

HOUSE OF LORDS
MINUTES OF EVIDENCE
TAKEN BEFORE
SELECT COMMITTEE ON ECONOMIC AFFAIRS
(FINANCE BILL SUB-COMMITTEE)

**ASPECTS OF THE FINANCE BILL, INCLUDING:
CAPITAL GAINS TAX AND THE ENTREPRENEURS' RELIEF RESIDENCE
AND DOMICILE ENCOURAGING ENTERPRISE**

WEDNESDAY 23 APRIL 2008

MR MALCOLM GAMMIE, QC

Evidence heard in Public

Questions 1 - 33

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WEDNESDAY 23 APRIL 2008

Present

Barnett, L
MacGregor of Pulham Market, L
Moonie, L
Paul, L
Sheppard of Didgemere, L
Vallance of Tummel, L (Chairman)
Wakeham, L

Witness: **Mr Malcolm Gammie, QC**, Research Director, Tax Law Review Committee, Institute for Fiscal Studies, examined.

Q1 Chairman: Good afternoon and welcome again, as an old hand, to the Committee. This is the first public session of the Sub-Committee on the Finance Bill for 2008 and, as you know, we will be focusing on three main aspects of the Bill, that is Capital Gains Tax for Residence and Domicile and Encouraging Enterprise. In previous years you have been very good to us and given us a good background to the topics we have been choosing to look at, and I hope very much that we will be able to do that again this afternoon. So after that brief introduction, let me hand over to you.

Mr Gammie: Thank you, my Lord Chairman, and I am very happy to be here again, although I feel this year I may have rather less to say than I have in previous years because although two at least of the topics which you have chosen to look at have attracted considerable publicity and attention, of course that has been on aspects of those proposals which are not principally your concern, but I will obviously aim to cover the administrative and simplicity aspects of those particular proposals. Of the three which you have chosen perhaps I can start with Capital Gains Tax. Clause 6, Schedule 2 of the Finance Bill introduced the very considerable changes which are being made to Capital Gains Tax which were announced in

the Pre-Budget Report last year. The principal elements of those proposals include the introduction of a single rate of 18% for Capital Gains Tax, the abolition of taper relief for Capital Gains Tax, which was introduced by the current Government in 1998, and in 1998 when they introduced taper relief they froze the indexation allowance which had been accrued on assets held at that time and the frozen indexation relief is also being abolished. Under previous reforms which were made by the Conservative Government at the time most assets were re-based at 31 March 1982 (in other words in calculating the gain one took the market value of the asset at 1982) but there were still options to elect to take an earlier value in calculating the gain and those rules are also being abolished. With the clearing out of taper relief, the residual elements of indexation relief and the few assets which could take an earlier value than 31 March 1982, the rules for computation of Capital Gains Tax for individuals and trustees have, of course, been very considerably simplified and that also means that the special rules which apply to what are called fungible assets, principally shares and securities where it is not possible to identify a particular asset from the disposal of a pool of assets, those rules for dealing with fungible assets can also be very considerably simplified. In effect, the reforms which are in this year's Finance Bill return us to the situation of Capital Gains Tax which existed between its introduction in 1965 and 1982 when the first elements of indexation were introduced, although obviously the rate at 18% is considerably lower than the rate which applied between 1965 and 1982 of 30%. Of course, previously from 1989 the rate of Capital Gains Tax was theoretically the income tax rate, although both indexation and taper relief had the effect of reducing the rate of charge on capital gains, and the link between the income tax rate from the Capital Gains Tax rate is another element of the system which can be abolished. So whilst the schedule dealing with the changes is a very large schedule and the changes which are being made to the Capital Gains Tax Act are very considerable, they do in total, I think, add up to a very considerable simplification of Capital Gains Tax computations.

The one complication (if one wants to put it that way) which has been introduced is, of course, the introduction of entrepreneurs' relief in clause 7 of schedule 3 of the Bill. This, of course, allows claims to be made on disposals of businesses, including shareholdings in trading companies and groups and certain other business assets, to reduce the rate of tax on gains on those assets from 18% to 10% subject to a cumulative lifetime limit of £1 million. The provisions which are introduced for entrepreneurs' relief look very similar to what was previously known as retirement relief and which goes back again to the beginnings of Capital Gains Tax but which was phased out by the current Government when it introduced taper relief. The relief for business assets taper relief and the entrepreneurs' relief do not entirely correspond, but the provisions which are in schedule 3 have many common and well-recognised features for these types of relief and while obviously being able to meet all the various conditions and comply with the requirements to get that particular relief involves some complication, I would have said it is no greater complication than has previously existed with retirement relief, or indeed with many of the reliefs which have been introduced over the years for entrepreneurs or to encourage entrepreneurial investment, some of which we will come to when I talk about the third item which you have chosen to look at. I think that is all I wish to say about the Capital Gains Tax changes. If I could now turn to the second topic, the changes to residence and the remittance basis. In relation to the changes on residence, of course whether or not an individual is resident in the United Kingdom is fundamental to their liability to both income tax and Capital Gains Tax and the rules which have been used over the years for determining whether or not an individual, in particular individuals who move between this country and other countries, are resident in the United Kingdom is based very largely on case law with a minimal amount of statutory provision. In practice, the Inland Revenue has developed over many years guidelines which it published in a booklet known as IR20, which for practical purposes has served for most people in this position in determining

whether they are or have become either resident in the United Kingdom or non-resident. Those rules of determining residence are principally, of course, determined by counting the number of days which an individual is present in the United Kingdom during the tax year and the change which is being made this year is principally as to how you count those days. Up until now days of arrival and departure have not been included in the count of days present in the United Kingdom. Now under the new statutory rule being introduced a day will count if the individual is present in the United Kingdom at the end of the day, in other words midnight, counting midnight at the end of the day rather than the start of the new day, subject to some relief for individuals who are transiting through the UK and who are not performing any other function in the UK beyond that involved in their travel arrangements. I do not think this will make any significant difference in terms of the obligations it imposes upon individuals in this position to count the days. It will obviously make a difference in the number of days they may be present or counted as present in the United Kingdom and they will have to change, perhaps, the basis of their record keeping. To disregard days of arrival and departure is relatively easy. There will be some slight change in perhaps counting whether you are here at the end of a day. It may make some difference as to whether you choose a flight arriving in the United Kingdom early in the morning or leaving the United Kingdom late at night, but I am sure that will not affect the airlines significantly. The changes in the remittance basis are obviously very much more fundamental. Of course, historically foreign income for all persons, whether resident, domicile or whatever in the United Kingdom, was on a remittance basis, if we think back to the nineteenth century, and over the years the remittance basis has by governments of all complexions been restricted in one way or another until we reached the situation where it is limited to individuals who are not domiciled in the United Kingdom or not ordinarily resident in the United Kingdom. The changes which are being made this year are perhaps the most fundamental changes which

have been made for some while to the remittance basis and they restrict the ability to claim the remittance basis, in particular for long-term residents who are resident in the United Kingdom for seven out of ten years who to claim the remittance basis will have to pay effectively a £30,000 toll charge for the ability to keep their foreign income and gains outside the scope of the United Kingdom tax. Of course, that is a toll charge which will only apply to those extremely wealthy individuals who have significant foreign income and gains which they wish to shelter from the United Kingdom tax even though they are resident in the United Kingdom. More significantly, individuals who want to claim the benefit of the remittance basis will no longer be able to claim their personal allowances or their annual Capital Gains Tax exemption in a year in which they claim the remittance basis. This may obviously affect a much wider group of individuals who are resident in the United Kingdom but not domiciled here and who have much smaller income and gains outside the United Kingdom which otherwise they would shelter on a remittance basis. A de minimis exemption is introduced of £2,000 so that individuals who have foreign income and gains unremitted to the United Kingdom of less than that amount will be entitled to the remittance basis without the necessity to claim it. The other main changes which are being made are of a far more technical nature and really account for the significant amount of legislation which can be found in the Finance Bill. There has been a variety of ways in which individuals have been able to effectively enjoy the benefit of foreign income and gains in the United Kingdom without technically remitting them to the United Kingdom and therefore having to pay tax on in. There are various changes to the rules to ensure that if somebody does enjoy income and gains in the United Kingdom they will pay tax on the basis that they have been remitted. There are many other far more technical modifications being made to the taxation of foreign income which are consequent upon these changes in the remittance basis. Broadly speaking there is, of course, a large number of rules which tax the foreign income of UK residents whether they enjoy it

directly or whether they enjoy it through offshore companies or trusts and these are extremely technical rules. Most of those provisions dealing with the taxation of foreign income have embedded within them special rules for individuals who are resident but not domiciled in the United Kingdom to give effect to the benefit of the remittance basis within the context of those particular rules. Of course, all of those technical changes, in particular to trusts and to offshore companies, are having to be modified to fit within the policy of this year's legislation, and indeed the Finance Bill legislation is not entirely complete in this respect because Her Majesty's Revenue and Customs are still working on the details of some of those rules and amendments will be introduced as the Bill passes through the other House. Standing back and looking at all of those changes, inevitably if one is going to bring within the scope of United Kingdom tax a larger proportion of the income and gains enjoyed by individuals in this position the likelihood is that their tax affairs will become more complicated. In particular, for those wealth individuals who in particular may have trusts and offshore companies and a great deal of offshore income there will have to be considerable restructuring of their arrangements, and indeed much of that will probably have gone on before 6 April 2008 in anticipation of these changes. That is an inevitable consequence of the change in policy which this Government has introduced this year. Whilst it will complicate their tax affairs, I am not sure their tax affairs will become, in terms of administrative and simplistic considerations, significantly more complicated than they probably already were. This is a highly specialised area in which most of the wealthy individuals will have separate professional advice and they will have been taking a great deal of that advice in recent times. For those individuals with much smaller income and gains there is, of course, a considerable question which surrounds the 2000 de minimis exemption. Essentially, as I have said, the position will be that you will have to claim the benefit of the remittance basis and if you do you will lose the benefit of your personal allowances and the annual Capital Gains Tax

exemption, but if you can say that you have less than £2,000 foreign income and gains which you have not remitted, then of course you do not have to claim the benefit of the remittance basis, you just file your tax return on the basis that you have not remitted that foreign income and gains and you are not liable to pay tax on it. Precisely how it will be possible actually to administer that exemption and how Her Majesty's Revenue and Customs will actually be able to check whether people are doing this correctly is, I think, one of the more significant questions which arises from an administrative perspective in relation to these arrangements. If I could then just pass on to the question of the venture capital reliefs. The changes which are made in the Finance Bill this year are in fact extremely minor. It is an increase in the permitted amount of investment in the enterprise investment scheme and one minor change to the definition of "prohibited" or impermissible activities, if you like, under the enterprise investment scheme and venture capital trusts to exclude shipbuilding, coal and steel activities, to comply with European law. The implementation of the increase in the EIS limit is, of course, subject to European approval under the state aids provisions, but in expectation that that will be achieved the Bill gives the Treasury power to introduce the increase in the limit from £400,000 to £500,000 per annum by statutory instrument but with effect from 6 April 2008. The change which has been made in the Finance Bill, though, has come with the publication of three documents. The most relevant from my own perspective and from the perspective of the tax legislation is a consultation document published by the Treasury and Her Majesty's Revenue and Customs with the Budget called the Enterprise Investment Scheme: A Consultation Document, the aim of which is to examine the requirements of that particular scheme to see in what way the scheme could be simplified, the administrative and regulatory burdens reduced and how awareness of the scheme could be raised amongst potential users. The Revenue's consultative document provides a very good outline of the scheme and raises a variety of questions for consultation from interested parties with an eye to

achieving those three aims. Of course, the common feature of the Enterprise Investment Scheme, venture capital trusts and also the Corporate Venture Scheme, and also the entrepreneurs' relief introduced for Capital Gains Tax, is that they aim to incentivise or secure the raising of capital (in the case of the EIS, for example) for smaller, higher risk companies by lowering the tax burden on income and gains which are generated from investments in those companies. So the investment under the EIS scheme provides tax relief on the amount of investment, exemption for capital gains arising from that investment and enhanced relief for any losses incurred. A common feature of any of those schemes is that they have to be passed around with conditions so that the policy aims of the scheme can hopefully be reflected in the detailed statutory conditions laid down. Inevitably those conditions bring complication and as the Revenue's consultative document highlights, one of the problems with the EIS scheme is the accidental breaches which occur in the conditions which then lead to the reliefs being withdrawn and the aims of the scheme being compounded. It is very difficult, I think, to suggest in what way these schemes can be simplified in terms of reducing the conditions because, as I say, they effectively reflect the policy aims which Government had in introducing these reliefs. One can obviously focus upon the guidance which the Revenue can provide and the clearances and other assistance which the Inland Revenue can provide to the taxpaying companies and the investors in seeking to obtain relief under these schemes and those are certainly aspects of the consultation which Revenue and Customs hope will produce improvements both in raising awareness and ensuring compliance. My Lords, I do not think I should say any more, but I would be happy to answer any questions which you have.

Q2 Chairman: Thank you very much indeed for a very comprehensive review of all three topics. What we will do is we will ask questions on each of the topics in order, starting off with Capital Gains Tax. I wonder if I can start off myself? With Capital Gains Tax at the rate

of 18% for all gains, including short-term gains, there will be an incentive to turn income which is taxed at 40% into capital gains taxed at 18%. Do you think there is sufficient protection in the legislation to prevent this happening?

Mr Gammie: My Lord Chairman, that of course was a particular issue up until 1982, when although we had a 30% Capital Gains Tax of course personal tax rates were very much higher then and so there was a similar incentive. Since that time, of course, there has been a great deal of other change in the tax system which to an extent has reduced the opportunities which were perhaps available in the 1970s and 1980s when, of course, there were many artificial schemes implemented, particularly either to convert income into capital or to avoid tax on capital gains. I do not think these provisions in themselves contain a great deal of added weaponry for Revenue and Customs to deal with that sort of activity but there has been, as I say, change elsewhere within the tax system which will ensure they have greater scope to counter it than they did previously.

Chairman: Thank you.

Q3 Lord Barnett: Good afternoon, Mr Gammie. It is nice to see you again. The Capital Gains Tax changes, whilst controversial for the obvious reason of an increase from 10 to 18% for some people, overlooked the reduction from 40% to 18% for others, like any major changes, but do you see it as a simplification? Is it welcome in that sense?

Mr Gammie: There is no doubt that Capital Gains Tax computations will be significantly simpler under this system than they were before. As your remarks may have recognised, if you make a change which reduces the tax rate for some but increases it for others, the people you tend to hear from are those who suffer the increase in the tax rate and to an extent when you have a taper relief system, as we had, because that requires people to hold assets for certain periods it builds into itself an expectation that the rate is not going to change if people do actually hold the asset for that period, which may have accounted for some of the –

Chairman: This is what we all dread! I am afraid we are going to have to intervene briefly to vote.

The Committee suspended from 4.34 pm to 4.44 pm for a division in the House

Q4 Chairman: You were in mid-answer to Lord Barnett, I think, so if we could ask you to resume?

Mr Gammie: My Lord Chairman, I think I had just about completed it because I was giving Lord Barnett the assurance that it does result in a simplification in the computations, even though, as he noted, fixing a rate of 18% benefits some and disadvantages others.

Q5 Lord Barnett: It is a simplification but too high?

Mr Gammie: Well, my Lord, I think the choice of rate is effectively a choice for the Government. I am not sure that in making the proposal it was necessarily intended to find some happy medium between the lower rate for non-business assets, which was 24%, and the lowest rate for business assets, which was 10%. If you aggregated them and divided by two it would not come to 18.

Q6 Lord Wakeham: The Government have made no attempt to conceal the fact that they want to raise more money from Capital Gains Tax than they have in the past under these changes?

Mr Gammie: Certainly they have indicated that they expect to raise more revenue under this change, yes.

Q7 Lord Barnett: But it is so complicated, an issue like Capital Gains Tax. Is it not rather difficult to judge just how much revenue you are going to get, because nowadays anything less than about £10 billion is petty cash? How can the Government be sure that they are going to collect up to £500 million in three years' time?

Mr Gammie: My Lord, I think you would probably have to ask Revenue and Customs or the Treasury as to precisely how they have arrived at that figure. Inevitably with a tax like Capital Gains Tax, which is dependent upon individuals making disposals in particular years, there must be a great deal of uncertainty as to precisely how much gain will be realised by the aggregate of individuals across the year and that will also be dependent upon the performance of, in particular, the Stock Exchange because of the high proportion of share gains which would be in the total. One can well imagine that those estimates which were made last year and again at the Budget in March may not have factored in significantly changes in the property market and the stock market since, but precisely how those figures were arrived at I cannot comment.

Lord Wakeham: I am very interested in this. As a matter of fact, I put a written question down for the Government when they brought in the concession for entrepreneurs and I asked how much this was going to cost them, and if I remember rightly they said £200 million. I said, "How do you estimate it?" and they were very confident in their basis of estimation. They were absolutely sure they knew how to do it.

Lord Barnett: They were getting their estimates from the Revenue, but the Revenue had not got a clue either. That makes it very difficult.

Lord Wakeham: The Government gave no indication that they thought their estimates were in any way other than pretty firm.

Chairman: Shall we pass on? Lord Paul, do you have anything you want to ask on this topic?

Q8 Lord Paul: Yes. The press carried a lot of reports about people selling assets before 6 April 2008 to obtain these benefits. Should this have been anticipated by the Revenue and perhaps we could have had some legislation to stop this happening?

Mr Gammie: It is always possible, of course, when you announce a change well in advance to anticipate that that will be the consequence and to introduce forestalling legislation to deal with that. I suspect that because of the nature of this change, in particular the increase in the tax rate for some from 10% to 18%, the view was taken that individuals should have the opportunity to reorganise their assets and affairs if they felt it was appropriate to do so, given the change, and of course although they will be paying tax at a lower rate, if they have realised, at 10% before 6 April 2008, they will have accelerated their liability because they will now have to pay tax much earlier than they would otherwise do.

Q9 Lord Paul: One of the main things they said when they started with the Budget was that life would be much less complicated after this Budget. How far do you think they have succeeded in that?

Mr Gammie: I think from my previous remarks, they have succeeded very well and I have no doubt that the aim to simplify the Capital Gains Tax computations was one of the principal factors underlying this reform and the complication for some of entrepreneurs' relief is offset by the fact that they get the benefit of a lower tax rate.

Chairman: Are there any other questions on Capital Gains Tax?

Q10 Lord Sheppard of Didgemere: Let me go back to the point you touched on earlier, the question of avoidance and going back to pre-1982, or whenever it was, when a lot of accountants, and I suppose lawyers, made a lot of income by advising on switching between the two income sources. Surely that complexity is bound to come back again and all the avoidance legislation is going to be complicated, is it not, by these changes?

Mr Gammie: Obviously in every Finance Bill in recent years, over many years but in particular in recent years, we have seen a large amount of anti-avoidance legislation and this year's Finance Bill is no different in that respect. Her Majesty's Revenue and Customs now

have disclosure rules, of course, which were introduced in 2004 and those disclosure rules at least allow the Revenue to react more quickly to avoidance arrangements, and that in part accounts for the increased flow of anti-avoidance legislation in Finance Bills. So whilst your point may be absolutely correct that the difference in rates will inevitably drive people to look for ways in which they can get the benefit of the lower rate and that may generate a certain amount of avoidance activity, which will generate anti-avoidance legislation, that is a process which is already going on within our tax system more generally and it is one to which the Revenue has directed its attention in particular areas to see if it can find a better way of dealing with avoidance than current ways of specific legislation and it may generate proposals from the Revenue next year, not specifically in relation to Capital Gains Tax but in other areas, which if successful may be adopted elsewhere. So I do not offer any sort of optimistic reply to your question in the sense that there will not be complication, but this has to be seen as a much broader issue about how we deal with avoidance within the tax system.

Q11 Lord MacGregor of Pulham Market: That is also the point which I think was causing us most interest following the Chairman's question because I too well remember the period when some of these schemes were coming forward and I think it was one reason why Capital Gains Tax was put at the same rate as the higher rate of income tax. When you talk about the anti-avoidance side, have you in mind in particular the provision now that accountancy firms and others have to submit schemes which look as though they are getting around certain rules, or any schemes of that sort which they are putting to their clients, or is there something more specific, because I find it quite difficult at the moment to see exactly how this will work out, whether there will be ways of devising means of transferring income to capital gain without having to have a scheme itself? It is that you are really thinking of, is it, the fact that accountancy firms now have to submit any proposals they have of that nature?

Mr Gammie: That was certainly what I was referring to in terms of the disclosure rules, yes. That, as I say, has so far tended to generate increased anti-avoidance legislation in Finance Bills, as the Revenue have closed off schemes and arrangements which have been disclosed to them. That is a process which will continue and to the extent that there is increased avoidance activity in relation to Capital Gains Tax because of the change of the rate, one would expect the same process to go on there of disclosure and specific provision to deal with it. But as I say, the Revenue, certainly in the financial products area, have been looking at trying to adopt a different approach to avoidance legislation which they hope will provide a more satisfactory remedy. That is something they are continuing to consult on and if it is successful in one area, no doubt it is an approach they may try and adopt elsewhere to resolve the issue.

Q12 Lord MacGregor of Pulham Market: Exactly how does that latter point work?

Mr Gammie: The particular provisions they have been consulting on is what they have called principles-based avoidance legislation, so that instead of having highly detailed technical legislation they try and express the purpose or the principle which is embodied in the legislation in more general language, which will then hopefully be more effective at catching particular arrangements. That is in the financial products field they have been looking at it, but obviously if they could develop something successfully there they might well look elsewhere.

Q13 Lord MacGregor of Pulham Market: I see, it is the principles-based bit that you are referring to really?

Mr Gammie: Yes.

Lord MacGregor of Pulham Market: It will be interesting to see.

Q14 Lord Wakeham: Just really following on that, surely what will happen, to some degree in any case, is that it will not be avoidance as such, it will be activities which create a genuine capital gain which will be much more favourably attractive to people? For instance, you might be a dealer in land, buying and selling land. You will be an investor in land and you will turn it over much more slowly and you will be able to argue, with some reasonableness, that if you held it for a sufficient length of time you get the lower rate of tax. That is not a scheme, it is just a pattern of life based on the tax system, is it not?

Mr Gammie: Yes, you are absolutely right, my Lord. If you introduce differential rates for either activities or investments where you can substitute one for the other, then inevitably the tax system has a distortion in it which will tend to make people favour activities and investments which carry the lower rate. That is the inevitable consequence and, as you say, it is not all necessarily described as avoidance, and that will happen.

Chairman: Are there any other questions on Capital Gains Tax?

Q15 Lord Barnett: Yes. On the entrepreneurs' relief, is there any evidence as to how the number, if any, of companies or individuals starting up businesses has reduced or come in late because of the changes in Capital Gains Tax?

Mr Gammie: I do not think, in relation to the changes which have been introduced now, it would be possible to assess what the behavioural effect of those may or may not be. Inevitably in relation to all of the sorts of reliefs we have had over many years for favouring entrepreneurial investment or for raising equity, such as the venture capital relief, there is a certain amount of evidence now as to the impact they have had on either allowing capital to be raised or in terms of business formation or business growth, but inevitably all of these things are extremely difficult to assess with any degree of accuracy.

Q16 Chairman: Shall we move on to residence and domicile? May I just kick off again and ask a general question, and that is to ask you why you think the PBR announcement and the subsequent detailed proposals caused so much controversy, and should that have been anticipated and headed off in some way?

Mr Gammie: The idea of changing the rules for non-domiciled individuals has, of course, been one which has been around for a long time and this Government announced some years ago that it was reviewing the position, but because it had made no announcement I think it was getting to the point where people were anticipating there was not going to be any change. Inevitably, when you change rules such as these you are going to stir up a large response from those who are liable to pay more tax under it and I think in particular the concept of just having a sort of £30,000 toll charge is a new concept, something we have not previously seen in the tax system, and I think that of itself was going to raise questions as to whether that was a fair way of changing the rules and of dealing with a particular situation. The removal of the personal allowances and the Capital Gains Tax exemption effectively across the board I think was something which had not necessarily been anticipated, and because that affected a much broader population of individuals again it was going to raise questions both as to fairness and as to the practical way in which it could be administered. I think one of the problems, of course, in this particular area is that particularly high net worth individuals who are in this position will put in place arrangements which are built around the existing rules and which are not necessarily easy to restructure in terms of trusts and offshore investments and the way in which they have structured their investment into the United Kingdom. Of course, the Revenue are not necessarily conversant with all the ways in which these things are structured because they are structured in a way which does not require any report necessarily to the Inland Revenue of what has been done. Therefore, on the highly technical aspects of these particular rules I think the Revenue probably had some difficulty in formulating exactly what

changes they wanted to make, and of course when they published draft legislation that apparently went very much further and had a very much greater impact than had generally been anticipated, even from the announcement in the Pre-Budget Report, especially as to whether or not some of the changes are going to operate retrospectively in the sense that income and gains could be taxed in the current year which had effectively accrued before any of these changes had been made. I think that really the general uncertainty it generated as to what precisely the rules were going to be, how wide-ranging they were going to be, really led to the degree of outcry that there was and the publicity it obtained.

Chairman: Thank you very much. I am going to have to leave you at this point, but I am handing over to the capable hands of Lord Wakeham. Thank you very much indeed.

In the absence of the Chairman, Lord Wakeham took the Chair

Q17 Lord Barnett: The £30,000 a year annual charge would not be made if the unremitted foreign income and gains are less than £2,000 a year. How on earth would the Revenue ever know the size, whether it is more or less than the £2,000?

Mr Gammie: Maybe I did not make it absolutely clear. I should explain that the £30,000 charge and the £2,000 de minimis are entirely separate aspects of these proposals. The £30,000 charge only comes in for long-term residents, individuals who have been resident in the United Kingdom for seven years out of ten. The £2,000 charge is related to whether individuals want to claim the benefit of the remittance basis, even when they are not long-term residents, so it has a much broader effect than the £30,000 charge. As to how easily the Revenue will be able to monitor whether individuals are filing their self-assessments correctly when they have got foreign income and gains of more or less than £2,000 I think is a major question and it is left entirely to the individual to file his self-assessment, as I say, as he thinks fit. He obviously has to file it according to the rules, but how you actually check what their foreign income and gains are I think is extremely difficult to fathom.

Q18 Lord Barnett: Yes. The long-term residence of course is a point you have made, seven out of ten years before the annual tax charge of £30,000 takes effect, but there are some rather complex rules about residence. They are going to charge a person who spends from midnight at the end of a day. Are they going to have something on a tax return saying, “Did you leave at midnight or 11.55?” How on earth are they going to be able to administer such a residence rule?

Mr Gammie: Of course, for the vast majority of individuals there is no doubt as to where they are resident. The change in the rules of residence and counting the days by reference to whether you are here at midnight will normally be for those people who want to claim they are not resident in the United Kingdom because they are not spending enough time in the United Kingdom to make them resident here and the complexity which surrounds that is not significantly different from the complexity which is already in the system because at the moment we still have to count days to work out whether somebody is resident or not, it is just that we ignore days of entry and days of leaving. So you just exclude them from the calculation. Now we will still have to count days but it is just that we will use a different basis for doing so. So it has changed, but it is not more complicated.

The Committee suspended from 5.05 pm to 5.12 pm for a division in the House

Q19 Lord Paul: Mr Gammie, as you said, this has been going on for almost 50 years, this discussion about being non-domiciled or domiciled. The press have raised a lot of questions for the last ten years almost and governments did not come to any decision, neither of the governments in the last few years. All of a sudden, once the Government announced it, the press went exactly opposite to what they were saying before this announcement. It started with a reaction from one party, whether it was a teaser or whether it was thought of or anything, I do not know, £25,000, and then the Chancellor jumped it to £30,000. Can you tell us what tempted him to amend(?) it later, but he censored it?

Mr Gammie: I think in relation to the press comment, obviously the press tends to react to the sort of information it is fed, I think, and whilst the press prior to the announcement of any changes had obviously been very hostile to the idea that there should be individuals here who are paying far less tax because of their domicile status, then of course when the proposals come out I suppose the press starts picking up the reactions from individuals, from the City and from others and it reflects that. It may not say very much about the way in which the press analyses the information which comes through to it.

Q20 Lord Paul: But I am still not sure whether Britain has gained from it or lost. Have you any view on that?

Mr Gammie: One of the large problems in this particular area is that most of what is said and most information available is very anecdotal, so it is extremely difficult to know precisely what the impact of these sorts of measures are. Inevitably, any government making any change has to approach that change with that view, that it is quite difficult to predict.

Lord Paul: I do want to declare that I am non-domiciled and very proud of that status.

Q21 Lord Sheppard of Didgemere: Maybe I can make a statement and you can tell me whether it is correct is a better way? Two points. One is, all the press comments or most of the comments seem to have been about the resident test applied to non-Brits working in Britain, mainly in the City or elsewhere, but there was also an issue, we found, for executives who had gone and run bits of companies all over the world and were not therefore paying UK tax, and suddenly – because they used to be very careful in counting their days – now they have to count them slightly differently. I do not know if it becomes more complex, but it becomes another calculation to do, does it not, both for the firm and for the individual?

Mr Gammie: It becomes a different calculation for the individual to do and it will be less favourable for the individual in the sense that more days will now be counted than was

previously the case under the old rule. As I say, it is different but it is difficult to say that it is more onerous than was previously the case. It may mean that some individuals who were managing to maintain non-resident status will either have to alter their practices or –

Q22 Lord Sheppard of Didgemere: It gives them another reason for not coming to a UK board meeting of the parent company!

Mr Gammie: Certainly for counting their days or spending less days maybe doing that, yes.

Q23 Lord MacGregor of Pulham Market: Can I go back to the question of the £2,000 de minimis limit for personal allowances and Capital Gains Tax exemptions and just ask you not a political question but a really technical question? How is this actually going to be operated? If you take a high net worth individual, presumably the Revenue have some suspicions that his foreign income is not less than £2,000 and will wish to ask him questions about it. I do not know whether that is right or whether that is all they can do. If you take the question of the Polish plumber, for example, people of that sort who are doing a self-assessment and maybe have substantial property back in Poland, or wherever, is there any way that the Revenue can get at that? I understand perfectly well that in the UK under self-assessment they have lots of means of going to UK banks and other institutions and finding out what you are actually earning and interest, but there is no provision whereby you can do that with other countries, is there? Therefore, how are they actually going to make it work?

Mr Gammie: As a general matter, they are only going to make it work, I suspect, if they enquire into an individual's self-assessment return. So people will self-assess on a particular basis that they are entitled to this de minimis exemption and if nothing is done to enquire into their return then that will just be taken to be a truthful return. If the Revenue chooses to enquire into the self-assessment, they can obviously ask the individual questions. To the extent they need to obtain information from other countries, then generally speaking they

would have to look either to the United Kingdom's double taxation agreements with other countries to see whether or not they had powers to get information under that, or within the European Union of course there is a Mutual Assistance Directive and they would have to look to those sorts of powers to be able to get information from the other country about what income or gains the individual was reporting there, or what information they could supply. But administratively it is a complicated, difficult and time-consuming exercise to do all that.

Q24 Lord MacGregor of Pulham Market: So presumably it is going to be directed more at high net worth individuals than the average plumber who is assumed not to have that income or capital gains, or it is just not worth following up?

Mr Gammie: I think that is a fair assumption to make, yes.

Q25 Lord MacGregor of Pulham Market: Could you just explain a bit more how the EU thing works? They may have the right under it to find out from the opposite number at HMRC in another EU country what the tax returns of that individual are, is that right, or can they even go further and see whether, in the same way as they can do here, those tax returns are accurate?

Mr Gammie: They would not have exactly the same powers under either the Treaty or the Directives to be able to get information as they have, for example, powers here to get information from third parties and from the taxpayer himself. As I say, to invoke those powers is time-consuming and difficult and one suspects that unless they believe there was a significant amount of tax at stake I would not imagine they would go to the trouble to do that.

Q26 Lord Sheppard of Didgemere: My second point is that surely the other problem with this is that one does not know the economic effect long-term until long-term? In other words,

you cannot measure the psychological effect on whether people are willing to come to this country or not until after maybe some years' time?

Mr Gammie: I think there are two comments one could make on that, for example in relation to the remittance basis but also the residence rules. To the extent you are dealing with high net worth individuals, whether one likes the statement or not the reality is they are not in business to pay more tax to the United Kingdom than they absolutely have to, so one can assume that under the new rules, just as under the previous rules, they will take whatever measures are open to them to minimise their liabilities. That does not necessarily mean that they leave the United Kingdom or that they do not invest in the United Kingdom. They will just structure their arrangements in a way which minimises their tax, and that is an inevitable consequence. The question of whether or not it has a broader economic impact, for example on the City of London, because people are no longer prepared to come to the United Kingdom because of the greater tax or greater administrative burden, I think is extremely difficult and that is where I say information is largely anecdotal, but one would assume that at the margin at least there will be some impact on individuals staying for more than seven years, for example. Quite how large that effect is and whether it is significant I think is probably impossible to say, but you would expect it to have some small impact at the margins.

Chairman: I would like to move on. Lord Barnett has one short question.

Q27 Lord Barnett: The Revenue reckons that all the loopholes and anomalies of the remittance-based rules have been removed. Would you agree with that?

Mr Gammie: I would say a significant number of the more obvious loopholes have been removed. It would be optimistic to think that highly paid lawyers and accountants will not be scrutinising the new legislation extremely carefully to see what alternative loopholes may have been created.

Q28 Chairman: The last topic we have taken is encouraging enterprise and, as you rightly say, there is a very small change in the Finance Bill relating to it, but we were also quite interested in the University of Sussex's study. Most of us have been Treasury ministers and quite a few around here have all been busy promoting these schemes over the years and they are great things for politicians to make speeches about, and of course they have some effect on the individuals who use them because they get tax relief from doing it. The question I am interested in is whether they have any serious economic effect on the country and the prosperity of the country generally. Is there any evidence of that at all?

Mr Gammie: My Lord Chairman, I have obviously seen the report. I will not necessarily claim to be an expert in the sorts of things which that report is looking at, so I read it and I am sure your assessment of it is probably better than mine, but I did not take away from it the impression that these had been particularly significant. On the other hand, of course, they represent a series of measures which over many years, I think probably starting with Lord Howard about 1981 with the business start-up scheme, governments have introduced to try and encourage equity investment in smaller businesses. If we had never had them, would we be in a significantly worse position or are we in a significantly better position because we have had them? I think that is very difficult to assess.

Q29 Lord Barnett: Do you know any small businesses which read econometric studies?

Mr Gammie: Not many, no, but I know some small economics businesses which probably do, but there are not many of them.

Q30 Lord MacGregor of Pulham Market: I do remember one scheme at that particular period because I was minister for small businesses at the time when the business start-up scheme was starting, and so on. We had one to encourage investment in small workshops, which were almost non-existent at that time, and it was so successful that we actually felt

after a while that we had achieved our objective and stopped it. So it can happen and it can also, I think, change a culture and that cannot be demonstrated in an econometric study. So the question really is what things would have been like if you did not have them, and that is the one which, as you say, is difficult to assess?

Mr Gammie: Yes, indeed. Inevitably most of these schemes have targeted at what governments have tended to describe as sort of high risk businesses, and so on. Inevitably, as soon as you put a tax relief into the system people look to find the securest investment which will meet the conditions laid down for the relief. So the incentives can work both in a good way and in a perverse way, but as you say it is extremely difficult to say what the impact would be if you had never had them.

Q31 Lord MacGregor of Pulham Market: Were you aware of any demand for an increase in the EIS investment limit?

Mr Gammie: Not specifically, no.

Q32 Lord MacGregor of Pulham Market: So it is probably a lollipop rather than something which is responding to a real requirement?

Mr Gammie: Well, inevitably the Government, I assume, reviews the limits which are put in place for these schemes and decides whether or not there will be some incremental value by increasing their limits. In this case the EIS, I think, has gone up from £200,000 to £400,000 and now £500,000 and that is presumably based on some assessment that it is having some impact upon firms and the capital they can raise.

Q33 Lord Sheppard of Didgemere: Certainly in terms of impact they are quite useful, as a small company, for individuals (not so much institutions obviously) to be able to say to the

potential investors other than, “We’re marvellous!” Whether they believe you is another question.

Mr Gammie: It must be true to an extent. Again, I suspect this is anecdotal rather than anything else, but there is a number of reasonably wealthy individuals who would probably not know about specific small investments but who, through either the venture capital trusts or through EIS funds, are able to put some money in that direction which otherwise they would just invest or spend, or do something different with but would not put it into a small business.

Chairman: If I may say so, you have not disappointed us once again by coming and getting us going at the beginning of our inquiry into the Finance Bill and, as usual, we are extremely grateful to you for doing just that. Thank you very much for coming and thank you very much for your informative start to our proceedings.