THE CITY OF LONDON LAW SOCIETY

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30 September 2009

The Related Companies Simplification Review Team
Room 2/E1
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

By email: relatedcompanies.simplification@hm-treasury.x.gsi.gov.uk

Dear Sir,

Simplification Review: Capital Gains Rules for Groups of Companies

We are grateful for the opportunity to comment on the proposals relating to the simplification of the capital gains rules for groups of companies as set out in the discussion document dated July 2009. You have included in that document at Section 6 a summary of the questions for consultation, and our comments address those questions in turn to the extent that we have comments. Terms used follow the discussion document.

By way of background, the City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Revenue Law Committee.

CAPITAL LOSSES

3(i) Do you agree that a combination of options 3B and 3C would be the most effective approach to simplification, given the need to preserve the streaming of losses realised in a company before a change of ownership?

We agree that option 3B (involving aligning the change of ownership rules retained within Schedule 7A with the approach of the second TAAR) would be a sensible move, although we consider that section 184C(6) TCGA should not be replicated because this could lead to relatively small changes of shareholdings in commercial circumstances triggering streaming inappropriately.

As regards option 3C (involving the introduction of a permissive rule allowing carry forward of losses which relate to a trade or business that continues in a recognisable form), we have certain queries and observations.

Is the proposal that capital losses cannot be carried forward on a change of ownership if they do not "relate to a trade or business that continues in a recognisable form? If so, this would seem to be a more restrictive rule than the one currently contained in Schedule 7A.

Capital losses can, of course, be made on disposals of assets which are not trade or business assets eg shareholding not qualifying for SSE, capital distributions. Under the current rules, such losses could be used against "pre-entry gains" (broadly, gains made or accrued prior to the change of ownership). Under the option 3C proposal, it would seem that such losses would not be available for carry forward on a change of ownership, even against pre-entry gains. Is this correct?

We are unclear what the logic is for "streaming" capital losses by reference to continuing trades/businesses. There is clearly logic in this type of "streaming" in the case of trading losses/management expenses. However, as noted above, in the case of capital losses, these may arise other than by reference to a trade/business. Also, the "streaming" under the current Schedule 7A is generally by reference to the ownership of assets pre and post the change of ownership rather than by reference to trades/businesses. We are not therefore clear why we would move to a "streaming" by reference to trades/businesses in this context.

Also, what is meant by a "trade or business in recognisable form"? Does this mean that if the trade/business does not cease the losses on the disposal of trade/business assets can be carried forward, even if there is what in the income context is termed a "major change in the nature or conduct of the trade/business"?

We also wonder whether losses arising on disposals of subsidiaries holding trades/businesses which continue in recognisable form (eg which do not qualify for SSE because the 12 month ownership condition is not satisfied) are intended to be carried forward.

In summary, whilst we recognise that option 3C may give more simplicity, it would also seem illogical and unduly restrictive and on this basis, we consider that retaining the current rules is preferable if a simplified "streaming" on current principles is not considered possible.

VALUE-SHIFTING

4(i) Do you support the idea that the section 30 TCGA value shifting provisions applying to intra-group dividends and asset transfers be replaced by a less prescriptive, principles-based provisions within the corporate groups code?

We do support this.

4(ii) Do you feel that the present depreciatory transactions rules in section 176 should be amended so as to apply to augment or create a gain (option 4A) or would you prefer to see a separate rule to do this (option 4B)?

We agree that on balance a separate rule is probably preferable.

4(iii) The key requirement for a new rule appears to be that where there has been a sale of shares in a group company whose value has been reduced then the profit or loss can be adjusted to the extent that the movement in value has not otherwise been taxed within the group. Are there any other requirements that you would see as fundamental to the rule?

We agree with your analysis of the key requirement. Our only comment is that there may be a timing point here. You refer to a movement in value that has not otherwise been taxed within the group. However, you mention in this context the intra-group transfer of an asset at market value which may result in a reduction in value of the shares in the company that acquires the asset. This is said to be on the basis that the acquiring company will take on the tax base cost of the asset. We presume that the point here is that the acquiring company will have taken on a latent capital gain as a result of the historic base cost and to this extent value has moved from the transferee to the transferor. On this basis, there may be said to be a movement of value but such value would be potentially taxed *in the future* within the group by reason of the lower base cost.

4(iv) Please outline any rationale for or against the view that transactions should be covered by value shifting/depreciatory transaction provisions only if they take place within a certain period before a share disposal. If you think that they should, please provide your reasoned view on the six year time limit suggested in option 4C.

The rationale for such a time limit is effectively the same as that in relation to degrouping charges. As you say in paragraph 5.16 of the discussion document, the degrouping charge time limit is a "relaxation from a strict approach of the principles" and "represents an appropriate compromise between effectiveness and practicality". The six year limit also has the same merit as that identified by yourselves in the discussion document in the context of degrouping charges.

DEGROUPING CHARGES

5(i) Would the proposed just and reasonable adjustment in option 5A provide adequate reduction in compliance and administrative burdens for companies?

We are not sure that it would. As noted in the discussion document, the main administrative issue cited as creating an administrative burden is the need to know about all group transactions over the previous 6 years in order to identify degrouping charges. Option 5A does not alleviate this burden as it is still necessary to know where the degrouping charges arise before any just and reasonable adjustment may be made to them.

5(ii) Would option 5D result in a lower administrative burden than the present arrangements for electing a gain back into the vendor group?

We believe that option 5D would not lower the administrative burden and may lead to complexity and practical difficulties. For example, what if the transferor company has been sold out of the group or been liquidated? What if the principal company has changed? Our view is therefore that the current arrangements are preferable in this respect. The company leaving the group is the best default place for the charge and the election to move the charge gives the relevant parties flexibility as to where the charge should be commercially borne.

5(iii) Would the proposed switch off of the degrouping charge under the option outlined in 5G be adequate to ensure that all divisionalised trades that are restructured to ensure that the disposal of a subsidiary would fall within SSE achieve the correct tax outcome?

The proposed switch off is helpful but it may be that a restructuring to achieve SSE involves the transfer of trading subsidiaries or holding companies of trading sub-groups as well as the transfer of trading assets.

Yours faithfully

David McIntosh
Chair
City of London Law Society

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

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