# Summary: Intervention & Options

| **Department /Agency:**<br>**HM Treasury**<br>**HM Revenue & Customs** | **Title:**<br>**Proposals to simplify capital gains rules for groups of companies** | |
|---|---|---|
| **Stage:** Consultation | **Version:** 1 | **Date:** 18 February 2010 |
| **Related Publications:** 7 July 2009 discussion document / XX February 2010 consultation document: *Simplification review – capital gains rules for groups of companies* | | |

**Available to view or download at:** http://www.hm-treasury.gov.uk/consult_capitalgains.htm

**Contact for enquiries:** Alex Harris **Telephone:** 0207 270 6104

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

As a result of provisions designed to remove economic distortion and anti-avoidance provisions, the corporate gains regime has a necessary degree of complexity, but there is scope for simplification nonetheless. Business has identified the capital gains legislation as it applies to groups of companies as a priority for simplification.

What are the policy objectives and the intended effects?

The proposals included in the document aim to simplify the corporate gains legislation as it applies to groups of companies. The intention is to reduce admin costs faced by groups of companies and to provide certainty and clarity on how the rules apply. A further objective is to match tax outcomes with economic outcomes, where this is consistent with simplification and with anti-avoidance safeguards.

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

The discussion document published in July 2009 identified options for simplifying the rules on three areas of capital gains legislation for groups of companies. These were: capital losses after a change in ownership; value shifting and depreciatory transactions; and degrouping charges.

Section 2 of the evidence base of this Impact Assessment outlines the individual options that were considered and the reasons the Government has chosen certain of these to be developed further.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The impacts of any changes to legislation following from the consultation process will be monitored within 3-5 years of the implementation of the changes.

**Ministerial Sign-off** For consultation stage Impact Assessments:

***I have read the impact assessment and 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: 18 February 2010

# Summary: Analysis & Evidence

| Proposal A | Description: Proposal to simplify the rules on the treatment of capital losses after a change in company ownership. |
|---|---|

## COSTS

| ANNUAL COSTS | | Description and scale of **key monetised costs** by 'main affected groups' |
|---|---|---|
| **One-off** (Transition) | **Yrs** | None. The proposal would not introduce any additional administrative requirements. |
| **£ 0** | N/A | |
| **Average Annual Cost** (excluding one-off) | | |
| **£ 0** | | **Total Cost** (PV) **£ 0** |

Other **key non-monetised costs** by 'main affected groups'

None.

## BENEFITS

| ANNUAL BENEFITS | | Description and scale of **key monetised benefits** by 'main affected groups' |
|---|---|---|
| **One-off** | **Yrs** | The removal of the need for companies to time-apportion assets would lead to a small reduction in admin burdens on groups of companies. However, the Government estimates that this effect alone would be less than £100,000 per annum. |
| **£ Neg** | N/A | |
| **Average Annual Benefit** (excluding one-off) | | |
| **£ Neg** | | **Total Benefit** (PV) **£ Neg** |

Other **key non-monetised benefits** by 'main affected groups' The Standard Cost Model (SCM) only captures admin burdens. The proposal improves alignment between economic and tax outcomes, which in turn could improve equity of treatment between companies. By removing a tax barrier to restructuring a trade, the proposal could potentially have economic efficiency benefits.

Key Assumptions/Sensitivities/Risks

None.

| Price Base Year N/A | Time Period Years N/A | **Net Benefit Range** (NPV) £ N/A | **NET BENEFIT** (NPV Best estimate) £ Neg |
|---|---|---|---|

| Question | Answer | | | |
|---|---|---|---|---|
| What is the geographic coverage of the policy/option? | United Kingdom | | | |
| On what date will the policy be implemented? | N/A | | | |
| Which organisation(s) will enforce the policy? | HMRC | | | |
| What is the total annual cost of enforcement for these organisations? | £ nil | | | |
| Does enforcement comply with Hampton principles? | N/A | | | |
| Will implementation go beyond minimum EU requirements? | No | | | |
| What is the value of the proposed offsetting measure per year? | £ n/a | | | |
| What is the value of changes in greenhouse gas emissions? | £ n/a | | | |
| Will the proposal have a significant impact on competition? | No | | | |
| Annual cost (£-£) per organisation (excluding one-off) | Micro 0 | Small 0 | Medium 0 | Large Neg |
| Are any of these organisations exempt? | No | No | N/A | N/A |

| **Impact on Admin Burdens Baseline** (2005 Prices) | | | | | (Increase - Decrease) |
|---|---|---|---|---|---|
| Increase of | £ Neg | Decrease of | £ Neg | **Net Impact** | £ Neg |

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

# Summary: Analysis & Evidence

| Proposal B | Proposal to simplify the rules on value shifting and depreciatory transactions. |
|---|---|

**COSTS**

| ANNUAL COSTS | | Description and scale of **key monetised costs** by 'main affected groups' |
|---|---|---|
| **One-off** (Transition) | **Yrs** | None. The proposal would not introduce any additional administrative requirements. |
| £ **0** | N/A | |
| **Average Annual Cost** (excluding one-off) | | |
| £ **0** | | **Total Cost** (PV) £ **0** |

Other **key non-monetised costs** by 'main affected groups' Companies and HMRC staff need to be familiarised with the new form of the legislation, which is a one-off compliance cost.

**BENEFITS**

| ANNUAL BENEFITS | | Description and scale of **key monetised benefits** by 'main affected groups' |
|---|---|---|
| **One-off** | **Yrs** | The proposal would reduce admin burdens on groups of companies. Companies undertaking transactions without any tax motivation would not need to consider the new value shifting rule. |
| £ **Neg** | N/A | |
| **Average Annual Benefit** (excluding one-off) | | |
| £ **Neg** | | **Total Benefit** (PV) £ **Neg** |

Other **key non-monetised benefits** by 'main affected groups' Key benefits not captured by the SCM are simplification and clarification of the rules on value shifting and depreciatory transactions. The proposal would give groups of companies greater certainty in their tax liabilities, and make the legislation easier to apply.

Key Assumptions/Sensitivities/Risks

None.

| Price Base Year N/A | Time Period Years N/A | **Net Benefit Range** (NPV) £ N/A | **NET BENEFIT** (NPV Best estimate) £ Neg |
|---|---|---|---|

| Question | | | | |
|---|---|---|---|---|
| What is the geographic coverage of the policy/option? | | | United Kingdom | |
| On what date will the policy be implemented? | | | N/A | |
| Which organisation(s) will enforce the policy? | | | HMRC | |
| What is the total annual cost of enforcement for these organisations? | | | £ nil | |
| Does enforcement comply with Hampton principles? | | | N/A | |
| Will implementation go beyond minimum EU requirements? | | | No | |
| What is the value of the proposed offsetting measure per year? | | | £ n/a | |
| What is the value of changes in greenhouse gas emissions? | | | £ n/a | |
| Will the proposal have a significant impact on competition? | | | No | |
| Annual cost (£-£) per organisation (excluding one-off) | Micro 0 | Small 0 | Medium 0 | Large Neg |
| Are any of these organisations exempt? | No | No | N/A | N/A |

**Impact on Admin Burdens Baseline** (2005 Prices) (Increase - Decrease)

Increase of £ Neg Decrease of £ Neg **Net Impact** £ Neg

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

# Summary: Analysis & Evidence

| Proposal C | Description: Proposal to simplify the degrouping charge rules and to ensure that tax outcomes under these rules reflect the true economic profit from the relevant transactions. |
|---|---|

**COSTS**

| ANNUAL COSTS | | Description and scale of **key monetised costs** by 'main affected groups' | |
|---|---|---|---|
| **One-off** (Transition) | **Yrs** | The introduction of a facility for adjustments could lead to some additional ongoing administrative costs, but these are estimated to be negligible. | |
| **£ Neg** | N/A | | |
| **Average Annual Cost** (excluding one-off) | | | |
| **£ Neg** | | **Total Cost** (PV) | **£ 0** |

Other **key non-monetised costs** by 'main affected groups' Companies and HMRC staff need to be familiarised with new legislation, which is a one-off compliance cost.

**BENEFITS**

| ANNUAL BENEFITS | | Description and scale of **key monetised benefits** by 'main affected groups' | |
|---|---|---|---|
| **One-off** | **Yrs** | | |
| **£ Neg** | N/A | | |
| **Average Annual Benefit** (excluding one-off) | | | |
| **£ Neg** | | **Total Benefit** (PV) | **£ Neg** |

Other **key non-monetised benefits** by 'main affected groups' Discussions with stakeholders have indicated that one of the major benefits of the proposal (not captured by the SCM) would be to remove the need for complex tax planning when restructuring a trade. The proposal would also provide greater certainty to companies and ensure alignment of economic and tax outcomes.

Key Assumptions/Sensitivities/Risks

None.

| Price Base Year N/A | Time Period Years N/A | **Net Benefit Range** (NPV) £ N/A | **NET BENEFIT** (NPV Best estimate) £ Neg |
|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| What is the geographic coverage of the policy/option? | United Kingdom | | | |
| On what date will the policy be implemented? | N/A | | | |
| Which organisation(s) will enforce the policy? | HMRC | | | |
| What is the total annual cost of enforcement for these organisations? | £ nil | | | |
| Does enforcement comply with Hampton principles? | N/A | | | |
| Will implementation go beyond minimum EU requirements? | No | | | |
| What is the value of the proposed offsetting measure per year? | £ n/a | | | |
| What is the value of changes in greenhouse gas emissions? | £ n/a | | | |
| Will the proposal have a significant impact on competition? | No | | | |
| Annual cost (£-£) per organisation (excluding one-off) | Micro 0 | Small 0 | Medium 0 | Large Neg |
| Are any of these organisations exempt? | No | No | N/A | N/A |

| **Impact on Admin Burdens Baseline** (2005 Prices) | | | | | (Increase - Decrease) |
|---|---|---|---|---|---|
| Increase of | £ Neg | Decrease of | £ Neg | **Net Impact** | £ Neg |

Key: Annual costs and benefits: Constant Prices (Net) Present Value

# Evidence Base (for summary sheets)

## 1. Issue

As a result of provisions designed to remove economic distortion and anti-avoidance provisions, the corporate gains regime has a necessary degree of complexity. However, there are aspects of this complex regime that have the potential to be simplified, and business has identified the capital gains rules for groups of companies as an area where simplification would be particularly useful.

Initial dialogue with representative bodies and the responses received to the discussion document published in July 2009 has assisted the Government in developing a package of proposals to simplify the corporate capital gains rules, in the three areas of the legislation outlined below. An outline of the proposals is provided in section 3 below.

Capital losses following a change in ownership

In 2006, the Government introduced three Targeted Anti-Avoidance Rules (TAARs). The second of these rules restricts capital loss and gains buying i.e. the practice of acquiring a company primarily for the purpose of gaining access to its capital losses or gains, whether these are realised or latent. The Government believes that some of the existing legislation pre-dating the TAARs in this area – in Schedule 7A of the Taxation of Chargeable Gains Act 1992 (TCGA) – can now be repealed.

The rules in Schedule 7A limit the scope for capital loss buying, but they do not contain a purpose test and so are not confined to cases where a group acquires a company primarily to obtain the benefit of realised or unrealised capital losses. The rules also provide a mechanism for 'streaming' losses. This means ensuring that they can, broadly, only be used against gains on assets that were owned by the company when it joined the group or against assets acquired subsequently which are used for a trade conducted by the company when it joined the group. Allowing capital losses to be used in this way was intended to minimise the tax barriers involved to restructuring a trade, while protecting Exchequer revenue. However, following the introduction of the TAARs it is now possible to reduce the scope of the streaming rules consistently with protecting revenue, as outlined in section 2 below.

Value shifting and depreciatory transactions

A 'shift' in the value of an asset will typically take place when the asset is transferred at other than its market value, which often happens where the parties are companies within a single group, or when a dividend is paid to shareholders. The rule at section 30 TCGA (subject to restrictions in sections 31 to 33) addresses tax avoidance involving value shifting. These provisions have been identified as particularly complex and time-consuming for groups of companies and their advisers, and are hence a priority for simplification.

Section 176 TCGA (extended to non-group situations by section 177) deals with situations where a loss arises, or is increased, when shares are sold after the value of a company has been reduced in similar ways to those described in the paragraph above. When shares in a company are disposed of following a depreciatory transaction, then without this rule a tax loss could arise that does not reflect any economic loss. Such a situation could arise following entirely routine commercial transactions. There is at present some overlap between this rule and the value shifting rule at section 30.

Degrouping charges

The degrouping charge ensures that if a company leaves a group holding an asset acquired through a tax-free transfer from a fellow group member within the last six years, then any gain or loss deferred at the time of the transfer is reinstated. However, in some circumstances the current rules can lead to economic double taxation, and the July discussion document suggested that this outcome should be revisited. The degrouping charge also presently falls on the company leaving the group, rather than the company that initially transferred the asset free of tax. The Government

proposes to change the rules to improve certainty to taxpayers and to achieve a better match between economic and tax outcomes.

The degrouping charge rules interact with the provisions in Schedule 7AC TCGA, the Substantial Shareholding Exemption (SSE). Under the current provisions, a degrouping charge may arise in respect of a trade asset owned by a trading company while the share sale which gives rise to the degrouping event would itself be an exempt disposal for chargeable gains purposes by virtue of the provisions in the SSE.

## 2. Options considered

The July 2009 discussion document identified the following possible options[1].

Capital losses after a change in ownership

**3A** Repeal only those parts of Schedule 7A that are no longer required following the introduction of the second TAAR (section 184D, TCGA).

**3B** Align the change of ownership rules retained within Schedule 7A with the approach of the second TAAR.

**3C** Repeal the loss buying rules in Schedule 7A and introduce in their place a permissive rule that allows realised capital losses to be carried forward without restriction in cases where the losses relate to a trade or business that continues in a recognisable form.

**3D** Repeal the loss buying rules in Schedule 7A without replacement.

Option 3A was determined to be of limited benefit to business. Option 3D, while popular with business, would entail an unacceptable Exchequer cost.
The Government's proposal, outlined in the consultation document, consists in a combination of 3B and 3C, to deliver significant simplification while protecting tax revenues.

Value shifting and depreciatory transactions

**4A** Simply to extend the existing depreciatory transaction rules to allow for adjustment to gains on shares (including the creation of a gain); or

**4B** Retain the existing depreciatory transaction legislation and create a new value shifting rule within the chapter of TCGA dealing with groups of companies[2] which would be effect based as in the present depreciatory transactions rules.

**4C** In addition to the above, to align the time limit for adjustments between the two sets of rules, to six years (to match the present provision in section 31).

Feedback from stakeholders has indicated that option 4A would have the disadvantage of altering rules that are already well understood by business. As a result, the Government's proposal, outlined below, builds on option 4B, and also includes 4C to remove an obligation for companies that is unnecessary for the purpose of revenue protection.

Degrouping charges

**5A** Introduce a facility to make a just and reasonable adjustment to the degrouping charge through a taxpayer election where the present rules give a result that does not reflect a true economic profit.

[1] The numbering of the options is the same as that used in the discussion document
[2] Part VI, Chapter 1 TCGA

**5B** Introduce a mechanism to switch off the degrouping charge where the whole gain is realised at the shareholder level, to replace the exceptions in the present section 179(2) TCGA.

**5C** Leave the degrouping charge as it stands, but look for a means to adjust the base cost of the shares in the company being sold, so that together the degrouping charge and any gain or loss on the share sale reflect the true economic profit from the whole transaction, and thereby eliminate any excess degrouping charge.

**5D** Amend the degrouping charge rules so that any charge will arise either in the transferor company or the group's principal UK company, providing for elections to subsidiaries if necessary.

**5E** Reduce the six year limit in the degrouping charge rules to three years.

**5F** Replace the current de-grouping charge with a principle based TAAR.

**5G** The degrouping charges rules could be disapplied in respect of trade assets where a disposal of shares in a group company qualifies for the exemption under SSE.

Option 5E has been ruled out because of concerns that it could give rise to tax avoidance activity. Responses to the discussion document indicated that option 5F would be unpopular with business, and in removing the current degrouping charges, the option would have the disadvantage that it would not provide for adjustments to tax outcomes in the absence of tax-motivated transactions. As mentioned in the July discussion document, option 5A would deliver the aim of options 5B and 5C without the introduction of bespoke, mechanical rules that those options would require. Along with option A, options 5D and 5G form the basis of the proposal, as outlined in section 3 below.

## 3. Proposals being taken forward

A: Capital losses following a change in ownership

The Government proposes to repeal much of the legislation at Schedule 7A TCGA and introduce simplified rules. To maintain protection of the UK tax base, the simplified rules would retain the effect of streaming pre-acquisition realised capital losses after a commercially-motivated merger or acquisition. Under the proposal, however, only realised losses before the change would be subject to streaming; the streaming of unrealised losses would be removed.

The Government considers that a key benefit of the measure would be to improve alignment between economic and tax outcomes.

B: Value shifting and depreciatory transactions

The Government proposes introducing a new, simple anti-avoidance rule that explicitly targets tax driven arrangements intended to exploit reductions of value before a share sale. This contrasts with the current mechanical rules, which are potentially wide in application, and whose scope is then cut back by a number of specific exceptions to prevent double taxation.

Discussions with business have indicated that the existing depreciatory transactions rules at sections 176-177 TCGA are well understood, and so the proposal would not seek to amend the mechanism of these rules. However, to reduce wider compliance burdens while maintaining revenue protection, the Government proposes to introduce a time limit of six years between the time of the depreciatory transaction and the disposal of shares.

C: Degrouping charges

To lower compliance burdens and facilitate commercially-motivated restructurings, the lead proposal will introduce several changes, to:

(a) clarify the existing exception to the degrouping charges for asset transfers between "associated companies" that leave a group together,

(b) amend the way that degrouping charges are applied, particularly where the event that triggers the charge is a sale of shares in a trading company which is exempt under the Substantial Shareholdings Exemption (SSE),

(c) reduce the number of occasions that require a claim to reallocate the tax charge to another company and the complexity of tax indemnities in M&A agreements, by ensuring the tax is initially payable by the vendor group rather than the company which has been sold, and

(d) allow for the degrouping charge to be reduced where doing so is just and reasonable, taking into account the circumstances under which the company leaving the group acquired the asset. This will provide a further safeguard against the possibility of economic double taxation. Such a reduction would be made following a claim.

The change at (b) above would reduce the administrative burden currently caused by degrouping charges. Significantly, it would also ensure that a wider range of companies can benefit from the SSE without complex tax planning (to ensure that other conditions have been complied with) to ensure that the associated companies' exception applies.

**4. Current administrative burden estimates**

In understanding the figures in the summary sheets above, it is important to note that the 'Standard Cost Model' (SCM) has been used to derive an estimate of the costs to business of complying with HMRC obligations to disclose information to HMRC or to third parties. The SCM considers which activities a business has to carry out to comply with an HMRC obligation, how many businesses have to comply, and how often they need to comply. HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular: the admin burden on business of disclosing information to HMRC or to third parties.

The SCM estimates the cost of using agents, the cost of undertaking work in-house and the cost of actually transmitting the information. The SCM does not consider costs that a business would have incurred had the relevant HMRC obligation not existed. In addition, the SCM does not consider wider compliance cost issues, such as the costs of business uncertainty, cash flow costs, or the costs of deciding whether or not to do something.

As indicated in the summary sheets above, the proposals are estimated to have little impact on the admin burdens baseline, as calculated according to the SCM. However, this figure does not include wider benefits, including compliance benefits achieved through improved certainty and clarity (which discussions with business have identified as being substantial), and benefits in aligning economic and tax outcomes.

A further key benefit not captured by the SCM relates to savings for companies in structuring their arrangements to ensure that commercially-motivated transactions are not subject to tax charges provided for by anti-avoidance legislation. For example, business and professional services firms have widely welcomed proposal C for the reason that it would remove the need for much complex tax planning when restructuring a trade.

**5. Population potentially affected by the proposals**

All three measures would be expected to impact almost exclusively on large corporate groups. The Government's current assessment is that between 50 and 100 large groups would be impacted in any one year. However, under normal circumstances several companies in each group may be impacted.

Proposal A will affect a group when it is restructuring after acquiring another group or company and when it realises losses on the disposal of capital assets held in the target group or company.

Proposal B would make it much clearer that the transactions undertaken by those not attempting to avoid tax will not be caught by the value shifting rules. It is intended to apply to any disposal of

shares by a company as part of a tax-avoidance scheme, and so it can potentially affect single companies as well as groups. However, it will be large groups that will mostly benefit from no longer needing to be concerned whether entirely commercial transactions are caught by the existing mechanical rules.

Proposal C will affect any group that is disposing of its interest in a business, e.g. through a demerger or sale.

## 6. Consultation process

The central aim of the policy options is to simplify the legislation on the capital gains rules for groups of companies, as this has been identified as an area where simplification would be particularly useful. HMRC welcomes responses from companies on existing non-tax costs which they incur as a result of existing legislation that comes within the scope of the discussion document.

## 7. Impact tests

Competition Assessment

The Government's assessment is that the options for consultation, if implemented, would be unlikely to have an impact on the capacity of any business to enter markets or to compete rigorously within them. This is because the policy options would apply equally to all UK companies, and their central objective is to reduce compliance burdens. In particular, to the extent that there is potential for degrouping charges to result in economic double taxation is reduced, the proposals would be likely to promote competition through removing a potential market distortion.

Small Firms Impact Test

Any new legislation resulting from the discussion document will apply to small business. However, the policy options for discussion affect only groups of companies, and so are expected to affect almost exclusively affect large business. Section 4 of this document contains a question to help determined whether companies with fewer than 20 subsidiaries are in practice affected by the existing legislation, which will help to inform subsequent assessments of the impact on small firms, as part of the policy development process. The Government's current assessment is that the policy options have no negative impacts for small business.

Legal Aid

The Government's assessment is that the policy options for discussion will not have any implications for Legal Aid.

Sustainable Development

The Government's assessment is that the policy options for discussion will not have any effect on sustainable development.

Carbon Assessment

The Government's assessment is that the policy options for discussion will not affect carbon emissions.

Other Environment

The Government's assessment is that the policy options for discussion will not cause any other environmental impacts.

Health Impact Assessment

The Government's assessment is that the policy options for discussion will not impact on people's health.

Race Equality

The policy options for discussion apply only to companies, not to individuals, and hence do not directly discriminate on grounds of race. On the matter of indirect discrimination, the policy options

would apply to all companies, and are concerned with reducing deadweight compliance cost and matching tax outcomes with economic outcomes. As such, they should not have any indirect discriminatory impact.

Disability Equality

The policy options for discussion apply only to companies, not to individuals, and hence do not directly discriminate on grounds of disability. On the matter of indirect discrimination, the policy options would apply to all companies, and are concerned with reducing deadweight compliance cost and matching tax outcomes with economic outcomes. As such, they should not have any indirect discriminatory impact.

Gender Equality

The policy options for discussion apply only to companies, not to individuals, and hence do not directly discriminate on grounds of gender. On the matter of indirect discrimination, the policy options would apply to all companies, and are concerned with reducing deadweight compliance cost and matching tax outcomes with economic outcomes. As such, they should not have any indirect discriminatory impact.

Human Rights

The Government has been advised that the policy options for discussion do not have any Human Rights Act implications.

Rural Proofing

The Government's assessment is that the policy options for discussion will not be to the detriment of rural communities.

# 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** | ***Results in Evidence Base?*** | ***Results annexed?*** |
|---|---|---|
| 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 |