

Tax Representation



TAXREP 51/09

SIMPLIFICATION OF CORPORATE GAINS RULES FOR GROUPS OF COMPANIES

Memorandum submitted on 30 September 2009 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a discussion document published on 7 July 2009 by HM Treasury

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SIMPLIFICATION OF CORPORATE GAINS RULES FOR GROUPS OF COMPANIES

INTRODUCTION

1. We welcome the opportunity to comment on the discussion document published on 7 July 2009 by HM Treasury entitled Simplification review: Capital gains rules for groups of companies – a discussion document.
2. We provide below our comments on and responses to the discussion points.
3. 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.

KEY POINT SUMMARY

4. Groups of companies would welcome simplification of the existing rules applying to chargeable gains.
5. It is our view that the whole of Sch 7A, Taxation of Chargeable Gains Act 1992 (TCGA 1992), which may restrict the use of brought forward capital losses in groups of companies, should be abolished.
6. We favour leaving the depreciatory transactions legislation unchanged because these rules are generally well understood but a new effect-based value shifting rule should be introduced.
7. The suggested reduction in the period during which the degrouping charge can arise from six years to three years would be welcomed, as would the opportunity for the degrouping charges rules to be disapplied in respect of business assets where a disposal of shares in a group company qualifies for the exemption under SSE.

GENERAL

8. We are pleased to note that the consultation document acknowledges the difficulties and issues faced by groups of companies in connection with capital gains and losses.
9. Adverse tax charges should not be suffered by companies where there is no tax advantage in a transaction. Currently the legislation can operate in an unfair way where certain commercial transactions are concerned.
10. Whatever approach is taken we believe that there should be clarity in the legislation and any approach which requires companies to refer to and rely on guidance to ascertain their position should be rejected.

CAPITAL LOSSES AFTER A CHANGE IN OWNERSHIP (SECTION 3)

11. The options being considered are:

- 3A Repeal only those parts of Sch 7A, TCGA 1992 that are no longer required following the introduction of the second targeted anti-avoidance rule in s 184D, TCGA 1992 (the second TAAR);
 - 3B Align the change of ownership rules retained within Sch 7A, TCGA 1992 with the approach of the second targeted anti-avoidance rule (TAAR);
 - 3C Repeal the loss buying rules in Sch 7A, TCGA 1992 and introduce in their place a permissive rule that allows realised capital losses to be carried forward without restriction in cases where the losses relate to a trade or business that continues in a recognisable form; and
 - 3D Repeal the loss buying rules in Sch 7A, TCGA 1992 without replacement.
12. Currently when group transactions take place there is a combination of complex rules and TAARs to consider. The existing legislation in this area is lengthy, extremely complicated and difficult to interpret.
 13. Furthermore, tax cases such as *Five Oaks Properties Ltd v Revenue and Customs Commissioners* [2006] STC (SCD) 769 and more recently *Revenue and Customs Commissioners v Limitgood Ltd* heard with *Revenue and Customs Commissioners v Prizedome Ltd* [2008] STC 361 followed by the Court of Appeal case *Revenue and Customs Commissioners v Prizedome Ltd* [2009] STC 980 have exposed the considerable complexity and uncertainty of these provisions. It would therefore be much simpler to have only the TAARs.
 14. There would seem to be no justification for brought forward capital losses to be subject to restrictions where a company/group has been acquired for purely commercial reasons. In such circumstances the TAAR in ss 184A and 184B, TCGA 1992 would not apply but Sch 7A, TCGA 1992 still does, so the losses are subject to what we consider to be inappropriate restrictions.
 15. It is therefore our view, although not one of the specified options, that the whole of Sch 7A, TCGA 1992 should be abolished but that the second TAAR introduced in Finance Act 2006 could be retained.
 16. If Sch 7A, TCGA 1992 is to be retained in full or part, then we recommend that consideration be given to limiting its application to larger companies. This could be by having a 'de minimis' so that where the capital losses are less than a certain amount the provisions do not apply or perhaps by disapplying the provisions for small and medium sized companies.
 17. If this approach is not taken, our preferred approach would be to adopt proposal 3C. Provided that the proposed permissive rule is drafted appropriately and clearly, replacing the complex rules in Sch 7A, TCGA 1992 will then allow businesses to concentrate on structuring their activities in the most suitable way, without needing to investigate whether their plans were likely to fall foul of the rules in that schedule.
 18. It is very important that although any legislation introduced should frustrate the purchase of capital losses it should not adversely impact bona fide

business transactions. We therefore suggest that any changed provisions could be drafted to mirror for capital losses the rules in s 768 of Income and Corporation Taxes Act 1988 (ICTA 1988) as they relate to trading losses. Section 768, ICTA 1988 applies when a loss making company is taken over and there is a change in the nature or conduct of the trade within a certain period. We believe that similar criteria could be applied to capital losses but for capital losses it would seem more appropriate to consider the 'business' rather than the 'trade'.

VALUE SHIFTING AND DEPRECIATORY TRANSACTIONS (SECTION 4)

19. The options being considered are:
 - 4A Simply to extend the existing depreciatory transaction rules to allow for adjustment to gains on shares (including the creation of a gain); or
 - 4B Retain the existing depreciatory transaction legislation and create a new value shifting rule within the chapter of TCGA 1992 dealing with groups of companies which would be effect based as in the present depreciatory transactions rules.
20. An additional separate option was also discussed:
 - 4C In addition to the above, to align the time limit for adjustments between the two sets of rules, to six years (to match the present provision in section 31).
21. Members generally tell us that, because the existing depreciatory transactions rules are well understood, they would like them to be retained.
22. In contrast, the value shifting rules are considered very difficult to understand and will often apply to transactions which have been undertaken for commercial reasons with no intention to obtain taxation advantage.
23. We therefore favour proposal 4B which would leave the depreciatory transactions legislation unchanged but introduce a new effect-based value shifting rule.
24. It is worth noting that since the introduction of substantial shareholding exemption (SSE) in 2002, the complexity of the value shifting provisions has been less of a problem to deal with in practice. Nonetheless, there is still an issue for investment companies and where shareholdings are less than 10% so we should welcome the opportunity being taken to simplify this aspect of the legislation.
25. There is some support for the idea that the s 30, TCGA value shifting provisions applying to intra-group dividends and asset transfers should be replaced by a less prescriptive, principles-based provision within the corporate groups code.

DEGROUPING CHARGES (SECTION 5)

26. As noted in paragraph 5.6 of the discussion document ‘transferring assets around a group – particularly before a reorganisation or demerger – is a common commercial practice and the complexity of the degrouping charge rules mean that there is a significant compliance and administrative cost to groups in ensuring that this does not give rise to economic double taxation.’
27. The options being considered to alleviate the difficulties faced by groups are:
- 5A Introduce a facility to make a just and reasonable adjustment to the degrouping charge through a taxpayer election where the present rules give a result that does not reflect a true economic profit.
 - 5B Introduce a mechanism to switch off the degrouping charge where the whole gain is realised at the shareholder level, to replace the exceptions in the present s 179(2), TCGA.
 - 5C Leave the degrouping charge as it stands, but look for a means to adjust the base cost of the shares in the company being sold, so that together the degrouping charge and any gain or loss on the share sale reflect the true economic profit from the whole transaction, and thereby eliminate any excess degrouping charge.
 - 5D Amend the degrouping charge rules so that any charge will arise either in the transferor company or the group’s principal UK company, providing for elections to subsidiaries if necessary.
 - 5E Reduce the six year limit in the degrouping charge rules to three years.
 - 5F Replace the current de-grouping charge with a principle based TAAR.

The Government’s preferred option is:

- 5G The degrouping charges rules could be disapplied in respect of trade assets where a disposal of shares in a group company qualifies for the exemption under SSE.
28. While simplification is to be welcomed, and although there is on occasion some uncertainty about the degrouping charges, it is generally felt that the charges do not present a major problem to companies which are informed purchasers. As noted in paragraph 5.7 of the discussion document, the gain will not fall on the company leaving the group (the ‘wrong’ company) if an election is made for the gain to be passed to the group making the sale. Furthermore, any charge arising might be dealt with by the indemnities given by the vendor group.
29. Turning now to the proposals being considered, proposal 5A may appear attractive to some but we consider that other options would better achieve simplification and would not require valuations which add costs and can be very subjective.

30. Neither of proposals 5D or 5F found favour with many members and proposal 5C seems to involve unwarranted complexity.
31. Although in principle the proposals in 5B appear to be a sensible approach, as mentioned above, we consider that any proposals which involve assessment of values, or increase or decrease thereof, will add to costs and uncertainty and such an approach should therefore be avoided.
32. The proposal in 5E to reduce the period during which the degrouping charge can arise from six years to three years would, however, meet with considerable approval from companies as it would significantly reduce the costs associated with the due diligence work on acquisitions and mergers and it would reduce the work associated with maintaining dormant company records. It would also align the provision with the equivalent stamp duty land tax provision.
33. In addition, the proposal at 5E would give greater certainty to businesses. Six years is a considerable time in the life of businesses and business plans and objectives can change considerably during this period. Reduction of the time span during which the de-grouping charge applies would allow business to grow and change unfettered by considerations relating to the charge.
34. Proposal 5G would be welcomed as it would in effect extend the SSE exemption to groups and also to companies that use divisions rather than separate companies for trading purposes. Currently a company which operates through three separate divisions rather than through three subsidiaries will be at a disadvantage when it wishes to sell one business. This is because the restructuring required to separate out the division to be sold will give rise to a degrouping charge when the business is sold. In contrast, a subsidiary may be sold and the SSE exemption claimed.
35. Members consider that proposal 5G would meet the objectives stated.
36. As regards question 5(iv) we cannot immediately think of any behavioural changes that might occur but such consequences should not be ruled out.

COMPLIANCE BURDENS AND WIDER IMPACTS

37. Section 6 of the discussion document asks for details of compliance burdens and wider impacts. We cannot provide specific cost details of compliance burdens placed on companies by the existing legislation.
38. Members have, however, told us that the longer the length of time that there is exposure to various provisions, the greater the time and cost to the business of ascertaining the information needed to deal with the chargeable gains implications of transactions.

AW 30.09.09

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 out 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.

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.