The City of London Law Society

4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 - Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

David Gauke MP
Exchequer Secretary to the Treasury
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

13th March 2012

Dear Mr Gauke

Retrospective Legislation: Debt Buybacks

This letter is sent on behalf of the Revenue Law Committee of The City of London Law Society ("CLLS"). CLLS represents approximately 14,000 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.

We refer to your written Ministerial Statement of 27 February 2012 on debt buybacks.

We would like to express our deep concern at the retrospective element of the changes. Our Committee members are unanimous that this is not a situation where retrospective legislation is justified and we disagree that this legislation falls within the "wholly exceptional" category in the Protocol on unscheduled announcements.

Our main concern is the irreparable damage that may be done to the UK's standing as a place to do business. As has been explicitly acknowledged by the Government, business places a premium on certainty and stability in tax systems. Retrospective legislation of this type calls into question the integrity of the UK tax system and affects business's confidence in operating here. We believe this announcement will undo much of the work done in recent years to improve the UK's competitiveness.

Our second concern is that retrospective legislation is particularly dangerous in this area given that buybacks, as well as being used opportunistically by solvent companies, are often part of restructurings of insolvent companies as a means of eliminating unsustainable debt (and of course if these companies were subject to a

deemed release then they would have no resources to pay the resultant tax, and would in many cases enter insolvency proceedings with an obvious adverse impact on jobs and the wider economy). It is unfortunate the anti-avoidance legislation in this area makes no distinction between opportunistic buybacks and restructuring buybacks (save for the very limited restructuring exemption which is of little practical use). We fear that the possibility of the operation of the new TAAR or further retrospective legislation in this area is going to make it difficult to reach commercial agreement on debt restructurings going forward; parties will be concerned that necessary steps to preserve a business could be caught by the new TAAR or subsequent retrospective legislation and give rise to very significant taxes. Without Government clarification very soon, some debt restructurings may stall for this reason, and the Government risks businesses that might have been saved instead entering insolvency proceedings.

More generally, as a matter of principle, and to respect the rule of law, the majority of our Committee members object outright to retrospective legislation. A minority of our Committee members believe that retrospective legislation can be justified in very limited circumstances; for example, clarifying a generally understood interpretation or for totally artificial arrangements which go to the heart of the integrity of the tax system as a whole (like the arrangements in the *Huitson* litigation). However, those of our Committee members who accept the principle of retrospective legislation in very limited circumstances do not see the recent debt buyback draft legislation as a suitable candidate for retrospection.

We also have doubts as to whether the retrospective element of these changes would survive a challenge under the Human Rights Act 1998. The arrangements in the *Huitson* litigation can be distinguished on a number of grounds, including:

- In *Huitson* there had been previous retrospective legislation in 1987 which both the Minister and the Court acknowledged had put the taxpayer on notice that retrospective legislation was likely to be used again. The affected taxpayers here were not on such notice - previous changes to that part of the Loan Relationship code to deal with perceived avoidance were prospective only.

- *Huitson* was a completely artificial arrangement which struck at the heart of the integrity of the UK tax system – indeed the Courts noted that a resident being taxed on his income was a fundamental feature of the UK tax system. It was acknowledged to be a highly abusive scheme with no commercial justification at all. The arrangements targeted by the debt buybacks draft legislation are commercially driven transactions structured to be tax efficient, under a complex prescriptive tax code where the policy/intention of the legislation as a whole is not crystal clear (but where it is clear that in some circumstances it should be possible to achieve the commercial effect of waiving debt without a tax charge arising on the debtor).

- In *Huitson*, both HMG and HMRC doubted the scheme worked (as did the Courts) and the changes were said not to change what was generally understood to be the meaning of the law but merely to clarify it. At the time the Minister said the intention of the legislation was to "put beyond doubt" that the *Padmore* type schemes did not work. Here there was no ambiguity in the law on which the taxpayer sought to rely; there was (as we understand it) no tenable argument that the law as drawn failed to deliver the taxpayer's desired result. This is a profoundly different circumstance to one such as *Huitson* where a taxpayer adopted a very aggressive interpretation of

legislation which HMRC might realistically expect a court to disagree with. If the Government decides unambiguous, and long-standing, legislation offers tax mitigation opportunities to taxpayers which go beyond what it considers appropriate, that is a policy change, not a clarification.

- Unlike *Huitson*, this proposed legislation appears to be a specifically targeted retrospective rule against an identified taxpayer or small group of taxpayers.

- The complex rules of the loan relationships code on debt buy-ins offer a number of different ways in which transactions commercially equivalent to the transaction which we understand was implemented by the bank in question might be implemented without a tax charge arising. It is therefore entirely possible that had the relevant taxpayers known what the law applying to their transaction was at the time it was implemented, they could have used an alternative structure to prevent tax arising (or alternatively could have opted to do nothing). This is very different from *Huitson* where a profit was made from the taxpayer's main consultancy activity and intended to be taken outside the UK tax net (and so where it might more easily be assumed that the services would have been provided anyway had the planning been known to fail).

Further, we think the Government are wrong to justify retrospective tax legislation on the grounds of an alleged breach of the Banking Code of Practice. At no time was it ever announced that an alleged breach would lead to retrospective legislation – the stated sanctions at the time were raising the alleged breach with the Board of the bank and/or a report to a professional body. Also, and critically, the retrospective change (necessarily) applies to all taxpayers, not just ones covered by the Banking Code of Practice. At least one of our member firms advised on such a transaction in December where no bank was involved. The Government's professed justification for the retrospective element of the measures is inapplicable to such cases.

Additionally, in the loan relationships/corporation tax area there has been no explicit Ministerial Statement that retrospective legislation would be used to tackle any perceived abuse, as there was in 2004 in relation to employment taxes.

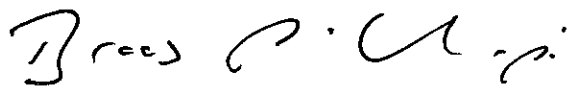
Whilst our Committee members are unanimously opposed to this proposed use of retrospective legislation, we suggest that to protect the competitiveness of the UK and the UK's reputation, the Government should urgently consult on the principles that divide acceptable from unacceptable/egregious tax planning and clarify what the principles are going forward for retrospective changes as opposed to prospective changes only, both in relation to perceived tax avoidance generally and in relation to debt buybacks specifically.

On the acceptable versus unacceptable point above, it is also relevant to refer to the current discussions around introducing a GAAR. The Committee has met Chris Davidson of HMRC to discuss the Aaronson GAAR proposal. Whilst our Committee members do not support egregious tax schemes and therefore support, in principle, a GAAR aimed to stop such schemes, we consider it vital that the so called centre ground of responsible tax planning is protected so as not to further erode the competiveness of the UK tax regime. We also believe it critical that the existence of a GAAR does not create further uncertainty for taxpayers. We understand that if the Government is to take the GAAR proposal further forward, there will be further consultation and the Committee will seek to be fully involved in that exercise. In our view, it would be appropriate for the Government to reconsider its position on introducing retrospective legislation as part of that exercise. If the GAAR is enacted,

we think it would be both appropriate and sensible for the Government to make a commitment to not use retrospective legislation to tackle avoidance.

In summary, we reiterate our deep concern over the use of retrospective legislation for this type of tax planning and ask that the Government liaises with business and the tax profession on the principles for any potential future use of retrospective legislation.

Yours sincerely



Bradley Philips

Chair

The City of London Law Society Revenue Law Committee

cc Chris Davidson, HMRC

cc Tony Sadler, HMRC

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

Individuals and firms represented on the Revenue Law Committee are as follows.

B.S. Phillips (Herbert Smith LLP) (Chairman)

H. Barclay (Macfarlanes LLP)

C.N. Bates (Norton Rose LLP)

D. Friel (Latham & Watkins LLP)

P.D. Hale (Simmons & Simmons)

M.J. Hardwick (Linklaters LLP)

C. Hargreaves (Freshfields Bruckhaus Deringer)

C. Yorke (Allen & Overy LLP)

K. Hughes (Lovells LLP)

G. Miles (Slaughter and May)

J. Scobie (Kirkland & Ellis LLP)

V. Maguire (Clifford Chance LLP)

C.G. Vanderspar (Berwin Leighton Paisner)

S. Yates (Travers Smith LLP)