

House of Lords

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Board of Inland Revenue

FINANCE BILL, 1936

Note on the Inland Revenue Provisions of the
Finance Bill.

Clause 14

Clause 14 increases the standard rate of Income Tax by 3d. to 4s.9d. in the £. This increase of 3d. in the standard rate represents the direct taxpayer's contribution by way of taxation to the increased cost of national defence, and is thus a complement of the increase in the tea duty falling to be paid by the indirect taxpayer. In a speech winding up the Budget debate the Chancellor said: "I deliberately put on fresh taxation because I believed that the people of this country ought to feel that they have to pay for the necessities of the situation and, in the second place, I felt that only if we submitted to some of the sacrifices now could we come with a clear conscience in the future and borrow." (Parliamentary Debates, 23rd April, 1936, Col. 436.)

In the Commons the increase in the standard rate was criticised on the ground that it was not necessary, as the estimates were conservative; but this criticism cannot now be advanced, as the Chancellor in his speech on the third reading of the Finance Bill made it quite clear that even now it was ^{impossible} ~~inadvisable~~, in face of the rising expenditure, to avoid a deficit this year.

The increase of 3d. in the standard rate is estimated to yield £12 millions in the current year and £14 millions in a full year.

Clause 15

Clause 15 determines the rates of Sur-tax payable in the current year. The Sur-tax payable on the 1st January,

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1937, is that charged for the year 1935-36, and Clause 15 continues for 1935-36 the rates that obtained for the preceding year.

Cluses 16 & 17

Clause 16 increases the personal allowance for married taxpayers from £170 to £180, and Clause 17 increases the children's allowance from £50 per child to £60 per child. These concessions in favour of the family cost £2 millions in the current year and £4 millions in a full year. In the case of the family with small or moderate incomes the relief given by the increase in the marriage allowance and in the children allowance more than compensates for the increase in the standard rate.

Cluses relating
to avoidance.

Provisions relating to avoidance of tax.

Clauses 18, 19, 20 and 21 and the Second Schedule relate to the measures necessary to stop the serious avoidance of tax which has been found to exist in recent years. They are complicated provisions and have been criticised on that ground, but it must be borne in mind that the subject matter is exceedingly difficult and complicated and it is, therefore, impossible to expect the legislation to be simple.

It is estimated that the provisions relating to avoidance will yield about £6 millions in a full year and about £2½ millions in the current year.

Clause 18

Clause 18 deals with that kind of avoidance of tax which results from individuals transferring assets abroad in such circumstances that the income is the income of persons abroad and is not receivable by the individual as income but the individual has power to enjoy that income. A simple

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example would be the case where an individual in this country transfers assets to a company in some Dominion or foreign country and holds redeemable debentures of that company of such an amount that he has complete financial control of the company; the income arising on the assets is the income of the company, and the individual obtains the enjoyment of it by cashing his debentures and so receives the income in capital form, in which form it is not liable to Income Tax.

The charging provision of the Clause (Subsection (1)) provides that, where an individual who is ordinarily resident in this country has transferred assets to any person who is resident or domiciled outside this country and has rights by virtue of which he has the power to enjoy the income received by the person outside the country, that income is to be deemed for Income Tax purposes to be the income of the individual, unless he can show that the transfer was effected mainly for some purpose other than the avoidance of taxation. The object of the proviso to Sub-section (1), declaring that the charge will not apply if the individual shows that the transfer was effected mainly for some other purpose than the avoidance of taxation, is to protect from the charge those genuine cases in which a transfer may have been made for good business or personal reasons. For example, an individual in this country might form a "one man" company abroad under his control for some trading venture, and in the absence of the proviso he might be liable to tax upon the whole income of that company and

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not merely upon the amount paid annually as dividend by the company; he would thus be in a worse position than the man who controlled a "one man" company at home, who, if the company distributes a reasonable dividend, is liable to Sur-tax only on the dividend paid by the company. The proviso may be criticised on the ground that it makes taxation depend upon the motive of the individual, but the whole purpose of this legislation is to deal with cases where individuals resort to all sorts of artificial transactions in order to escape paying their proper share of the national expenditure, and it is only by a general test of this character that one can distinguish cases of avoidance from other cases in which trading or some other genuine interest has dictated the transaction. It would be impossible to define the particular forms of transactions which constitute avoidance, because every case of avoidance of tax proceeds by taking advantage of some legal form which, in itself, is quite innocent and may cover a bona fide transaction as well as an avoidance transaction.

In the Bill as introduced in the House of Commons it was provided that the taxpayer or the Revenue authorities would have a right of appeal to the Board of Referees on the finding of the Special Commissioners under the proviso to Subsection (1). The right of appeal to the Board of Referees was provided primarily in the interest of the taxpayer, but in the course of the debates on the Finance Bill it was urged upon the Chancellor that the provision of an additional tribunal increased the cost to the taxpayer and was out of accord with the general tendency

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nowadays to limit the numbers of tribunals and that the Special Commissioners were a tribunal in which the taxpayer had every confidence. In deference to these representations the Chancellor withdrew the provisions relating to the Board of Referees, and, on the question of fact involved in the proviso to Subsection (1), the Special Commissioners of Income Tax are now the only tribunal. There is, of course, a right of appeal to the High Court on any question of law arising either in connection with the question of fact in the proviso or in connection with any legal question relating to the charge.

It should be noted in particular that the charge under this Clause applies only to individuals who are ordinarily resident in this country and in respect of transfers of assets which they made while ordinarily resident in this country. Consequently, if a foreigner comes here who has entered into transactions abroad before coming to this country, no liability will attach to him in respect of the transactions which he entered into before becoming resident in this country; but, if he becomes ordinarily resident in this country, he will be treated in the same way as anyone else in respect of any transactions which he may then enter into.

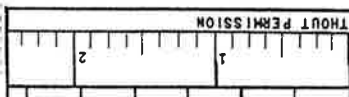
Subsection (3) is an important provision of the Clause, for it defines "power to enjoy income", and the various provisions of that Subsection are all designed to carry out the broad test of whether the individual can obtain the income abroad "in meal or in malt".

Subsection (7) provides that the Clause will apply for /the

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the assessment of Sur-tax for the year 1935-36 but for the assessment of the whole Income Tax - both standard rate and Sur-tax - for all subsequent years. With the exception of the interest payable on certain British Government securities (3½% War Loan, 4% Victory Bonds, 4% Funding Loan and 2½% Treasury Bonds), all income arising in this country is subjected to tax at the standard rate. Consequently, if the assets transferred consisted, for example, of stocks and shares in any British company, the Exchequer has already received the standard rate, and the avoidance of tax relates only to the Sur-tax. But, if the stocks transferred abroad were those British Government securities mentioned above which carry an exemption from Income Tax in favour of the non-resident, or if the stocks transferred abroad were foreign and colonial securities, the Exchequer loses, as the result of the avoidance scheme, not only the Sur-tax but also the standard rate. In the Finance Bill as introduced in the House of Commons the charge for the year 1935-36 extended to Income Tax - both standard rate and Sur-tax. This provision was criticised on the ground that it involved retrospective taxation, and on the Report Stage of the Bill the Chancellor made a concession to meet this criticism by limiting the charge for the year 1935-36 to the Sur-tax only. In the case of the Sur-tax for 1935-36 the assessments have not yet been made and the rates of charge are being fixed by Clause 15 of the Bill, so that no retrospection is involved in the charge to Sur-tax. In making this concession the Chancellor said that he felt it necessary to give a warning that, in cases of avoidance of

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the type dealt with in this Clause, persons should not in future assume that in no circumstances would there be retrospection.

Clause 19

Clauses 19 and 20 deal with avoidance of tax in the home sphere by means of what are known as "one-man" companies, the former covering all "one-man" companies and the latter only "one-man" investment companies.

Under the law as it stands (Section 21 of the Finance Act, 1922, as amended) there are special provisions relating to "one-man" companies, under which the Special Commissioners have power to charge the income of the company as the income of the shareholders if it is found that the company is not distributing a reasonable amount of its income in the form of dividend. These provisions relate, broadly speaking, only to private companies which are under the control of five or fewer individuals. Under the law as it stands, control is defined as existing where five or fewer individuals hold the majority of the voting power or more than half of the share capital, and these provisions are reproduced with additions in Subsection (1) of Clause 19. The additions are to cover the case where the taxpayer has a potential control by being able to acquire more than half of the voting power or the share capital, and also the case where the taxpayer has financial control. The test of financial control is whether, in the event of the income of the company being distributed, five or fewer persons would obtain more than half of the income, and this test is provided in paragraphs (b) and (c) of Subsection (1).

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