

CAW Prime Minister (2)  
 MS 23/2



THE BOARD ROOM  
 INLAND REVENUE  
 SOMERSET HOUSE

CD Wasson  
 Chancellor. I am

very worried indeed  
 about these proposals - and that they

22 February 1982

seem to have got so far without any

Private Secretary to the Chancellor

reference to you.

The article seems  
 substantially justified - me

INTERNATIONAL TAX AVOIDANCE: SUNDAY EXPRESS ARTICLE  
 21 FEBRUARY 1982

- ... 1. This article (copy attached) gives a one-sided and somewhat hysterical account of proposals which arose out of a general review of the increased scope for international tax avoidance since the abolition of exchange control. It deliberately ignores the underlying objectives of these proposals (although these have been clearly stated and accepted - at least in principle - by many representative bodies and other interested parties).
2. However, it is fair to say that there is widespread concern about the detailed implications of the proposed legislation. For this reason, it was agreed at a recent meeting with the Financial Secretary and the Economic Secretary that the legislation should not be introduced in this year's Finance Bill but should be deferred for a year, to allow further public examination of the proposals. A recommendation to this effect will be made to the Chancellor.

cc PS/Chief Secretary  
 PS/Financial Secretary  
 PS/Minister of State (L)  
 Economic Secretary  
 Sir Douglas Wass  
 Mr Douglas French  
 Mr Battishill  
 Mr Lavelle  
 Mr Gordon  
 Mr Robson  
 Mr Reed  
 Mr Perfect

Sir Lawrence Airey  
 Mr Dalton  
 Mr Rogers  
 Mr Taylor Thompson  
 Mr Pollard  
 Mr Keith  
 Mr D A Jones  
 Mr Hunter  
 Mr Fairley  
 Mr Munro  
 Mr Dunbar

## Background to the proposals

3. There is much past history on these proposals, but briefly the background is as follows. Although the proposals are presented as a complete package, each is largely self-contained and to some extent raises different issues. If enacted in their present form they would:-

- i. Abolish Section 482 of the Taxes Act (which imposes criminal penalties on the emigration of companies, and certain other transactions, without Treasury consent). It is widely accepted that such a provision is inappropriate in a climate of free exchanges.
- ii. Introduce new criteria, more in keeping with present-day commercial reality, for determining whether or not a company is resident here for tax purposes. The emphasis would be placed on where a company's business as a whole is managed rather than where a company's affairs are controlled. We have been concerned for some time that the present rules are unsatisfactory. Without the protection of Section 482, UK companies could artificially contrive non-residence in order to secure a tax advantage. Moreover, there are other ways in which the rules can be exploited against which Section 482 provides no defence.
- iii. Impose a new charge on UK companies which accumulate surplus overseas profits and income in tax haven 'money box' companies in order to avoid UK tax. In recent years UK groups have made increasing use of such companies and the abolition of exchange control clearly increases the scope for arrangements of this sort.
- iv. Remove the present tax advantages available where UK-owned overseas companies remit profits in the form of an 'upstream loan' instead of a dividend.

4. In attacking the proposals, the writer of the article rests his case on three main contentions. In the first place, a satisfactory case has not been made out for the proposals. In

particular, no estimates have been published of the amount of tax at stake. Secondly, in preparing the draft legislation, the Revenue has totally ignored the representations made during the earlier period of consultation. Finally, the proposals would, if enacted in their present form, have disastrous consequences not only for businesses but for the economy as a whole. In particular, they would reimpose exchange controls by the back door and jeopardise the UK's position as a major international financial centre.

#### Justification for the proposals

5. The proposals to abolish Section 482 (about which there is little argument) and to redefine company residence need to be considered separately. Despite the claims made in the article, many representative bodies now acknowledge that the present company residence law is unsatisfactory and could be exploited if Section 482 were to be repealed. The main reason for the continuing opposition to this proposal is the inevitable uncertainty inherent in any change in the law. The revenue lost through current exploitation is probably relatively insignificant.

6. On the other hand the tax havens and upstream loans proposals are directed at specific avoidance arrangements which UK companies are increasingly utilising. Section 482 and other anti-avoidance provisions in the Taxes Acts are no defence against such avoidance. By its very nature, such avoidance is difficult to quantify, but isolated cases we have seen indicate that substantial amounts of tax are at stake.

#### Previous representations

7. The article implies that previous representations were unanimous in their opposition to these proposals, but that the objections made were rejected out of hand. This is quite untrue, particularly as regards the proposals on tax haven companies. A full report on the outcome of the first round of consultations was made to Ministers and, in the light of these comments, a number of important changes were made to the proposals.

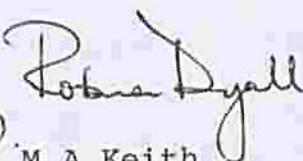
## Likely consequences of the proposals

8. The predictions of the disastrous consequences of the proposals are at best exaggerated and at worst nonsensical. Thus, it is claimed that to tax unremitted overseas income would be contrary to the policies underlying the abolition of exchange control. But the aim of abolishing exchange control was to give UK residents the freedom to choose where to invest, and how to finance such investment thereby allowing companies to earn the best possible return on their capital and so to make the best possible contribution to the national income. The accumulation of income in tax haven 'money box' companies makes no contribution to the national income, but instead leads to a substantial loss of revenue.

9. Similarly, the proposals would not automatically deny to UK companies the benefit of overseas tax incentives, but would only apply where such companies then banked their increased profits in tax havens instead of repatriating them.

10. The claim that our invisible earnings would be damaged because foreign companies based in this country would be frightened away is presumably directed at the possibility that such companies might, under the proposed definition of company residence, be regarded as resident here. In general, we believe that the vast majority of companies, whether resident here now or trading here as non-residents, would not be affected. It is by no means clear that the proposals would have the effect claimed and, even if they did, that this would drive such companies away.

11. Finally, the assertion that the proposed legislation would confer on the Revenue unprecedented powers to obtain information from companies is plainly wrong. Such powers already exist for Section 485 of the Taxes Act (transfer pricing) and in general have attracted relatively little criticism.

  
pp. M A Keith  
Assistant Secretary

City notebook

by KENNETH FLEET

# THE TAX BOMB IN THE BUDGET IN-TRAY

A DANGEROUS bomb is ticking away in the Chancellor of the Exchequer's office.

Encased in a yellow cover, it is timed to explode on Budget Day, March 9. If it does go off the damage from fall-out in the City of London and the international reaches of British industry, will be extensive and irreparable.

There are signs that those who planted it, the Board of Inland Revenue, are now themselves shocked at what they have done. They may agree to defuse it.

They had better. For should it go off, their master, Sir Geoffrey Howe, probably deceived by the device's innocent appearance, will be left with more than egg on his face.

If I tell you that the Inland Revenue's misguided plot is code-named "International Tax Avoidance I Company Residence II Tax Havens and the Corporate Sector III Upstream Loans" you may show a flicker of interest in tax havens and then turn off the light and go back to sleep.

If I tell you that the Revenue is effectively seeking

- To reimpose through the tax system exchange controls the same Sir Geoffrey Howe bravely abolished in October 1979:

- To remove from British companies operating abroad tax incentives given them by the countries where they trade;

- To reduce and inhibit the overseas business of British banks;

- To strike terror into the pocket of every expatriate and foreigner with a bank deposit;

- To encourage foreien-owned companies to abandon both the City (still the world's leading international financial



Sir Lawrence Alray: Inland Revenue Chairman

centre) and the United Kingdom as the effective centre of their operations;

- To cut at a stroke this country's important "invisible" earnings;

- To plunge the tax system into years of confusion and uncertainty;

- And to take onto itself breathtaking powers of investigation into every British company's every book—the sort of powers the U.S. Congress specifically refused the U.S. Internal Revenue Service: then perhaps you will have another cup of tea and bear with me for a few bars.

The Inland Revenue, of course, has a case when it comes to tax havens. It is not an open-and-shut case but no tax inspector worth his professional salt can possibly resist the challenge of those who seek to avoid or evade paying what the inspector believes are their dues.

The Revenue knows it can rely on the moral support, much of it bogus, of those who resent others "getting away" with anything, even though it may be legal. And the Revenue is currently in a very strong position vis-à-vis

the majority party in the Commons.

Some of the Tory MPs who actually comprehend taxation—Peter Roes (now at the Department of Trade) and Tom Benyon, for instance—have been liberally tarred with the brush of Economist, past masters of tax avoidance schemes. They might find it awkward even to open their mouths.

Nonetheless, the Revenue is pushing its luck in wanting to overturn all the rules which determine a company's residence and therefore where it is liable to pay tax—rules, I might add, painfully arrived at over the years.

I said at the beginning that if the Revenue has its way, it will have brought back a large measure of exchange control through the back door of Somerset House. I suspect that its first thought was to change the residence rules to make it easy to police tax havens.

The price is unacceptable whether expressed as the damage the Revenue's proposals will do to British companies and our invisible earnings, or looked at through the extra taxes the Revenue believes it can rake in. The former is huge, though incalculable, the latter unknown because the Revenue has given no estimates.

In January last year the Revenue issued two consultative documents, one on company residence, the other on tax havens. It invited comments—and it got them, in volumes.

Last November the Revenue responded to the blast in two ways. It showed it had ignored virtually all the counter arguments of industry and the accountancy profession. And it put out its yellow document, containing draft legislation.

Warning to its task, the Revenue also threw in a pernicious set of rules designed to kill the use by

British companies of loans made to them by their overseas subsidiaries. And it promised that if the new laws were given the official nod, they would be in the 1982 Finance Bill.

One thing the Revenue may not have reckoned on was such an early Budget (March 9, when Sir Geoffrey would have to make his intentions known). Even without that, the time allowed would have been rather too short.

The Revenue is pushing hard for this year because it realises its chances in the 1982 Budget would be slim and thereafter it would have to wait for Tony Benn.

The tax collectors' legitimate professional ambitions and their reading of the political odds are not, in my view, sufficient excuses to disregard the serious objections to these proposals. Nor do they relieve the Revenue of the necessity of properly arguing its case.

The gaps in its evidence are astonishing. It scarcely begins to justify such sweeping changes. It appears to have given no consideration to the broader economic consequences of tax changes of this magnitude. It offers no estimates of future tax yield or the administrative costs of the new regime.

The Revenue, as always, is plausible in its general approach and clever in its detailed draftsmanship. It has a neat way, for example, of not falling foul of all Double Tax Agreements with other countries.

But boil it all down and you are left with a campaign that, if successful, can only make the international business of British companies more costly and less competitive.

In Sir Geoffrey Howe's book, ignorance of the real world should not be a sufficient cause for letting the Revenue run riot.

Stubbe stuck to his ambition

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