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

21<sup>st</sup> May 2010

Dear Sir

**Re: SIMPLIFICATION REVIEW: CAPITAL GAINS RULES FOR GROUPS OF COMPANIES**

We are grateful for the opportunity to comment on the proposals and draft legislation relating to the simplification of the capital gains rules for groups of companies as set out in the discussion document dated February 2010.

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.

You have included in that document at Chapter 5 of the discussion document, 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.

**GENERAL QUESTIONS**

1. **Do you agree that the proposed changes would deliver closer alignment between tax and economic outcomes?**

Broadly, yes though much will depend on the application in practice of some of the new provisions (e.g. "just and reasonable" test in the "degroupping" rules).

2. **Do you see any particular technical issues that need to be resolved in any of the draft legislation, that have not yet been addressed?**

No.

3. **Do you consider the attached draft legislation to be as clear as possible? If not, where could it be made clearer, and how?**

We believe that the legislation might be clarified in a number of places and we discuss this in some of our subsequent answers where appropriate.

#### **IMPACT ASSESSMENT**

4. **We would be grateful for any information relating to the administrative savings and/or the reduction in transaction/compliance costs that you would expect to result from this draft legislation.**

As far as degrouping charges are concerned, and as we mentioned in our previous response, we cannot see obvious administrative savings resulting from the proposals. This is mainly because of the requirement to know about all group transactions over the previous 6 years in order to identify degrouping charges.

#### **CAPITAL LOSSES AFTER A CHANGE IN OWNERSHIP**

5. **Given that Government does not believe that a complete repeal of Schedule 7A is a viable option, do you agree that the new scheme proposed represents a worthwhile simplification of the rules?**

We agree that the proposed partial repeal of Schedule 7A is a worthwhile simplification. The retention of the remaining provisions of Schedule 7A, and in particular the streaming of pre-entry capital losses with no time limit, would however continue to impose a compliance burden on businesses.

6. **Are there other aspects of the rules that you consider could be further simplified while retaining an effective means to stream the use of pre-entry losses?**

As noted in our previous representations relating to the discussion document, we were in favour of aligning the change of ownership rules within Schedule 7A with the approval of the second TAAR (option 3B in the discussion document).

7. **Do you agree that the revisions to the rules governing situations where a company undergoes more than one change of ownership provide greater clarity than the present rules?**

We do agree that the legislation is now clearer in this respect.

8. **Do you agree that the revisions to the rules governing situations where a company undergoes more than one change of ownership do not create any material change in the current rules? If not, please give details of any changes that you consider arise.**

We consider that the revisions reflect the interpretation of the current rules as set down in the Limitgood and Prizedome cases.

## VALUE SHIFTING AND DEPRECIATORY TRANSACTIONS

### General

We welcome the emphasis on simplification of the very complex value shifting rules. However, we would question whether the inclusion of a TAAR will lead to the additional certainty for business which it is hoped the changes will deliver.

In the past uncertainty was created by the difficulty of applying a complex, but essentially mechanical, set of provisions to actual factual situations. In the future, it may well be that uncertainty is instead created by the presence of the TAAR – no major group will undertake a restructuring of any significance without taking tax advice, and it will inevitably choose the route to the desired outcome that leads to the payment of the least tax. This may lead to real difficulty in determining whether the TAAR might apply.

We assume from the third question in the consultation document that the intention is to clarify in guidance what sort of transactions will and will not be considered to be avoidance motivated. This would be helpful, but would ultimately be unsatisfactory due to the potential for HMRC to change its view of what does and does not constitute legitimate tax planning. In an area such as this, there may be a significant time gap between the transaction which may or may not be seen as having the purpose of securing a tax advantage, and the eventual crystallisation of that advantage. In the event of change, should one apply the guidance in place at the beginning or the end of the process?

We believe that if the TAAR route is to be adopted it should be accompanied by a statutory clearance procedure which could be used prior to the implementation of the arrangements referred to in new s.31(1)(a). We appreciate that there is a cost associated with making clearance procedures available, but we do not see that the introduction of motive tests where previously they did not feature can be said to promote simplicity and certainty in the absence of such a procedure.

If a clearance procedure is not to be available then we would recommend the production of extensive, detailed guidance notes which should themselves be put out to consultation. Areas of obvious difficulty, where the question of whether there was a tax avoidance purpose might genuinely be nuanced and subject to differences of view, would include pre-sale dividends, group relief surrenders for less than full consideration, transfer pricing corresponding adjustments and intra-group debt waivers.

9. **Do you consider that the attached draft legislation is effectively targeted against transactions that are designed to produce a tax advantage?**

Yes, subject to the caveat discussed above relating to the inevitable uncertainty of scope of a TAAR, especially in the context of the type of transactions which are often tax sensitive and where advice is usually taken to ensure that the transactions are not carried out in an unnecessarily tax-inefficient manner.

We would note that although the consultation document states (at para 3.17) that the rule would apply only to tax advantages where the advantage relates to tax on chargeable gains, the draft legislation currently defines tax advantage by

reference to all corporation tax (new s.31(7)). We assume that this is an oversight in the drafting: given the express purpose of this targeted provision we consider that only tax advantages relating to chargeable gains should be seen as relevant.

10. **Would the attached legislation provide appropriate reassurance for taxpayers undertaking commercial transactions?**

As discussed above, not in isolation. At the very least, detailed guidance would be necessary to achieve this, but ideally a clearance procedure would be available.

11. **Are there specific circumstances or examples that you would like HMRC to cover in guidance to show how the legislation applies?**

Again as discussed above, we think that guidance will need to be very extensive if the new legislation is to meet its objective of providing business with a simpler and more certain legal framework. It would be extremely helpful if the guidance were to contain a "white list" and a "black list" of transaction types which HMRC consider to be legitimate tax planning on the one hand, and avoidance on the other. These need not be exclusive (ie it would be possible for transactions not listed to fall into either category), but should be as lengthy as possible. In particular we think it is crucial that the guidance should give as many examples as possible of transactions which HMRC consider to be unacceptable (possibly by reference to hallmarks).

#### **DEGROUPING CHARGES**

12. **What benefits or otherwise do you see arising from the proposal to treat most degrouping charges as adjustments to the computation of gains or losses from a share disposal? Where appropriate, please consider any impacts on transactional costs, administrative burden and tax compliance costs.**

We note that this approach may mean that where a degrouping loss arises on a share sale to which the SSE applies the loss will not be available. We accept that this is an appropriate corollary to a degrouping gain benefitting from SSE.

As previously mentioned this approach does not alleviate the burden of needing to know about all group transactions within the previous 6 years.

13. **The proposals include a rule for reallocating degrouping gains and losses between disposals by different companies and between different classes of shares. Do you think this could be simplified? If so, please explain how.**

We understand these provisions to mean that on a "group disposal" including more than one shareholder, the degrouping gain or loss may be allocated between such shareholders as the parties chose e.g. a gain may be allocated to a shareholder benefitting from SSE and conversely a loss may be allocated to one which does not qualify for SSE. If there are two shareholders, one selling 76% of the shares and one selling 24%, can the gain/loss be allocated to the one selling 24% although a sale by the 76% holder would have been a "group disposal" within sub section (3A)? i.e. arguably Company A does not cease to be

a group member in consequence of the 24% sale. If one shareholder were selling 74% and the other 26%, presumably the gain/loss could be allocated to the 26% shareholder and we cannot see any reason for a distinction between the two scenarios if the sale by both shareholders is part of a single transaction. The position in this respect might be clarified.

14. **Do you agree that the revision to the rules relating to the old 'associated companies' exception provides a clear and unambiguous rule?**

We do not agree that the existing provisions should be extended beyond *Johnston Publishing (North) Ltd v Revenue & Customs Commissioners [2008] STC 3116* so that A and B must "remain" connected throughout the period of ownership of the asset. There are often commercial and regulatory reasons to undertake group reorganisations which may mean it is necessary to alter the group structure which may mean that the connection is temporarily broken.

We would welcome clarification on the drafting in paragraph 2 (2ZA) (b) and (2ZB) (b). Is the intention that the phrase "until after the companies cease to be members of the group" be read as "immediately after".

15. **Are you content that the 'backstop' rule to prevent economic double taxation would be sufficient to address the issue, both from a technical and practical viewpoint?**

In principle a "backstop" rule is helpful. However, as noted in our previous response we do not believe that the "just and reasonable" approach helps from an administrative perspective.

If it is intended that the associated companies exemption should apply where one of the companies is dormant and has been removed from the group, this should be specifically legislated for and not dealt with in any guidance or by an "just and reasonable" test.

Also, should sub-section 179ZA(5)(a) refer to the amount of share capital of company A or any "relevant" associated company which is disposed of, directly or indirectly, pursuant to a group disposal or group disposals, as applicable.

16. **Are there particular examples that you would wish HMRC to address in guidance to demonstrate how the 'backstop' rule would operate?**

See our comments above about extending the legislation to deal with some crucial points rather than by guidance.

17. **Do you agree that the proposals to repeal section 179A, 179B and Schedule 7B TCGA are appropriate given the scope of the changes elsewhere in these proposals? If not, please explain why you believe an alternative course would be better.**

We assume that the reference to Schedule 7B should be to Schedule 7AB. We are not sure that the new provisions do render Section 179A redundant. By way of example, we believe that where the disposing entity is a non-UK resident company which holds shares in a UK company which are not chargeable assets the rules in paragraph (3B) of Schedule 1 would not cover that situation and so section 179A would still be needed to cater for this situation.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Bradley Phillips', written in a cursive style.

**Bradley Phillips**

**Chair**

**City of London Law Society Revenue Committee**

**THE CITY OF LONDON LAW SOCIETY  
REVENUE LAW COMMITTEE**

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