

Tax Law Rewrite
Response to Paper CC/SC (08) 04

**Relief against income for losses on the disposal of
shares**

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Relief against income for losses on the disposal of shares

Introduction

1. We published Committee Paper CC/SC (08) 04 on 9 January 2008 on the HMRC internet website www.hmrc.gov.uk/rewrite. The closing date for responses was 18 April 2008. The draft clauses rewrite the provisions relating to relief against income for losses on the disposal of shares incurred by investment companies in Chapter 5A of Part 13 of ICTA.

2. The purpose of this response document is to provide details of the substantive 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.

3. We received written responses from the following:

- The Institute of Chartered Accountants in England and Wales
- The Chartered Institute of Taxation and
- The CBI.

4. We are very 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.

5. A number of minor changes were proposed in the Committee Papers. In relation to all the changes, each respondent either approved of the change or stated that they did not object to it.

6. The following abbreviations for tax legislation are used:

- FA 1981 Finance Act 1981 (and similarly for other Finance Acts)
- ICTA the Income and Corporation Taxes Act 1988
- ICTA 1970 the Income and Corporation Taxes Act 1970
- ITA the Income Tax Act 2007
- TCGA the Taxation of Chargeable Gains Act 1992.

Chapter 5: Losses on disposal of shares

One respondent was surprised that, given the close parallel between the income tax relief in ITA and the corporation tax relief, there are some

significant differences between the two, at least in the organisation of the legislation. The respondent noted in particular that the identification rules come near the beginning of the Chapter, whereas in ITA they come at the end and that the two “How relief works” sections are also differently expressed.

The respondent considered that while the taxpayer would only be concerned with income tax or corporation tax, practitioners may well deal with both and that it would be more helpful for them if provisions which mean the same thing are expressed in the same way. In general the respondent regarded this consideration as outweighing any benefit which may be obtained by refining the drafting at the second attempt.

7. Our approach to the rewrite of these provisions took account of the differences between the income tax and corporation tax rules.

8. The order of the sections in ITA is dictated by the fact that, whereas the rules relating to qualifying trading companies apply only to shares to which EIS relief is not attributable, the identification rules apply to both EIS shares and to shares to which EIS relief is not attributable.

9. EIS relief is only available in relation to shares subscribed for by individuals and has no application to shares subscribed for by investment companies. Accordingly we considered it more helpful to users to bring clauses 8 to 10 (corresponding to sections 147 to 149 of ITA) with clauses 6 and 7 (corresponding to sections 135 and 136 of ITA) ahead of all the clauses dealing with the meaning of “qualifying trading company”.

10. Also, the two “How relief works” provisions are based on different sections of ICTA (section 573 in the case of corporation tax relief and section 574 in the case of income tax relief) and are worded differently to reflect the different bases on which the reliefs are available.

11. Where, however, provisions are common to both income tax and corporation tax, that is the provisions of sections 575 and 576 of ICTA, we have avoided variation in the language between these clauses and the corresponding sections of ITA. In particular, clauses 11 to 21 rewrite sections 576A to 576K of ICTA, which were introduced into ICTA by ITA and mirror sections 134 and 137 to 146 of ITA, with only minor changes of language which conform them more, rather than less, closely with the sections of ITA.

12. ***We do not propose to amend the order of the clauses.***

Clause 2: Eligibility conditions

One respondent considered that the drafting of subsection (1) is a little ponderous and suggested that the fact that the Chapter only applies to investment companies could be made more prominent by reversing the order

of subsections (2) and (3) and relabelling condition B as condition A and vice versa. Another respondent suggested that a signpost to the definition of “excluded company” in clause 23 would be helpful in subsection (4).

13. The structure of subsection (1) is necessary in order to introduce the subscribing company, the qualifying trading company and the shares mentioned in the rest of the clause. But we do agree that it makes sense to deal with condition B first. As condition C is connected to the subject matter of condition B, we consider that the revised order should be B, C and A. We agree that a signpost to clause 23 will be helpful.

14. ***We will revise the order of the conditions in subsections (2) to (4) and include the suggested signpost.***

Clause 3: Entitlement to claim

A respondent queried whether, in a case where a company seeks to deduct the loss in calculating income of an earlier accounting period, section 573(2) of ICTA has the effect of requiring the company to have been an investment company throughout the accounting period. The respondent considered that a more natural reading of section 573(2) would be to require the company to be an investment company at some time during the earlier accounting period. The respondent preferred that, in any event, the word “only” in subsection (3) be located immediately before the word “if”.

15. We consider that the words “if the company was then an investment company” in section 573(2)(b) of ICTA do mean that the company has to be an investment company throughout the accounting period in question. The provision now in section 573(2) of ICTA has been in this form since its introduction as section 36(2) of FA 1981. That section of FA 1981 followed section 177(2) of ICTA 1970 (losses other than terminal losses) where those words also had the meaning of throughout the period in question:

... the company may make a claim requiring that the loss be set off for the purposes of corporation tax against profits (of whatever description) of that accounting period and, if the company was then carrying on the trade and the claim so requires, of preceding accounting periods ending within the time specified in subsection (3) below ...

16. See also HMRC’s Venture Capital Schemes Manual at VCM49300:

If the claim so requires, any remaining loss may then be set against the CT income for the preceding accounting period or periods, see VCM49350, provided that the claimant was also an investment company throughout that period, or periods.

17. ***We propose to adopt the suggestion for the location of the word “only” but otherwise not to amend subsection (3).***

Clause 4: How relief works

A respondent considered that it would be much more helpful if, even where different reliefs were involved, the same ideas could be conveyed in the same way. The respondent contrasted the way in which carry-back of losses is dealt with in this clause with the way in which it is dealt with in clause 3 in committee paper CC/SC (07) 38 rewriting section 393A of ICTA.

18. There is already a resemblance between clause 3(2) (entitlement to claim) and clause 3(3) of committee paper CC/SC (07) 38. Clause 4(1) has been kept separate so that clause 3 mirrors section 132 of ITA and clause 4(1) mirrors section 133(1) of ITA.

19. In the light of the respondent's general comment about the corporation tax provisions mirroring the income tax provisions, we consider that it is more important to achieve the mirroring of the share loss relief provisions than to seek resemblance with the carry-back of losses provisions.

20. ***We do not propose to amend the structure of clauses 3 and 4.***

A respondent commented that Step 2 in subsection (1) should be qualified as applying only if the claim so requires. The respondent stated that section 133 of ITA dealt with this point satisfactorily and it was not obvious why the precedent of that section could not have been followed more closely.

21. As mentioned earlier in this document clauses 3 and 4 differ from sections 132 and 133 of ITA as they are based on different sections of ICTA. The qualification is here included in clause 3(2)(b).

22. ***We do not propose to repeat the qualification in clause 4.***

A respondent preferred the word "only" in subsection (4) to be located immediately before "after".

23. ***We propose to adopt this suggestion.***

Clause 5: Limit on deduction if accounting period falls partly within 12 month period

A respondent commented that in subsection (2) "the amount of the deduction under Step 2..." would actually be the aggregate of the deductions made against profits of all accounting periods falling wholly or partly within the 12 month period and that the wording needed to be amended to make it clear that only the amount deductible from profits of the straddling accounting period is meant.

24. We think that this comment proceeds on a misreading of the clause. The reference in subsection (2) to "the accounting period" can only refer to an accounting

period to which the clause applies, namely “an accounting period [which] falls partly within the period of 12 months...” mentioned in subsection (1). Accordingly, the rule in subsection (2) relates to the particular accounting period mentioned in subsection (1) of the clause.

25. *We do not propose to amend the drafting of this clause.*

Clause 8: Limits on relief

*A respondent suggested that, in subsection (5)(b) the second parenthetical note be amended to read “(taken as **another** single asset)” to provide additional clarity.*

26. We do not consider that any clarification is necessary. The drafting reflects the similar use of two identical parenthetical descriptions in section 127 of TCGA.

27. *We do not propose to adopt this suggestion.*

Clause 10: Section 9: supplementary

A respondent preferred, as being simpler, the words “(or is treated as applying)” in place of the words “(including a case where that section applies by virtue of an enactment relating to chargeable gains)” in subsection (1), with a possible amendment also to subsection (3).

28. The words in parenthesis are based on the words in paragraph 93(7) of Schedule 15 to FA 2000. Those words were substituted for words in that paragraph referring to section 135(3) of TCGA by Schedule 9 to FA 2002 which substituted new sections 135 and 136 of TCGA and introduced Schedule 5AA to TCGA. Although we agree that the words are somewhat cumbersome, they achieve the desired result. We do not consider that it is necessary to change them here and then have to consider whether to leave an inconsistency with section 149 of ITA or to make what is only a minor drafting improvement to that section.

29. *We do not propose to make any amendment.*

Clause 14: The control and independence requirement

A respondent queried why section 576D(4)(b) of ICTA (definition of control in section 576D(2)(a) to be in accordance with section 840 of ICTA) had not been rewritten.

30. *Section 840 of ICTA is to be rewritten in Bill 6, which will also include a provision equivalent to section 1021(2) of ITA providing that the rewritten definition applies for the purposes of Bill 6 unless otherwise indicated.*

Another respondent considered that it would assist clarity if either the clause contained a signpost to the definition of control for the purposes of subsection (2)(a)(ii) or it was made clearer that the definition of control in subsection (4) does not apply for those purposes.

31. ***We are considering adopting the latter suggestion.***

A respondent stated that, on balance, they would prefer the extension of the definition of “arrangements” in subsection (4) to be covered by a change note which in time could incorporate the other similar changes being made in Bill 6.

32. A change note is only appropriate where the rewritten provision makes a change in the law. As stated in the explanatory notes to this clause, the additional words merely change the presentation and not the substance of the source legislation.

33. ***We do not propose to prepare a change note.***

A respondent objected to the proposed expansion of the definition of “arrangements”, on the grounds that it is verbose and that it introduces yet another difference from the income tax version of this relief. The respondent commented that moreover the words “whether or not legally enforceable” obviously apply only to schemes agreements and understandings, and represent the whole point of the definition as it stands in the source legislation. In the respondent’s opinion inserting the reference to transactions, to which those words cannot apply, completely destroys the logic.

The respondent was in favour of adopting a consistent definition for all corporation tax purposes, but considered that the existing wording in section 576D of ICTA would be perfectly adequate for that purpose. This was on the basis that the inserted reference to transactions serves no practical purpose, since the definition is not expressed as being exhaustive and “arrangements” obviously include transactions anyway.

34. We note that the respondent is, in principle, in favour of adopting a consistent definition of “arrangements” for all corporation tax purposes. We agree that it would be of benefit to users if, so far as possible, consistency can be achieved in this respect.

35. With this aim in mind, our proposal is to have a single definition of “arrangements” at the end of Bill 6 applying for the purposes of the Bill as a whole. But we have yet to determine whether a general definition will produce a satisfactory outcome across the Bill as a whole. This is something we will consider at draft Bill stage.

36. Our initial view is that, although it may in principle be helpful for users, the inclusion in a general definition of a reference to “transactions” may not be apposite in the context of many of the Bill 6 provisions which would rely on it. If ultimately that is our conclusion, then we agree with the respondent that for the purposes of a

general definition we should not include a reference to “transactions or series of transactions”. But, as stated, we need to determine the precise wording of the general definition at a later stage in the context of the Bill as a whole.

37. *We are keeping the question of the definition of “arrangements” under review.*

Clause 20: Relief after exchange of shares for shares in another company

A respondent, while not objecting to the inclusion of clause 20(3)(a), found the wording of subsection (3) rather difficult to follow. The respondent noted that the wording follows that in section 145(3) of ITA.

38. While an alternative form might be less awkward, we do not consider that the difficulty is sufficient to justify our amending this clause and then having to consider whether to leave an inconsistency with section 145 of ITA or to make what is only a minor drafting improvement to that section.

39. *We do not propose to amend this clause.*