

Chapter X: Company reconstructions without a change of ownership

Overview

1. The draft clauses rewrite sections 343 to 344 of ICTA (company reconstructions without a change of ownership).

2. It is possible (and common) for the trade, assets and liabilities of one company (“the predecessor”) to be transferred to another (“the successor”). As a rule, on such a transfer the predecessor’s trade ceases. This has two consequences in particular.

3. First, if the predecessor has incurred qualifying expenditure on plant and machinery, a balancing charge is imposed or a balancing allowance is given under Part 2 of CAA 2001 (plant and machinery allowances). Also, the successor is entitled to plant and machinery allowances on the amount paid to the predecessor for the plant and machinery. Similar rules apply to the other types of capital allowance.

4. Second, if the predecessor has incurred losses in its trade they cannot be carried forward under section 393 of ICTA. To the extent that they cannot be relieved under section 393A of ICTA or by group relief, they are wasted.

5. But the predecessor and the successor will not necessarily be independent. If they are under common ownership, the owners of the companies may have commercial reasons for transferring the trade and net assets from one to another. Where this is the case, section 343 of ICTA makes it possible for:

- capital allowances to be given to the successor as if the trade was still being carried on by the predecessor; and
- the predecessor’s unrelieved trade losses to be carried forward to the successor.

6. Sections 343 and 344 of ICTA were based on section 61 of FA 1965, which was itself modelled on section 17 of, and Schedule 3 to, FA 1954. The drafting of sections 343 and 344 of ICTA is old-fashioned and gives interpreters difficulty. For example, Bramwell et al. observe:¹

“[Section 343(7)] is obscure even by the high standards of the rest of the section ...”

7. Section 343A of ICTA was inserted by paragraph 1 of Schedule 6 to FA 2007.

8. The criticisms of the drafting of sections 343 and 344 of ICTA have been addressed by giving them a radical restructuring. The draft clauses rewriting sections 343 to 344 of ICTA are laid out in the following order.

¹ *Taxation of Companies and Company Reconstructions* (Thomson, Sweet & Maxwell, June 2003) paragraph E4.4.6.

- Clauses 1 and 2 are introductory.
- Clauses 3 to 5 set out the conditions to be met if the Chapter is to apply to a transfer.
- Clauses 6 to 13 specify the effect of the Chapter in relation to transfers to which it applies.
- Clauses 14 and 15 are supplementary.

Q1. We welcome comments on the structure of the Chapter.

9. The detailed commentary below highlights points at which the draft clauses:
- make explicit matters which the source legislation leaves to be inferred;
 - deliberately retain the wording of the source legislation; or
 - omit the wording of the source legislation as inappropriate or redundant.

Chapter 1: Company reconstructions without a change of ownership

10. The word “reconstruction” does not actually appear either in this Chapter or in sections 343 to 344 of ICTA. The Chapter nonetheless retains the familiar title “company reconstructions without a change of ownership”, because “reconstruction” is used in other taxing provisions dealing with this kind of transaction:

- sections 136 and 139 of TCGA (in which “scheme of reconstruction” has the meaning given by Schedule 5AA to that Act); and
- section 75 of FA 1986 (stamp duty).

Clause 1: Application and overview of Chapter

11. This clause states when the Chapter applies and summarises its structure. It is based on section 343(1) of ICTA.

Clause 2: Transfer of trade

12. This clause specifies when there is a transfer of a trade. It is based on section 343(1) and (8) of ICTA.

13. *Subsections (2) to (5)* deal with transfers of parts of trade. They refer to “activities” of a trade and “part” of a trade, as these expressions have been the subject of judicial comment: see Falmer Jeans Ltd v Rodin (1990), 63 TC 55.²

Clause 3: The ownership condition

14. This clause lays down the first of the two conditions which need to be met if the Chapter is to apply to a transfer. It is based on sections 343(1) and 344(1), (2) and (4) of ICTA.

15. The ownership condition works in the following way. First, it is necessary to identify persons having a 75% interest in the transferred trade at the time of the transfer or at any time in the two-year period beginning immediately after the transfer. Then, it is necessary to see whether those same persons have a 75% interest in the transferred trade at any time in the one-year period beginning immediately before the transfer. If they do, the ownership condition is met.

16. *Subsections (4) and (5)* are based on the second sentence of section 343(1) of ICTA; in that context, “comprise” is considered to be non-exhaustive.

17. The deeming provisions of section 343(8) of ICTA operate for the purpose of determining whether there has been a transfer of a trade at all; this is reflected in clause 2(2)(b) and (4)(b). But they do not apply for the purpose of determining whether the ownership condition is met. To make this clear, subsection (4) says “If at any time the activities of the transferred trade are *actually* included in the activities of another trade ...” (emphasis added).

18. *Subsection (6)(a)* is based on section 344(1)(a) of ICTA. Section 344(1)(a) refers to “a trade carried on by two or more persons”, but does not actually need to cover trades carried on by non-corporates. Subsection (6)(a) therefore says, more precisely, “if two or more companies carry on a trade”.

Clause 4: Options that may be applied for the purposes of the ownership condition

19. This clause sets out various options that may be applied to see whether the ownership condition is met. It is based on section 344(2) and (3) of ICTA.

20. Schedule 1 to the Interpretation Act 1978 defines “person” as including a body of persons corporate or incorporate. Option 3 in *subsection (1)* therefore compresses “person or body of persons” in the tail words of section 344(2) of ICTA to “person”.

21. Option 3 in subsection (1) is more focused on the final result than the tail words of section 344(2) of ICTA. But this difference is merely verbal.

² [1990] STC 270.

22. It is implicit in section 344(3)(c) of ICTA that ownership includes indirect ownership; *subsection (6)* makes this implication explicit.

23. Section 838 of ICTA (subsidiaries) will be rewritten for corporation tax purposes in this Bill. The reference in *subsection (7)* to section 838(5) to (10) of ICTA will therefore be updated in due course.

Clause 5: The tax condition

24. This clause lays down the second of the two conditions which need to be met if the Chapter is to apply to a transfer. It is based on section 343(1) of ICTA.

25. Briefly, the tax condition is that the trade has been subject to corporation tax at all material times.

26. Section 343(1)(b) of ICTA refers to the trade not being carried on otherwise than by a company “which is within the charge to tax in respect of it”. Section 832(3) of that Act provides that “tax”, where neither income tax nor corporation tax is specified, means either of those taxes – except so far as the context otherwise requires. In section 343(1)(b) of ICTA the reference can only be to corporation tax, and so *subsection (1)* refers expressly to companies “within the charge to corporation tax in respect of the trade”.

27. Section 343(1)(b) of ICTA has a cryptic reference to “the period taken for the comparison under paragraph (a) above”. *Subsection (2)* expressly defines this period. *Subsection (2)* refers to clause 3(1)(a) and (b) in reverse order. This is deliberate. Clause 3 (the ownership condition), starts with the new owners of the transferred trade and moves from there to see whether common ownership can be established. By contrast, clause 5 (the tax condition) is seeking to establish whether the trade has been subject to corporation tax throughout the relevant period and so starts at the beginning of that period and works forwards.

28. The deeming provisions of section 343(8) of ICTA do not apply for the purpose of determining whether the ownership condition is met. To make this clear, *subsection (3)* says “If at any time the activities of the transferred trade are *actually* included in the activities of another trade ...” (emphasis added). See the commentary on clause 3(4).

Clause 6: Modified application of Chapter 2 of Part []

29. This clause modifies the application of the Chapter of this Bill giving relief for trade losses. It is based on section 343(1), (3) and (4A) of ICTA.

30. If this Chapter applies to a transfer of a trade, *subsection (2)* disapplies the terminal loss rules and *subsection (3)* entitles the successor to relief for trade losses carried forward.

31. Sections 393 and 393A of ICTA (relief for trade losses) are also being rewritten in this Bill; see CC/SC (07) 38.

Clause 7: Cases in which predecessor retains more liabilities than assets

32. This clause restricts the relief given to the successor under clause 6(3) to the extent that (a) the successor does not take over the predecessor's liabilities and (b) the predecessor does not have enough assets to meet them in full. It is based on section 343(4) of ICTA.

33. The aim of this clause is to stop tax relief being given twice for the same expenditure. It is fairly common, especially in receivership cases, for the liabilities of the business not to be transferred with the trade. Those liabilities are then left stranded in the predecessor company, and the creditors stand little or no chance of being paid. In such a case, the creditors will have to write off the debts owed to them by the predecessor. If these creditors have incurred these debts in the course of their trades of (a) supplying goods or services or (b) lending money, the write-offs will be tax deductible as trading expenses.

34. But for this clause, the successor could also claim tax relief for the same expenditure under the heading of losses carried forward. Under this clause, broadly speaking, the losses disallowed in the successor's hands equate to the amount of the debts which the predecessor is unable to pay.

35. *Subsection (2)* uses a formula to quantify the amount by which the successor's relief is restricted. "L" and "A" in that formula are defined in clauses 8 and 10 respectively.

Clause 8: "L"

36. This clause defines "L" in clause 7. It is based on section 344(6) to (8) of ICTA.

37. Section 344(6) of ICTA does not expressly provide that, if there has been an apportionment, only the liabilities apportioned to the transferred trade are to be taken into account. *Subsection (5)* makes this point explicit.

Clause 9: Treatment of predecessor's capital in calculating "L"

38. This clause supplements clause 9. It is based on section 344(6), (9), (11) and (12) of ICTA.

39. This clause recasts section 344(9) of ICTA to remove the curious expression "a liability *representing* the predecessor's share capital, share premium account, reserves or relevant loan stock".

40. In section 344(11) of ICTA, the parenthesis "(whether secured or unsecured)" blocks the argument that unsecured loan notes cannot be "relevant loan stock"

because if they are not secured they cannot be securities. *Subsection (4)* therefore retains this parenthesis.

41. In *subsection (6)(a)*, the expression “issued or otherwise originated” is broad enough to cover a transfer to reserves.

42. The wording of section 344(9) of ICTA is broad enough to cover a series of conversions of capital. *Subsection (6)(a)* makes this point explicit. In practice, however, such a series would be unlikely to meet the temporal condition imposed by *subsection (6)(b)*.

Clause 10: “A”

43. This clause defines “A” in clause 7. It is based on section 344(5) to (7) and (10) of ICTA.

44. Section 344(7)(a) of ICTA defines “the value of assets (other than money)”. *Subsection (3)* omits as redundant the reference to money.

45. Section 344(5) of ICTA does not expressly provide that, if there has been an apportionment, only the assets apportioned to the transferred trade are to be taken into account. *Subsection (8)* makes this point explicit.

Clause 11: Modified application of CAA 2001

46. This clause modifies the application of CAA 2001. It is based on section 343(1) and (2) of ICTA.

47. To the extent that the full-out words at the beginning of section 343(2) of ICTA are redundant, *subsections (1)* and *(2)* omit them.

48. Section 561A(2)(c) of CAA 2001 refers to section 343 of ICTA, whereas section 561(5) of CAA 2001 refers to section 343(2). Nothing turns on this distinction, therefore *subsection (1)* simply refers to sections 561 and 561A of CAA 2001.

49. Under *subsection (2)*, for capital allowances purposes, the transfer neither discontinues the transferred trade nor begins a new one.

50. Under *subsections (3)* to *(6)*, for capital allowances purposes, the successor stands in the predecessor’s shoes.

Clause 12: Transfers of trades involving business of leasing plant or machinery

51. This clause deals with transfers of trades involving businesses of leasing plant or machinery. It is based on section 343A of ICTA.

52. Section 343A of ICTA was one of a number of provisions inserted by FA 2007 to reinforce the leasing regime introduced by Schedule 10 to FA 2006.

Schedule 10 to FA 2006 is being rewritten in this Bill, and this clause may be revised as work on the rewrite of Schedule 10 to FA 2006 progresses.

Clause 13: Modified application of section 731 of ICTA

53. This clause modifies the application of section 731 of ICTA (purchase and sale of securities). It is based on section 343(1) and (5) of ICTA.

54. Section 731 of ICTA is an anti-avoidance provision dating from 1959 which has been largely superseded by more recent legislation.

Clause 14: Apportionment if part of trade treated as separate trade

55. This clause provides for apportionments to be made if, in accordance with clause 2(3) or (5), part of a trade is treated as a separate trade. It is based on section 343(9) and (10).

56. *Subsection (2)* expressly requires apportionments to be reasonable as well as just. This is a minor change in the law: see *Change 604* in Annex 1. The same change has been made in previous rewrite Acts.

Q2. We welcome comments on the proposal to make it explicit that apportionments under clause 14 are to be reasonable as well as just (Change 604).

57. If the companies affected by the apportionment do not agree that it is to be determined by the Special Commissioners, and the companies are not under the jurisdiction of the same body of General Commissioners, section 343(10) of ICTA gives the Board the power to direct which bodies of General Commissioners are to determine the apportionment. In practice, the Commissioners for Her Majesty's Revenue and Customs delegate this power to officers of Revenue and Customs, and *subsection (6)* reflects this. This is a minor change in the law: see *Change 601* in Annex 1.

Q3. We welcome comments on the proposal to give officers of Revenue and Customs the power to direct, in certain circumstances, which bodies of General Commissioners are to determine the apportionment under clause 14 (Change 601).

Clause 15: Application of Chapter to further transfers of transferred trade

58. This clause deals with further transfers of trades. It is based on section 343(7) of ICTA.

Schedule 2: Transitionals and savings etc

59. Saving provisions arising from the rewrite of sections 343 to 344 of ICTA will be published as part of the draft Bill 6. Meanwhile, the opportunity has been taken to

note that savings will preserve the effect of the closing sentences of section 343(2) and (4) of ICTA.

Schedule 3: Repeals and revocations

60. Repeals arising from the rewrite of sections 343 to 344 of ICTA will be published as part of the draft Bill 6. Meanwhile, the opportunity has been taken to note two salient points.

61. Section 343(11) of ICTA predates Corporation Tax Self Assessment and is now redundant. It will be repealed without replacement.

62. Section 343(12) of ICTA is a saving for the amendments made to the predecessor of section 343(9) and (10) of that Act by FA 1986. It is now spent, and will be repealed without replacement.

Annex 1

Change 604: Requiring an apportionment to be both just and reasonable: clause 14

This change requires any apportionment that is not required by the source legislation to be made on a just and reasonable basis to be made on such a basis.

In some cases where there is an apportionment under legislation rewritten in this Act, the apportionment is required by the source legislation to be made on a just and reasonable basis. In other cases, it is required to be made only on a just basis or only on a reasonable basis, or there are no requirements. In new tax legislation it is now the practice to require an apportionment to be just and reasonable. For example, before it was replaced by ITEPA, section 140B(4) of ICTA (inserted by FA 1998) required a just and reasonable apportionment to be made of any consideration given partly in respect of one thing and partly in respect of another. There is no reason why an apportionment should not be on a just and reasonable basis. And it is desirable that all apportionments should be made on the same basis.

Accordingly, where an apportionment under legislation rewritten in this Act is not required to be made on a just and reasonable basis, the rewritten provision requires the apportionment to be made on a just and reasonable basis. The changes are as follows:

- Section 343(9) of ICTA (apportionment of receipts, expenses, assets and liabilities required to be just if part of trade treated as separate trade) (see clause 14);
- ...

The same change was made in ITTOIA to provide a uniform expression of the basis on which apportionments are to be made.

This change makes minor amendments to a number of existing rules, but is expected to have no practical effect as it is in line with generally accepted practice.

Change 601: References to “officer of Revenue and Customs”: clause 14

This change replaces references to the “Board of Inland Revenue” in the source legislation with references to “an officer of Revenue and Customs”.

It brings the income and corporation tax codes into line.

References in the source legislation to the “Board of Inland Revenue” are treated by section 50(1) of the Commissioners for Revenue and Customs Act 2005 (CRCA) as references to “the Commissioners for Her Majesty’s Revenue and Customs”. The rest of this note accordingly refers to the Commissioners for Her Majesty’s Revenue and Customs (“the Commissioners”) rather than to the Board of Inland Revenue.

The provisions affected by this change will in future authorise or require things to be done by or in relation to an officer of Revenue and Customs rather than by or in relation to the Commissioners. This reflects the way in which Her Majesty’s Revenue and Customs is organised and operates in practice. Section 13 of CRCA allows nearly all functions conferred on the Commissioners to be exercised by any officer. All of the functions affected by this change, which are in the main concerned with administrative processes, are in fact exercised by officers of the Commissioners, and the Commissioners themselves are not personally involved in their exercise.

Each provision affected by the conversion of references to the Commissioners will be identified in the Table of Origins by a cross-reference to this change.

This change has no implications for the amount of tax due, who pays it or when. It affects (in principle and in practice) only administrative matters.