



TECHNICAL RELEASE

TAXGUIDE 1/14 (TECH 01/14 TAX)

IHT BUSINESS PROPERTY RELIEF – INTERESTS IN PARTNERSHIPS/LLPS AND SURPLUS CASH HOLDINGS

Guidance agreed with HMRC relating to the availability of inheritance tax business property relief on:

- (i) interests in partnerships and limited liability partnerships, and**
 - (ii) holdings of surplus cash by trading companies,**
- issued in January 2014 by ICAEW Tax Faculty, CIOT and STEP**

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ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skill and expertise, we provide insight and leadership to the global accountancy and finance profession.

Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

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CONTENTS

	Page
Foreword	4
Guidance	
Part A –Partnerships and LLPs: analysis sent to HMRC and HMRC’s response	5 – 7
Part B – Partnerships and LLPs: examples provided to HMRC with HMRC’s responses	8 – 14
Part C – Surplus cash holdings: analysis sent to HMRC with HMRC’s response	15
Appendix	
Ten Tenets for a Better Tax System	16

FOREWORD

1. The aim of this technical release is to provide guidance on some of the technical questions being faced by members in respect of the availability of inheritance tax (IHT) business property relief (BPR). This technical release is published jointly by ICAEW Tax Faculty, CIOT and STEP.
2. This TAXGUIDE does not set out in detail the legislative provisions or the qualifying conditions which must be met in order for BPR to be available. Instead it considers the availability of the relief on certain assets and in certain situations.
3. The purpose of this technical release is to address issues in relation to the availability of BPR on an interest in a partnership/limited liability partnership (LLP). A question mark has arisen over the availability of BPR where shares are held in companies through a partnership or LLP, where relief would be available if held directly by an individual. The possibility that BPR is not due, if correct, would appear to be at variance with the policy rationale behind the introduction of BPR, and ICAEW, CIOT and STEP consider that this issue should be addressed. It is assumed that this anomaly has arisen because BPR legislation has not yet been reviewed despite partnerships and LLPs becoming more widely accepted commercial alternatives to a corporation, the latter being the main holding vehicle used when the Inheritance Tax Act was introduced.
4. When introduced the original BPR provisions did not anticipate the introduction of the Limited Liability Partnership Act in 2000 or the increased use of partnership/LLP entities commercially since the changes to the IHT regime in Finance Act 2006.
5. This guide seeks to clarify HMRC's treatment of interests in partnerships/LLPs for BPR purposes and also to confirm the current view of HMRC on a number of ancillary BPR points.
6. Part A outlines the treatment of Partnerships and LLPs and sets out the current view of HMRC regarding the situation where either a partnership or a LLP holds shares in underlying companies.
7. Part B provides a number of examples of situations which have been seen in practice and which were put to HMRC for clarification of their treatment. We are grateful to HMRC for allowing us to publish their responses.
8. Part C provides guidance in relation to the view of HMRC on surplus cash held by businesses and companies which is increasingly common in the light of the current economic situation.

PART A – BPR TREATMENT OF PARTNERSHIP/LLP INTEREST: ANALYSIS SENT TO HMRC WITH HMRC RESPONSE

Analysis sent to HMRC

1. The central issue to be determined is how the IHT business property relief rules apply in relation to partnerships/LLPs which own shares in an unquoted trading company. In order to establish this we must first clarify the differences between the two entities. A general partnership under English Law is treated as opaque for IHT purposes but is transparent for income tax and capital gains tax purposes. As per s.267A IHTA 1984, LLPs are treated as general partnerships in this regard and would therefore appear to receive the same opaque IHT treatment.
2. When assessing the availability of BPR, it is necessary to decide whether to look solely at the level of the business activity in the partnership/LLP (treating it as opaque for IHT purposes) or whether to look through to the underlying asset and assess whether BPR would be available on the shares as if they were held directly by an individual (where, for instance, an investment partnership/LLP holds shares in a trading company).
3. The HMRC manuals appear to indicate that no relief is available where private company shares are held by the partnership/LLP which would otherwise qualify for relief if held directly. Specifically referring to LLPs, the HMRC manuals at [IHTM 25094](#) state (for additional text see para 12 below):
 - a. "...an interest in a LLP is deemed to be an interest in each and every asset of the partnership, while an interest in a traditional partnership is a 'chose in action', valued by reference to the net underlying assets of the business. This may require you to consider issues of situs of property. In cases of doubt refer to Technical Group (TG) for advice.
 - b. However, in considering if an LLP is an investment business ([IHTM25261](#)), you should look at the nature of the business underpinned by those assets, rather than the nature of the assets themselves, to see whether IHTA84/S105(3) is in point"
4. The manuals set out here an apparent contradiction between viewing the partnership/LLP as transparent for say IHT valuation purposes, and looking at the level of their business when considering BPR for an interest in a partnership/LLP. The HMRC manuals seem to indicate that if, for instance, the sole or main activity of a partnership/LLP is holding shares in unquoted trading companies (which would qualify for BPR if held directly), then no BPR is available as the business is wholly or mainly one of holding investments.
5. This description of an apparent contradiction is replicated in the discussion in McCutcheon on Inheritance Tax (5th edition, London 2009) 26-46 (pp 814-815), perhaps in deference to the HMRC manual. McCutcheon concludes that it would at the very least be prudent to consider that relief is not available.
6. In reality this confusion would appear to be attributable to the way the legislation is drafted. S.267A IHTA 1984 states:

"For the purposes of this Act and any other enactments relating to inheritance tax-

- a. property to which a limited liability partnership is entitled, or which it occupies or uses, shall be treated as property to which its members are entitled, or which they occupy or use, as partners,
 - b. any business carried on by a limited liability partnership shall be treated as carried on in partnership by its members,
7. The important words here in (a) are "as partners." If the property is treated as held "as partners" then no relief will apply because a general partnership is not transparent for IHT purposes - the asset for IHT purposes is a chose in action (the partnership interest), not a direct interest in any of the assets held by the partnership.
 8. The general intention of s.267A IHTA 1984 would appear to be to treat LLPs as though they were general partnerships for IHT purposes, and the wording of the section would seem to be sufficiently clear to achieve this. This would then seem to have the effect of limiting the transparency of the arrangement for BPR purposes. Confirmation that s.267A IHTA 1984 relates solely to UK LLPs would also be welcomed.
 9. To qualify for BPR the partnership/LLP's business must not be wholly or mainly that of making or holding investments, and holding shares in a trading company is primarily an investment activity. If it carries on a trade in addition to holding shares, it could have a hybrid business which is not wholly or mainly one of making or holding investments, dependent on the facts.
 10. For companies whose activity is wholly or mainly being the holding company of a predominantly trading group there is a specific let out so that they can qualify for BPR (s.105(4)(b) IHTA 1984), but there is no such let out for partnerships/LLPs owning shares in trading companies.
 11. This would further suggest that no relief is available where a partnership/LLP acts as a holding vehicle for shares in the holding company of a trading group. The policy justification for this approach should be addressed as there appears to be no apparent justification for treating partnerships/LLPs different from that of closely held companies and groups.

HMRC Guidance

12. Set out below is the Guidance found in the Inheritance tax manual in relation to Limited Liability Partnerships. Following on from this we have set down HMRC's response to the points made above.

"IHTM25094 – What is a partnership; Limited Liability Partnerships

The Limited Liability Partnerships Act 2000 came into force on 6 April 2001. Its main purpose and effect was to introduce a new form of legal entity known as a limited liability partnership (LLP). The pressure for the change was largely to resolve problems arising out of the nature of traditional partnerships for larger professional practices, but the use of LLPs is not restricted to them.

These practices, usually accountancy or law firms, can have partners world-wide who may be concerned about the fact that they have been subject to joint personal liability on matters over which they had little control.

The LLP Act 2000 has made a small amendment to the IHT legislation by directing (under s.11 LLP Act 2000) that a new paragraph (IHTA84/S267A) should be inserted after IHTA84/S267. The effect of this paragraph is that we look through LLPs so that they will be treated in the same way as traditional partnerships. The result of this is that:

- Where a traditional partnership incorporates itself as a LLP, a partner's period of ownership for the purposes of qualifying for business (or agricultural) relief will not be regarded as being interrupted.
- The normal reliefs and exemptions available to partners in a traditional partnership will also be available to members of a LLP. In particular, IHTA84/S10 (which provides an exemption for dispositions not intended to confer gratuitous benefit) will apply.

A further change is that an interest in a LLP is deemed to be an interest in each and every asset of the partnership, while an interest in a traditional partnership is a 'chose in action', valued by reference to the net underlying assets of the business. This may require you to consider issues of situs of property. In cases of doubt refer to Technical Group (TG) for advice.

However, in considering if an LLP is an investment business (IHTM25261), you should look at the nature of the business underpinned by those assets, rather than the nature of the assets themselves, to see whether IHTA84/S105(3) is in point.

Thus, in the case of an LLP investing in unquoted shares in trading companies, it would be inappropriate to allow relief on the basis that the underlying assets constitute business property: the true position is that the nature of the business conducted by the LLP falls within IHTA84/S105(3) so that relief is not available."

HMRC response

13. We do not think that how a partnership or LLP's activities are regarded for the purposes of determining whether it is carrying on an investment business for the purposes of s.105 (3) IHTA 1984 necessarily conflicts with our view that BPR is not available in relation to an interest in a partnership or LLP whose business is the holding of shares in unquoted trading companies (which could qualify for BPR if held directly by the individual partner). Therefore the view set out in IHTM25094 continues to reflect our general understanding. However, we have reviewed the matter and plan to amend the wording of IHTM25094 so that the final paragraph at 12 above is replaced by the following:

"There has been an increase in the use of LLPs in commercial structures, and sometimes there can be a different outcome for Business Property Relief (BPR) purposes than that available from a conventional corporate structure.-In the case of an LLP simply taking the place of a holding company, S.267A has the effect of preventing the LLP from benefitting from S.105(4)(b). In cases where the LLP itself also carries on a qualifying business, the business may be regarded as a hybrid, and if the shares in the subsidiary companies are used in the business (rather than being held as investments), then it is possible that the interest in the LLP may qualify for relief if it does not fail the 'wholly or mainly' test (IHTM25264). The question of whether an asset is used in the business or held as an investment will be highly fact specific. –

For example, a professional farming partnership might be required to hold a minimum stake within a genetics company in order to get specific semen for their bovine herds, or in a crop company to get the best seed at the best price.

If this stake is not held as an investment, but with the intention of ensuring that the trade continues and succeeds, then holding such a stake is unlikely to cause any restriction or removal of relief.”

This interpretation draws on and is reflected in the responses in Examples 2 and 5 in Part B below.

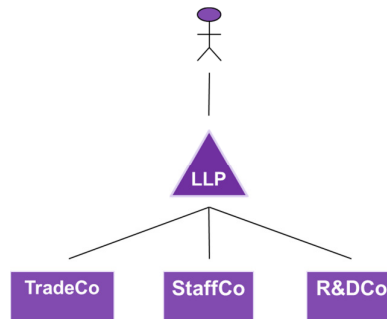
14. Given the increasing use of Partnerships and LLPs in structuring commercial arrangements, we appreciate the anomaly which can arise on the availability of BPR when comparing, say a LLP holding entity to an actual holding company. We have not seen many of these hybrid structures where the holding entity takes the form of an LLP; however it is thought this is a timing difference given the introduction of LLPs in 2000.
15. We confirm that s.267A IHTA 1984 relates solely to UK LLPs.
16. Although we appreciate that at present there appears to be an anomaly between companies and partnerships/LLPs in this regard, that is what the legislation directs us to and is a result of the drafting of the provisions.

PART B – BPR TREATMENT OF PARTNERSHIP/LLP INTEREST: EXAMPLES PROVIDED TO HMRC WITH HMRC'S RESPONSES

Example 1

Analysis sent to HMRC

1. It is becoming increasingly common for LLPs to be established as holding entities due to the transparent treatment from which they benefit in terms of income tax and capital gains tax. The LLP operates as a 'holding entity' with the members of the LLP carrying out the management of the various subsidiaries. There may be various subsidiary companies that enable the LLP to carry out the trade, and this structure is very common in professional partnerships. This is demonstrated in the example below.
2. If the LLP was a company, then BPR would still be available by virtue of section 105(4)(b) IHTA 1984, which enables holding companies to qualify for relief. However this provision does not extend to partnerships or LLPs.
3. We would be grateful for your comments on the availability of relief and the guidance in IHTM25094 which would appear that 'it would be inappropriate to allow relief (in this circumstance) on the basis that the underlying assets constitute business property'.



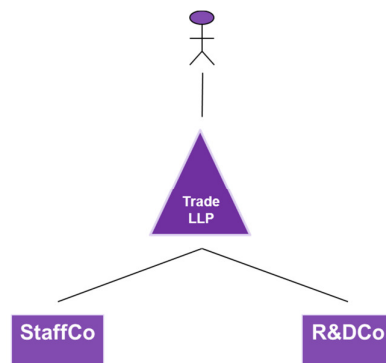
HMRC response to Example 1

4. As partnerships (and therefore LLPs) are not transparent for IHT purposes, we would be required to look at the business of the actual partnership /LLP itself. As the business consists wholly or mainly of holding investments then relief would be denied under s.105(3) IHTA 1984.
5. We agree that the exemptions from s.105(3) IHTA 1984 under s.105(4) IHTA 1984 do not have effect in this regard. S.267A IHTA1984 prevents the LLP from benefitting from S.105(4)(b).

Example 2

Analysis sent to HMRC

6. Let us assume that we have the same structure as outlined in Example 1. However, in this scenario the actual business of the group is carried on by the LLP. The subsidiary companies purely provide a number of ancillary services to the group, such as the provision of staff services etc.
7. In this scenario the value of the subsidiary companies does not result in the LLP falling within s.105(3) IHTA1984 as an interest in a business which consists wholly or mainly of making or holding investments.
8. In this regard, there are conflicting views as to how this situation is treated and HMRC manuals do not appear to provide any further clarification.
9. In the first instance, the LLP might be treated as a 'hybrid business' as explained in SVM111220. This is because the assets (i.e. holding in subsidiary) are held for the purposes of a separate business being the holding of shares in associated trading companies.
10. Alternatively, the hybrid business argument may not apply which means that shares are excepted assets because they are not used for the purposes of the business.
11. Obviously, if the value of the subsidiary arms outweigh the trading assets within the LLP, then relief would be denied under s.105 (3) IHTA 1984.



HMRC response to Example 2

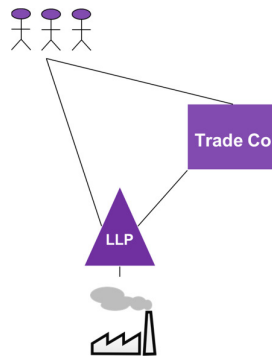
12. A distinction is made in IHTM25273 and SVM111160 as to the holding of an asset as an investment and the running of a 'business'. In this regard, where the assets are held as investments, it is clear that their holding alone cannot be classified as a 'business' activity unless it can be shown the investments are used in the course of the LLP's business. However, it is possible in this scenario that if the investments are used in the LLP's business, then the business may well not fail the 'wholly or mainly' test by virtue of the dominant nature of the business carried on in the LLP not being one of investment. The question of whether the investment **is** used in the LLP's business is highly fact-specific.

13. In a situation where the investments are not used in the LLPs business, we are required to look at s.112 IHTA 1984 to determine whether the assets are excepted.

Example 3

Analysis sent to HMRC

14. It is becoming increasingly popular for property to be held outside of the main trading company. There are various reasons for this including protecting the property from trading risk, and also allowing the owners to benefit from a single CGT charge on any onward sale.
15. If the property were held directly by the owners, then as this was an asset used wholly or mainly for the purposes of a business carried on by a company which they control (or partnership in which they are partners), then they would have qualified for 50% BPR under s.105(1)(d) IHTA 1984.
16. However, in our scenario and in order to mitigate the difficulties of owning land jointly, the owners decide to hold the property via a LLP. On this basis, the asset which they hold is an interest in the partnership. We then assess the business of the partnership which will either be determined to be dealing in land or buildings or the holding of investments and therefore BPR will be denied.



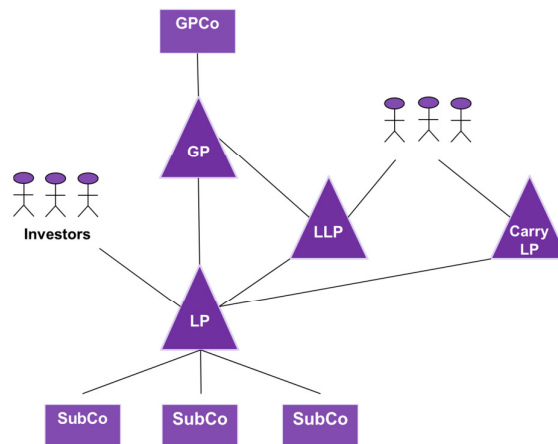
HMRC response to Example 3

17. We confirm the analysis above, and agree that there is a divergence in the availability of the relief.
18. When assessing the level of relief available on the partnership interest, we recognise that the underlying asset is indeed held for business purposes and is employed in this manner. However, the legislation does not enable us to assess the underlying assets and we must look at the business actually carried on by the partnership. On this basis, relief is denied by s.105(3) IHTA 1984.

Example 4

Analysis sent to HMRC

19. The use of Limited Partnerships (LPs), LLPs and general partnerships has now become common place in venture capital structures. A typical venture capital structure is outlined below.
20. The venture capital investors use the LLP to carry out the management function of running the fund and obtain their return via the Carry LP. The bottom LP is then invested in by third parties, and makes further investments into subsidiary companies. The various partnership entities are used in this scenario due to their transparent nature for both income tax and capital gains tax.
21. In respect of the venture capital investors, they hold interests in the management LLP and also the Carry LP. Both partnerships carry on the business of making or holding investments and therefore relief will be denied under s.105(3) IHTA 1984. There may be an argument that the LLP is trading as it advises and manages the investment LP. However, it is understood that the LLP holds minimal value, and the majority of which is established by the interest in the underlying LP, which will be treated similar to the underlying entities explored in Example 2.
22. In relation to the investors in the LP which makes further investments, similarly it is understood that BPR will be denied on the interest in the LP as it carries on a business of wholly or mainly making or holding investments.
23. Finally, in a simpler Investment LP Fund, where there are none of the other entities, relief would also be denied via s.105(3) IHTA 1984.



HMRC response to Example 4

24. We confirm the analysis above that BPR will be denied on all interests (with the possible exclusion of the LLP dependent upon the activities conducted) by virtue of s.105(3) IHTA 1984.

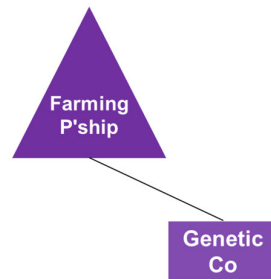
In respect of the LLP the same conclusions apply as were reached in our analysis of example 2.

25. We also confirm that an interest in a Limited Partnership which exists solely to hold investments in subsidiaries would not qualify for relief.

Example 5

Analysis sent to HMRC

26. It is increasingly common in commercial situations for trading entities to be required to be a member of an entity from which they acquire services/products/intellectual property. For example it is extremely common for professional farming partnerships to hold a minimum stake within a genetics company in order to get specific semen for their bovine herds, or in a crop company to get the best seed at the best price.
27. This stake is not held as an investment, and the motivation behind the ownership is to ensure that the trade continues and succeeds, not to generate an income or realise a gain.
28. When determining whether BPR is available we are required to look at the nature of the partnership. The partnership conducts a farming trade and has no other activities. In order to carry out this trade effectively it is necessary to hold a very minor stake in a company.
29. Despite shares in an unquoted company being held, our members have found that business property relief has not been denied in this situation as the stake held in the genetics company is not an excepted asset. In general the value of the shares held would be low.



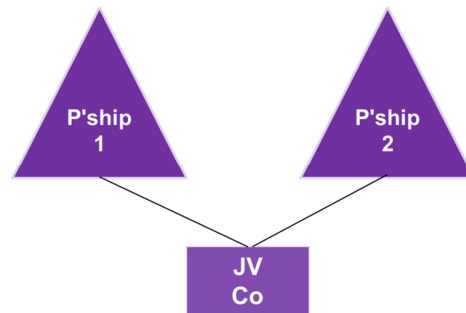
HMRC response to Example 5

30. We generally regard this situation as the same as example 2. The issues are whether the investment is used in the business, and the outcome of the 'wholly or mainly' test. In this specific scenario, it would seem to be the case that BPR will be available. As in example 2, the precise facts are of key importance - it would be possible for such a minority shareholding to be held purely as an investment.

Example 6

Analysis sent to HMRC

31. In the current economic climate, joint ventures are becoming increasingly popular as they enable businesses to work together to obtain commercial synergies whilst reducing the element of financial risk often involved in new developments. The Joint Venture itself is often undertaken in a company due to some of the advantageous research and development tax incentives and the organisational merit of using a company in this regard.
32. Therefore where two newly formed partnerships (or LLPs) wish to undertake a joint venture, it is anticipated that BPR relief should be available.
33. However, and as outlined in IHTM25094, the current guidelines do not assess the underlying assets of each partnership, and as there is no equivalent 'holding' provision, such as the one in s.105(4) IHTA 1984, then relief would not appear to be available. Conversely if the partnership/LLP was a company, then relief would be available.



HMRC response to Example 6

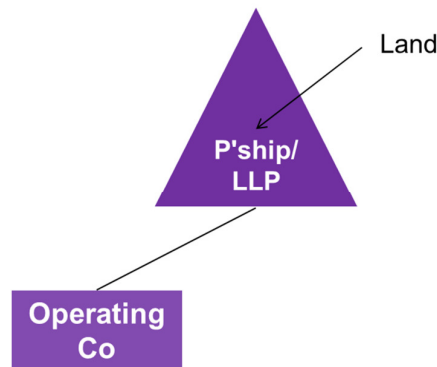
34. We confirm that no relief is available for the interest in the partnership/LLP as the business carried on is wholly or mainly that of holding investments.
35. There is also no relief from s.105(3) IHTA1984 by virtue of s.105(4) IHTA 1984 as these provisions relate solely to companies. We do not agree that if a company were used instead of partnerships/LLPs then relief would be available (assuming all other conditions are met). 50:50 corporate joint ventures do not satisfy Section 1159 (1)(a) of the CA 2006. A 50:50 corporate joint venture would only qualify for relief if it qualified as a 'subsidiary' under other subsections of that act, for example (1)(b) or (1)(c).

Example 7

Analysis sent to HMRC

36. As outlined previously, partnerships and LLPs are being used in the same guise as traditional holding company's in order to separate the trading risk from what is normally the most valuable asset of the company, the land and buildings.
37. In this scenario the partnership (or LLP) owns the land on their balance sheet and they also own the shares in a company which conducts the trade of the business.

38. Similar to many of the examples above; relief will be denied on the basis that the company consists of wholly or mainly the holding of investments. As there is no corresponding relief as there is for companies under s.105(4)(b), then relief will be denied on the total value of the partnership (or LLP).



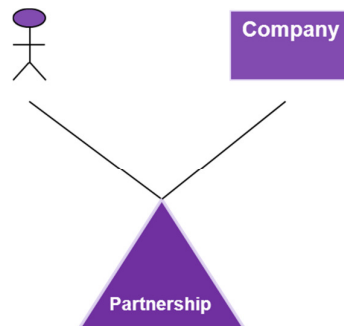
HMRC response to Example 7

39. We confirm the position you have stated that relief will be denied on the basis of s.105(3) IHTA 1984.

Example 8

Analysis sent to HMRC

- 40. Let us assume that a partnership/LLP is conducting a 'qualifying' trade for BPR purposes and its members are an individual and a company.
- 41. The individual holds an interest in a trading partnership and will qualify for BPR. However, on the basis of the above analysis the question arises as to whether the shares in the company will qualify for relief.
- 42. The unquoted shares are in a company which holds an interest in a trading business. On this basis, and assessing the underlying assets of the company, BPR would be available. The availability of relief would be different if the partnership/LLP held shares in private trading companies.



HMRC response to Example 8

43. We confirm the position that if the partnership is carrying on a trade (which is not excluded by s.105(3) IHTA 1984) then the shares in the corporate member would qualify for BPR.

PART C – SURPLUS CASH HOLDINGS: ANALYSIS SENT TO HMRC WITH HMRC'S RESPONSE

Analysis sent to HMRC

1. Where a company holds an amount of cash which is in excess of the amount which it 'normally holds' and there is no evidence of any given project upon which the funds will be expended, then BP relief will be denied as the excess will be treated as an excepted asset.
2. Members are aware of the HMRC guidance in IHTM25352, IHTM25342 and SVM111220 and this guidance has proved sufficient in demonstrating the position of HMRC. It clarifies that cash balances should be viewed in light of the business's trading cycle and that businesses should keep evidence of discussions surrounding the intended use of cash balances.
3. However, in the light of the current economic climate and in order to weather the financial adversity faced by many businesses within the UK, it is widely recognised that businesses are retaining increased cash buffers in case of any further downturn in their trade. This is a widely accepted tactic in surviving a recession to ensure that businesses succeed and reverts to the cliché that 'cash is king'.
4. In this regard, confirmation from HMRC that they are aware of this change in mind-set of business owners and company directors, and look favourably on surplus cash held in this regard, would be extremely useful to our members.

HMRC response

5. We understand that due to the financial circumstances in which business find themselves, they may choose to hold more cash in case of a potential downturn in trade. We can also confirm that in recent times we have seen this on a more frequent basis where businesses hold cash in excess of what they would traditionally require.
6. However, our guidance remains the same, and unless there is evidence which directs us to the fact that the cash is held for an identifiable future purpose, then it is likely it will be treated as an excepted asset. Therefore the holding of funds as an 'excess buffer' to weather the economic climate is not a sufficient reason for it not to be classed as an excepted asset.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)