Tax Representation

TAX FACULTY

TAXREP 34/09

SHARES ACQUIRED BEFORE 10 APRIL 2003 BY EXERCISING EMPLOYEE SHARE OPTIONS – ALLOWABLE DEDUCTIONS: REVENUE & CUSTOMS BRIEF 30/09:

Text of a letter submitted on 4 June 2009 to HM Revenue & Customs by the Tax Faculty of the Institute of Chartered Accountants in England and Wales following publication of Revenue and Customs Brief 30/09 on 12 May 2009.

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SHARES ACQUIRED BEFORE 10 APRIL 2003 BY EXERCISING EMPLOYEE SHARE OPTIONS – ALLOWABLE DEDUCTIONS: REVENUE & CUSTOMS BRIEF 30/09:

INTRODUCTION

1. On 12 May 2009 HMRC published *Revenue & Customs Brief* 30/09 entitled *Shares acquired before 10 April 2003 by exercising employee share options – allowable deductions*. In this Brief HMRC advises that it now has legal advice that guidance previously published is incorrect.

2. The original guidance related to the disposal of shares acquired through unapproved or EMI share option schemes and was issued following the 2002 Court of Appeal decision in *Mansworth v Jelley* [2002] EWCA Civ 1829. The guidance stated that HMRC considered the gain or loss on disposal should be calculated by deducting from the disposal proceeds both:

   - the market value of the shares at the time the option was exercised and
   - any amount chargeable to income tax on the exercise (generally the difference between the price paid for the shares and their market value when the option was exercised).

3. In the Brief issued on 12 May 2009, HMRC now states that, following legal advice taken, in computing any capital gain or loss on a disposal of shares acquired prior to 10 April 2003 by exercise of unapproved share options, or in other circumstances where the exercise was liable to income tax, no deduction is due for any amount that was chargeable to income tax on exercising the option. This effectively overturns its previous guidance.

4. HMRC goes on to state that it will be amending its guidance to reflect the new advice and that those affected by the change may need to make or amend a self assessment return or loss claim provided they are in time to do so.

5. As HMRC did not provide any further information or guidance, we have written asking for further clarification of a number of issues which arise from the Brief. The text of the letter and accompanying questions posed are reproduced below.

6. 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 when evaluating legislation are summarised in Annex B.

TEXT OF THE LETTER TO HMRC

On 12 May 2009 HM Revenue & Customs published *Revenue & Customs Brief* 30/09 (Brief 30/09) on the subject of shares acquired before 10 April 2003 by exercising employee share options. As you know this issue was the subject of litigation in the case of *Mansworth v Jelley* [2002] EWCA Civ 1829. Following the Court of Appeal decision in favour of the taxpayer the then Inland Revenue released on 8 January 2003 a note on its implications (legislation was also enacted changing the law which is why we are only concerned here with shares acquired prior to 10 April 2003).

Where unapproved employee share options and Enterprise Management Incentive share options were exercised before 10 April 2003, the Inland Revenue note of 8 January 2003 made it clear that the capital gains tax acquisition cost of the shares was 'their market value at the time the option is exercised plus any amount charged to income tax on the exercise'. The practical result was that capital losses were usually realised on the sale of the shares.

Brief 30/09 indicates that new legal advice has been received to the effect that 'HMRC's guidance is incorrect' and goes on to state that

> *Where the shares are treated as having been acquired at market value, that value is the full measure of their deemed cost of acquisition. The cost is not augmented by any amount chargeable to income tax on the exercise of the option. Thus in computing any capital gain or loss accruing on a disposal of the shares no deduction falls to be made of, or in respect of, any amount that is chargeable to income tax on exercising the option. Our guidance will be amended accordingly.*

There is no technical analysis of the reasoning behind this change and the only comments with respect to the practical implications for taxpayers who are affected are as follows:

> *Those affected by the change may need to make or amend a Self Assessment return or loss claim provided they are in time to do so.*
>
> *HMRC will apply our new understanding of the law in cases where there is an open enquiry or appeal.*

We do not feel that the above is adequate to explain the practical ramifications to taxpayers on whom this announcement potentially impacts. We are also concerned that the wording of Brief 30/09 indicates that the announced change does not only have effect for transactions (meaning share sales) occurring after the date of its publication. The Inland Revenue note of 8 January 2003 was adopted as prevailing practice (as evidenced in various commentaries on capital gains tax). While we understand that HMRC is entitled to change its guidance based on new legal advice, we consider that it is unacceptable and contrary to the legitimate expectations of taxpayers for any change to be effective before this new view was made public. We urge HMRC to announce immediately that they are consulting further on the issues raised and that taxpayers should wait for the results of this consultation before taking any action. We would like to join those consultations.

In order to assist such consultations, we set down in the appendix to this letter various questions. We should like to be able to provide our members with further guidance at the earliest opportunity. Accordingly, we should be grateful if you would arrange for these queries to be answered as a matter of urgency and grant permission for us to make these questions and the HMRC answers public.

APPENDIX TO LETTER – QUESTIONS

Position where losses have been crystallised and the enquiry window is now closed: tax years from 1996/97 onwards

Example

In 2001/02 Susie sold for £45,000 some shares she had acquired earlier that tax year through the exercise of an unapproved share option. The market value at the time she exercised the options was £44,000, the exercise price was £25,000 and she had therefore paid income tax on £19,000. Based on the Revenue note of 8 January 2003 Susie realised a capital loss of £18,000. In 2008/09 Susie realised capital gains of £27,000 in the expectation that she would not have a capital gains tax liability because her capital losses brought forward and the annual exemption would reduce the chargeable gains to nil.

We believe that Susie does not have to recalculate her 2001/02 gain and that the £18,000 loss will still be allowable in full. CG15813 indicates that under self assessment:

The amount of an allowable loss accruing in 1996/97 or later years will become final if the claim is not enquired into within the enquiry time limit. The deduction of an allowable loss from chargeable gains does not require a claim and does not extend the time limit for enquiring into the original loss claim.

We understand this to mean that where a claim has already been made, either in a return or as a stand alone claim, and the enquiry window has passed for the return/claim (or an enquiry has been settled), then those losses are final. This means that the quantum of the losses brought forward in these cases cannot be changed after the enquiry window has closed.

This interpretation is supported by TGCA 1992 16(2A) read in conjunction with TMA sections 8, 9A, 28A, 42, 43 and schedule 1A. We believe that the effect of the legislation is that the quantum of losses is final once the enquiry window has lapsed.

Question 1

a. Please would HMRC confirm that our understanding is correct?

b. If HMRC considers that such brought forward losses should be recomputed in line with HMRC's new guidance, on what basis has it reached this conclusion?

Position where losses have been crystallised in tax years prior to 1996/97

CG15812 states

For years before the introduction of Self Assessment there is no statutory mechanism for agreeing or litigating the amount of capital losses in the absence of gains for them to be set against, except for cases falling within TCGA92/S253 and TCGA92/S254, see CG15830 and CG65900+. A taxpayer cannot have the quantum of a loss brought before the First-tier Tribunal until such time as a gain arises against which the loss can be set. This statutory position was endorsed in the tax case *Tod v South Essex Motors (Basildon) Ltd* 60TC598.

We appreciate that given the timeline there are relatively few taxpayers who will have pre 1996/97 losses of this nature. There will, however, be some real life examples and so we should appreciate clarification of HMRC's view of whether such losses can be considered to be final.

As with self assessment losses, the taxpayer may have based current and future investment decisions on the future availability of these losses, relying on the Inland Revenue note of 8 January 2003. It does not seem reasonable that such brought forward losses from many years ago which have been computed on the basis of practice at the time, should now be recomputed as and when gains arise against which the losses can be offset.

Question 2

a. Does HMRC agree that where pre 1996/97 losses have already been notified to HMRC, usually by way of disclosure on the SA return, the losses can be considered as final? (That is, they do not need to be recomputed, as a result of the change in guidance, as and when gains arise against which the losses can be offset?)

b. If HMRC considers that such brought forward losses should be recomputed in line with HMRC's new guidance, on what basis has it reached this conclusion?

c. Should such brought forward losses have to be recomputed, taxpayers would seem to be in an invidious position as regards pre 1996/97 losses because every time there is change of view of law or practice, the quantum of losses might change. If this is the case it would appear appropriate to ask for a change in legislation to give taxpayers more certainty. What is HMRC's view on this matter?

Tax years that are still open – HMRC's stance

It appears from the new guidance that HMRC may consider that it is entitled to revisit the treatment of returns/claims already filed where the enquiry window is still open. We could understand such a treatment applying where, for instance, a court decision clarified what the law was (and always had been), but the previously generally held view was different to the court decision. As far as Brief 30/09 is concerned, however, there is only a change in the HMRC view of the law. HMRC's original guidance will have created a legitimate expectation for taxpayers who carried out transactions (e.g. share sales) while the old guidance was current. Accordingly, it would only seem appropriate for this new view to apply to transactions (i.e. share sales) on or after the date of the publication of the change of view by HMRC.

Question 4

Are we correct in taking Brief 30/09 to mean that HMRC considers that it is able to contend that the capital loss calculation should be revised on returns/claims which are currently open or for which the Enquiry window has not passed and in which the capital loss accrued?

If we are correct, how can this be justified when weighed against the fact that the taxpayer filed in line with HMRC guidance and has a legitimate expectation that the tax treatment should be more favourable than this changed guidance will allow?

Tax years that are still open – the position of the taxpayer

A return already filed which was made in accordance with HMRC's original published guidance would have been made in accordance with the practice generally prevailing at the time it was made. We do not therefore consider that the taxpayer is under any duty to amend such a loss claim. It would therefore appear that if a return is not amended, and no enquiry is made within the relevant enquiry time limits, then no discovery assessment would be possible.

Furthermore, it is likely that affected taxpayers may not realise there has been a change in the HMRC stance and having followed HMRC guidance at the time of filing their return, they will not have considered it necessary to monitor the HMRC website for changes of view. In fact it would be quite unreasonable to expect them to do so.

Question 5

a. Does HMRC consider that returns/claims which are within the relevant time limit for amendments to be made, must be amended?

b. If so, what are the grounds for this contention?

Tax years under enquiry

An enquiry may be open into an aspect of a tax return unrelated to the losses claimed, which were claimed in accordance with the published guidance at that time.

Question 6

a. Would HMRC seek to amend the amount of losses claimed in the return to reflect the new interpretation, even though the return would otherwise be outside the enquiry window, the losses were claimed in accordance with practice at the time and the enquiry was into an unrelated matter?

b. Would HMRC's answer be the same if the enquiry was a 'full' enquiry?

c. If HMRC's view is that the figures should be amended, on what grounds has it reached this conclusion

2008/09 tax returns

We understand from Brief 30/09 that HMRC is expecting taxpayers to complete their 2008/09 tax returns on the basis of its revised guidance, which has been issued after the end of that tax year. .As stated above, we do not consider that this is right. Taxpayers will have entered into transactions with a legitimate expectation that the tax consequences would be based on guidance available at the time of the transactions, being the Inland Revenue note of 8 January 2003.

A taxpayer may, for example, have sold in 2008/09, before the new guidance was issued, shares acquired via an option exercised prior to 10 April 2003. At the time of the sale the taxpayer expected a loss (or smaller gain) to arise, based on computing his base cost in accordance with the HMRC guidance at the time of sale.

Then, expecting those losses to be available for offset, the taxpayer sold other assets at a gain in 2008/09. If the taxpayer files his return on the basis of the new guidance, he will have a higher tax liability than he could reasonably have expected, based on the available HMRC guidance at the time of the sales. Furthermore, it is probable that he would not have entered into the transactions if he had known the quantum of the tax liability that would arise (or may have been expecting that there would be no liability due to losses).

Question 7

Please would HMRC comment on whether they think that their actions are reasonable and fair on taxpayers in such a situation?

Disclosure

It would be very helpful to know the precise basis for HMRC's change of position, in order to allow taxpayers to be able to assess whether they agree, and to make adequate disclosure on their tax return if they disagree.

Question 8

Please would HMRC provide details of the legal advice they have received which forms the basis for their change of position?

We assume that if a taxpayer disagrees with the new HMRC guidance and files their return on a different basis they should disclose in the white space that they are disagreeing with HMRC's newly published view, and that this would provide protection against a discovery assessment.

Question 9

Please would HMRC confirm this?

ANNEX A

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

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.

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