Tax Representation

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

TAXREP 56/09

SIMPLIFYING TRANSACTIONS IN SECURITIES LEGISLATION

Memorandum submitted on 29 October 2009 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation document published in July 2009 by HMRC

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SIMPLIFYING TRANSACTIONS IN SECURITIES LEGISLATION

INTRODUCTION

1. We welcome the opportunity to comment on the proposals published in the consultation document on 31 July 2009 by HMRC

2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B.

MAJOR POINTS

Support for the initiative

3. We wholeheartedly welcome the proposals set out in the consultation document (condoc) to simplify and modernise the Transactions in Securities (TiS) provisions. A large part of the TiS legislation is now out of date and its very wide potential application means that it can 'catch' straightforward company sales etc which results, currently, in there being far too many clearance applications.

Will the proposals provide customers with simplification and increased certainty?

4. In our view the majority of the deficiencies in the current legislation have been tackled in the proposed package of reforms.

5. In particular, the introduction of the 'fundamental change of ownership' test in relation to each individual shareholder should reduce the need to apply for clearance in the vast majority of company sales which will reduce compliance costs.

Are there opportunities to further simplify the TiS legislation?

6. Following the reforms, this would only leave the 'old' circumstances D and E 'merged' in the new section 684 ITA 2007. We find it hard to envisage cases where companies would be within the ambit of the more focussed TiS legislation and we feel that the opportunity should be taken to remove the legislation for companies completely (within the Corporation Tax Act 2010).

7. In practice, there appears to be some misunderstanding and uncertainty about the application of the TiS legislation to liquidations. We feel that the opportunity should be taken to be more prescriptive about the type of liquidation scenarios that should fall outside the TiS regime – perhaps some additional wording within the 'fundamental change of ownership' rules could achieve this. Clearly, HMRC would wish to protect its position where, for example, 'phoenixism' was involved. Such changes may also assist with the statutory enactment of ESC C16.

OUR RESPONSES TO SPECIFIC QUESTIONS

8. We have answered the general 'overview' questions at the end of section 2 of the condoc in the above section of our TAXREP. In the rest of the document we answer the specific questions raised in the remainder of the condoc.

PROPOSAL 1 : REFOCUS THE TRANSACTIONS IN SECURITIES PURPOSE TEST TO TARGET TAX AVOIDANCE

Do you have any thoughts on this shift in focus within the TiS legislation? Do you consider there are there any pitfalls you can see for customers?

9. The new s683 ITA 2007 results in the TiS legislation being triggered where obtaining a tax advantage is the main or one of the main purposes driving the relevant transaction. It is proposed that the existing 'commercial purpose' test would be dropped.

10. It would appear that the existing 'commercial purpose' let-out has been reconfigured as the new 'fundamental change of ownership' test in the new s685 ITA 2007. However, this over simplifies matters since there will still be many cases where the 'commercial purpose' test is helpful. For example, the taxpayer could show that the relevant TiS was entered into for purely commercial reasons and obtaining a tax advantage was a merely a subsidiary outcome. Although this TiS might still escape 'counteraction' under the new rules, it is felt that the taxpayer's legal position would be strengthened by retaining the commercial purpose test within in the proposed s683 ITA 2007, especially as there is a established body of jurisprudence in this area.

11. We would therefore favour the retention of a commercial purpose test since this would avoid concentrating only on the likely tax savings flowing from the proposed transaction with the taxpayer then being in the difficult position of having to demonstrate that they were not a main purpose or one of the main purposes (as illustrated in the recent case of Snell v HMRC [2006] EWHC 3350).

12. We would also appreciate confirmation that failure to meet the s685 (fundamental change of ownership rule) would not necessarily lead to a refusal to grant clearance where the transaction was essentially commercially-driven and any tax advantage was viewed as a by-product. The retention of a complementary 'commercial purpose' test would enable HMRC and the appellate bodies etc. to also look at the commercial reasons rather than simply seek out the potential tax avoidance ones.

13. Problems may arise in marginal or difficult cases where the seller only remains connected due to the wide definition of connected persons within s993 ITA 2007, yet in commercial terms the transaction would essentially be seen as a 'clean sale' (since the vendor has no economic influence over the relevant 'connected' purchasers). We feel that the adoption of the more 'restricted' associates test in s227 ICTA 1988, which applies for company purchases of own shares, might be more appropriate here. It may also be helpful to remove business partners from the 'associates' test since this has been shown to cause unnecessary complications in practice (see, for example, the proviso to s13(4) ICTA 1988 introduced by s35 FA 2008).

14. The draft legislation at s685(3) requires the parties to check that they have never been connected.This would seem to require one to look back indefinitely in testing the position.As well as the practical difficulties in obtaining conclusive information this may well act to include connections which have long since ceased to exist and that can have no conceivable bearing on the present transaction in securities.We would propose a time restriction should operate for no more than three years.

Do you consider this will this help provide certainty and clarity for customers?
Do you consider this will lead to less work or more work for our customers?

15. The 'fundamental change of ownership' rule would give customers and their advisers more certainty where there are no or minimal 'continuing' shareholding connections post-sale. These would clearly fall outside the scope of the revised TiS legislation and would give welcome certainty in such cases.

16. We would expect the 'fundamental change of ownership' rule in s685 ITA 2007 to filter out a large majority of 'clean exits' where a company is sold to a 'third-party' purchaser. This would obviate the need to apply for s701 ITA 2007 clearances in such cases. As a result, this change would clearly be beneficial to users of the TiS legislation since it will reduce the time and cost involved in getting advance clearance where the TiS is a 'clean' exit satisfying the proposed fundamental change of ownership rule in s685 ITA 2007.

17. However, clearance applications will often still be required under s138 TCGA 1992 (for example where shares, loan notes, or deemed s138A TCGA 1992 securities form part of the sale consideration or where there is a company demerger or reconstruction).

18. We would also like to see an appeal procedure for a refusal to grant clearance under s701 ITA 2007 (as opposed to the appeal against a counteraction assessment dealt with within s705 ITA 2007 which may be issued a long time after the original transaction). This would give the taxpayer the ability to argue their case immediately and obtain certainty (since this could prevent the case escalating to a counteraction assessment further down the line).

19. Would it be possible to confirm that an adviser could use the new 'internal review' procedure where clearance is refused and ask for the case to be looked at afresh?

PROPOSAL 2 : ADOPT THE DEFINITION OF A CLOSE COMPANY FOR A 'RELEVANT COMPANY' IN SECTION 691 ITA 2007

Do you consider this change will be beneficial for HMRC's customers?
Do you have any reservations about the change of close company definition?
Do you foresee any practical problems or benefits?

20. The adoption of the 'close company' definition in s414 and s415 ICTA 1988 would bring some minor benefits (as outlined at 4.3 of the condoc), and helpfully counter the artificial practice of 'D-proofing'.

21. The close company definition is fairly well understood amongst advisers and we see no substantive problems with its adoption in the TiS legislation, especially since taxpayers would have the benefit of the 'fundamental change of ownership' exemption.

Can you foresee any issues with certain situations, such as Management Buy Outs (where more than 5 managers buy control of a company), which would be affected by the change of the close company definition?

22. We would generally expect most Management Buy Out (MBO) companies to fall within the TiS legislation. There may be a small number of cases where the wider 'close company' definition would bring them into the TiS regime, on (say) a secondary buy-out but this is likely to be balanced by the 'fundamental change of ownership' exemption in the vast majority of cases.

23. The guidance notes outlined in paras 101130 should also give some clarity here. See also our comments in paragraph 9 to 13 above.

PROPOSAL 3: SIMPLIFYING THE REMAINING CIRCUMSTANCES IN SECTIONS 686 TO 690 ITA 2007

Do you agree with the repeals of section 686 ITA 2007 and its CT counterpart?
Do you agree with the repeals of sections 688, 692, 693, 694 ITA 2007?

24. We welcome the repeals of Section 686, 692, 693 and 694 since they are now of no real practical application under the current tax regime.

Do you agree that sections 689 and 690 ITA should be merged into one single circumstance? Or would you prefer to have these two provisions retained in their current form?

25. The merging of s689 and s690 as alternate conditions A and B of s684 works quite effectively and is an improvement on the existing TiS provisions.

Do you have any views on the new section 684?
Do you have any views or suggestions on how to amend the new section 684 so that it can be made clearer and more easily understood by our customers?

26. We consider that the new section s684 is reasonably clear and since it contains similar wording to the current provisions, existing case law precedent would assist with its interpretation.

PROPOSAL 4: THE FUNDAMENTAL CHANGE OF OWNERSHIP RULE

Do you consider this change will benefit potential clearance applicants and their advisers?
Do you consider that the proposed test accurately describes what a fundamental change of ownership is? If not, what other factors should be considered?

27. We would like to see the test address contingent cases. For example, we have seen a number of company sales where, for example, as a result of a contractual breach, the seller would have the contractual right or option to 're-

purchase' their shares, even though this was never contemplated at the outset. It is our view that such 'contingent' cases should fall within the 'fundamental change of ownership' test in s685 ITA 2007 but this needs to be made clear.

Are you aware of any other indicators that can be used to separate genuine transactions from those implemented for avoidance purposes?

28. We should like to see a *de minimis* rule for very small minority shareholders along the lines of provisions in s137 (2) TCGA 1992. The rationale is that such shareholders are not in a position to influence the terms of a company sale or the sale of a major stake in a company. Furthermore the risk of a loss of revenue must be small. A suitable *de minimis* rule (whether percentage stake or monetary consideration driven) would remove a lot of compliance angst for small shareholders who generally have to follow the terms of the deal put to them.

29. Once the new TiS provisions are introduced, we recommend that the anti-avoidance team continue to monitor clearance applications and seek to identify further filters or gateways tests that could be introduced to simplify the TiS provisions further.

Do you consider 75% is an appropriate level for this proposal? If not, what level do you feel would be more appropriate and why?

30. Setting the 75% threshold is clearly a subjective matter but seems to strike the right balance. However, there are likely to be many cases where sales with a more than 25% 'continuing shareholding' are less tax motivated than ones which meets the 75% 'fundamental change of ownership' rule. Sellers will generally seek to do deals based on the best post-tax return. Such deals are commercially driven and cannot always be tied to a 75% test. This is why we feel the commercial purpose test should be retained (see our response in paragraphs 9 to 13 above).

31. We consider the connection test to be unnecessarily wide since it could embrace various persons who could not generally be seen as acting together (see our comments in paragraphs 9 to 13 above)

PROPOSAL 5: DEFINING AND QUANTIFYING 'TAX ADVANTAGE'

Do you consider there are benefits to quantifying the 'tax advantage' in statute in the way set out in the new section 683 ITA 2007?

32. We welcome the increased clarity provided by s683 ITA 2007 and the illustrative guidance showing how the income tax and capital gains tax amounts would be arrived out.

Do you agree with the principle and approach detailed above?
Do you consider it would be appropriate to include any conditions or restrictions? If so where and why?
Do you have any other comments or concerns with this proposal? If so, what are they?

33. It is helpful to have legislative confirmation and guidance supporting the fact that the relevant proceeds would be tested against the amount of the company's distributable reserves. We understand that in a group situation HMRC have tended to look to the group's 'underlying' reserves on the basis that the holding company could procure a distribution from each of its subsidiaries at the relevant time. Some confirmation of the position with regard to the treatment of group companies would be helpful.

34. Given that this is a notional calculation of CGT on the amount of the distributable reserves, the guidance notes do not make it clear how the CGT base cost and any relevant CGT reliefs would be applied , such as (for example) Entrepreneurs' relief, in arriving at the CGT payable for s683(1)(d) ITA 2007 purposes. There may also be changes of circumstance when reliefs or losses become available which could affect the result of this calculation.

35. Assuming that the company is sold for an amount in excess of its net asset value, we presume that any earn-out consideration would not enter the 'comparative' calculation since this would normally be in excess of the company's distributable reserves at the relevant sale date. Some clarification of this area would also be welcome. There may also need to be further guidance when the rules on IFRS (International Financial Reporting Standards) change for SMEs.

PROPOSAL 6: CLARIFYING THE SCOPE OF THE TRANSACTION IN SECURITIES RULE

Do you have any concerns with this proposal

36. We consider that the new s686 ITA 2007 will provide the required certainty in this area for individuals and trusts.

37. With regard to companies, it is our view that corporate sellers should be removed from the TiS legislation altogether since we find it difficult to see a 'revenue' risk here (see our comments in paragraphs 6 and 7 above).

PROPOSAL 7: FRAMEWORK GUIDANCE FOR TRANSACTIONS IN SECURITIES

Would better guidance increase certainty and reduce administrative burdens?
Would better guidance reduce your need to submit clearance applications to HMRC
Are there any other areas or subjects you would like to see included in the guidance?
Does our proposed layout meet customers' needs (i.e. is it appropriate and comprehensive? If not, what changes would you suggest to the proposed layout and content?

38. It is difficult to provide detailed comments on the draft guidance (as most of the detail is missing). However, looking at the framework for the guidance and the 'sample' sections 100400 to 100406, the notes should prove to be a useful aid to practitioners and advisers. Based on the detail provided in the 'sample' sections, this would give tax advisers sufficient clarity about when an advance s701 ITA 2007 clearance was required.

39. Other suggested areas for inclusion in guidance are group reserves (see 7.6.4) and the treatment of relevant reserves where redeemable loan notes issued (e.g. the current HMRC practice to look at the reserves of the loan note issuer at the time of redemption).

40. We would also welcome further worked examples of the comparative income and capital gains tax payable calculations where different reliefs and tax rates are involved (e.g. the treatment of the new dividend tax rate of 42.5% for those with income over £150,000 from 2010/11)

If the proposed layout is adopted, what specific case law guidance would you like?

41. The proposed commentary on Key cases appears to be sufficient. HMRC's interpretation of each case, especially in relation to the new legislation, would be helpful.

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ANNEX A

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

2. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.

4. To find our more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

ANNEX B

THE 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 www.icaew.co.uk/index.cfm?route=128518.