

# **Tax Law Rewrite – Bill 6**

## **Responses to Papers CC/SC (08) 11 and 23**

### **Company Distributions**

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<http://www.hmrc.gov.uk/rewrite>

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#### **INTRODUCTION**

1. In March 2008 we published Committee Paper CC/SC (08) 11 on the HMRC internet website [www.hmrc.gov.uk/rewrite](http://www.hmrc.gov.uk/rewrite). The closing date for responses was 27 June 2008. The draft clauses rewrite the legislation dealing with company distributions.

2. At that time, decisions were still pending about how best to deal with certain administrative provisions within the distributions legislation, and provisions that have an income tax effect.

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3. We concluded that it would be preferable for users of the rewritten legislation if the specific administrative provisions were included with the distributions legislation. We also concluded that the inclusion of the income tax effects of company distributions in the term “Corporation Tax Acts” means that we could include provisions affecting income tax in a corporation tax bill.

4. In the light of this we issued further draft clauses to cover the additional material at the end of June 2008 with Committee Paper CC/SC (08) 23. In order to assist users we also reissued all the March material so that readers could see the new provisions in context. Responses were invited by 19 September 2008.

5. The purpose of this response document is to provide details of the substantive technical points made and to explain our analysis and proposals in respect of them. Minor points, such as suggestions to improve punctuation, are not covered but all comments received have been carefully considered. Some respondents made useful suggestions about the explanatory notes. We have not commented on these in every case but we will revisit the explanatory notes with them in mind.

6. Two minor changes were proposed in the Committee Papers. In the responses received they either received approval or were not mentioned.

7. We received written responses from the following:

- The Confederation of British Industry
- The Institute of Chartered Accountants in England and Wales
- One individual

8. The following abbreviations for tax legislation are used in this response document:

- CAA            Capital Allowances Act 2001
- FA             Finance Act
- ICTA          Income and Corporation Taxes Act 1988
- ITA            Income Tax Act 2007
- ITEPA        Income Tax (Earnings and Pensions) Act 2003
- ITTOIA        Income Tax (Trading and Other Income) Act 2005

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9. We are grateful for all the comments made, many of which were detailed, and we appreciate the time and effort that went into them. We are sending each respondent a copy of this response document.

10. This document deals separately with the two drafts so that the numbering used by respondents can be matched to the relevant draft clauses. Some minor errors in the March draft were corrected in the June draft – these are noted below.

**March Draft – Committee Paper CC/SC (08) 11**

**Clause 10: The principal secured: non-commercial securities**

*The reference to section 99(5) should be a reference to section 99(6)*

11. The reference was corrected in the June draft. The revised reference is to clause 121(6) in the June draft.

12. ***The revised text is in clause 10 of the June draft.***

*The relationship between subsections (3A) and (3AA) of section 209 – rewritten in clauses 10 and 11 – is difficult, but appears not to be correctly described in the commentary. The commentary says that clause 11 applies if and only if the new consideration payable on issue of the security exceeds the amount secured, and the excess is not in the form of a premium. It appears to us, on the contrary, that any case in which the new consideration exceeds the amount secured falls within clause 11 whether or not the excess can be described as a premium. This seems perfectly clear from the words of clause 11(1), and appears also to be the current position as described in the HMRC manual at CTM15501. Clause 10(2) et seq will therefore apply only in cases where clause 11 is disapplied by clause 12 or clause 15.*

13. ***We agree. We will amend the commentary accordingly.***

*The heading of clause 11 is inaccurate, for the reasons mentioned above: it does not modify section 10 so much as override it.*

*The draft legislation itself closely follows the source legislation, and so cannot be faulted technically. Nevertheless it does perpetuate the difficulty for the reader in seeing when each of the two clauses will apply, and it would be very helpful if something could be done to clarify this. The fact that the commentary finds it necessary to resort to a table to explain the position is strong evidence that the actual legislation is not as clear as it should be. One could consider moving sub-clauses (2) to (4) of clause 10 into a separate clause positioned after clause 11 (since clause 11 is actually the more general rule), and/or stating explicitly in clause 10(2) that it applies only where clause 11 does not.*

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*Certainly the phrase "(but see also section 11)" in clause 10(2) is not sufficient to convey this point.*

14. ***We will review the drafting of these clauses to see if they can be made easier to use.***

*It is hard to imagine any circumstances in which the two-part calculation in clause 10(4) would produce a different result from simply calculating a reasonable commercial return on the new consideration invested (as the manual effectively concedes). In fact it is difficult even to ascribe a meaning to clause 10(4), since what an investor receives a return on is simply a sum of money, no part of which can be specifically identified as principal or premium. We consider therefore that section 10(4) should be omitted, in the interests of simplification, unless HMRC can point to some real purpose behind it. If it is argued that this is a policy issue outside the remit of the rewrite project, we would not accept that removing a provision which has no practical effect involves any consideration of policy.*

15. The drafting follows the source legislation. Whilst the change suggested may not have an effect in a large number of cases, the possibility nonetheless remains that investments could be structured with these elements separately identified. It is important to ensure that the law as it currently applies continues to have the same effect in such cases.

16. ***We do not propose to amend the clause.***

**Clause 16: Exception to section 15**

*Sub-clause (3) may well represent the intention of the source legislation, but it does not appear to us to reproduce what it actually says. It seems that section 209B(5) is so expressed that the condition would be satisfied if amounts intended to offset some or all of the deduction were to arise otherwise than to a company within paragraph (a) or (b), provided that they do not so arise "at that time or within a reasonable time before or after it". We do not object to what appears to be a sensible clarification, but we think the fact that it may actually represent a change in the law should be flagged.*

17. This analysis implies that in section 209B(5) of ICTA, the words "at that time, or within a reasonable time before or after it" limit the application of the words that follow (ie: of the requirement that certain amounts arise to the issuing company etc), rather than imposing a requirement about the time at which certain amounts must arise. We do not agree that this is a natural reading of the subsection.

18. This is borne out by the explanatory notes to section 102 of FA 2002, which introduced section 209B of ICTA. The explanatory note for this particular subsection

states that it “requires that where there is a corporation tax deduction in relation to a security, every amount that is intended, under the hedging arrangements, to offset this deduction must be realised in the issuing company or in a group member of the issuing company at the same time or within a reasonable amount of time”.

19. *We do not propose to amend the clause.*

**Clause 19 - Section 18: supplementary**

*It is unusual, and possibly ambiguous, to split a test such as that in sub-clause (2) into two paragraphs linked by "and", in a case where (apparently) one is merely intended as an example of the other.*

20. We agree. The test has been restructured in Clause 20(2) of the June draft to meet this point. The part of the test beginning “and in particular” has been absorbed into subsection (2)(b) so that it now forms a highlighted aspect of that part of the test rather than being an element of the test in its own right.

21. *The wording of the clause was revised in clause 20 of the June draft.*

**Clause 32: Distribution as part of a cross-border merger.**

*This clause says exactly the opposite of what is intended. The words "a distribution of a company" in the last line should be replaced by "treated for the purposes of section 31 as a distribution in respect of share capital in a winding up". Alternatively, simply inserting the word "not" would seem to produce the same result.*

22. We agree. The wording was corrected in the June draft.

23. *The corrected text is in clause 33 of the June draft.*

**Clause 37 - Determining the period of ownership**

*The reference in the second line of paragraph (a) of sub-clause (3) to "personal representatives of a previous owner" should be to personal representatives of the previous owner. As it stands it would extend the period of deemed ownership to include a period when the shares were held by the personal representatives of the last owner but one, which is presumably not intended.*

24. *We will revise the draft to “the previous owner” so that the legislation clearly reflects the source.*

**Clause 38: Reduction of seller's interest as shareholder**

*Inserting the word "still" before "owns shares in the company" in sub-clause (1) would make the meaning more obvious.*

25. The inclusion of “still” could constrain the meaning of the provision by comparison with the source and would therefore have to be considered as a change in the law.

26. ***We do not propose to amend the clause.***

**Clause 48: Sections 34 to 47: other interpretation**

*The definition of "group", in the phrase "trading group", does not appear to have been rewritten.*

*We note that in the source section 229(1) ICTA definition of “trading group”, “group” is defined as meaning a company which has one or more 75% subsidiaries together with those subsidiaries. This part of the definition of “trading group” is not rewritten in clause 48, and “group” is defined (as in the source s 222(9) ICTA) in clause 47(1) by reference to a company and its 51% subsidiaries. What is the reason for this? As the purchase of own shares legislation applies to a trading company (or the unquoted holding company of a trading group) we assume that the s 222(9) ICTA definition of a ‘group’, as in effect relating to a trading group, clashes with the s 229(1) ICTA definition of ‘trading group’ and that the clause 48(1) definition of ‘trading group’ resolves this now in accordance with practice; but should this be subject to a Change note?*

27. ***We will restore the missing definition.***

*Why is the source s 229(1) ICTA definition of ‘control’ omitted?*

28. The definition of “control” in section 840 of ICTA applies only to those provisions that specifically apply it, including section 229(1) of ICTA. The approach taken in ITA 2007 and in the recently published Corporation Tax Bill is for the meaning of “control” to apply unless it is specifically disappplied. We anticipate following this approach for this Bill and will ensure that the correct links are made.

29. ***We will ensure that the correct link to the definition of “control” is made.***

*Is the reference to the construction of “trading activities” in the source section 229(1) ICTA definition of ‘trade’ now considered superfluous (as it is not rewritten in clause 48(1))?*

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30. Although this definition appears in section 229(1) and applies to sections 219 to 228 of ICTA, the term is not actually used in those sections. Therefore the definition is redundant.

31. *The definition is omitted as redundant.*

**Clause 60: Connected persons**

*The rewrite refers, at the end of paragraph (a) in sub-clause (6), to "the equity holder" where the source legislation has "an equity holder". This must be wrong, since there has been no previous reference to any particular equity holder (or not in those terms), though the source legislation seems little better. What is actually needed is a reference to the person mentioned in sub-clause (4).*

32. *We will review the drafting so that it accurately reflects the source.*

**Clause 63: Exception for benefits treated as employment income etc.**

*The effect of the phrase "... employment to which Part 3 of ITEPA ... applies without the exclusion in section 216 of [ITEPA] ..." is difficult to understand and possibly ambiguous. It could be read as bringing in only "lower-paid" employees, on the basis that they are the people who would be taxable under Part 3 on the benefits in question in the absence of section 216, or as bringing in only the "higher-paid" on the basis that they are the ones to whom the section 216 exclusion does not apply. Presumably the latter is meant, but this is a very obscure way of expressing it.*

33. The drafting follows the source legislation. ITEPA 2003 changed the structure of the legislation so that all employees are within the benefits in kind Part unless specifically excluded. In contrast, ICTA specifically stated which employees were within the charge. The revised wording of section 418(3)(a) of ICTA reflects this restructuring, and clause 63 follows that structure.

34. *We do not propose to amend the clause.*

**Clause 64: Exception for certain transfers between UK resident companies**

*Are the bracketed words '(and only if)', which do not appear in the s 418(6) ICTA source legislation, necessary? Similar comments apply to clause 93(4) (Other definitions etc).*

35. We have included these words to emphasise that the definition of "owned as trading stock" is exhaustive, not partial.

36. *We propose to retain the words “(and only if)” as a helpful clarification.*

**Clause 65: Extension of references to close companies and participators**

*The drafting of clause 65(2) is somewhat cumbersome. May we instead suggest ‘Each company is treated for the purposes of sections 62 to 64 as making the payment to the recipient who is a participator in it’?*

37. We have drafted the clause in this way to emphasise that both the company and the participator are affected by this particular rule. The suggested revision loses that aspect and therefore could make it less transparent for users.

38. *We do not propose to amend the clause.*

**Clause 67: Mutual businesses: distribution out of surpluses not charged to tax**

*It is not clear what is meant by “distributions to which the enactments relating to corporation tax that relate to distributions apply under section 66”. Clause 66(2) tells one how much of the distributions made by a mutual company are to be treated as distributions for corporation tax. It is then unclear whether the phrase in clause 67 means (1) the part which is treated as a distribution for CT purposes (since that is the amount to which “the enactments that relate to distributions” actually apply), or (2) the part which is not (since that is the amount whose treatment is actually affected by clause 66); or (3) both (since it is clause 66 that draws the line between them). And even if the meaning were clear, the wording is excessively convoluted to convey what is, presumably, intended to be a reasonably simple concept.*

39. *We will review the drafting of the clause.*

**Clause 93: Other definitions etc**

*The definition of “member” does not refer to the source s 214(2)(a) ICTA exception (rewritten as clause 85(2)(b)).*

40. *We agree and will reinstate this definition.*

**Clause 97: “New consideration”**

*There appears to be no reason why ‘or value’ should not be included in clause 97(5)(b), but the source s 254(6)(b) ICTA refers to ‘money received’ only.*

41. *We will delete the words “or value” to ensure that the clause reflects the source.*

**Clause 99: Other interpretation**

*Should clause 99(7), or an equivalent separate sub-clause, also apply to securities (as in the source s 254(12) ICTA)?*

42. We had originally considered that the additional definition had no actual application in Part 6. However, on a further review we have identified a possible application and will therefore restore this definition.

43. *We will restore the extension of the definition to “securities”.*

**Schedule 2: Transitionals and savings**

*Several of the provisions of Chapter 2 apply only to shares or securities issued (or repaid, in the case of clause 24) after either 6 April 1965 or 5 April 1972. Although those dates are long past, the cut-off continues to be relevant indefinitely: there is nothing improbable about shares or securities issued before those dates being still in existence, nor about a company which repaid share capital before 7 April 1965 being still in existence. That being so we consider that the references to these starting dates should be rewritten in the body of the legislation, rather than being relegated to the schedule of transitionals (where they would of course be much less conspicuous in the complete Bill than they are in the consultation paper).*

44. We do not consider it helpful to users for the main legislation to contain this type of material. We have provided a signpost in the explanatory notes.

45. *We do not propose to move these provisions from the schedule of transitionals to the main body of the legislation.*

**June Draft – Committee Paper CC/SC (08) 23**

**Clause 19: Meaning of “equity note” in section 18**

*The reference to ‘subsection (4)’ should be to ‘subsection (2)’.*

46. *We agree and will amend the clause.*

**Clause 49 - Information about schemes etc.**

*Sub-clause (5) is not grammatically correct. At the least it needs the word “with” at the end, but a less inelegant way of expressing it could probably be found.*

47. *We agree and will amend the clause.*

**Clause 56 - Share capital to which section 53 applies: returns**

*In sub-clause (1) "each return period" would be better than "the return period". The word "it" in the third line is most naturally read as referring to (all) the share capital issued in the accounting period, so more than one return period may be relevant.*

48. *We agree and will amend the clause.*

**Clause 90 - Chargeable payments connected with exempt distributions**

*Sub-clause (4) is another good example of old-style drafting. Why can it not say what it means? In order to tie in with the terms of Clause 5 of Bill 5 there seems to be no reason why clause 90(4) should not simply echo clause 90(3). (We have already objected to the opaque drafting of clause 5(1) of Bill 5, but at least clause 5(2) provides the necessary link for the approach we suggest here.)*

49. *We will review the drafting of this clause.*

**Clause 101: Chargeable payments etc: returns**

*Within the brackets, should 'and' (stamp duty land tax) be 'or'?*

50. We consider that "and" is correct. The use of "and" means that potential avoidance of both taxes has to be considered, even though avoidance of only one of them is necessary for the condition to bite, whereas "or" might imply that only one or the other should be considered.

51. *We propose to retain the word "and" rather than "or".*

**Clause 109: Non-qualifying distributions etc: additional information**

*Would it be clearer to refer to 'person or persons' on whose behalf the shares or loan capital are registered?*

52. Section 6 of the Interpretation Act 1978 provides that "in any Act, unless the contrary intention appears, words in the singular include the plural". Therefore, there is no need for the term "or persons" in this instance.

53. *We do not propose to amend the clause.*

**Clause 124 - Recovery of overpaid tax credit etc.**

*Unlike the other administrative provisions in this draft, this one is not closely linked to any particular charging provision. It is not even specifically concerned with corporation tax. That being so, it would be better located in*

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*the Taxes Management Act. In any case, we do not think that there are now any circumstances in which a tax credit can be set off against corporation tax. This clause, insofar as it relates to recovery of "any corporation tax that should have been paid", is therefore only required as a transitional provision, if at all. And insofar as it deals with recovery of payments of tax credit that should not have been made there is no point in duplicating it, by rewriting it both here and in the proposed section 401A ITTOIA.*

54. *We will look again at the most appropriate location for this material.*