HM Revenue & Customs

Modernising the taxation of corporate debt and derivative contracts

Summary of Responses
December 2013

Contents

Executive Summary

At Budget 2013, the Government announced consultation on a package of proposals to modernise the corporation tax rules governing the taxation of corporate debt, with a view to legislating in Finance Bill 2014 and Finance Bill 2015. Subsequently, the *Modernising the taxation of corporate debt and derivative contracts* consultation was launched in June 2013. The consultation document set out proposals and options for updating the regime governing the taxation of debt (loan relationships) and derivative contracts held by companies. This work supports the Government's aim of promoting a tax system which is efficient, competitive, predictable, simple and fair.

The key areas for consultation were as follows:

- Refining the core structure of the regime, including clarification of the role to be played by accountancy in determining taxable amounts.
- Basing taxable amounts on accounting profit and loss, rather than, as now, taking account of debits and credits appearing in any part of a company's financial statements.
- Combining the rules which apply separately to loan relationships and derivative contracts.
- Revision of some of the detailed rules in the areas of connected party debt, intra-group transfers, partnerships, foreign exchange movements, hedging, debt restructuring and the treatment of bond funds and certain particular types of instrument.
- Introducing an integrated and comprehensive anti-avoidance provision.

During and subsequent to the written consultation period, the Government has engaged in detailed discussions with interested parties through bilateral contacts and a series of joint working groups, which have met regularly and which are expected to continue throughout the project.

At a general level, there was widespread support for the aims of the review; the principles of simplicity, fairness and certainty were welcomed. However, general concerns were expressed about the potential for uncertainty arising from change beyond what is essential and about the timing of the proposed changes, particularly the interaction with new accounting standards expected to take effect in 2015.

In most areas there was at least some support for the detailed proposals or one of the options presented, and in those cases the Government will, as explained in the following chapters, continue to explore the issues in consultation with stakeholders to refine understanding and inform the detailed policy design.

In a few areas there was little support for the approach suggested in the consultation document. In particular, respondents did not welcome the prospect of a non-specific override to accountancy in determining taxable amounts, or repeal of the bond fund rules. In these cases the Government will continue to evaluate with stakeholders the objections raised, and where appropriate will explore the possibility of alternative approaches to achieve the relevant policy aims.

It was proposed to introduce a small number of changes in Finance Bill 2014, with the bulk being included in Finance Bill 2015. In the light of consultation responses and subsequent discussion with stakeholders, measures for Finance Bill 2014 will now be restricted to those concerning, firstly, loan relationships and derivative contracts held by partnerships with corporate partners (see Chapter 9 below) and, secondly, bond funds. In the case of bond funds, the legislation to be introduced will reflect an alternative approach to that presented in the consultation document, as discussed in Chapter 13 below.

Two measures will not be introduced in Finance Bill 2014 as originally intended. First, events since the consultation document was published have indicated that the rules on the taxation of index linked gilt-edged securities are sufficiently robust, and no changes are now planned in this area. Second, the "unallowable purpose" anti-avoidance rule will now be updated as part of the main changes in Finance Bill 2015.

The Government is grateful to those who have taken the time and effort to respond to this consultation. HMRC would particularly like to thank those involved with the working groups or who have otherwise attended meetings. These have been, and continue to be, extremely constructive and informative.

1. Introduction

1.1 The loan relationships regime was introduced in 1996, followed by a similar regime for the taxation of derivative contracts in 2002. Since that time, frequent changes have been made to the legislation for reasons which include the development of new types of financial instrument, the evolution of accountancy and persistent attempts to avoid tax.

1.2 This process of continual piecemeal change has tended to compromise the coherence of the regime, eroding transparency and certainty and introducing complexity and further loopholes.

1.3 The purpose of this consultation is therefore to explore ways to ensure that the rules can be made to work more effectively for both industry and Government, In particular, the aim is a regime which is more efficient, more certain in its application, easier to apply and understand and more robust against avoidance.

1.4 The Government has adopted a collaborative approach to the consultation process. Following publication of the consultation document, an open day event was held in June to explain the background to the consultation and facilitate participation in it. Close co-operation with stakeholders has been maintained since then through both bilateral contacts and a series of joint working groups, which between them cover the entire scope of the consultation document material. These groups, which have met regularly since the summer, include representation from companies, representative bodies, advisers and other interested parties. The Government is grateful to those who have contributed to and supported this process, and continue to do so.

1.5 The consultation document posed a wide range of general and specific questions regarding the proposed modernisation of the loan relationships and derivative contracts regime. Fifty four written responses were received; many of these were detailed and all were helpful, and the Government is very grateful for all the contributions. A list of the respondents to the consultation is included at Annex A.

1.6 This document provides a summary of the responses, and comments on how the Government intends to proceed. It reflects the layout of chapters in the June consultation document itself. The consultation document contained a full account of the issues, options and proposals presented, and this summary of responses should be read in conjunction with it.

1.7 Although the summaries necessarily omit much of the detail in individual responses, all contributions have been fully considered and will be taken into account in designing both policy and draft legislation.

1.8 In some areas the proposals have evolved considerably since the written consultation closed in August, in part as a result of written responses to the consultation document but also in the light of further informal consultation and discussion with stakeholders. The summaries in this document focus mainly on the issues that were raised in the June 2013 consultation document and the responses received.

2. Responses – General remarks

2.1 Broadly, respondents supported the aims of the review and, in many areas, the detailed proposals or one of the options presented; the principles of simplicity, fairness and certainty were welcomed. However, a number of general concerns were expressed.

2.2 Many expressed a general preference for limited incremental change as opposed to more radical options, and this was a theme of responses in many of the areas of detail considered in the consultation document. This reflects a concern that changes may lead to uncertainty and unforeseen tax or commercial consequences. Notwithstanding frequent adverse comment received by the Government in the past about inadequacies and complexity in the loan relationships and derivative contracts regime, some respondents suggested that the consultation may be seeking to renew a regime which, while not perfect, is nonetheless workable and familiar.

2.3 The Government takes note of these responses, but continues to believe that it is right to explore appropriate changes in pursuit of the policy objectives set out particularly with a view to ensuring the stability of the regime in the long term, to the benefit of affected taxpayers generally, as well as HMRC. However, the Government will, in considering individual areas of proposed change in continuing consultation with stakeholders, take full account of the balance of potential benefits and risks of moving away from existing approaches.

Box 2.1: Comment on the aims of the consultation

> ***"We welcome the overall aims of Government to make the tax regime simpler and clearer for taxpayers and more robust against tax avoidance. However, it is also important for taxpayers to have a stable tax regime and this naturally generates some tension against the pressures for change."***

2.4 There was widespread concern that certain specific proposals might lead to unwelcome commercial and tax uncertainty. This stemmed largely from discussion in the consultation document about the role to be played by accountancy in determining the existence, timing and quantum of taxable amounts arising from loan relationships and derivative contracts. In particular, respondents were concerned that instances of departure from the default accounting treatment might be insufficiently defined in legislation. These issues are discussed further in Chapters 3 and 4 below.

Timetable and interaction with changes in accountancy

2.5 Some respondents raised issues about the timetable for the review. Several felt that the timetable was ambitious in view of the scope of the work involved. In addition, there was a widespread view that the timing might be unhelpful if new measures take effect alongside significant changes to UK Generally Accepted Accounting Practice (UK GAAP) scheduled for 2015. Other respondents proposed that certain changes be brought forward so that they were in place before the accountancy changes.

2.6 Many UK companies will be required to adopt one of EU-endorsed IFRS, FRS 101 or FRS 102 for periods commencing on or after 1 January 2015. Given the views expressed by respondents, the Government would expect the majority of changes proposed by this consultation to have effect in respect of periods commencing on or after 1 January 2016 at the earliest. This, together with transitional measures including appropriate grandfathering of existing instruments, should largely address the concerns expressed.

2.7 Certain measures are proposed for Finance Bill 2014 and they are expected to apply ahead of the main accountancy changes. However, these are not expected to give rise to significant transitional issues for the majority of companies.

2.8 Following specific points raised by respondents, the Government will work with stakeholders to consider limited changes to existing secondary legislation with a view to easing the transition to FRS 101 and FRS 102. Specific concerns raised by respondents include foreign exchange movements on permanent-as-equity debt; the time limits and complexity of elections under regulation 6 of the Disregard Regulations; and the need to update statutory references following the tax law rewrite of the loan relationship and derivative contract rules.

2.9 The Government will continue to work with companies and their advisers to assist with the tax issues that could arise on transition to the new accounting standards. As part of this work, HMRC will publish new guidance to help businesses identify significant tax differences that may arise under FRS 101 and FRS 102 compared with current UK GAAP.

3. Responses – The framework

3.1 Chapter 3 of the consultation document set out the Government's view that an effective regime needs to be underpinned by a clear understanding and expression of its purpose and scope and of how taxable amounts are to be measured. It suggested that the purpose of the regime could be formulated as:

Box 3.1: Purpose of the loan relationships and derivative contracts regime

> ***To tax or relieve, as the case may be, profits, gains and losses of a company on its loan relationships and derivative contracts.***

3.2 This was not considered to amount to a substantive change from the current approach, and there was no intention fundamentally to change the nature of the subject matter to which the regime applies.

3.3 It was recognised that in the vast majority of cases, the accounting treatment of an instrument or transaction will provide an appropriate indication of the existence, the measure and the timing of taxable amounts. However, the document suggested that this will not be universally true, in part because loan relationships are constructs of tax law and not accounting concepts.

3.4 It was proposed that the legislation should reflect this by making clear that, while the accounts are the default indicator of tax treatment, they are capable of being overridden in cases where they do not give an appropriate picture of the existence of a particular loan relationship or of the profits, gains or losses arising from it.

3.5 In addition, it was proposed that a revised regime should include an overriding provision ensuring that amounts brought into tax reflect the intentions of the regime. It was envisaged that determination of taxable amounts might be based on the statement of purpose in box 1 above, referring to the familiar tax terminology of "profits, gains and losses", possibly with some further qualifying words.

3.6 The consultation document set out a basic "default" approach to determining a taxable amount under the loan relationships and derivative contracts regime. It went on to propose categorising those occasions where provision is to be made for a departure from that default approach, including cases where accounting treatment is to be disregarded or modified. The aim was to make transparent the purpose and context of a particular rule within the overall framework of the regime, so that it would be easier to use and harder to manipulate. It would also facilitate the inclusion of any new rules which may become necessary in future without compromising the coherence of the legislation.

3.7 Respondents were invited to comment on the overall approach of the chapter, the extent to which “profits, gains and losses” could serve to determine taxable amounts, and the value of categorising circumstances in which determination of taxable amounts are to depart from the default approach.

3.8 Views on the overall approach of the chapter were mixed. There was support for the idea of a clear statement of the regime’s purpose, and for clarification of the role to be played by accountancy in determining tax outcomes. Respondents generally considered accountancy to provide the best (or only) measure of commercial profits and losses, and therefore the appropriate default method to quantify taxable amounts. While it was generally acknowledged that departures from that approach would be necessary, a number commented in particular that legislation governing such departures must be clear and specific, leaving minimum room for uncertainty or doubt.

3.9 There was little support for the proposal for a non-specific override to accountancy in determining taxable amounts. There was widespread concern that this would introduce unwelcome uncertainty at the heart of the regime, as well as resourcing issues for HMRC in responding to requests for pre-transaction comment. In addition respondents cited the absence of any obvious alternative measure of profits; “profits, gains and losses” was thought to be too nebulous a concept in this context.

3.10 There were mixed views on whether it would be helpful to set out categories of cases in which accounting treatment was not to be followed, with 10 respondents agreeing and 7 disagreeing – the majority expressed no view. Several of those supporting the proposal considered that this would add to clarity, so long as it was clear that the categories were exhaustive. Comments ranged widely, as illustrated in Box 3.2.

Box 3.2: Responses to Question 3.4

> ***“Yes, extremely helpful. Detailed provisions in each category should then be clearly signposted to give certainty.”***
>
> ***“Approach is burdensome and probably not suitable.”***

3.11 Most respondents had no view on whether the categories set out in the consultation document would comprehensively capture occasions of departure from the default approach. Of those who expressed a view, some considered the suggested categorisation to be adequate, while others thought it impossible to guarantee that every possible situation would be covered. A few respondents suggested that, while categorisations might be helpful, they were more appropriate to guidance than to legislation.

3.12 In the light of the responses received, the Government continues to believe that a clear statement of the regime's purpose will be helpful, and that in the great majority of cases, taxable amounts can be derived from accounting treatments. The Government agrees that specific tax treatments which depart from or override that approach should be as few and as clearly defined as possible, but also believes that it remains appropriate to ensure that amounts brought into tax reflect the economic effects of individual loan relationships and derivative contracts in cases where accounting rules are not designed to do that. The

3.13 Government notes the widely expressed view that an approach to achieving this aim which includes a tax provision overriding accounting treatments in situations which are not specifically identified may invoke an unhelpful degree of uncertainty. The Government therefore intends to continue to explore with stakeholders the possibility of a revised regime which takes account of that concern, while ensuring, for the potential benefit of both taxpayers and the Exchequer, that taxable outcomes are not inappropriately distorted by particular accounting treatments.

3.14 The Government will continue to consider the extent to which it is useful to categorise occasions where a specific tax treatment is to be imposed, either in legislation or in guidance.

3.15 It is intended that changes covered by this chapter of the consultation document will be included in Finance Bill 2015.

4. Responses – Looking behind the accounts

4.1 Chapter 4 of the consultation document, entitled *"Looking behind the accounts"*, developed the consideration of situations in which accounting presentation of profit and loss may not provide an appropriate picture of the economic effects of particular loan relationships for tax purposes. It identified a number of scenarios where this may arise and went on to propose the need for a rule which would set out the circumstances, including cases of attempted tax avoidance, in which it is necessary to look behind the presentation on the face of the financial statements to identify the amounts to be brought into tax.

4.2 The consultation document proposed a rule which would, in outline, ensure that in certain circumstances tax would not be determined solely by reference to the amounts recognised in a company's financial statements. Rather, it would refer to amounts which would be brought into account in respect of loan relationships or derivative contracts if the accounting treatment were not influenced or bound up with the reporting of other instruments or transactions. It was suggested that this rule should apply where, over the life of the arrangements concerned, cumulative amounts recognised in the accounts would differ substantially from the economic profit because of the interaction of the accounting treatment of two or more instruments or transactions. In such circumstances, there would be a requirement to identify, measure and bring into account amounts relating to the loan relationships or derivative contracts, notwithstanding the accounts presentation. Respondents were invited to give their views on this proposition.

4.3 Among the nineteen respondents who addressed this area, there was a fairly even balance of views. Those who supported the proposal, at least in principle, recognised that amounts reported in profit and loss may not always reflect amounts which the tax regime seeks to identify, and that such a rule could operate to either increase or decrease taxable amounts.

4.4 Others were again concerned by the potential for uncertainty if application of the rule were not sufficiently clear, and for an increase in the compliance burden. It was suggested that the accounts provide the best representation of commercial profit, and that there was no significant need to look beyond that, subject to any necessary anti-avoidance provisions. Some respondents expressed reservations about the practicalities of devising and operating such a rule, citing difficulty in establishing the "economic profit", particularly over the expected life of the arrangements, or suggesting that the need for the rule was overstated.

Box 4.1: Comments on Chapter 4

"Agree with the rule in principle: the issue will be the circumstances in which it applies."

"Taxation of loan relationships should be based on the principle that amounts to be taxed should be commercial profits and losses, measured using accounting principles... Any derogations should be clear from the legislation."

"The rule relies on the premise that it is always clear and certain that there is one economic profit. The definition of this for tax purposes would be the basis for success or failure."

4.5 In the light of consultation responses and of experience of situations where accounting does not give an appropriate tax result, the Government intends to continue to explore, in the context of wider proposals in the consultation document, the need for a rule such as that outlined and the difficulties which have been raised, and to consider in more detail how it might be formulated. If the Government concludes that such a rule is appropriate, it is intended it would be included in Finance Bill 2015.

5. Responses – Accounting issues

5.1 Chapter 5 of the consultation document set out a number of proposals with the aim of improving the mechanism by which the accounts are used as a starting point to determine a company's profit or loss from its loans and derivatives. In particular, the Government proposed that amounts recognised in profit or loss should be used as the primary reference point for the measure and timing of taxable amounts under the loan relationship and derivative contract provisions. Further proposals concerned excluding certain perpetual instruments, bringing together the rules for dealing with changes in accounting policy, and aligning the rules for dealing with capitalised amounts.

Using amounts recognised in profit or loss

5.2 The majority of respondents were very supportive of the proposals to base the regime on amounts recognised to profit or loss. This was generally seen as a sensible starting place, and it was felt that this should result in the removal of some complexity and had the potential for reducing volatility in taxable profits.

5.3 A few respondents commented however that it would be preferable to continue to tax amounts recognised as items of profit or loss or other comprehensive income (OCI), with specific exclusions where necessary. In particular, they were not convinced that the proposals would represent a significant simplification for companies, given the need, in any case, to provide rules to diverge from the accounts in certain cases.

5.4 A specific concern was raised by insurers, who hold assets to back liabilities to policyholders. For such companies, future accounting changes may cause mismatches in respect of the amounts recognised in profit or loss, whereas the total amounts recognised (including items of OCI) may provide a better representation of the company's profit for the period.

Regulatory capital

5.5 The consultation document included reference to specific rules to deal with banking regulatory capital. Respondents raised questions regarding the position of the insurance industry. The regulatory position for insurers is currently unclear as the industry moves towards a new regulatory regime under the EU's Solvency II directive. HMRC is working with the insurance industry to explore this issue further, but that work falls outside the scope of this consultation.

Perpetual debt

5.6 The consultation document proposed that instruments carrying no repayment obligation other than on liquidation of the issuer should be explicitly excluded from the loan relationship regime, notwithstanding that they may in legal terms be regarded as debt. The coupons on them should be treated as distributions. Those who expressed a view did not generally support this proposal. They considered that the current legal meaning of debt provided an appropriate delineation between debt and equity.

5.7 There was some concern that these proposals might affect the treatment of existing instruments. The Government does not intend to change the treatment of existing instruments; the proposal would apply to instruments issued after the relevant date only.

Other proposals

5.8 There was general support for the proposals for dealing with changes in accounting policy and the tax treatment of capitalised amounts, although some expressed caution that the detail of the legislation will need careful thought.

5.9 The consultation document did not propose any changes to the 10-year spreading of most adjustments arising from a change in accounting practice, but did indicate that this would be reassessed once the impact of proposals under IFRS 9 become clearer. Some respondents commented that the spreading period should be shortened to around four to six years, in line with representations made to the Government in the past. On the other hand, others expressed a strong desire to maintain, and certainly not reduce, the current period.

Overall

5.10 The Government remains of the view that there is substantial merit in the proposals set out in this chapter. The Government intends to continue discussions with stakeholders to further understand the implications of the consultation document proposals, to explore specific difficulties identified by respondents and to consider how they can be addressed, where necessary.

6. Responses – A unified regime?

6.1 Chapter 6 of the consultation document suggested that some of the provisions of Part 5 and Part 7 of CTA 2009, dealing with loan relationships and derivative contracts respectively, are effectively duplications, being similarly or identically worded. The consultation provided an opportunity to consider whether it would be simpler and clearer to reduce duplication by replacing provisions in Parts 5 and 7 CTA 2009 with a single combined code dealing with the taxation of both loan relationships and derivatives contracts.

6.2 It was envisaged that, even in a combined regime, the two types of instrument would still need to be defined separately and would have to be treated differently in some respects. Currently some provisions apply specifically to either loan relationships or derivative contracts. It was suggested that there was an opportunity to consider whether all these special treatments were needed and whether there is scope for simplification.

6.3 The consultation document set out an overarching objective that the provisions governing the corporate taxation of loan relationships and derivative contracts should be clear, unambiguous and robust, with a consistent approach to both except where there is a policy reason for a difference. It was assumed that a combined or harmonised regime could achieve that aim better than the current arrangements, but no firm view was taken by the Government.

6.4 Respondents were invited to comment on whether they would support any move to a unified regime, on the benefits and difficulties they would anticipate from unification and how any such difficulties might be addressed.

6.5 Views on the overall approach of the chapter were mixed. Of the thirteen respondents who addressed this area, a small majority agreed that a unified regime would have benefits of increased simplicity and clarity, and a consequential reduction in compliance burden. However, some felt that the potential advantages were unlikely to outweigh the inevitable disruption and uncertainty of making such a change.

6.6 A number of respondents went on to say that there would be a need to retain differences and separate rules between the two types of instrument even in a combined regime, and that this would increase complexity and reduce the benefits of unification. Some suggested that keeping two separate but parallel and consistent regimes under a common framework may therefore be a better solution.

Box 6.1: Responses to Chapter 6

"We do not foresee any substantial difficulties arising from combining the two rules. We think any transitional issues can be managed, e.g. through careful definitions, and, in any case, there will be some disruption from the changes proposed to both regimes even if they are not combined."

"Instead of rewriting the two regimes, another approach would be to ensure the two regimes apply to catch transactions which potentially straddle the two regimes and in such cases that the two regimes operate on a joined up basis."

6.7 There were several comments on the timetable for this part of the review. In particular, some respondents did not see combining Parts 5 and 7 of CTA 2009 as a priority, and suggested that it would be preferable to allow the main Finance Bill 2015 changes to bed in, before considering unification as a separate and later exercise.

6.8 In the light of the responses received, the Government will continue to consider with stakeholders whether suggested changes to the regime in this area should be implemented in Finance Bill 2015.

7. Responses – Connected party debt

7.1 Chapter 7 of the consultation document set out the policy objective of the connected party debt rules: to prevent the exploitation of asymmetries between the accounting policies of connected companies, in both domestic and cross border contexts. Where they apply, they can represent an important instance of departure from accounting treatment. They are aimed in particular at inappropriate relief for impairment of debts and include a rule (the "late-paid interest rule") aimed at countering mismatches, including deliberate manipulation, between the taxation and relief of interest between connected companies; this rule operates by deferring relief for interest accrued, but remaining unpaid after 12 months, until it is actually paid. Problems with the current rules were identified in a number of areas.

7.2 Views were invited on two options. The first of these was broadly to retain the rules as they are, while making changes to the definition of connection and to the tax definition of the amortised cost basis, which the rules require to be used in computing profits and losses from loan relationships between connected companies. This option, involving a minimum of change, was expected to deal with some of the problems identified, but not all, notably the need for computational adjustments where a company does not use the amortised cost basis in its accounts and the interaction with the debt release rules. The second option was an extension of the first, which would potentially address all the issues but would involve a more extensive overhaul of the rules.

7.3 Of those respondents who expressed a clear view, most preferred either no change or Option 1 (minimum change), with a minority favouring Option 2. This reflected in particular widespread support for harmonisation of the tax and accounting definitions of the amortised cost basis and, on the other hand, concern about the potential for increased complexity and uncertainty arising from more extensive reform as envisaged by Option 2. A number of respondents also suggested that Option 2 could lead to tax charges which would discourage corporate rescues.

Box 7.1: Comments on Chapter 7

> ***"The current rules require departures from the accounts but they have the advantage of being familiar which provides valued certainty to businesses… Option 1 is therefore preferred."***
>
> ***"For the vast majority of corporation taxpayers we envisage that Option 2 will be more straightforward and avoid the need for any adjustments to the 'follow the profit and loss' approach."***

7.4 In addition, the consultation document set out the Government's intention, in any case, to make changes to, and possibly repeal, the late-paid interest rule, and many respondents commented on this proposal. Most, though not all, opposed it. This was on the basis that the rule has provided a mechanism by which groups could control the emergence of taxable profits and losses so as to maximise the benefit of losses which cannot be surrendered to other group companies once carried forward from their period of origin, and which might therefore become "trapped". Members of the insurance industry saw this as a particular issue for them, citing issues of profit volatility and regulatory pressures.

Box 7.2: Comments on late-paid interest rule

"Although the late interest rules were introduced as an anti-avoidance measure their significance is much wider. The rules may now appear to be a policy anachronism but they have developed into a practical tool for many businesses. The rules have allowed groups to access economic losses that otherwise would have been trapped…If HMRC conclude that late interest rules should be repealed there will need to be improvements to the Loss/Group Relief regimes."

"X is supportive of proposed changes to the late interest rule so that connected companies would generally deduct interest on loans from 'non-qualifying territories' in accordance with normal principles as this would simplify the compliance burden."

7.5 The Government will continue to consider with stakeholders the desirable extent of reform of the rules governing the taxation of connected party debt. In the context of the late-paid interest rule, the Government believes in principle that the employment for tax planning of what is intended as an anti-avoidance rule is not appropriate. Because of this, and considering the now restricted scope of the rule, there remains a need for change as discussed in the consultation document. The Government will consider the detail of that change in consultation with stakeholders. Any case for measures to mitigate the perceived "trapping" of losses should stand on its own merits.

7.6 It remains the Government's intention that legislative changes in the area covered by Chapter 7 of the consultation document will be included in Finance Bill 2015.

8. Responses – Intra-group transfers (group continuity)

8.1 The group continuity rules constitute another significant area of departure from the core treatment of loan relationships and derivative contracts. They are intended to ensure that loans and derivatives can be transferred within a group without tax consequences, that all profits and losses are brought into tax while a loan is held within a group, and that there is no artificial acceleration of losses. The consultation document highlighted a number of difficulties experienced with the current rules: the imposition on the transferee for tax purposes of a notional carrying value derived from the value attributed in the accounts of the transferor, unintended impacts arising from accounting rules, and exploitation of the rules for tax avoidance purposes.

8.2 Views were invited on the merits of three options. First, a minimum change approach continuing to derive the transaction consideration for tax purposes from the amount recognised in the transferor's accounts ("forward continuity"), making detailed changes to address technical anomalies and strengthening the protection against attempted avoidance. Option 2 proposed a "backward continuity" approach, with the transferor picking up the opening carrying value in the transferor's accounts. This was thought to be administratively simpler and less susceptible to avoidance. Finally, it was suggested, as Option 3, that it may be possible to eliminate the group continuity rule altogether, leaving both parties to bring amounts relating to the transfer under normal principles. This would be a significant simplification to the legislation.

8.3 Of the 26 respondents who addressed this area, a clear majority favoured Option 1, with some wanting no change at all and only a few preferring Option 3; there was almost no support for Option 2. Respondents were attracted to the conceptual similarity of Option 1 to the current rules and to equivalent chargeable gains rules. They thought it best preserved the principle of neutrality, regarded almost universally as a key consideration. There was concern that the other options would be more complex and might introduce tax charges in circumstances where the transaction did not result in any realised profit from a group perspective. There was also a widely expressed view that Options 2 and 3 would lead to an increased compliance burden.

8.4 In the light of the views expressed by respondents, the Government does not intend to pursue change under either Option 2 or 3. The Government will continue, in conjunction with other stakeholders, to develop its policy in line with Option 1, which is expected to be reflected in Finance Bill 2015. The consultation proposed a change to the degrouping provision, which currently operates to bring into account credits but not debits. The Government will continue to discuss this specific issue with interested parties, particularly in relation to financial sector restructurings.

9. Responses – Partnerships and transparent entities

9.1 The consultation document recognised that partnerships are often used by companies as commercial vehicles, but pointed out that they are also used to facilitate tax avoidance. It identified a particular difficulty for a regime which largely takes its lead from accounting treatments in that partners' accounts do not generally include profits and losses of the partnership until they are treated as distributed to partners. Other complexities arise from the need to deal effectively with income allocation, disposal of assets by the partnership and transactions between partners, including changes in profit shares. The underlying policy aim was described as ensuring that amounts brought into tax in respect of a loan relationship or derivative contract of a partnership match amounts which would be taxed if the partners were individually direct parties to the instrument.

9.2 The document suggested that the existing rules do deal effectively with partnerships in most cases. However, it identified a number of areas where the treatment is not explicit or is open to interpretation, leading to risk and uncertainty. These include a fundamental mismatch between the policy aim and the mechanism used to determine the debits and credits attributable to corporate partners in section 381 CTA 2009. In addition the rules do not explicitly set out the treatment of changes in partnership shares. Four options were set out for comment.

Option 1 Retain the current approach, simply clarifying the application of some of the individual loan relationship and derivative contracts rules to partnerships.

Option 2 Retain the current approach while consolidating the rules so that, across the regime as a whole, each partner is treated as being party to a share of partnership loans and derivative contracts.

Option 3 Extend Option 2 to bring into tax unrealised profits and losses arising to corporate partners on changes in partnership interests.

Option 4 Independent of Options 1 to 3, there was a possibility of refining the approach to the determination of partnership shares for a period.

9.3 Eleven respondents addressed this area, most of whom preferred Option 2; the remainder favoured Option 1. Option 2 was widely thought to have potential to address the main issues with the existing rules without introducing uncertainty or complexity. A few respondents suggested that it might be possible to use the approach of HMRC's Statement of Practice D12, applicable to capital gains in partnerships, as a framework for determining partners' shares, but noted that its application to loan relationships and derivative contracts would be more complex. There was no support for Option 3, except possibly in cases of avoidance; however some suggested that such situations would be best dealt with by way of an anti-avoidance rule. Taxing unrealised profits and losses was generally thought to be inhibiting to commercial partnership reorganisations and overly complex. There was very little comment on, and no support for, a less mechanical approach the calculation of partners' shares in partnership loans and derivative contracts, as suggested in Option 4.

9.4 In the light of the responses received, the Government will publish draft clauses for inclusion in Finance Bill 2014, along the lines of Option 2. This will be in co-ordination with a separate measure, confirmed in Autumn Statement 2013, aimed at addressing the potential for tax leakage through disguised employment arrangements and changes in partnership shares[1].

[1] See the consultation document *"Partnerships: A review of two aspects of the tax rules"* published on 20 May 2013.

10. Responses – Exchange gains and losses and hedging

10.1 Chapter 10 of the consultation document set out proposals for overhauling the rules dealing with foreign exchange (forex) movements and other hedging relationships. For forex movements, the default position would be to tax movements only in respect of instruments held for trading or property business purposes. Forex movements on instruments (other than certain hedging instruments) held for investment purposes would not be brought into account. For hedging instruments, the tax treatment of forex movements should be aligned with the treatment of the hedged item, both in terms of how the amount is to be taxed (if at all) and timing.

10.2 For non-forex hedging relationships, the tax treatment would follow the approach proposed in Chapter 5 of the consultation document – generally to follow items of profit or loss – in determining amounts brought into account for tax purposes.

10.3 Respondents were invited to comment on any potential difficulties arising from the proposals presented and to suggest how they might be addressed.

Foreign exchange

10.4 There was general support for the proposition that forex movements on hedging should follow the hedged item. The proposals on this point were largely to follow the existing approach in the "EGLBAGL" regulations[2]. In particular, effect would be given to hedges of investments in shares, ships and aircraft. However, certain respondents considered that there was scope for the rules to be more principles based which could both simplify and improve the operation of the rules.

10.5 There were very mixed comments on the proposals to exclude foreign exchange movements on non-trading items where there was no hedging relationship. A substantial number of respondents did not see merit in the proposals. Others supported the basic principle but had concerns as to how it would apply in practice.

10.6 Some respondents did not see the policy rationale for excluding forex movements from tax. Other concerns included uncertainty arising from the need to distinguish between trading and non-trading activities; scope for mismatches; potential for new avoidance opportunities; and transitional difficulties. While some the proposal as a welcome simplification, others thought it would add significantly to complexity, compliance risk and uncertainty.

[2] The Exchange Gains and Losses (Bringing into Account Gains or Losses) Regulations 2002 (SI 2002/1970).

10.7 Respondents also noted that there would be certain cases where a non-trading company had foreign exchange exposure which should be taxed; excluding such amounts could lead to large variances in the effective tax rate in the consolidated accounts. Specific examples included investment funds and cases where groups have third party, unhedged exposures. Particular difficulties for life insurers' basic life assurance and general annuity business (BLAGAB) were also cited.

Non-forex hedging relationships

10.8 There was general acceptance that the Disregard Regulations are complicated; respondents would welcome simplification in this area. Respondents also appeared to be content with the proposals to make it easier for companies to follow the accounts in respect of designated hedging relationships (particularly the proposals in respect of following amounts recognised in profit or loss, and the treatment of connected party debt where there is a designated fair value hedge).

10.9 There were mixed views in the context of undesignated hedges. Some companies commented that they already made elections under the Disregard Regulations to follow amounts in profit or loss and supported the proposals which they saw as reducing complexity and uncertainty. The majority of respondents, however, expressed a strong desire to retain something similar to the Disregard Regulations for dealing with tax volatility on economic hedges. In the absence of specific rules for undesignated hedges, economic hedges could lead to significant cash tax volatility generated by fair value accounting.

10.10 A particular concern was around timing of any changes, with many companies expecting to apply fair value accounting for the first time in 2015 with the introduction of the new UK GAAP. There was some concern that companies may choose not to designate hedges at an entity level due to the expense and complexity, or they may not be able to meet the hedging requirements. In addition, the changes proposed in IFRS 9 to deal with general hedging are not yet final, would be subject to endorsement by the EU and are not expected to cover macro hedging, at least for now. Even where a hedging designation is made, hedge ineffectiveness will be recognised in profit or loss.

10.11 Concern was also expressed about potential impacts on existing hedging instruments. In particular, a number of companies are currently assessing whether to designate hedging relationships for accounting purposes ahead of the forthcoming transition to new UK GAAP. In this respect, it is not the Government's intention that a company which makes a decision now as to whether or not to designate a hedging relationship for accounting purposes should be disadvantaged if, in the future, the tax rules are amended to align the tax rules to the accounting treatment.

Overall

10.12 The Government notes the concerns raised by respondents on these proposals, but remains of the view that there is substantial merit of reforming the existing rules in this area. The Government intends to continue discussions with stakeholders to explore further the difficulties identified by respondents and to consider how they can be addressed where necessary. There is, however, no intention to introduce any substantial change ahead of the accounting transition to new UK GAAP in 2015 (see Chapter 2).

11. Responses – Debt restructuring

11.1 Chapter 11 of the consultation document set out a number of areas of difficulty which have arisen in connection with the rules governing the application of exemptions from tax in respect of debt releases and deemed releases. It proposed two options for change. The first of these centred on the proposition that exemption from tax of a credit arising to a loan debtor in respect of release of a debt should be explicitly linked to debt restructuring in corporate rescue situations, and not limited to debt for equity swaps. This option, which was the Government's preference, could permit some rationalisation of the existing rules. The second option was based on a restriction of the existing exemption for debt for equity swaps to arm's length loan relationships.

11.2 Respondents were invited to comment on any potential difficulties arising from the preferred option presented or on any wider problems with the existing debt restructuring rules not raised in the consultation document, and to suggest solutions.

11.3 Some respondents were keen to emphasise the importance, in the current economic climate, of companies seeking to trade their way out of difficulties being able to undertake financial restructuring, including debt for equity swaps, without increasing tax liabilities.

11.4 Several respondents considered that there was no pressing need for change, with the inevitable short term uncertainty it would entail, to the legislation in this area, arguing that the current system was working adequately and is well understood. The proposals could in fact constrain commercial recovery and, in particular, could have serious consequences for companies which are distressed but not yet insolvent.

11.5 There was widespread support for exemptions relating to corporate rescues generally, when undertaken for the purpose of allowing the debtor to carry on as a going concern and to meet its liabilities as they fall due, and not just where there is an issue of shares. A number of respondents considered that any exemption should apply in all cases where distressed debt is released as part of a restructuring arrangement. However, a number of respondents expressed a concern that removing the existing specific debt-to-equity exemption could give rise to additional uncertainty.

11.6 Most respondents were opposed to the proposal to link a specific corporate rescue exemption to the insolvency conditions currently set out in s361A. These conditions were seen as restrictive and difficult to apply because of factual uncertainty over whether a company meets the subjective conditions combined with a distortive "cliff edge" distinction in the treatment of companies meeting, or not meeting, them. It was suggested that the legislation needs to be flexible enough to address the full spectrum of company rescue transactions. Further, a number of respondents suggested that directors would have difficulty applying the test without falling foul of the wrongful trading provisions in the insolvency legislation, and may consequently be deterred from pursuing a rescue at all. A view underlying many submissions was that the provisions should start from the assumption that all debits and credits resulting from debt reconstruction in a troubled company are non-taxable.

11.8 A number of respondents suggested that HMRC guidance in this area should be extended with more examples based on situations HMRC have considered and given clearance to; it was felt that this would minimise the number of pre-transaction clearance applications made to HMRC.

11.9 The Government intends to continue discussions with stakeholders to understand the implications of the consultation document proposals, to explore difficulties identified by respondents and to consider how they can be addressed, where necessary.

12. Responses – Hybrids and “special treatment” instruments

12.1 Chapter 12 of the consultation document set out proposals in respect of hybrid and “special treatment” instruments. The main element of the proposals was to repeal the rules providing for ‘annual chargeable gains’ for holders of convertible debt and property derivatives. Rules for the issuer of convertibles would be retained in some form. The consultation document also set out proposed changes to the tax treatment of index-linked gilts to focus relief more narrowly.

Convertible and share-linked instruments

12.2 The proposal relating to the holders of convertible and share-linked instruments was generally supported. Respondents noted that the rules were not commonly used in any case. A few expressed a desire to retain a capital treatment where the underlying subject matter is capital in nature.

12.3 Respondents agreed with the need to keep the rules dealing with issuers of convertible and share-linked instruments. There was general support for the current treatment of standard convertibles. However there was some concern that the rules do not align with structures that corporates use to issue hybrid debt, which could result in disparity of tax treatment from case to case.

12.4 A few respondents expressed concern about the differences in the treatment between the holder and issuer of hybrid instruments, particularly in the context of connected party debt. Suggestions included following the legal form of the instrument as a whole (ignoring any bifurcation in the accounts and taxing or relieving interest on an accruals basis) or allowing bifurcation for both holder and issuer, potentially by election.

Property based derivatives

12.5 Some respondents noted that property based derivatives can be used by investors seeking exposure to the property market without the costs of direct ownership and issues with the illiquid nature of property. They are also sometimes used to reduce property exposure when the company cannot sell the underlying asset. Those respondents expressed a preference to keep the current treatment.

Index linked gilts

12.6 Respondents generally considered that there was a case for redrafting the rules to clarify the target of this relief, commenting that the policy rationale for the relief is not currently clear. A number noted that this relief is not available to insurance companies to the extent that the gilts relate to life assurance business in any case. Events since the consultation document was published have indicated that the rules on the taxation of index linked gilt-edged securities are sufficiently robust at present, and the Government does not intend to proceed with changes in this area.

Overall

12.7 The Government will continue to consider with stakeholders the appropriate treatment for convertible debt, share-linked instruments and property based derivatives. It remains the Government's intention that legislative changes in these areas will be included in Finance Bill 2015.

13. Bond funds and "corporate streaming"

13.1 Chapter 13 of the consultation document was concerned with two sets of rules, both intended to prevent companies liable to the full rate of corporation tax from reducing their tax bill by holding certain types of investment, such as bonds, through collective investment schemes – the bond fund and "corporate streaming" rules. In each case, the application of these rules can be complex for the relatively few companies affected, and they have been exploited in tax avoidance arrangements.

Bond Funds

13.2 The bond fund rules apply to companies with holdings in authorised investment funds (AIFs), unauthorised unit trusts (UUTs) and offshore funds (OFs). The consultation document broadly proposed that the bond fund rules should be abolished, with particular issues being addressed by specific rules as necessary.

13.3 In the case of AIFs and UUTs, the main effect of repealing the rules would be that movements, positive or negative, in the fair value of debt assets would not be taxed. In the case of OFs, particular provision would be needed to prevent companies receiving income from underlying debt-type investments as exempt dividends.

13.4 Views were sought on the potential impact of such a change. In addition, a new anti-avoidance rule, targeted on funds with a single, or very few, investors, was proposed to counter manipulation in the absence of the bond fund rules.

13.5 The key concern of the majority of respondents was that the current rules ensure broadly consistent tax treatment, under the loan relationships regime, between debt-type assets held directly and indirectly through collective investment schemes. Repealing the rules would change this – holdings in funds investing primarily in debt-type assets would generally fall within the capital gains regime. The current consistency of treatment was seen by many as an appropriate policy outcome in itself, which should be retained notwithstanding any anti-avoidance function of the current rules. It was suggested that the proposal could lead to distortion of commercial investment decisions by tax considerations and discourage investors from taking advantage of the commercial benefits of pooled investments.

13.6 There was also concern that set off of capital losses which might arise would be less flexible than non-trade loan relationship deficits, and may not provide equivalent benefit where there are no chargeable gains against which they could be set.

13.7 Some particular concerns were expressed in relation to the life insurance industry, which accounts for a significant proportion of investments into UK funds. Section 213 Taxation of Capital Gains Act 1992 spreads capital gains and losses over seven years for insurance companies. Respondents suggested that, while in recent years profits have been taxed as income, the current economic cycle means that expected future losses may be treated as capital in nature and spread over seven years. In addition, it was thought that the changes could impact on the Income minus Expenses (I – E) results, reducing income and accelerating the trend towards a general excess of expenses over income. Existing products, which may have many years to run, had been priced on the basis that the bond fund rules would apply. Further, there was a suggestion that the proposals could put strain on regulatory capital, as unrealised capital losses would be less likely to result in deferred tax assets being recognised on balance sheets.

13.8 Only one corporate respondent supported abolition of the bond fund rules, recognising the potential disparity of tax treatment but considering that this would be outweighed by the benefit of removing the requirement continually to monitor fund assets and the availability of indexation against capital gains. This respondent also noted that for life insurers fair value movements within the I – E computation lead to tax volatility, which would be reduced under the spreading rules of section 213.

13.9 There was a widespread view that the threshold test for identifying a bond fund can be difficult for investors to monitor because the relevant information is in the control of the fund managers. In addition the "cliff edge" nature of the test meant that a fund could sometimes be treated as a bond fund when in fact its business was not in substance investing primarily in debt-type assets. Many respondents would welcome measures to mitigate these difficulties.

13.10 A few respondents considered the proposed anti-avoidance rule to be unnecessary in view of the General Anti-Abuse Rule and the rule proposed in Chapter 14 of the consultation document. Generally, respondents were concerned that any anti avoidance rule should not be unnecessarily burdensome and should include a purpose test to exclude genuine commercial transactions. Most respondents who commented thought that the Genuine Diversity of Ownership rules[3] could provide a suitable mechanism to distinguish closely and widely held funds.

13.11 Overall, there was support for the prospect of simplification and rationalisation of the test for identifying bond funds, and recognition of the need for effective anti-avoidance provision. However, taking into account the points summarised above, as well as perceived transitional difficulties, responses were, overall, overwhelmingly against the proposal to abolish the bond fund rules.

13.12 In the light of this, HMRC has been exploring with stakeholders, and continues to do so, a less radical approach, which will retain the bond fund rules, while addressing both the tax avoidance issues and some of the diificulties with the operation of the test for identifying a bond fund. As set out in the consultation document, it is intended that changes in this area will be included in Finance Bill 2014.

[3] See Regulation 9A SI2006/964 (as inserted by SI 2009/2036).

Corporate Streaming

13.13 The corporate streaming rules are intended to prevent companies benefiting from a rate of tax lower than the main corporation tax rate by investing indirectly through an AIF, which would itself be subject to tax at a rate equivalent to the basic rate of income tax. Since the differential between these rates has reduced, and is expected to disappear from 2015, the need for these rules has become questionable. Like the bond fund rules, the corporate streaming rules can be complex to apply and have been exploited in tax avoidance schemes. The consultation document proposed therefore that the rules could either be abolished or retained in a form which would remove the possibility of investing companies with no liability to corporation tax obtaining the benefit of the tax credit deemed to attach to the unfranked element of a streamed distribution from an AIF. Comment was invited on these options.

13.14 A few respondents supported the proposal to abolish the rules on the basis that they are unnecessary for most taxpayers. There was however concern that tax rates might diverge again in the future, and it was suggested that any abolition should be accompanied by a firm commitment not to reintroduce the rules after funds had switched off the IT systems needed to comply with them.

13.15 On the other hand, there was widespread opposition within the life insurance industry to both the options identified in the consultation document. Although the rules were originally introduced as anti-avoidance provisions, they were said to perform an important function for life insurance companies in ensuring a level playing field for tax exempt pension business between direct investment and indirect investment through funds. This was because life companies investing in debt assets through a UK fund are, under the corporate streaming rules, able to reclaim a tax credit for tax assumed to have been paid by the fund on the unfranked portion of any dividend paid, regardless of whether the life company pays tax or makes losses.

13.16 Under either of the options identified, therefore, a life company would no longer have relief for the tax suffered at the fund level. Such a tax cost, which ultimately might impact on pensioner policyholders, would not arise had the life company made an investment directly, or through an offshore fund. Respondents suggested therefore that either option would put life company investors in a worse position from investing in a UK fund. As with the bond fund proposal, respondents felt that commercial decisions would be unduly influenced by tax considerations.

13.17 A number of respondents also cited potential adverse effects on Property Authorised Investment Funds (PAIFs). These typically use unit trusts as feeder funds so as not to be in breach of the 10 per cent limit on corporate investors. It was suggested that corporate streaming was required at the level of the feeder fund to ensure that life companies achieve equivalent tax treatment to investing directly in property assets. If the corporate streaming rules were repealed, PAIF structures would become commercially unattractive, jeopardising current and future PAIFs in the UK.

13.18 Overall, therefore, most respondents thought corporate streaming should be retained or replaced with something delivering a similar effect, at least for the long term business of life companies.

13.19 The Government notes the issues raised and intends to explore further with stakeholders implications arising from the identified options before determining the way forward. It is expected that any changes in this area can be implemented by way of secondary legislation under existing regulation-making powers conferred on HM Treasury[4].

[4] See sections 17(3) and 18 Finance (No. 2) Act 2005.

14. Responses – Anti-avoidance measures

14.1 Chapter 14 of the consultation document considered anti-avoidance measures to combat avoidance arrangements split broadly into four classes, aiming to:

- sidestep or exploit the detailed rules themselves;
- include amounts in accounts which do not represent amounts the regime is aimed at;
- implement a transaction or instrument with an unallowable purpose; and
- implement a transaction or instrument not conforming to the arm's length principle.

14.2 It was envisaged that the scope for some of this activity would be reduced by the suggested changes in other chapters of the consultation document. In addition, the General Anti-Abuse Rule (GAAR), the unallowable purpose rules and transfer pricing rules will have an impact; however, they will not provide complete protection without the addition of functional and comprehensive anti-avoidance provisions.

14.3 Current anti-avoidance provisions across the loan relationships and derivative contracts regimes reflect a piecemeal approach to blocking particular schemes as they come to light; this has been a source of complexity.

14.4 The consultation document discussed changes in two areas. First, a proposal for a regime-wide anti-avoidance rule and, second, changes to the unallowable purpose rules to clarify areas of uncertainty and dispute.

Regime targeted anti-avoidance rule

14.5 The consultation document proposed to replace many of the existing provisions with a "regime Targeted Anti-Avoidance Rule" ("regime TAAR"), which would cover the codes as a whole, be triggered by a test of purpose and require remedies on a just and reasonable basis. Such a rule would allow much of the existing piecemeal legislation to be repealed and eliminate gaps between existing specific provisions.

14.6 Subject to development of the detailed wording following consultation, it was broadly intended that the regime TAAR would apply where arrangements had a main purpose of avoiding or exploiting the loan relationships or derivative contracts rules to obtain a tax advantage for one or more parties to the arrangements. Tax advantage would be defined as an increase in deductible amounts or a decrease in taxable amounts under the regime.

14.7 It was recognised in the consultation document that alongside a regime TAAR some specific additional rules may still be required, or requirements may emerge as the revised regime framework is developed.

14.8 Comment was invited on the proposed regime TAAR, the need to retain any existing rules alongside it and on the possibility of supplementing the rule with illustrative examples.

14.9 There were twenty one responses to this chapter. Of these, ten did not favour a regime TAAR, questioning the need for it in the light of the GAAR and suggesting it would lead to uncertainty rather than simplification. The positive responses thought the TAAR could be advantageous overall, depending on the detailed drafting, but many commented that it would only reduce complexity if it replaced rather than supplemented existing rules. A small number of responses also questioned whether the unallowable purpose rules would be required if a regime TAAR were enacted.

14.10 The majority of respondents did not cite any particular provisions which would need to remain separate from the TAAR. The three who did mentioned a targeted restriction of the late-paid interest rule, rules on imported losses and corporate migrations, while others commented in general terms that this would depend on the wording of the TAAR.

14.11 All respondents who supported the idea of a TAAR also felt that illustrative examples would be helpful. Generally, it was felt that these should appear in HMRC guidance rather then legislation.

Unallowable purpose rules

14.12 The consultation document pointed out that the unallowable purpose rules identify loan relationships and derivative contracts that have such a purpose (including tax avoidance) and disallow the debits which can be attributed to it. The document described the policy intention behind the rules, noting that their application should include cases where financing costs accrue on a debt for which there is no intention or ability to bear the costs of finance or to repay the debt. They should also operate where assets are acquired with a main object of securing a larger interest deduction. The unallowable purpose rules have been effective against many but not all of the schemes using loan relationships and derivative contracts to facilitate avoidance.

14.13 Application of the unallowable purpose rules has led to extended and costly debate between HMRC and some taxpayers. While HMRC continues to dispute interpretations in a number of cases, it is clear that some aspects of the legislation can be seen as capable of more than one interpretation; this is unhelpful to business and poses an Exchequer risk. The consultation document highlighted some specific areas where there has been disagreement and where clarification of the scope of the rules would be appropriate. Proposals were therefore made to address a number of specific perceived uncertainties and anomalies in the application of the unallowable purpose rules.

14.14 Respondents were invited to comment on the potential effectiveness of the proposals, the possibility that they might impact on commercial transactions where there is no intention to avoid tax, and on anticipated difficulties with the proposals.

14.15 Four of the ten respondents who commented on the effectiveness of proposals for the unallowable purpose rules felt that they would be effective. Those who disagreed cited a number of specific situations where uncertainty could remain. Some commented that the legislation is too broad or is applied too widely.

Six respondents felt that there could be an impact even where there was no intention to avoid tax.

14.17 There was some comment on the timeframe for changes to the unallowable purpose rules, anticipating problems with amending them in isolation ahead of the main changes to the regime in Finance Bill 2015. It was suggested that there was clear read-across between elements of the proposed changes to the unallowable purpose rules and changes to the wider regime, for example the proposals in Chapter 4 of the consultation document *"Looking behind the accounts"*. It would therefore be preferable to consider and address these changes together.

Box 14.1: Responses to Chapter 14

"We consider that the proposed changes…will address the areas of uncertainty and dispute highlighted in the condoc."

"The perceived uncertainties [in the unallowable purpose rules] will not survive the just and reasonable approach to counteraction. If the relevant tax advantages constitute legitimate tax planning they should not be caught by the regime TAAR or by an unallowable purpose rule"

14.18 The Government intends to proceed with introduction of a regime TAAR, and will continue to consult on the detail of how the rule should be framed. In the light of the responses received, changes to the unallowable purpose rules are now planned for inclusion in Finance Bill 2015.

15. Tax impact assessment

15.1 Chapter 15 of the consultation document pointed out that the broad thrust of the proposals made was aimed at updating, rationalising and simplifying the existing regime rather than at radical changes to the effective tax treatment. It therefore anticipated no significant overall impact on the UK economy generally. It was recognised that the impact on the Exchequer, the amount and timing of individual companies' tax liabilities, and on companies' administration burdens and compliance costs would depend on the final detailed policy design, informed by the consultation process. Subject to this proviso, respondents were invited to comment on the potential tax and cost effects, in either general or specific terms.

15.2 There was limited response to this chapter. Generally it was felt to be too early to take any meaningful view of tax impacts, and no respondents attempted to make any quantification of them. A number of respondents commented that they did not expect any significant impact on tax liabilities. Others referred to specific proposals which they felt would have an impact. In particular there were concerns that changes to the taxation of hedging arrangements might increase tax volatility and that changes to the "late-paid interest rule" would impact on some companies' ability to make use of losses, as discussed in Chapter 7. It was also suggested that the simplification benefits of some of the options discussed, such as removal of specific group continuity rules and the disregard regulations, might be outweighed by consequential increase in tax volatility.

15.3 In general, respondents agreed that a simpler and clearer regime should reduce compliance costs. However, some felt that, depending on the detailed drafting of legislation, there was a danger that certain aspects of the changes proposed might in fact increase costs, often because of a perception of potentially increased uncertainty and, therefore, compliance risk. Areas cited here were the proposals in Chapter 4 of the consultation document *"Looking behind the accounts"* and the anti-avoidance rule proposed in Chapter 14.

15.4 One company remarked that its commercial IT systems are currently configured to provide the data required for tax compliance without additional cost; and that changes could therefore lead to new costs, at least on transition. There was also a comment that proposed changes to the corporate streaming rules might, for life insurance companies, lead to restructuring costs, which could impact on pension policyholders and the competitiveness of UK authorised investment funds and property authorised investment funds (see Chapter 13). No responses attempted to quantify any potential changes to compliance costs or administrative burdens.

15.5 The Government will continue to evaluate the tax and compliance cost impacts of the proposals as the detailed policy design and legislation is developed. An assessment of these impacts will be set out in any Tax Information and Impact Notes published alongside specific draft legislation.

16. Next steps

16.1 Legislation to give effect to the main changes arising from this consultation is expected to be included in Finance Bill 2015. For the changes to be made in Finance Bill 2014 (concerning partnerships and bond funds), draft clauses will be published for further consultation early in 2014.

16.2 The Government has carefully considered the responses made to the consultation document. The suggestions, concerns and criticisms received during the consultation process will be fully taken into account in the continuing development of policy and drafting of legislation. The Government will continue to engage with stakeholders over the coming months to inform that process and further written consultation documents will be issued if appropriate.

Annexe A: List of stakeholders consulted

Below is a list of those who provided written responses to the consultation:

The 100 Group
Aegon
The Alternative Investment Management Association
Association of British Insurers
Association of Business Recovery Professionals
Association for Financial Markets in Europe
Association of Investment Companies
Association of Real Estate Funds
Association of Taxation Technicians
AstraZeneca
Aviva
British American Tobacco
British Bankers' Association
British Private Equity and Venture Capital Association
British Sky Broadcasting
BDO LLP
BUPA
Centrica
Chartered Institute of Taxation
City of London Law Society
Clifford Chance LLP
CMS Cameron McKenna LLP
Confederation of British Industry
Deloitte LLP
Ernst and Young LLP
Friends Life
FTI Consulting
Fund Administrators' Tax Discussion Group
Grant Thornton LLP
Grosvenor Ltd
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland
Investment and Life Assurance Group
Investment Management Association
Insolvency Lawyers' Association
KPMG LLP
Law Society
Legal and General
Loan Market Association
National Grid
Old Mutual
Pennon Group
The Pensions Regulator
Pinsent Masons LLP
PricewaterhouseCoopers LLP

Royal Bank of Scotland
Rio Tinto
Rolls Royce
SSE
Standard Life
Swiss Re
Tesco
Zurich

One further response was received from an individual.