

Minutes of WG2 Meeting

10am – 11.30am Monday 25 June 2014

HMRC, Left Auditorium, 1 Horse Guards Road, London, SW1A 2HQ

Attendees

Ann Brennan (GE / BBA Rep)
Lara Okukenu (Deloitte)
Catherine Linsey (ECI Partners)
Lydia Challen (A&O / Law Society)
David Gregory (Grant Thornton)
Jonathan Richards (Ernst & Young)
Andrew Hastie (LBG)
Vincent Maguire (Clifford Chance)
Paul Baldwin (FTI Consulting)
Graham Iverson (BVCA / Slaughter & May)
Ashley Greenbank (Law society / Macfarlanes)
David Boneham (CIOT / Deloitte)
Adam Blakemore (Cadwalader)
Paul Miller (Ashurst)
Kevin Cummings (BDO)

(collectively the “group”)

Tony Sadler (HMRC) - **Chairman**
Graham Williams (HMRC)
James Duncan (HMRC)
Mark Lafone (HMRC)
Richard Daniel (HMRC)
Liz Ward-Penny (HMRC)
Andy Stewardson (HMRC)
Roger Bath (HMRC)

(collectively “HMRC”)

Apologies

Kathryn Hiddleston (Grant Thornton)
Andrew Seagren (KPMG)
Nikol Davies (Taylor Wessing)
Stuart Sinclair (Bingham McCutchen)
Vincent Maguire (Clifford Chance)

1. Introductions and background

HMRC confirmed that the main intention of the meeting was to focus on discussion papers circulated by HMRC (on 4 June 2014) and the group (on 23 June 2014).

HMRC also made the following observations:

- a. HMRC were yet to receive any comments on the partnerships draft guidance circulated. Any comments would be appreciated.
- b. HMRC were still working on the connected companies draft legislation and would provide this as soon as available.

As an administrative matter, HMRC proposed to cancel the next scheduled meeting and instead to reconvene on 25 July 2014.

2. Corporate rescue exemption

HMRC opened discussions by commenting that they were not entirely wedded to their draft discussion paper / draft legislation and were interested in having an open dialogue with the group.

Scope & policy intention

From HMRC’s perspective, the group’s discussion paper seemed to encapsulate a wider form of debt restructuring than HMRC envisaged. HMRC were keen to ensure that a clear divide exists between genuine financial distress and general liability management exercises. Failing this, there would be a risk of extending the scenarios where credits are not taxed, which HMRC did not consider policy’s intention.

Whilst the group acknowledged HMRC’s concern over ‘casting the net too widely’, it was felt that the current draft did not adequately cover ‘real life’ scenarios where a company in financial distress seeks to consensually restructure its debt.

Furthermore, the group felt it unlikely that taxpayers would be bold enough to use the new relief to enable a tax-efficient liability management, particularly given the GAAR.

The group suggested one approach may be for HMRC to draft an explicit statement that the purpose of the legislation is to facilitate the restructuring of the debt of companies in financial distress with supporting guidance providing a list of situations that do and do not fall within the intended purpose of the legislation. HMRC commented they would consider this latter point.

Insolvency conditions

The group commented that HMRC's paper imposed an undue restriction that, in order to qualify for the corporate rescue exemption, it must be reasonable to assume that, but for the release, the company would within a period of 12 months have met one of the insolvency conditions set out in section 322 CTA 2009. The group felt this would result in a number of commercial restructurings seemingly falling foul of this definition e.g.:

1. A company can function for a long period of time without being in default, simply by virtue of their debts not being due for a long period of time but the company being able to service the high interest costs in the interim. This is not to say that were the debt due the company would not be insolvent.
2. A bank may seek to release a distressed company from its debt liabilities where the alternative is a vulture takeover which would dis-incentivise management.

The group's interpretation of HMRC's paper was that in both scenarios it may be difficult to say that a formal insolvency process within 12 months is reasonably foreseeable (even for companies that are in significant financial distress).

On point 1, HMRC commented that it is reasonable to assume that the company could continue to limp on and that trading conditions sufficiently change such that the company escapes insolvency. Invoking the corporate rescue exception earlier therefore ignores the possibility that the market may change.

On point 2, HMRC commented that a bank may be willing to accept less than par (on a release) as it affords the lender an ability to invest the capital elsewhere at a higher rate of return.

HMRC commented that in their view, the new corporate rescue exemption should address scenarios where the company is in impending insolvency. In their view this did not go so far as to say the company is at the time facing insolvency proceedings.

The group commented that this latter point was not clear from the current drafting (which links the exemption to the current insolvency conditions at section 322). The group's reading of the proposed draft was that it would not be enough that, but for the release, the company may be unable to pay its debts as they fall due but instead the company would need to satisfy itself that actual insolvency is "more likely than not".

The group reiterated the point that a company choosing to take action now (to avoid insolvency) should be seen as a positive action and that a third party bank being willing to release the debt (i.e. give something up) should be seen as something serious enough to invoke the corporate rescue exception.

On this latter point, HMRC questioned whether it would be sensible to introduce an "arm's length test".

12 months

The group commented that the 12 month window proposed is too short. The group's view was that borrowers in distress seek to plan ahead and restructure debt before the point in time at which it is too late. HMRC's approach seemed to favour the companies who "stick their head in

the sand". The group felt this to be a perverse incentive for companies to wait until their financial situation deteriorated before acting.

HMRC commented that there was no underlying magic to the 12 month timeframe but that in their experience, the practical reality was that group's do leave restructuring to the last minute i.e. to a point where they are facing impending insolvency.

Tax pushing company over the edge

The group felt that the uncertainty over the current drafting would mean that clearances would continue to be sought. Furthermore if companies feeling unsure as to whether the exemption applies, or nervous about relying on it, then the new corporate rescue exemption would simply act as an added layer of comfort with the current approach continuing to be followed. This seemed contrary to the initial policy intention of aligning the exemption with commercial reality.

Additionally, the group commented that the possibility of imposing a tax charge on a genuine restructuring will by definition prevent a restructuring from being successful, and in most cases not result in any tax being collected by the Exchequer.

A suggestion was made that HMRC could use the potential for "tax pushing a company over the edge" as one of the objective indicators in HMRC guidance.

3. Next steps & Timing

HMRC suggested that the most effective and efficient next step would be for them to prepare guidance (as opposed to amended draft legislation). In doing so, HMRC would give further thoughts to the points raised above e.g. the arm's length test, including the potential for tax to push a company over the edge in guidance etc.