

Tax Law Rewrite – Bill 6

Response to Paper CC/SC (07) 40

Company reconstructions without a change of ownership

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

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Company reconstructions without a change of ownership

Introduction

1. In November 2007 we published Committee Paper CC/SC (07) 40 on the HMRC internet website www.hmrc.gov.uk/rewrite. The closing date for responses was 29 February 2008. The draft clauses rewrite the legislation for company reconstructions without a change of ownership.

2. 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. 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.

3. One of the respondents made a policy suggestion for reform. Such issues are outside the remit of the Tax Law Rewrite project but we have passed the suggestion to the relevant specialists for consideration.

4. A number of minor changes were proposed in the Committee Papers. Where no mention is made of these in this response document, they either received approval or were not mentioned in responses.

5. We received written responses from the following:

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

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

- FA 1954 Finance Act 1954
- ICTA Income and Corporation Taxes Act 1988

7. 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 have sent each respondent a copy of this response document.

General comments

Q1 We welcome comments on the structure of the Chapter.

The respondents were content with the radical structuring in the rewritten clauses; one observed that the general layout of the Chapter was clear and logical.

8. ***We will adopt the proposed structure for the Chapter.***

Clause 2{j4901Brm}: Transfer of trade

One respondent thought it would be clearer if clause 2{j4901Brm} explicitly gave an exhaustive definition of “transfer of a trade”, to rule out the possibility that there could be transfers not within the terms of clause 2{j4901Brm}.

9. The expression “transfer of a trade” does not have a clear meaning in normal English parlance; its meaning is given by clause 2{j4901Brm}. Therefore, there is no risk that there could be transfers not within the terms of clause 2{j4901Brm}.

One respondent wished the statute to move away from the deeming in clause 2{j4901Brm}(3) and (5).

10. It is not clear that this suggestion could be adopted without changing the law in ways which might not be to the taxpayer’s advantage. Also, the clause as drafted has a logical structure; subsection (1) deals with the main case, and subsections (3) and (5) address possible variations on it.

11. ***We do not propose to adjust the clause.***

Clause 3{j4902rm}: The ownership condition

A member of the Consultative Committee expressed concern that the repeated use of the symbol ‘A’ in close proximity might be confusing for users. It was used to denote a time period A (in clause 3{j4902rm}), a company A (in clause 4{j4903rm}) and to the sum of asset values A (in clause 10{j4906rm}).

A member of the Consultative Committee suggested that as the definitions of periods A and B in clause 3{j4902rm}(2) and (3) were brief, consideration might be given to merging them with subsection (1) thereby obviating the need for symbols.

12. ***We are happy to adopt the suggestion of dealing with the periods in question in subsection (1).***

One respondent thought that the words “on the transfer of the transferred trade or” could be omitted as otiose.

13. The words under review helpfully emphasise that the ownership condition will very often be satisfied at the point of time when the trade is transferred. We therefore do not think that they are otiose.

One respondent thought that it would be preferable for clause 3{j4902rm}(1)(a) and (b) to be transposed.

14. Clause 3{j4902rm}(1)(a) and (b) reflect the logic and working of the ownership condition, as explained in paragraph 15 of the draft commentary.

15. ***We have carefully considered these points but do not propose to adjust the draft clauses.***

Clause 5{j4903Arm}: The tax condition

One respondent queried the rewrite, in clause 5{j4903Arm}, of “the period taken for comparison” in section 343(1)(b) of ICTA.

16. The draft clause reflects HMRC’s interpretation of section 343(1)(b). Bramwell et al. endorse this interpretation:¹

“The reference in section 343(1)(b) to “the period taken for comparison” under (a) might appear to mean the whole of the year before the transfer together with the whole of the two years thereafter (three years in all). If correct this would give rise to curious results; eg if within one year prior to the transfer the trade had been transferred by a sole trader to a company in which he and his wife held all the shares, the relief would not be available. However, the correct interpretation appears to be that “the period for comparison” under (a) means the period between the latest point in time at which the conditions in (a) are satisfied as regards the predecessor company and the earliest point in time at which they are satisfied as regards the successor company.”

17. ***We do not propose to adjust the draft clause.***

Clause 6{j4901Arm}: Modified application of Chapter 2 of Part []

The respondent queried whether “in relation to loss” in clause 6{j4901Arm}(2) and (3) should, in each place, read “in relation to a loss”.

18. ***We agree, and will adjust the draft clause accordingly.***

Clause 8{j4905rm}: “L”

The sidenote on this clause is only one letter long, and the respondents thought it looked odd.

¹ *Taxation of Companies and Corporate Reconstructions* (Thomson, Sweet & Maxwell, June 2003) paragraph E.4.2.1 footnote 1.

19. ***We will reconsider the sidenote in the light of the points made.***

One respondent thought that the expression “is taken to cover” in clause 8{j4905rm}(3) was unclear.

20. We have considered this carefully. However, there is in our view no ambiguity which needs to be removed.

One respondent thought that, conceptually, assets should be dealt with before liabilities.

21. As the respondent acknowledged, L appears before A in clause 7{j4904rm}(1). The clauses defining them therefore appear in that order.

22. ***We do not propose to adjust the body of the draft clause.***

Clause 9{j4905Arm}: Treatment of predecessor’s capital in calculating “L”

Clause 9{j4905Arm}(6)(a) rewrites “arose” in section 344(9) of ICTA as “issued or otherwise originated”. One respondent thought that the word used in the source legislation was already sufficient.

23. As the respondent noted, paragraph 41 of the draft commentary explains that the use in clause 9{j4905Arm}(6)(a) of “issued or otherwise originated” is broad enough to cover a transfer to reserves. As paragraph 39 of the draft commentary explains, this clause recasts section 344(9) of ICTA to remove the expression “a liability representing the predecessor’s share capital, share premium account, reserves or relevant loan stock”. The longer expression is used in consequence of this reshaping; it does not change the law, and is slightly more informative.

One respondent did not object to the addition in clause 9{j4905Arm}(6)(a) of “that was itself recently converted capital”, but wondered whether this addition might actually constitute a change in the law.

24. We have considered this suggestion carefully. We think that the words under review are merely a drafting clarification and that they do not alter the existing effect of the law. Therefore, we do not think that this addition will change the law.

One respondent queried whether “the day on which the transferred trade occurs” could be compressed.

25. The reference to “the transferred trade” needs to be kept, to tie in with references to the transferred trade in clause 8{j4905rm}.

26. ***We do not propose to adjust the draft clause.***

Clause 10{j4906rm}: “A”

One respondent thought that, for the avoidance of any doubt, it would be preferable to retain the qualification in section 344(7)(a) of ICTA “(other than money)”.

27. We do not agree that there is any doubt which needs to be avoided. We consider that the words under review in section 344(7)(a) of ICTA are redundant and that they should be removed from the statute book.

28. ***We do not propose to adjust the body of the draft clause.***

The sidenote on this clause is only one letter long, and the respondents thought it looked odd.

29. ***We will reconsider the sidenote in the light of the points made.***

One respondent pointed out that the origin of clause 10{j4906rm}(6) was section 344(5) of ICTA.

30. ***We are grateful for this correction.***

Clause 11{j4908rm}: Modified application of CAA 2001

One respondent asked for the drafting of clause 11{j4908rm} to be revisited.

31. ***We will reconsider the drafting of this clause in the light of the points made.***

One respondent observed that the restriction on dual resident investing companies in section 343(2) of ICTA had not been rewritten.

32. As indicated in paragraph 59 of the draft commentary, this provision will be rewritten in the draft Bill to be published for consultation in Spring 2009.

33. ***The respondent’s observation is noted.***

Clause 14{j4901Crm}: Apportionment if part of trade treated as separate trade

One respondent considered that clause 14{j4901Crm} should make it clearer that the only occasion on which the Special Commissioners can be involved is if all the companies agree to the transfer of jurisdiction.

34. ***We note this suggestion. We are keeping under review the drafting of the Bill 6 clauses which rewrite this and similar provisions.***

The same respondent suggested that the law should be changed to enable the Special Commissioners to have jurisdiction even if not all the companies affected agreed to it.

35. If the companies did not all agree that the Special Commissioners should have jurisdiction, there would have to be a procedure to decide whose will should prevail. Devising such a procedure would be outside the remit of the Tax Law Rewrite project.

36. *We have passed on the suggestion to our policy colleagues.*

Clause 15{j4907rm}: Application of Chapter to further transfers of transferred trade

One respondent asked for clause 15{j4907rm} to be clarified.

37. Clause 15{j4907rm} is based on section 343(7) of ICTA. Section 343(7) ultimately derives from section 17(2) of FA 1954.

38. The main purpose of the FA 1954 legislation was to combat the avoidance of tax by use of contrived cessations and recommencements. At that time, companies paid income tax on a preceding year basis. In a period when profits were declining, a company could arrange to transfer its trade to a related company and, although the trade would continue under the same ownership, this would produce a cessation and a commencement for tax purposes. In consequence, a profitable year would fall out of assessment for the predecessor company whereas a less profitable year would be assessed twice over for the successor company.

39. The FA 1954 legislation blocked this by ignoring the transfer and providing for continuation treatment between the two companies if there was 75% common ownership. Section 17(2) of FA 1954 was included to stop companies circumventing section 17(1) of that Act by simply routing the trade through an intermediate company which did not satisfy the 75% ownership condition. For example if company A transferred its trade to company B which was a 51% subsidiary, section 17(1) would not apply. When B transferred its trade to company C a few days later once again section 17(1) would not apply. Section 17(2) provided that if the Inland Revenue could establish 75% common ownership between company A and company C (or between company A and a further transferee company) then, provided that there was 75% common ownership between the two companies within two years of the first transfer, section 17(1) would apply to each of the transfers.

40. When corporation tax was introduced in 1965, section 17 of FA 1954 was repealed and replaced by what is now section 343 of ICTA, which makes similar provision and uses some of the same terminology.

41. Clause 15{j4907rm} is based on section 343(7) of ICTA and reflects HMRC's interpretation, which is summarised in paragraph 06070 of the *Company Taxation Manual* (CTM 06070).

The respondent was concerned that the draft clause did not appear to be consistent with CTM 06070.

42. The departmental guidance in CTM 06070 does not attempt to cover all the possible applications of section 343(7) of ICTA. As the respondent noted, there can be circumstances in which section 343(7) of ICTA applies even though the third company is not in the same ownership as its predecessors.

The respondent queried whether clause 15{j4907rm}(1)(a) could be satisfied after the second (ie further) transfer.

43. We are happy to give this confirmation.

44. ***We do not propose to adjust the draft clause except as noted below.***

The same respondent suggested that in clause 15{j4907rm}(1)(b)(ii) “at or before the relevant time” would be preferable to “on or before the relevant time”.

45. The same point applies to clause 15{j4907rm}(5).

46. ***We agree, and will adjust the draft clause accordingly.***