the Disposal Proceeds and this can be repeated any number of times. The gain can also be rolled over into the purchase of more than one New Asset at the same time or on different occasions if the purchases take place within the time limits set out in section 4.

4. When finally the New Asset is sold and the Disposal Proceeds are not rolled over into further New Assets, the whole of the gain referable to the series of assets becomes chargeable to tax.

5. The New Asset and Old Asset ("*Eligible Assets*") must satisfy certain conditions, principally use in a Qualifying Activity. The relief can be claimed only by those engaged in a Qualifying Activity - this is defined in section 9 to include a trade, profession, office or employment (these terms are used in the same sense as in the income tax legislation so would include farming, market gardening and holiday lettings); public authorities; commercial woodlands and certain non-profit-making institutions.

6. The term "trader" in the context of this memorandum should be taken to mean any person engaged in a Qualifying Activity.

7. A trader can choose whether or not to claim roll-over relief - it is not mandatory.

8. Full roll-over relief is generally only available if the full Disposal Proceeds from the Old Asset are reinvested in the New Asset and both Old Asset and New Asset are used exclusively in the Qualifying Activity.

However, section 5 provides for partial roll-over relief in a number of circumstances - for example, where part of the Old or New Asset is used for a non-Qualifying Activity or the Old Asset is used for a non-Qualifying Activity for part of the *Period of Ownership.*

9. Similarly, section 6 allows partial roll-over relief if less than the full Disposal Proceeds are reinvested.

10. Reinvestment in assets with a predictable life of 60 years or less (*Depreciating Assets*) is subject to special rules set out in section 7.

ANALYSIS OF SECTIONS

B. DETAILS ON SECTION 1

1. The purpose stated in subsection 1.1 is only intended to give a general idea of the aims behind the relief. In order to qualify, any claim must satisfy the detailed conditions set out in section 2.

2. Subsection 1.2 makes it clear that roll-over relief is only available if it is claimed. (The time limits for making a claim are set out in section 3.)

3. The examples set out in Schedule 2 of the legislation illustrate both the basic principles of the relief and its operation in more complex situations. Subsection 1.4 makes it clear, however, that if there is any conflict between an arithmetical example and the legislation, then the legislation prevails.

C. DETAILS ON SECTION 2

Subsection *2.1*

1. Subsection 2.1 sets out the primary conditions required to be satisfied before any roll-over relief claim is possible. A claimant must then examine subsections 2.2, 2.3 and 2.4 for further detailed conditions relevant to the New and Old Assets.

2. Subsection 2.1 covers three important aspects of the relief: the categories of assets which will qualify for relief; what happens with the Disposal Proceeds and the time limits involved on disposal and acquisition.

3. *Categories of assets.* Under subsection 2.1A, a person must dispose of an Eligible Asset.

(a) Schedule 1 sets out the types of assets which are Eligible Assets and section K of this memorandum gives more details about the conditions to be satisfied.

(b) Under subsection 2.1B the trader must acquire another Eligible Asset rather than reacquire the Old Asset. Some modification to this is set out later in subsection 5.5.

(c) The New Asset does not need to be the same type of asset as the Old Asset. For example, a trader can sell land but acquire goodwill and if all other conditions are satisfied then the gain is eligible for relief. The trade in which the New Asset is used does not need to be the same

as the trade in which the Old Asset is used since the definition of Qualifying Activity includes one or more trades. Section J of this memorandum gives further details.

4. *Disposal Proceeds.* The trader does not need to apply the actual proceeds received from the sale of an Old Asset in the acquisition of a New Asset. The definition in section 9 which refers to "a sum equivalent to the consideration" makes this clear. (See section J of this memorandum for further details.)

5. *Time limits.* Subsection 2.1c provides that the disposal of the Old Asset and the acquisition of the New Asset must take place within certain time limits. These are set out later in section 4.

Subsection 2.2. This sets out the specific conditions to be satisfied in relation to the disposal of the Old Asset.

6. The Old Asset must have been used solely for the purposes of a Qualifying Activity throughout the *Period of Ownership.*

Period of Ownership is defined in section 9 to include only periods after March 1982. Thus, someone who purchased an asset before March 1982 for non-business purposes and then used it solely for the purposes of a Qualifying Activity during the whole period from March 1982 will receive full relief. Non-business periods prior to March 1982 are therefore ignored when calculating roll-over relief.

Equally no relief is due when the Old Asset was used in a Qualifying Activity until March 1982 and solely for non-business purposes from then until disposal.

An example of this is set out in paragraph 2 of Schedule 2.

7. The Qualifying Activity must be carried on by the person disposing of the Old Asset. For example, if a husband carries on a Qualifying Activity on land which is owned by his wife who takes no part in the business, no roll-over relief would be available on the disposal of that land by the wife.

Certain relaxations to this rule are given in section 8 for:

(a) companies which are members of a group; and

(b) individuals owning assets in companies.

8. Although subsection 2.2 requires the Old Asset to have been used solely for the purposes of a Qualifying Activity throughout the whole Period of Ownership, section 5 provides modifications to this which allow apportionment of the Disposal Proceeds where the Old Asset has had some non-business use.

Subsections 2.3 and 2.4. These set out the conditions for New Assets.

9. The New Asset must be taken into use promptly after its acquisition for the purposes of the Qualifying Activity. "Promptly" in this context means the earliest date upon which the claimant could reasonably be expected to take the New Asset into use. If the New Asset is used on acquisition only partly in the Qualifying Activity then an apportionment under subsection 5.3 is made.

As with the Old Asset (see point 7 above), the Qualifying Activity must be carried on by the person actually acquiring the New Asset. If, for example, the Old Asset is disposed of by a husband and the New Asset is acquired by his wife, even if they carry on in partnership the same Qualifying Activity, roll-over relief is not available as between those two assets.

10. The New Asset does not need to be used in a Qualifying Activity for any minimum period after acquisition. However, if a New Asset was only used in the Qualifying Activity for a very short time, the trader would need to show that the New Asset had been acquired for use in a Qualifying Activity. Subsection 2.4 requires the acquisition of a New Asset to be strictly for use in a Qualifying Activity. If assets are acquired with a view to resale at a profit, the relief does not apply.

11. If, at some later period after acquisition, a trader stops using the New Asset in a Qualifying Activity (perhaps because the Qualifying Activity ceases), then roll-over relief is not clawed back and no tax is payable until there is a disposal of the New Asset.

However, on that subsequent disposal of the New Asset ("the first New Asset") with the Disposal Proceeds fully reinvested in another New Asset, full roll-over relief could not be claimed since the first New Asset would not have been used in a Qualifying Activity throughout the Period of Ownership (see subsection 5.2).

D. DETAILS ON SECTION 3

Subsection 3.1

1. The effect of subsection 3.1 is that if a trader does not acquire the New Asset until three years after the disposal of the Old Asset he can claim roll-over relief for up to nine years after the end of the tax year (or in the case of companies the end of their accounting period) in which the disposal of the Old Asset took place.

Subsection 3.2

2. A computation in a straightforward case is set out in paragraph 1 of Schedule 2. If the full Disposal Proceeds are reinvested the trader is treated as if no chargeable gain had arisen on the disposal of the Old Asset and therefore no capital gains tax is payable.

However, the Acquisition Cost of the New Asset is reduced by the amount of the chargeable gain on the Old Asset. In short, the gain is not taxed when realised but is deducted from the purchase price of the New Asset and will thus be picked up for taxation when the New Asset comes to be sold (unless roll-over relief or another relief is then available).

Subsection 3.3

3. When a trader disposes of an Old Asset which he has owned from before 6 April 1965, the gain arising on a time apportionment basis between the date of acquisition and April 1965 (assuming the trader has not elected for revaluation of the asset as at 6 April 1965 under Schedule 2 of TCGA 1992) is not, on general principles, usually taxable. The trader does, of course, in certain circumstances have the option of making a rebasing election so that the 1982 value of the Old Asset is taken as the base cost in all cases. In addition, even if no rebasing election is made, generally the trader will find that taking the March 1982 market value of the Old Asset rather than applying the time apportionment provisions in Schedule 2 of TCGA 1992 will result in a smaller chargeable gain.

However, there may be some rare instances, for example, where the Old Asset was owned for a long period before 1965, when it is better to apply the time apportionment provisions in Schedule 2 of TCGA 1992. Subsection 3.3 effectively provides that it is only the gain arising after 1965 which is chargeable and therefore needs to be rolled over.

For example:

April 1950	B buys land (the "Old Asset") for £1,000.
31 March 1982	Market value of Old Asset was £10,000.
April 1995	Old Asset sold for £50,000.
April 1995	B buys another piece of land (the "New Asset") for £80,000.

Following the time apportionment provisions in Schedule 2 TCGA 1992 the period arising after April 1965 is 30 years out of a total period of ownership of 45 years.

	£
Chargeable gain on sale of Old Asset since 1950	49,000
Unindexed chargeable gain is 30/45 x £49,000	32,666
Deduct: Indexation allowance [0.876] x 10,000	(8,760)
Chargeable gain under Schedule 2 TCGA is (less than gain if March 1982 valuation was taken)	23,906

Disposal Proceeds fully reinvested so no CGT is due on the disposal of the Old Asset. The Acquisition Cost of the New Asset is reduced as follows:

	£
Acquisition Cost of New Asset	80,000
Less chargeable gain on sale of Old Asset	(23,906)
CGT base cost of New Asset	56,094

Rebasing

4. An issue arose when 1982 rebasing was introduced in situations where the Old Asset was acquired before 1 April 1982 and then disposed of before 6 April 1988 with the gain rolled into a New Asset. Some of the rolled-over gain accrued before 1982 but since the New Asset was not held on 31 March 1982, 1982 rebasing did not prima facie apply to reduce the rolled-over gain.

Schedule 4 of TCGA 1992 deals with this issue by halving the reduction in the Acquisition Cost of the New Asset. That schedule should be referred to for further details on conditions.

Subsection 3.4

5. Any adjustments for roll-over relief will only affect the trader himself and not the transferee of the Old Asset or the vendor of the New Asset. Their respective capital gains tax liabilities will be dealt with by reference to their own circumstances and claims.

Subsection 3.5: order of reliefs

6. A trader is given some flexibility in how to utilise a number of different reliefs. For example, he may wish to have the benefit of retirement relief (which will reduce or eradicate any gain) before roll-over relief which will only defer any gain. On the other hand, he may wish to use retirement relief on the disposal of another asset which does not qualify for roll-over relief - for example, shares. In the latter circumstance, a trader may choose to claim roll-over relief rather than receiving the benefit of retirement relief.

Similarly, a trader may claim roll-over relief in priority to the relief for incorporation of a business.

Subsection 3.6

7. This provides for a reasonable apportionment of the consideration where either:

(a) a trader reinvests the Disposal Proceeds in a number of assets, some of which are Eligible Assets and some of which are not; or

(b) a trader disposes of a number of assets some of which are Eligible Assets and some of which are not.

Each of the Eligible Assets may be the subject of a roll-over claim by reference to its proportionate part of the total cost of the bundle of assets.

Subsection 3.7

8. Where a trader acquires more than one New Asset with the Disposal Proceeds, it is up to him to decide how the rolled over gain is allocated against the respective Acquisition Costs of the New Assets. However, once a claim has been made to allocate the rolled over gain against the Acquisition Cost of a New Asset, the trader cannot subsequently revoke or change that claim by allocating the rolled over gain in part or whole against the Acquisition Costs of other New Assets acquired within the time limits. An example is set out in paragraph 7 of Schedule 2.

E. DETAILS ON SECTION 4 : TIME LIMITS

1. The New Asset must be acquired within a specified period before or after the disposal of the Old Asset. These time limits are set out in subsection 4.1.

2. The general CGT rule is that the date of disposal or date of acquisition is the date when an unconditional contract is made. However, *time of acquisition* and *time of disposal* are both modified for roll-over relief purposes.

Time of acquisition means the date when a trader obtains possession of the asset rather than the date of the contract. This then allows a claimant to satisfy the requirement to bring the New Asset into use promptly on acquisition which he could not do if he had not yet obtained possession of the asset although he had exchanged contracts.

Similarly, time of disposal does not mean the date when the trader enters into an unconditional contract but the date when the asset is conveyed or transferred.

See section J for further details.

F. DETAILS ON SECTION 5

Subsection 5.1

1. This sets out the overall purpose of section 5. A trader can benefit from several modifications at the same time. For example, a trader may acquire a New Asset which is a building. The ground floor is to be used as a shop but takes six months to fit out. The first floor is occupied by the trader as his private flat. In these circumstances, an apportionment of the Acquisition Cost will be made under subsection 5.3 for the non-qualifying use of the first floor but the trader may claim the benefit of subsection 5.4 in respect of the delayed use of the ground floor.

Subsection 5.2

2. Section 2 states that Eligible Assets must be used solely for a Qualifying Activity. However, where part of an Old Asset is used (and in the case of land and buildings occupied) for a Qualifying Activity and part is not, subsection 5.2 permits a reasonable apportionment of the Disposal Proceeds to be made.

The relief is applied as if the parts were separate assets. Therefore if the Disposal Proceeds received from the part of the Old Asset which was used in a Qualifying Activity are equal to or greater than the Acquisition Cost of the New Asset, no apportionment under section 6 (partial reinvestment) will be made even if the Acquisition Cost of the New Asset is less than the total Disposal Proceeds.

3. Section 2 requires that the Old Asset must have been used solely in a Qualifying Activity throughout the trader's Period of Ownership. However, where the Old Asset was used in the Qualifying Activity for part only of the Period of Ownership, then a reasonable apportionment of the Disposal Proceeds will be made. Once again the part that qualifies for relief will be treated as a separate asset in calculating whether or not there has been full reinvestment.

An example of partial use in a Qualifying Activity and partial use for a limited period of time combined in one transaction is set out in paragraph 2 of Schedule 2.

Subsection 5.3

4. Section 2 contains no requirement for the New Asset to be used in a Qualifying Activity for any minimum period of time. However, under section 2 the New Asset must be taken into use promptly on acquisition and solely for the purposes of a Qualifying Activity.

Subsection 5.3 provides for a reasonable apportionment of the Acquisition Cost of the New Asset when on acquisition only part of the New Asset is used for a Qualifying Activity.

An example is set out in paragraph 3 of Schedule 2.

Subsection 5.4

5. If the New Asset is to be improved or altered before being brought into use, subsection 5.4 will still allow roll-over relief to be claimed, provided work to alter or improve it is begun as soon as practicable.

The trader must not lease the New Asset or use it for any other purpose in the interim period.

Any period between acquisition and eventual use is treated as use in a Qualifying Activity so that if the trader later disposes of the New Asset which took six months to improve, and he wishes to claim roll-over relief on that disposal no apportionment needs to be made under subsection 5.2 in respect of the initial six months of non-qualifying use.

Subsection 5.5

6. Sometimes a trader may wish to purchase a further interest in or improve an existing Eligible Asset. For example, a trader may wish to extend a pre-existing factory or a tenant farmer may wish to purchase the freehold. Without this section no roll-over relief would be available since no New Asset is being acquired.

The existing Eligible Asset must be used promptly in a Qualifying Activity after the enhancement expenditure has been incurred even if it was not so used before. All the other conditions for relief must be satisfied.

G. DETAILS ON SECTION 6

1. If the full Disposal Proceeds are reinvested the whole gain is deferred. However, if the Disposal Proceeds are not fully reinvested, relief is restricted under section 6. In calculating whether or not the Disposal Proceeds have been fully reinvested, subsection 3.7 and the example in paragraph 7 make it clear that all New Assets acquired within the necessary time limits are taken into account. The Disposal Proceeds therefore do not have to be reinvested at one time but the reinvestment can be spread over a number of years provided the time limits in section 4 are observed.

2. The examples set out in paragraphs 4 to 7 of Schedule 2 illustrate how partial reinvestment of the Disposal Proceeds operates in a number of situations.

H. DETAILS ON SECTION 7

1. Roll-over relief is modified where the Disposal Proceeds from the sale of the Old Asset are reinvested in a New Asset which is a Depreciating Asset. The aim is to prevent the gain realised on the disposal of a non-depreciating asset being rolled over into the Acquisition Cost of a Depreciating Asset and escaping charge to tax entirely by being written off at the end of the life of the latter asset.

2. If the New Asset is a Depreciating Asset, the gain on the Old Asset cannot be deducted from the cost of the New Asset. Instead tax on the gain is held over until the Chargeable Occasion.

An example is set out in paragraph 8 of Schedule 2.

3. If before the held-over gain becomes chargeable the Depreciating Asset ceases to be used in a Qualifying Activity due to the death of an individual, such cessation of Qualifying Activity will not crystallise the held-over gain which instead is wiped out. Subsection 7.2 will not be relevant to a Depreciating Asset held by a company.

4. If before the held-over gain becomes chargeable a New Asset is acquired which is not depreciating, the held-over gain may be rolled over into that second New Asset.

An example is set out in paragraph 9 of Schedule 2.

The time limits set out in subsection 4.1 are therefore effectively extended so that the time between the disposal of the Old Asset and the acquisition of the second New Asset does not need to be within the period of twelve months before and three years after the disposal of the Old Asset.

5. If only part of the Disposal Proceeds is reinvested in acquiring the second New Asset, the amount not reinvested remains held over pending the occurrence of the Chargeable Occasion and the Acquisition Cost of the second New Asset is only reduced by the part of the held-over gain which is now rolled over into the second New Asset

An example is set out in paragraph 10 of Schedule 2.

6. Subsection 7.6 makes it clear that further reinvestments can take place to reduce the held-over gain remaining chargeable provided these reinvestments take place before the occurrence of the Chargeable Occasion. The trader therefore does not have to reinvest all the Disposal Proceeds on one occasion in a second New Asset but can spread his reinvestment in non-depreciating assets over a number of occasions provided the Chargeable Occasion has not yet occurred.

I. DETAILS ON SECTION 8

This section covers more specialised situations: individuals disposing of assets used in a company, groups of companies, trustees, and issues relating to non-residence.

Subsection 8.1

1. Section 2 requires the Old and New Assets to be owned and used by the same person who carries on a Qualifying Activity. However, subsection 8.1 gives a measure of relief to individuals who own Eligible Assets which are used in a Qualifying Activity carried on by a *Qualifying Company*.

2. The individual must dispose of the Old Asset and acquire the New Asset and both assets must be used in a Qualifying Activity carried on by the same Qualifying Company. The New and Old Assets do not need to be used in the same trade carried on by the Qualifying Company.

3. There is no requirement that the individual must be a full-time officer or employee of the Company and the payment of rent by the Company for use of the assets does not jeopardise relief.

4. The Qualifying Company itself, rather than any subsidiaries, must use the assets in a Qualifying Activity.

Subsections 8.2 to 8.6

5. These subsections deal with groups. Different trades or other activities set out in subsection 9.11 carried on by member companies of a group are treated as a single Qualifying Activity.

6. Subsection 8.4. Where one member of the group disposes of an Old Asset and another member acquires a New Asset, roll-over relief may be claimed provided that the claim is made by both companies. Subsection 8.4 applies even if the disposing company is not a group member at the time of the acquisition of the New Asset and/or the acquiring company is not a group member at the time of the disposal of the Old Asset.

However, if an Old Asset is transferred from one group member to another, it is the use during the period of ownership of the final group member which determines whether roll-over relief is available. Although all Qualifying Activities carried on by the group are treated as a single trade, members of a group are not treated as a single person. Therefore the final company will need to use the Old Asset either in its own trade or in another member's trade.

7. However, the New Asset must not be acquired by a dual resident investing company. A company is a dual resident investing company if (as defined in section 404 ICTA 1988) it is resident in the UK but within the charge to tax in some other territory by reason of its registration, place of management or residence. It is an investing company if it is not trading or its main function is borrowing money or purchasing or holding shares in other group members.

8. Under subsection 8.5 a non-trading member can claim relief on a disposal or acquisition if the Eligible Assets are used in a Qualifying Activity carried on by a trading group member(s). The New and Old Assets do not need to be used in the same trade or by the same member. The New and Old Assets must be used solely in a Qualifying Activity, subject to the rules on apportionment under subsections 5.2 and 5.3.

9. Roll-over relief does not apply where assets are transferred between members of a group on a no gain no loss basis. This prevents group gains being rolled into assets which are merely moved around the group.

10. Subsection 8.6 widens the rules in section 7 on Depreciating Assets. The effect is firstly, that the held-over gain does not become chargeable under subsections 7.1A or 7.1B as a result of an intra-group transfer and secondly, that the held-over gain accrues to the member owning the Depreciating Asset at the date when the held-over gain becomes chargeable.

Subsections 8.7, 8.8 and 8.9

11. Although not explicitly stated, neither the Old nor the New Assets need be situated in the United Kingdom for roll-over relief to apply. Furthermore, roll-over relief is fully available to an individual trader carrying on a Qualifying Activity who becomes non-resident between the disposal of the Old Asset and the acquisition of the New Asset even though his non-resident status takes a rolled-over gain out of charge.

However, neither trustees nor companies can claim roll-over relief if they become non-resident after the disposal of the Old Asset and before the acquisition of the New Asset(s) unless the New Assets are within the charge to capital gains tax because they are used in a Qualifying Activity carried on in the United Kingdom.

12. A person (whether an individual, trustee or company) who is not resident or not ordinarily resident in the UK at the date of disposal of the Old Asset but who has used the Old Asset in a

Qualifying Activity carried on in the UK can claim roll-over relief on the disposal of the Old Asset provided that the New Asset is also used in a Qualifying Activity carried on in the UK. Alternatively if the New Asset is used in a Qualifying Activity carried on outside the UK then the claimant must become resident or ordinarily resident in the UK.

13. Roll-over relief cannot be claimed if a company within a group disposes of an Old Asset and the New Asset is acquired by a dual resident investing company within that group. (See subsection 8.4.)

J. DETAILS ON SECTION 9

This section sets out the meaning of certain key words or phrases. Some particular points to note are as follows:

1. *Disposal Proceeds.* This definition is intended to ensure that in situations where the consideration received for the disposal of an Old Asset is not the actual consideration - for example, in the case of a gift or a transaction between connected parties - the relief is to be given by reference to the "deemed" consideration. The reference to "a sum equivalent to" makes it clear that it is not necessary to reinvest the actual cash received from the Old Asset in the New Asset.

It is by reference to the consideration deemed to be received that the relief will be computed. Therefore in order to obtain full relief the amount reinvested in the New Asset must be equal to or exceed the deemed rather than actual consideration for the Old Asset.

If the Old Asset is disposed of by way of a bargain made at arm's length, in exchange for consideration other than cash, the consideration received is the value of what is obtained. Thus if the Old Asset is disposed of in exchange for shares, the consideration received is the value of the shares received. Equally, if the Old Asset is disposed of in exchange for any other asset, for example a painting, the consideration received is the value of the asset obtained.

2. *Eligible Asset; New and Old Assets.* For further details on the meaning of these words see section K of this memorandum covering Schedule 1. The definition of Eligible Asset includes an interest in an asset, for example, an undivided share of land. The definition of New Asset means newly acquired (not newly created), so second-hand but newly acquired assets qualify. Note that deemed disposals and deemed acquisitions are included.

3. *Qualifying Activity.* This defines the types of activity in which the Eligible Assets must be used. The New Asset does not need to be used in the same trade or type of trade as the Old Asset.

By way of example, a farmer may therefore sell an Eligible Asset such as land, which is used and occupied for agricultural purposes, and reinvest the Disposal Proceeds in the goodwill of a bookshop. The fact that both the trade and the type of asset have changed will not jeopardise roll-over relief.

4. *Time of acquisition* is the date when a person obtains possession of the New Asset. The time of acquisition will be important for a number of reasons. For example, whether the New Asset was used promptly in a Qualifying Activity after acquisition as required by subsection 2.3 and whether there is any non-business use of the New Asset on acquisition for the purposes of subsection 5.3.

APPENDIX 5: NOTE ON ROLL-OVER RELIEF REWRITE

A. INTRODUCTION

1. *Accuracy.*

Our redraft of roll-over relief aims to reproduce the current legislation mainly contained in sections 152 - 159 TCGA 1992 in a clearer and more user-friendly way. However, we are concerned that greater comprehensibility should not be at the expense of accuracy.

The redrafted legislation is radically different in both structure and use of language. It is not possible to ensure that the legislation has exactly the same effect in all circumstances as the current legislation. However, our overall intention has been to preserve the current policy unless there are specific reasons why we feel it has been preferable to make a change. Section B outlines deliberate changes in policy; section C covers areas where we have clarified the existing legislation or expressly stated informal Revenue practice; section D mentions areas related to roll-over relief which we have deliberately not covered.

Our redraft comprises the primary legislation (see appendix 1), a Statement incorporating Statements of Practice (SPs), Extra-Statutory Concessions (ESCs) and Interpretations (IR Ints) (see appendix 3), and an Explanatory Memorandum (see appendix 4).

2. *Policy changes.*

Policy changes are generally minor. Section 5 produces a more fundamental policy change in relation to part use of New and Old Assets. An alternative version following the original legislation more closely is contained in the annex to the roll-over relief redraft at appendix 1. More detail on this is set out in section B below.

3. *Extra-statutory material.*

Where it is felt that existing Revenue practice or ESCs are sufficiently important to be contained within the primary legislation then they have been included. (See, for example, subsection 5.4 which covers part of ESC D24 and IR Int.7.) Other extra-statutory material remains outside the primary legislation in our redraft. No SPs have been incorporated into the primary legislation. The number of existing ESCs has been reduced from seven to three; in addition, we have changed one IR Int. on options into an explicit concession.

4. *Aims*

One issue which we note at paragraph 7.28 will arise on a rewrite of the legislation is how much of the existing practice and concession should be incorporated into the primary legislation. We have not tried to answer this in the redraft. Our more limited objective has been to show that a substantial body of primary legislation, ESCs and SPs can be produced in a more user-friendly way without loss of certainty or accuracy.

5. *Other legislation*

It has been difficult to adopt such a different language and structure in isolation from other pieces of legislation. Reference to other areas of tax is inevitable and therefore some sections in the redraft do not stand alone and will not be immediately comprehensible to the lay reader.

For example, subsection 3.3 refers to schedule 2 of TCGA 1992. Unless we redraft substantial parts of schedule 2 and put these in our redraft of roll-over relief, the layman will not be able to understand the tax treatment of assets owned prior to 1965 without referring to TCGA 1992. The Explanatory Memorandum aims to assist comprehension of subsection 3.3.

In the sort of rewrite we have undertaken, problems inevitably arise due to changes in wording which affect the way in which a relief operates technically even if it has the same practical result. This may have an unforeseen effect on other areas of CGT legislation. Subsection 3.2 illustrates this problem and is dealt with more fully in section B.

If all the capital gains tax legislation were redrafted in a similar style, then we believe such problems of integration would more easily be avoided.

6. *Revenue input*

We have shown our redraft of roll-over relief and the Explanatory Memorandum to the Revenue and we are most grateful for their comments. However we take full responsibility for the material. Neither the redraft nor the Explanatory Memorandum should be taken to represent the Revenue's interpretation of any particular piece of legislation.

B. CHANGES IN EFFECT OF LEGISLATION

1. *Subsection 3.1*

Section 152 TCGA 1992 contains no time limits within which claims for roll-over relief must be submitted. These claims are therefore governed by section 43 of Taxes Management Act 1970 which requires a claim to be made within a period of six years following the end of the year of assessment or accounting period "to which it relates". There is currently some doubt as to when this is.

Subsection 3.1 removes this doubt; the time limit for a claim is six years from the end of the Chargeable Period in which the disposal of the Old Asset *or* the acquisition of the New Asset occurs, whichever is the later.

2. *Subsection 3.2*

This changes the mechanism under which roll-over relief is given. Subsection 152(1) TCGA 1992 operates by reducing the consideration received for the disposal of the Old Asset. This in turn diminishes the amount of the chargeable gain.

Subsection 3.2 of the redraft operates differently; it reduces the amount of the chargeable gain directly. This has no direct consequences for the chargeable gain on either the Old Asset or the New Asset; either way, the chargeable gain (and hence the CGT payable) is reduced by the same amount.

There are other reliefs which operate through these mechanisms. For example, re-investment relief under section 164A TCGA 1992 is given by reduction of the consideration. But retirement relief under section 163 TCGA 1992 and hold-over relief under section 165 TCGA 1992 both operate by reducing the amount of the chargeable gain directly.

Where two or more reliefs are available against the same disposal, the order in which these reliefs are given may need to be established. It may affect the amount of unused relief where the total

amount of relief potentially available exceeds the amount of the chargeable gain. Reliefs which reduce the consideration are given in priority to reliefs which reduce the chargeable gain directly. Where two reliefs are given by the same mechanism - either both by reduction of the consideration, or both by reduction of the chargeable gain directly - the taxpayer is allowed to choose which to calculate first. (This choice is made explicit in subsection 3.5 of our redraft.)

Changing the mechanism in our redraft could therefore alter the CGT computations of a few taxpayers. At present, they may choose whether to calculate roll-over relief before or after, say, section 164A re-investment relief but it must be given in priority to retirement relief and hold-over relief. By contrast, under our redraft the re-investment relief would have to be given first, but the taxpayer could choose the order in which roll-over relief, retirement relief and hold-over relief were calculated.

3. *Subsection 5.2*

Subsections 152(6) and (7) TCGA 1992 relax the requirement that the Eligible Asset must have been used solely for the purposes of the Qualifying Activity throughout the period of ownership. Subsection 152(6) provides that where part of a building or structure is not used for the purposes of a trade for any substantial time the asset is effectively divided into two parts for roll-over relief purposes, namely one part representing the qualifying business use and the other part representing the non-qualifying use. Each part is then treated as a separate asset, roll-over relief being confined to the chargeable gain allocated to the part representing business use only.

Subsection 152(7) TCGA 1992 provides for a similar division where the Old Assets are not used for the purposes of the Qualifying Activity throughout the period of ownership.

Our redrafted subsection 5.1 simplifies subsections 152(6) and (7) in two ways:-

(a) partial use of Old Assets is not limited to buildings but includes all Eligible Assets. It is not thought that partial non-qualifying use of other assets (with the possible exception of a ship) is likely and therefore the change will make little material difference;

(b) subsection 152(6) only provides for an apportionment if there is non-business use for a substantial part of the period of ownership. There is no such restriction in subsection 5.2 of the redraft - an apportionment of the Disposal Proceeds is made whenever there is partial non-qualifying use. This is a simplification but at a cost for some taxpayers.

The existing legislation is reproduced more faithfully in the alternative version at the end of the roll-over redraft although following Revenue informal practice we have explicitly stated that de minimis non-qualifying use of New Assets on acquisition should be ignored (see subsection 5.3 below).

4. *Subsection 5.3*

Under the existing legislation, where there is mixed use of the New Asset on acquisition, roll-over relief (with the exception of partial use of land and buildings) is not strictly due no matter how small the non-qualifying use might be. (As stated above, the Revenue in practice allow very minor non-business use of all New Assets.) Under subsection 152(1) the New Asset must be "used only for the purposes of the trade". Subsection 5.3 allows for apportionment of the Acquisition Cost if there is partial non-qualifying use of the New Asset on acquisition.

5. *Subsection 5.4*

This brings ESC D24 into the primary legislation. There is a slight difference in that subsection 5.4A requires the New Asset to be "improved or altered" while ESC D24 refers to incurring "capital expenditure for the purposes of enhancing [the New Asset's] value".

6. *Subsection 5.5*

This incorporates ESCs D22 and D25 into the primary legislation. There is a slight difference regarding the conditions for use on acquisition of further interests in Eligible Assets.

C. CLARIFICATION OF LEGISLATION AND CURRENT REVENUE PRACTICE

In our redraft we have taken the opportunity to clarify certain areas of roll-over relief which have been open to query in the past but have been clarified by the Courts or are dealt with by Revenue practice.

1. *Subsection 2.1*

The categories of Eligible Assets in Schedule 1 follow those contained in section 155 TCGA 1992. Following the decision in *Williams v Evans, 59 TC 509* it is explicitly stated that machinery needs to be fixed (see Head B). We have not felt it necessary to define the assets in Head B in the same detail as section 155. We believe there would be no doubt about the meaning of milk quota or hovercraft.

Subsection 152(1) TCGA 1992 refers to the consideration which a person obtains from a disposal. The definition of Disposal Proceeds in the redraft makes it clear that:

(a) the reference to consideration includes deemed consideration following subsection 152(10); and

(b) direct application of the actual consideration for the Old Assets is not required in the acquisition of New Assets. This reflects current interpretation of section 152.

Similarly the definition of Acquisition Cost expressly refers to deemed acquisitions thus emphasising the point that where the legislation deems a sale or purchase price which is not the same as the actual price paid, the pretence that the deemed consideration has been received or paid is carried right through.

The times of disposal and acquisition are specifically defined and it is thus clarified that for roll-over purposes the dates of acquisition and disposal are different from the date when an unconditional contract is entered into. This states expressly what is contained in section 152 TCGA 1992 only by implication and follows the judgment in *Campbell Connelly & Co Ltd v Barnett [1994] STC 50.*

2. *Subsection 2.2*

The definition of Qualifying Activity in subsection 9.11 referred to in section 2 follows the categories of activities set out in section 158 TCGA 1992 although subsections 158(1)(d) and (e) have been condensed into subsection 9.11D. We believe that the effect is the same although rather than defining specifically the categories of activities which qualify we have given a more general definition and then excluded certain areas such as settlements.

3. *Subsection 2.3*

The New Asset must be taken into use for a Qualifying Activity "promptly" after its acquisition. Subsection 152(1) TCGA 1992 uses the words "on the acquisition" which are less explicit.

The definition of Qualifying Activity emphasises the point that the New Asset does not have to be used in the same trade as the Old Asset. Subsection 152(1) TCGA 1992 initially appears to confine relief to New Assets used in the same trade as the Old Assets although subsection 152(8) later makes it clear that two or more trades count as a single trade.

4. *Subsection 3.7*

Where the Disposal Proceeds are expended in acquiring more than one New Asset, there is nothing explicit in the legislation to say from which base cost(s) the deduction must be made. In practice, the Revenue accepts that this means the tax payer has a free choice although the base cost of each New Asset must be positive or zero, not negative. Subsection 3.7 in the redraft provides for this choice explicitly.

5. *Section 6*

Section 153 TCGA 1992 provides for partial reinvestment of the Disposal Proceeds. However, it is not explicitly stated that in calculating whether or not there has been full reinvestment you look at all New Assets acquired within the time limits. Section 6 explicitly allows matching the disposal of an Old Asset with two or more acquisitions of New Assets (whether or not at the same time).

6. *Section 7*

Our definition of Depreciating Assets clarifies current Revenue policy that where a building is constructed on leasehold land it is the length of the leaseholder's interest which determines whether the building is, or will become, a wasting asset. Therefore where the unexpired period of the lease does not exceed 60 years at the time a building is constructed that building will be regarded as a Depreciating Asset even if the building may continue to exist for a period in excess of 60 years. This is expressed explicitly in the definition contained in subsection 9.4.

Subsections 7.1B and 7.2 incorporate ESC D45 which states that the charge to tax does not arise where the asset ceases to be used in the claimant's trade on the death of the claimant.

Section 154 TCGA 1992 does not cover what happens when a claimant acquires a number of non-Depreciating Assets after acquiring a Depreciating Asset but before the held-over gain becomes chargeable. Subsection 7.6 of the redraft covers this point.

7. *Subsection 8.1*

The policy set out in section 157 TCGA 1992 regarding use of assets in personal companies is maintained. The redraft now explicitly states that it does not matter whether consideration is charged for the use of the Old Asset by the Qualifying Company. This statement is not in section 157.

Our redraft also states that the New Asset has to be used by the same Qualifying Company rather than any subsidiary. This follows current Revenue interpretation of section 157.

8. *Subsection 8.6*

This clarifies the wording in subsection 175(3) TCGA 1992 which applies the rules on depreciating assets "where the company making the claim is a member of a group of companies as if all members of the group for the time being were the same person."

9. *Subsections 8.7 - 8.9*

These incorporate the provisions on non-residence most relevant to roll-over relief i.e. sections 80, 84, 159 and 185 TCGA 1992. There is some question in the current legislation about whether a person needs to be not resident *and* not ordinarily resident in the UK for section 159 to apply since there is ambiguity between that section and section 10. The wider provisions on non-residence which also have an impact for roll-over relief claims (for example, section 25 TCGA 1992) are not included.

10. *Additional ESC*

IR Int. 11 allows roll-over relief to be claimed in respect of the gain which arises on the grant of an option provided the underlying land satisfies the conditions. This has now been incorporated as a formal concession within our Statement.

D. FURTHER POINTS

We have deliberately not included the following points in our redraft because either they are too specialised or they affect other areas of the capital gains tax legislation.

1. *Oil fields*

Section 198 TCGA 1992 provides that certain activities including oil extraction together with the acquisition, enjoyment or exploitation of oil rights, comprise a "ring fence trade". In this case, Disposal Proceeds from the oil or assets used in connection with an oil field must be reinvested in a ring fence trade - there is no scope for reinvestment in different trades.

2. *Rebasing*

The calculation of gains and losses arising from the disposal of an Eligible Asset which was acquired before 1 April 1982 and then disposed of before 5th April 1988 with the gain rolled over into a New Asset is dealt with in schedule 4 TCGA 1992. This legislation has not been incorporated in our redraft since it also affects a number of other types of disposals.

3. *Other areas*

Our redraft does not deal with roll-over relief in the following areas:

(a) compulsory acquisition of land - (section 247 TCGA 1992).

(b) exchange of joint interests - (ESC D26).

(c) disposals to trustees administering an Employees Share Ownership Plan ("ESOP").

(d) capital sums derived from destruction of assets - (section 23 TCGA 1992).

(e) incorporation of a business - (section 162 TCGA 1992).

(f) re-investment relief - (section 164A).

(g) compensation and damages - (ESC D33).

(h) transfer of the Independent Broadcasting Authority's transmission activities to a nominated company - (FA 1990 schedule 12).

(i) transfer of assets in connection with British Rail Privatisation - (FA 1994 schedule 6) and Northern Ireland Airports Ltd - (FA 1994 schedule 3).

(j) transfers between local constituency associations - (section 264 TCGA 1992).

APPENDIX 6: RELIEF FOR POST-CESSATION EXPENDITURE

NEW SECTION X

(1.) **[New section 109A]** In the Taxes Act 1988 after Section 109 insert the new section 109A shown below.

(2.) **[Interpretation]** In section 110(1) of the Taxes Act 1988 (interpretation etc.) for "sections 103 to 109" substitute "sections 103 to 109A".

(3.) **[Commencement]** This section has effect in relation to payments made or treated as made on or after 29th November 1994.

SECTION 109A: RELIEF FOR POST-CESSATION EXPENDITURE

Introduction

(1.) **[Former businesses: tax relief]** This section applies to a person who formerly carried on a trade, profession or vocation which has been permanently discontinued. It provides income tax relief on certain amounts paid by such a person in connection with the former trade, profession or vocation, and on certain debts.

(2.) **[Not applicable for corporation tax]** This section does not apply for the purposes of corporation tax.

Relevant amounts

(3.) **[Payments and debt write-offs within seven years]** The relief applies to certain amounts paid and certain debts written off within seven years of the discontinuance of the former trade, profession or vocation.

(4.) **[Qualifying payments]** The amounts referred to in subsection (3.) are payments made wholly and exclusively:

(a) in remedying, or as damages for, defective work done, goods supplied or services rendered in the course of the former trade, profession or vocation. Such damages may be either awarded or agreed.

(b) for legal or other professional services in connection with any claim that such work, goods or services was or were defective.

(c) for insurance against any expenditure which would be within (a) or (b).

(d) for recovery of a debt taken into account in computing the profits or gains of the former trade, profession or vocation.

(5.) **[Qualifying debt write-offs]** The debts referred to in subsection (3.) are unpaid debts taken into account in computing the profits or gains of the former trade, profession or vocation which are:

(a) proved to be bad, or

(b) released, in whole or in part, under a relevant arrangement or compromise (within the meaning of section 74 ICTA 1988).

The claimant must be entitled to the benefit of the debt. If the claimant is entitled to only part of the benefit of the debt, the relief is restricted to an appropriate proportion.

(6.) **[Relief for debt write-offs]** A debt or release (as the case may be) within subsection (5.) is treated as a payment on which relief may be claimed.

Parallel receipts

(7.) **[Payments treated as post-cessation receipts]** If a payment is made which falls within subsection (4.) so that relief is available under this legislation, certain receipts are deemed to be post cessation receipts to which section 103 ICTA 1988 applies (whether or not they would otherwise be so treated). No deduction is available under section 105 in respect of such deemed post cessation receipts. These receipts are:

(a) for payments within paragraph (a) or (b), any sum received by way of the proceeds of insurance or otherwise for the purpose of enabling the payment to be made or by means of which it is reimbursed;

(b) for payments within paragraph (c), any sum (not falling within (a) above) received by way of refund of premium or otherwise in connection with the insurance; and

(c) for payments within paragraph (d), any sum received to meet the cost of collecting the debt.

(8.) **[Amounts received before related payments]** If such a receipt is received before the year in which the related payment is made, it is treated as having been received in the later year and not in the earlier one. Any assessment may be modified or tax discharged or repaid if this is required to give effect to this subsection.

(9.) **[Debts recovered]** If the claimant receives any sum in payment of a debt for which relief has been given under this section by virtue of subsections (5.) and (6.), the receipt is deemed to be a post cessation receipt to which section 103 ICTA 1988 applies. No deduction is available under section 105 in respect of such a deemed post cessation receipt.

Unpaid expenses

(10.) **[Reduction for unpaid expenses]** Relief claimed under this section is reduced by the amount of any *unpaid expenses*. An unpaid expense is an amount which was deducted in computing the profits or gains of the former trade, profession or vocation but which had not actually been paid at the end of the year of assessment for which the relief is claimed.

(11.) **[Unpaid expenses in later years]** If relief is reduced in respect of an unpaid expense under subsection (10.), the expense is treated as having been paid, to the extent of the reduction, in the application of that subsection in relation to subsequent years of assessment.

(12.) **[Unpaid expenses subsequently paid]** If relief is reduced in respect of an unpaid expense under subsection (10.) and that expense is subsequently paid, the payment (or, if less, the amount of the reduction) is treated as a payment on which relief may be claimed under this section.

Mechanics of relief

(13.) **[Claims]** Relief may be claimed under this section by notice given in writing within twelve months from the 31st January next following the year in which the payment is made or treated as made. This time limit is extended for claims to relief for 1994-95 and 1995-96 to 5 April 1997 and 5 April 1998 respectively.

(14.) **[Income tax relief]** Relief from income tax is given on an amount of the claimant's income equal to the amount of the payment for which relief is available. The relief is given for the year in which the payment is made.

(15.) **[Capital gains tax relief]** If the payment for which relief is available exceeds the claimant's income for the year, the claimant may treat the excess as an allowable loss accruing to him in that year for the purposes of capital gains tax. The claimant must claim to do so in the notice given under subsection (13.).

(16.) **[Capital gains tax relief: restriction]** The excess treated as a capital gains tax loss under subsection (15.) is restricted to the amount on which the claimant would be chargeable to capital gains tax for that year if the following (and the effect of subsection (15.)) were disregarded:

(a) any allowable losses falling to be carried forward to that year from a previous year for the purposes of section 2(2) of the Taxation of Chargeable Gains Act 1992;

(b) section 3(1) of that Act (the annual exempt amount); and

(c) any relief against capital gains tax under section 72 of the Finance Act 1991 (deduction of trading losses).

(17.) **[Prevention of double relief]** Relief cannot be claimed under this section in respect of an amount for which relief has been given or is available under any other provision of the Income Tax Acts. But relief available under section 105 ICTA 1988 is given in respect of other amounts before any amount in respect of which relief is available under this section.

APPENDIX 7: POST-CESSATION EXPENDITURE RELIEF ORIGINAL LEGISLATION

Reliefs

Relief for post-cessation expenditure.

90.—(1) In Chapter VI of Part IV of the Taxes Act 1988 (provisions relating to the Schedule D charge: discontinuance, &c.), after section 109 insert—

"*Relief for post-cessation expenditure*

Relief for post-cessation expenditure.

109A.—(1) Where in connection with a trade, profession or vocation formerly carried on by him which has been permanently discontinued a person makes, within seven years of the discontinuance, a payment to which this section applies, he may, by notice given within twelve months from the 31st January next following the year of assessment in which the payment is made, claim relief from income tax on an amount of his income for that year equal to the amount of the payment.

(2) This section applies to payments made wholly and exclusively—

(a) in remedying defective work done, goods supplied or services rendered in the course of the former trade, profession or vocation or by way of damages (whether awarded or agreed) in respect of any such defective work, goods or services; or

(b) in defraying the expenses of legal or other professional services in connection with any claim that work done, goods supplied or services rendered in the course of the former trade, profession or vocation was or were defective;

(c) in insuring against any liabilities arising out of any such claim or against the incurring of such expenses; or

(d) for the purpose of collecting a debt taken into account in computing the profits or gains of the former trade, profession or vocation.

(3) Where a payment of any of the above descriptions is made in circumstances such that relief under this section is available, the following shall be treated as sums to which section 103 applies (whether or not they would be so treated apart from this subsection)—

(a) in the case of a payment within paragraph (a) or (b) of subsection (2) above, any sum received, by way of the proceeds of insurance or otherwise, for the purpose of enabling the payment to be made or by means of which it is reimbursed,

(b) in the case of a payment within paragraph (c) of that subsection, any sum (not falling within paragraph (a) above) received by way of refund of premium or otherwise in connection with the insurance, and

(c) in the case of a payment within paragraph (d) of that subsection, any sum received to meet the costs of collecting the debt;

and no deduction shall be made under section 105 in respect of any such sums.

Where such a sum is received in a year of assessment earlier than that in which the related payment is made, it shall be treated as having been received in that later year and not in the earlier year; and any such adjustment shall be made, by way of modification of any assessment or discharge or repayment of tax, as is required to give effect to this subsection.

(4) Where a trade, profession or vocation carried on by a person has been permanently discontinued and subsequently an unpaid debt which was taken into account in computing the profits or gains of that trade, profession or vocation and to the benefit of which he is entitled—

(a) is proved to be bad, or

(b) is released, in whole or in part, as part of a relevant arrangement or compromise (within the meaning of section 74),

he shall be treated as making a payment to which this section applies of an amount equal to the amount of the debt or, as the case may be, the amount released or, if he was entitled to only part of the benefit of the debt, to an appropriate proportion of that amount.

If any sum is subsequently received by him in payment of a debt for which relief has been given by virtue of this subsection, the sum shall be treated as one to which section 103 applies; and no deduction shall be made under section 105 in respect of any such sum.

(5) Where in the case of a trade, profession or vocation which has subsequently been permanently discontinued a deduction was made in computing the profits or losses of the trade, profession or vocation in respect of an expense not actually paid (an "unpaid expense"), then—

(a) if relief under this section in connection with that trade, profession or vocation is claimed in respect of any year of assessment, the amount of the relief shall be reduced by the amount of any unpaid expenses at the end of that year;

(b) for the purposes of the application of paragraph (a) above in relation to a subsequent year of assessment, any amount by which relief under this section has been reduced by virtue of that paragraph shall be treated as having been paid in respect of the expense in question; and

(c) if subsequently any amount is in fact paid in respect of an expense in respect of which a reduction has been made under paragraph (a), that amount (or, if less, the amount of the reduction) shall be treated as a payment to which this section applies.

(6) Relief shall not be given under this section in respect of an amount for which relief has been given or is available under any other provision of the Income Tax Acts.

In applying this subsection relief available under section 105 shall be treated as given in respect of other amounts before any amount in respect of which relief is available under this section.

(7) This section does not apply for the purposes of corporation tax.".

(2) Section 109A(1) of the Taxes Act 1988 (inserted by subsection (1) above) has effect as respects the years 1994-95 and 1995-96 with the substitution for the words "twelve months from the 31st January next following" of the words "two years after".

(3) In section 110(1) of the Taxes Act 1988 (interpretation, &c.) for "sections 103 to 109" substitute "sections 103 to 109A".

(4) Where under section 109A of the Taxes Act 1988 (inserted by subsection (1) above) a person makes a claim for relief for a year of assessment in respect of an amount which is available for relief under that section, he may in the notice by which the claim is made make a claim to have so much of that amount as cannot be set off against his income for the year (the "excess relief") treated for the purposes of capital gains tax as an allowable loss accruing to him in that year.

(5) No relief shall be available by virtue of subsection (4) above in respect of so much of the excess relief as exceeds the amount on which the claimant would be chargeable to capital gains tax for that year if the following (and the effect of that subsection) were disregarded—

(a) any allowable losses falling to be carried forward to that year from a previous year for the purposes of section 2(2) of the Taxation of Chargeable Gains Act 1992;

1992 c. 12.

(b) section 3(1) of that Act (the annual exempt amount); and

(c) any relief against capital gains tax under section 72 of the Finance Act 1991 (deduction of trading losses).

1991 c. 31.

(6) In section 105(2) of the Taxes Act 1988 (deductions allowed against post-cessation receipts: exclusion of amounts allowed elsewhere), after "any other provision of the Tax Acts" insert "or by virtue of section 90(4) of the Finance Act 1995".

(7) This section has effect in relation to payments made or treated as made (see subsection (4) of section 109A of the Taxes Act 1988 inserted by subsection (1) above) on or after 29th November 1994.

APPENDIX 8: EXPLANATORY MEMORANDUM ON POST-CESSATION EXPENDITURE RELIEF

A INTRODUCTION

1. Following the closure of a trade, profession or vocation ("business"), expenditure may be incurred or debts due to the business may prove to be uncollectible. Where these cannot be deducted in taxing the business up to the date of closure the only relief currently available is under section 105 ICTA 1988 against post-cessation receipts. However, many businesses have no post-cessation receipts against which to set such relief which is therefore effectively lost.

2. The purpose of the new relief, which does not apply for corporation tax, is to rectify this situation by giving income tax relief for:

- certain expenses which relate closely to the business activities while they were carried on (defined in subsection (4.)), and
- certain debts found to be bad or released (defined in subsection (5.))

which are either paid (expenses) or written off or released (debts) after the business has been permanently discontinued.

3. The relief is set against income of the year in which the expenditure is paid or the debt turns bad or is released. Where there is insufficient income it may be set against capital gains of the same year. Section 105 continues unaltered. The new relief applies to a narrower definition of expenditure.

4. The relief must be claimed. It applies to expenditure paid and debts found to be bad on or after 29 November 1994. The examples at Section C illustrate how the new relief works.

B DETAILS OF NEW SECTION 109A

Introduction

5. Subsection (1.) applies where a former business has been permanently discontinued. Permanent discontinuance is the term normally used for income tax purposes. A former business may either have ceased to exist (for example, if a shop was closed) or been taken over by another trader (for example, if a shop was sold as a going concern).

6. The new relief is available on the sums set out in subsection (4.) which are paid in connection with the former business. Payments which are not made "in connection with" a former business do not qualify for the new relief.

Relevant amounts

7. The wording of subsection (4.) deliberately echoes that of section 74(1)(a) ICTA 1988 and should therefore enable the existing case law on the meaning of "wholly and exclusively" to be applied.

8. Payments will qualify under subsection (4.)(b) whether the claim is admitted - so that a payment may also be made under (4.)(a) - or successfully defended. In any particular year the outcome of the claim may be unknown if correspondence or litigation remains in progress; payments will nevertheless qualify under (4.)(b).

9. The sort of payments which will fall within subsection (4.)(d) are court fees, bailiffs' charges, postage and travel costs (where the claimant incurs expenses himself in pursuing the debtor) and professional fees (where he engages legal or debt collection services on his behalf).

10. To qualify either under subsection (4.)(d) or (5.), a debt must have been taken into account in computing the Case I or II income from the former business - this therefore excludes debts which were on capital account, such as from the sale of capital assets.

11. The wording of subsection (5.) deliberately echoes that of section 74(1)(j) and (2) ICTA 1988 and should be interpreted in the same way. Unlike section 74(1)(j), there is no relief for doubtful debts. See Example 2.

12. Relief is only available to the extent that the debt belongs to the claimant. If, for example, he assigned the debt when he ceased trading (for example, as part of a contract by which the business was sold as a going concern) he cannot claim the new relief.

13. Subsection (6.) treats a debt which qualifies for relief under subsection (5.) as a payment. This is a purely mechanical device which triggers the commencement date (subsection (2.) of new section X) and the claims provisions and other mechanics at subsections (13.) onwards.

Parallel receipts

14. Payments will qualify for relief under subsection (4.) even when the economic cost of meeting the payment does not fall on the payer - for example, where he can claim on his insurance. Subsection (7.) claws back such relief when the insurance recovery is received. For example, if £100 is paid to rectify faulty work and £60 of this recovered through insurance, the new relief is the net £40 cost. If the insurance does not pay out until the following year, new relief of £100 is given in year 1 but a claw-back charge of £60 arises in year 2. Taking the two tax years together the relief is £40 net. See also Example 3.

15. Three broad categories of receipt are caught by subsection (7.). Of these:

- As well as insurance pay-outs, paragraph (a) catches any similar receipt - for example, where a retailer pays damages to a former customer but claims them back from the wholesaler or manufacturer. See Example 4.
- Paragraph (b) is deliberately very wide and is designed to prevent exploitation of the new relief.

16. The claw-back charge normally arises in the year the recovery is received - see Example 5. However if it is received before the subsection (4.) payment has been made, subsection (8.) defers the claw-back. See Example 4.

Unpaid expenses

17. The new relief is restricted where sums deducted in taxing the business before cessation have not been paid. Subsection (10.) does not claw-back these overallowances as such, but it does ensure that only the net payment by the former trader effectively qualifies for relief. For example, if

£70 had been charged in the final accounts but not paid and there was subsequently a £100 qualifying payment or debt, the new relief would be restricted to £30 (£100 minus £70).

18. Subsection (10.) refers to an amount "deducted in computing the profits or gains" of the former business. This will normally mean amounts included in the accounts of the former business. However the subsection catches only those sums which actually affected the taxable profit (or loss) - whether or not they were debited in the accounts.

19. Self-evidently, an expense which was unpaid at the end of one year may remain unpaid at the end of a subsequent year. If the new relief claimed for the first of those years was restricted, subsection (11.) prevents a further restriction being made for the same unpaid amount in any later year. For example, if qualifying payments of £100 and £80 are made in years 1 and 2 respectively and there are unpaid expenses of £60 throughout, the section 109A relief is restricted by £60 (to £40) in year 1 but full relief of £80 is given in year 2. See also Example 6.

20. A subsection (10.) restriction denies relief for all time in respect of a qualifying payment. However if the unpaid expense is subsequently paid, subsection (12.) treats the lower of:

(i) the payment of the unpaid expense, and

(ii) the amount of the restriction previously made under subsection (10.)

as a qualifying payment within section 109A - effectively as a payment within subsection (4.). For example, in year 1 a qualifying payment of £100 is made but no section 109A relief is allowed because of unpaid expenses of £250. In year 2, the £250 is paid and section 109A relief of £100 is due. See also Example 6.

If in this example less than the full £250 was paid, a new restriction for unpaid expenses would need to be calculated in year 2 so that although a qualifying payment of £100 is deemed to have been made, less than the full £100 of section 109A relief would be available.

21. The payment of the unpaid expenses must be made within seven years of the cessation of the business - the cut-off date for relief under section 109A (see subsection (3.)).

Mechanics of relief

22. Under subsection (13.) the new relief must be claimed by the 31st January which falls roughly 22 months after the end of the year for which the claim is made. This is the final date for filing self-assessment tax returns and paying tax due for the year following the year to which the claim relates. In effect the claimant has 12 months after filing his self-assessment for the relevant year to decide whether to put in a claim. The normal procedure for such claims will apply. Self-assessment does not operate until 1996-97. The time limits for claims for the pre-self-assessment years, 1994-95 and 1995-96, are the normal two years from the end of the year to which the claim relates, i.e. 5 April 1997 and 5 April 1998 respectively. See example 7.

23. Subsection (17.) denies the new relief in respect of payments which, inter alia, fall within section 109A but which were allowed in taxing the business under Case I or II.

24. Subsection (17.) also provides that in taxing post-cessation receipts, any relief under section 105 is to be given firstly for amounts which do not qualify for the new relief. Some payments could be available for relief under both section 105 and section 109A in the same year. Giving the section 105 relief for other amounts first maximises the section 109A relief.

C EXAMPLES

The following examples illustrate the operation of section 109A relief as described above.

Example 1

A traded as a builder until he sold the business in 1992. In 1994, after his final accounts had been settled with no provision for it, he received a claim for damages due to faulty workmanship. He initially contested the claim, instructing a solicitor, but settled out of court in October 1995. He paid damages of £5,000 and a solicitor's bill of £2,000. There are no unpaid expenses of the former trade as at 5 April 1996.

A is entitled to claim new relief of £7,000 for 1995-96 - £5,000 under subsection (4.)(a) and £2,000 under subsection (4.)(b).

Example 2

B's business closed down in 1993 with many debts owing. These were all thought to be recoverable when the accounts were drawn up and although a general provision was made this was disallowed for tax. One debt of £10,000 proved uncollectible and B wrote it off in June 1995 and paid £1,000 in professional charges and court fees incurred in pursuing it. There are no unpaid expenses of the former business as at 5 April 1996.

B is entitled to new relief of £11,000 in 1995-96 - £1,000 under subsection (4.)(d) and £10,000 under subsection (5.).

Example 3

C ceased in business in 1992. In February 1996 C agrees to settle a claim for faulty goods supplied by the business and makes a payment of £2,000 the same month. C's insurance company pays out £1,500 on a claim - £2,000 less an excess of £500. The insurance receipt arrives in May 1996. No provision was made in the business accounts. There are no unpaid expenses of the former business as at 5 April 1996.

C is entitled to new relief of £2,000 under subsection (4.)(a) for 1995-96. C is taxed on a post-cessation receipt of £1,500 under section 103 ICTA 1988 in 1996-97.

Example 4

D sold a butchery business in 1991. A personal injury claim had been made against D for allegedly selling unfit meat. In the final accounts a provision of £10,000 was allowed for tax. In January 1995 a court awarded damages of £25,000 against D who received £7,000 the following month by way of recompense from his former supplier. D did not pay the damages until September 1995. There are no unpaid expenses of the former business as at 5 April 1996.

There are no tax consequences for 1994-95. D is entitled to section 109A relief of £15,000 for 1995-96 under subsection (4.)(a) - the £25,000 award less £10,000 previously allowed in taxing the business. Also in 1995-96 D is taxed on a post-cessation receipt of £7,000, the recovery from the suppliers received the previous year.

Example 5

In example 2, B was allowed new relief of £11,000 in 1995-96 in respect of a written-off debt (£10,000 debt plus £1,000 recovery charges). In August 1997 B unexpectedly receives a cheque for £11,000 from the debtor.

B is taxed on a post-cessation receipt of £11,000 in 1997-98 (£10,000 under subsection (9.) and £1,000 under subsection (7.)(c)).

Example 6

E sold her accountancy practice in 1994 and started a new business. Expenses of £1,000 were charged in the final accounts but remained unpaid. In January 1995 she took out a professional indemnity insurance policy against claims arising from work she had done in the accountancy practice. The annual premium was £700 and the first payment made in January 1995.

E is not entitled to any section 109A relief for 1994-95. Although she paid £700 and this was not charged in the accounts it is exceeded by the unpaid expenses of £1,000.

E is entitled to section 109A relief of £400 for 1995-96. In this year she again pays a premium of £700 which qualifies under subsection (4.)(c). However, the £1,000 still has not been paid. £700 of this has been used to restrict the 1994-95 claim and is therefore treated as having been paid (subsection (11.)). This leaves unpaid expenses of £300 (£1,000 less £700). The section 109A relief is therefore restricted by £300.

E is entitled to section 109A relief of £700 for 1996-97 when she again pays a premium of £700. Although the £1,000 still has not been paid it has all been used to restrict relief in earlier years and is therefore treated as though it were paid. No restriction is due.

In 1997-98 E again pays a premium of £700. She also pays off the unpaid expenses of £1,000. She is entitled to section 109A relief of £1,700. The £700 qualifies, as before, under subsection (4.)(c). The unpaid expenses are not post-cessation expenditure since they were taken into account in computing the profits of E's accountancy practice and subsection (17.) prevents double allowance. However subsection (12.) treats them as qualifying payments.

Example 7

In example 2, B was allowed new relief of £11,000 in 1995-96 when he wrote off a debt (£10,000 debt plus £1,000 recovery charges). In that year his income was £8,000 and his chargeable gains £7,000.

Since B has claimed section 109A relief his 1995-96 income is reduced to nil with a balance of £3,000 section 109A relief unrelieved. If B's claim extends to subsection (15.), he can set this balance against his capital gains, reducing them to £4,000 which is entirely covered by the annual exemption. The balance of the annual exemption is lost.