

Summary: Intervention & Options

Title:

Simplification of the Transactions in Securities Legislation

Date: 27 July 2009

Related Publications:

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Contact for enquiries: Hussein Saleh

Telephone: 020 7438 6658

What is the problem under consideration? Why is government intervention necessary?

Transactions in Securities (TiS) can be broadly described as any transaction involving shares and other financial securities, which potentially affect the income and capital gains tax position of those involved. The TiS legislation, originating in 1960, has been identified as unduly complex and cumbersome. Currently there is insufficient guidance, leading to uncertainty on the practical application of provisions. HMRC are consulting on the wording and interpretation of the TiS legislation, seeking to take account of customers' views (typically tax professionals on behalf of their clients).

What are the policy objectives and the intended effects?

The aim is to create clearer, more focused legislation, supported by comprehensive guidance, to help customers understand the specific behaviours being targeted, improve certainty about how and when the legislation applies and consequently reduce administrative burdens (in the sense that benefits outweigh the one-off costs of familiarisation). This meets the twin aims of the simplification review, simplicity and revenue protection. Our consultation aims to review our proposals in detail and ensure these benefits will be delivered to customers.

What policy options have been considered? Please justify any preferred option.

Option 1 - Do nothing.

Option 2 - Consider a specific range of measures to significantly alter our approach and application of the TiS legislation, with the aim of providing greater clarity and certainty to our customers resulting in benefits that outweigh the costs associated with these measures.

Option 2 is our preferred option as it fundamentally reviews a section of legislation which customers consider complex and difficult to understand. By providing guidance and clarifying existing legislation, the customers' benefits should by far outweigh the associated costs.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Expected 3 years after the new framework is introduced.

Ministerial Sign-off For Consultation Stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



Date: 27 July 2009

Summary: Analysis & Evidence

Policy Option: 2	Description: Consider measures to alter our approach and application of the TIS legislation providing greater clarity and certainty to cutomers.
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' We estimate a first year one-off customer cost of £1.1m resulting from agents, on behalf of their customers, spending time familiarising themselves with the new rules. HMRC costs are expected to be negligible since this is simplification of existing tax legislation. Any training costs can be absorbed into current budgets.
	One-off (Transition) Yrs	
	£ 1.1m 1	
	Average Annual Cost (excluding one-off)	
	£ Nil	Total Cost (PV) £ 1.1m
Other key non-monetised costs by 'main affected groups' Since the main group affected by this tax legislation simplification will be tax professionals on behalf of their clients, one-off costs arise as a result of those tax professionals familiarising themselves with the simplified legislation.		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' We expect agents to spend less time explaining available options to their clients resulting in lower fees. Improved understanding of the rules will also lead to fewer applications. HMRC will benefit from the lower staff costs of processing fewer applications. We expect benefits to be projected over 5yrs.
	One-off Yrs	
	£ Nil	
	Average Annual Benefit (excluding one-off)	
	£ 1.2m	Total Benefit (PV) £ 5.7m
Other key non-monetised benefits by 'main affected groups' Providing consistency and clarity to customers will provide benefits, in terms of the reduced need for customers to apply for clearances, which will outweigh the one-off costs of familiarisation.		

Key Assumptions/Sensitivities/Risks The net benefits are projected over five years, in the interests of prudence, so therefore the Net Present Value (NPV) has been calculated on that basis. We also expect additional receipts and revenue protection of £160m in 2010/11 and £65m annually to 2013/14 from closing the relevant company loophole.

Price Base Year 2008	Time Period Years 5	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ 4.6m
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What is the geographic coverage of the policy/option?		UK	
On what date will the policy be implemented?		Finance Bill 2010	
Which organisation(s) will enforce the policy?		HMRC	
What is the total annual cost of enforcement for these organisations?		£ TBC	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		No	
What is the value of the proposed offsetting measure per year?		£	
What is the value of changes in greenhouse gas emissions?		£ NA	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium Large
Are any of these organisations exempt?	No	No	N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of £	Decrease of £ 140,000	Net Impact	£ 140,000

Key: Annual costs and benefits: (Net) Present

Overview of the Consultation Document

We are aware, from our consultations with stakeholders, that customers, advisors and representative bodies consider Transactions in Securities (TiS) legislation to be extremely complex and unnecessarily cumbersome. There is, therefore, a clear argument for simplifying Section 703 to Section 709 Income and Corporation Tax Acts (ICTA) 1988 and Section 682 to S713 Income Tax Acts (ITA) 2007 and clarifying its scope to ensure customers are not weighed down by unnecessary costs and/or excessive advisors fees.

The consultation document details a package of proposals which HMRC consider meet the objectives of the Anti Avoidance Simplification Review for Transactions in Securities. Specifically chapter 3 gives further details on each proposal. At the end of each chapter there will be a series of questions relating to each proposal on which we would appreciate customers' thoughts. Additionally, there are questions in the introduction regarding the package of measures as a whole.

It is important to bear in mind that this consultation is not a number of individual changes which could be implemented in isolation but a single package of proposals.

History of the Legislation

The TiS legislation at Section 703, ICTA 1988, was originally enacted in 1960 to combat specific income tax (IT) 'stripping' avoidance devices which, before the introduction of Capital Gains Tax (CGT), turned taxable income into tax exempt capital.

Since 1960, its general power has protected the Exchequer against a wide range of avoidance schemes in shares and securities transactions which seek to exploit the IT/CGT 'fault-line' which is a standard feature of the UK tax landscape.

In 2006, nearly 6,000 clearance applications were made of which approximately 98% were accepted. Most claims are processed quickly (90% in less than 8 days) because there is very little risk of S703 ICTA 1988 (S703) applying to what are clearly commercial transactions with no tax avoidance motive.

In 2007, the legislation was amended so that the ICTA 1988 legislation targets corporation tax (CT) advantages and the ITA legislation targets IT advantages arising after 5 April 2007.

History of the Anti Avoidance Simplification Review

The Pre-Budget Report (PBR) 2007 launched the Anti-Avoidance Simplification Review, to consider how anti-avoidance legislation can best meet the twin aims of simplicity and revenue protection.

The PBR document set out the Government's view of how simplification can best be achieved in anti-avoidance legislation through ensuring new anti-avoidance legislation is clear, effective and well targeted and by simplifying areas of existing anti-avoidance legislation.

At Budget 2008, HMRC published an update on the Anti-Avoidance Simplification review. (<http://www.hmrc.gov.uk/budget2008/aa-simplification.pdf>). This included a summary of the results of the initial engagement with business and professional stakeholders, who accepted the need for Government to ensure that anti-avoidance legislation provides effective protection to the Exchequer. However, they wanted legislation that is clear, well targeted and easier to use. Additionally they wanted to be able to understand the tax consequences of complex commercial transactions with reasonable certainty.

On 17 July 2008, HMRC published an update paper providing further information on three areas that were subject to the Anti-Avoidance Simplification Review. http://www.hmrc.gov.uk/avoidance/avoid_report.pdf These were: TiS legislation, Alignment of Purpose rules and the rules on Employment Related Securities.

Following this update paper, HMRC held a number of external stakeholder workshops with businesses, advisors and representative bodies at the start of September 2008. Between September 2008 and January 2009, we held a number of further one-to-one meetings with external stakeholders.

In January 2009, an additional workshop with a small number of external stakeholders was held, where we developed a set of draft proposals which form the basis of this consultation document.

The Proposed Measures

	Title	Summary
1	Refocus the Transactions in Securities Purpose Test to Target Tax Avoidance	<p>The aim of this proposal is to modernise the TiS legislation to ensure it is clearer and more focused. This should help customers understand the mischief being targeted, improve certainty regarding how it applies and consequently reduce compliance costs. The refocused legislation should only catch customers who enter into TiS that have a tax avoidance purpose. What was previously described as the prescribed circumstances and the 'Escape Clause' will now be incorporated into a new purpose test at s683 removing the need for a separate 'Escape Clause'.</p>
2	Adopt the definition of a close company for 'Relevant Company' in S691 ITA 2007.	<p>The aim of this proposal is to simplify the definition of a "Relevant Company" by aligning this definition, with the more widely known and understood definition of "Close Company" which is defined in s414 and s415 ICTA 1988. In doing so this has helped to achieve the following:</p> <p>(a) this has led to the proposal that s688 ITA 2007 (Circumstance C) be repealed (see Proposal 3). It is felt that by adopting the definition of close company rather than using relevant company for income tax purposes the TiS that would have previously been caught by s688 ITA 2007 will now be caught by the draft legislation in s684 where Conditions A or B have to be met (previously s689 and s690 ITA 2007). For CT purposes is not clear as to whether S704C ICTA 1988, which sets out the circumstance C for companies, may be repealed, so further work on this will continue over the next few months.</p> <p>(b) this would clear any uncertainty as to whether the definition of Relevant Company is EU compliant. It has been suggested to HMRC that because the current definition includes a requirement that a company has to be listed in the UK and dealt in on a recognised stock exchange in the UK, not to any other equivalent stock exchanges within the EU, there may be concerns that it is not EU compliant and may possibly have required updating to ensure it is EU compliant. Adopting a Close Company definition should resolve this matter. .</p> <p>(c) this proposal closes a current opportunity for avoidance which enables companies to fall out of the scope of the prescribed circumstance D currently found at s689 ITA 2007 with the assistance of inserting listed companies in their group structure, a practice known as 'D proofing'.</p> <p>Commensurate changes are proposed to the comparable sections of CTA 2010 which will replace ICTA 1988.sections of CTA 2010 which will replace ICTA 1988.</p>

3	Simplifying the remaining circumstances in S686 to S690 ITA 2007.	<p>The aim of this proposal is to create a more manageable piece of legislation by:</p> <p>(a) Repealing section 704A ICTA 1988 which is now largely obsolete apart from a very narrow application with regard to Shadow Advance Corporation Tax (ACT). We propose that a much more targeted amendment to the Shadow ACT Regulations (SI 1999/358) will suffice to prevent creating an avoidance risk.</p> <p>(b) Repealing section 686 ITA 2007 which sets out the equivalent circumstance A and is now considered redundant since the abolition of tax credits in 1999.</p> <p>(c) Repealing section 688 ITA 2007 which sets out the circumstance C. This can now be repealed for IT purposes in line with Proposal 2 (Adopt the definition of a close company for 'Relevant Company' in S691 ITA 2007). Replacing the definition of a relevant company will mean that the type of arrangements we have seen in the past that would normally fall within the circumstance C would now fall within the circumstance D, consequently, there is no longer a need to retain the circumstance C for IT purposes. At the current time it is not clear whether it will be possible to repeal the equivalent provision for CT purposes. Work to establish this is currently ongoing at the present time. We would welcome your thoughts on the appropriateness of this proposed repeal for CT.</p> <p>One consequence of repealing s686 and s688, will mean that there is no need to retain the following provisions in ITA 2007 sections 692, 693 and 694 ITA 2007. These sections relate to the meaning of abnormal dividends for the purposes of s686 and s688 ITA 2007. Whether the equivalent sections for CT purposes can be repealed will depend on whether it is possible to repeal section 704C ICTA 1988.</p> <p>Together, these changes should further increase certainty and clarity for customers.</p>
4	The Fundamental Change of Ownership Rule	<p>The aim of this proposal is to remove TiS that result from a fundamental change in ownership from the scope of the TiS legislation. Such a rule should increase certainty in circumstances where there has been a fundamental change in ownership, reducing the compliance costs and advisors fees for our customers. The fundamental change of ownership would be included in the legislation and s685 of the draft legislation demonstrates how it would be presented.</p>

5	Defining and Quantifying 'Tax Advantage'	<p>The aim of this proposal is to introduce a new statutory definition of 'income tax advantage' in the TiS legislation, based on current HMRC practice.</p> <p>The intention is to replace the existing meaning of income tax advantage in section 683 ITA 2007, with a more targeted definition to provide greater clarity to our customers that is based around the calculation of the amount of the tax advantage that would be subject to counteraction. This proposal does not include the introduction of a lower limit for when counteraction will take place. This is because each case will continue to be treated individually on its own set of facts.</p> <p>Although this consultation document focuses on IT advantages, it is envisaged a similar approach would be replicated for CT purposes in CTA 2010.</p> <p>This would be the first time HMRC has set out a clear definition of 'income tax advantage' for these purposes and how the 'tax advantage' is quantified within the legislation. The new definition of income tax advantage is contained in s686 in the draft legislation in Annex C.</p> <p>During this consultation, we are hoping to obtain opinions on the perceived benefits of quantifying the tax advantage in statute and whether the approach set out in the draft legislation under this proposal would be of benefit to customers.</p>
6	Clarifying the scope of the Transaction in Securities Legislation	<p>HMRC have received feedback from customers that suggests they would like clarity on whether the TiS Legislation applies to situations where capital gains are converted into income.</p> <p>For income tax purposes the proposed changes in Proposal 5 'Defining and Quantifying the Tax Advantage' relating to the draft legislation at s686 will provide sufficient certainty on this matter. No further amendments to the legislation will be required as s686 describes the comparator that needs to be considered and it does not include a reduction in the level of capital gains tax that is paid.</p> <p>It is envisaged that a similar approach will be adopted for Corporation Tax purposes and any amendments to the CT legislation are intended to be made in CTA 2010</p>
7	Guidance for Transactions in Securities	<p>There is currently limited guidance on the practical application of sections 703 to 709 ICTA 1988 and sections 682 to s713 ITA 2007 at CTM36805 to CTM36885. This proposal is therefore to publish clear and extensive guidance for the new TiS legislation that will result from this consultation and the draft legislation which will amend the current sections 682 to 694 ITA 2007.</p> <p>This should remove much of the ambiguity in the legislation, reducing customers' uncertainty and compliance costs</p>

Effect of this package of measures

The package of measures proposed in this consultation document will result in a fundamental and significant change in the approach and application of the TiS legislation. This will give greater clarity and

certainty to our customers, therefore providing benefits that exceed the costs of introducing changes to the legislation

These proposed changes will focus the scope of the legislation to target transactions in securities which had been entered into for a main purpose (or one of the main purposes) of obtaining a tax advantage.

The proposed changes would also a more targeted definition of income tax advantage based on the calculation of any tax advantage and thus the amount potentially at stake in any counteraction process.

The refocusing of the TiS purpose test would help ensure the legislation only takes effect where there is a clear tax avoidance purpose, and only then if certain other conditions are met, providing increased certainty for customers.

The aim is to create clearer, more focused legislation, supported by guidance, which should help customers understand the specific behaviour being targeted, improve certainty about how and when the legislation applies and therefore provide benefits to customers in their dealing with HMRC as well as meeting the twin aims of the simplification review of simplicity and revenue protection.

Costing Methodology

Costs and benefits have been estimated assuming that they arise as a result of the TiS legislation simplification package as a whole. They therefore cannot be apportioned to individual proposals.

Customer costs and benefits

Tax professionals, on behalf of their clients, will need to spend time familiarising themselves with the new rules. Therefore the one-off costs faced by customers have been estimated on this basis using data on typical per hour agent costs faced by small to medium size enterprises from the Standard Cost Model.

The specific assumptions made to estimate customer cost are:

1. These are one-off learning costs (given the nature of familiarisation)
2. Familiarisation takes tax professionals 4 hours on average to do.
3. The Standard Cost Model has been used to get an indication of per hour costs. In using this, the population of clients has been assumed to be evenly split between small (assumed to face agent costs of £150ph) and medium (assumed to face agent costs of £390ph) size business owners. This gives an average per hour agent cost of £270.
4. We are assuming that familiarisation costs are associated with each clearance application, in an effort to make a maximum and therefore cautious estimate.

Using these assumptions we arrive at an estimate of the one-off familiarisation costs of £1.1m.

On the other hand, we expect customers to benefits from reduced numbers of TiS applications, and reduced costs of making applications as less time spent reviewing available options leads to lower agent fees.

The specific assumptions made to estimate customer benefits are:

5. To reflect the economic climate in the baseline volume of transactions, we have assumed a 25% reduction from the 2007/8 levels. By making this adjustment we are essentially estimating 2008/09 clearance levels and assuming these remain flat until 2010/11, when these simplification proposals are presumed to be introduced. Note that early indications from available 2008/09 data confirm the prudence of such an adjustment.
6. A 2 week, detailed, data collection exercise revealed that some 13% of applications were s701-709 only. This forms the basis of the expected volume reduction effect (i.e. 13% fewer s701-709 applications will be made by customers). We may also see a reduction in time spent on s701-709 applications made as part of clearance applications under other provisions, but due to difficulties in quantifying this benefit we have based this costing on s701-s709 only applications.

7. Data from the Standard Cost Model has been used to give an indication of the cost of applying for clearances

Applying the volume reduction assumptions to the estimate of individual clearance costs yields a customer benefits estimate of around £1.2m on an annual basis. Assuming benefits over a 5 year time horizon gives a Net Present Value of £5.7m (using the HM Treasury Green Book assumed discount rate of 3.5%).

HMRC costs and benefits

We do not expect HMRC costs to be significant, on the basis that this is a one-off simplification of existing legislation. There may however be some staff training costs incurred, but we expect these to be absorbed into current budgets.

We expect some cost saving to HMRC as fewer applications being received.

Revenue Protection and Additional Receipts

The revenue protection and additions represents income tax receipts that will be protected plus any net additions as a result of closing the relevant company loophole. In 2010/11, revenue protection is estimated to be £130m with additional receipts estimated to be £30m. From 2011/12 to 2013/14, revenue protection and additional receipts are estimated at £50m and 15mn respectively.

The estimates represent a lower bound, where we are assuming only unquoted companies, consisting of five or few shareholders. We also assume that the affected population are entitled to entrepreneurs' relief, and we expect some front loading due to payment on account under IT SA.

Administrative Burdens Impact

A 13% reduction in the number of clearance applications under s701-s709 implies a corresponding reduction in the administrative burden of applying for clearance under those provisions. We therefore estimate an admin burden decrease of £140,000 from this package of proposals using the Standard Cost Model.

We intend to revisit this estimate after consultation and as new data becomes available.

Specific Impact Tests

Competition Assessment

Will the proposal have a significant impact on competition? No it will not. None of the 7 proposals will impact on competition.

Small Firms Impact Test

Will the proposal impact on small businesses? We have considered whether alternative approaches might be appropriate for firms with fewer than 20 employees. Businesses of all sizes will be affected by these changes. It is often small firms and family run companies that have to consider the transaction in securities legislation when they come to sell or otherwise alter ownership in their businesses. It is manipulation of this that the legislation has historically sought to prevent so there is no scope for providing small firms with an exemption. The proposed changes will not change who is affected by the legislation but the more comprehensive guidance should mean that small businesses do not have to spend excessive time and money establishing if the legislation will be relevant to their set of facts and circumstances.

External stakeholders have been involved in coming up with the proposals that form the basis for the consultation document. Small business and their representatives were present at that meeting and welcomed any guidance and clarification on the scope of the legislation to enable them to spend less time and money on considering if the legislation would be relevant to their set of circumstances.

Legal Aid Impact Test

Will the proposal introduce new criminal sanctions or civil penalties? No.

Sustainable Development

Does the proposal comply with Sustainable Development Principles? Yes it does.

Carbon Assessment

Will the proposal lead to change in the emissions of Greenhouse Gases? No

Other Environmental Issues

Air Quality, Water Pollution, Climate Change? No adverse effects.

Health Impact Assessment

Will the proposal have an impact on health, well-being or health inequalities? No.

Race Equality

This proposal will have no impact on racial equality.

Disability Equality

This proposal will have no impact on disability equality.

Gender Equality

This proposal will have no impact on gender equality.

Human Rights

Will the policy have an impact on human rights? No it will not impact on human rights.

Rural Proofing

Will the policy have a different impact in rural areas? No.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

