

Minutes of WG2 Meeting

2 – 3.30pm Monday 30 September 2013

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

Attendees

Ann Brennan (GE / BBA Rep)
Mark Lafone
Andrew Hastie (LBG)
Vincent Maguire (Clifford Chance)
Nikol Davies (Taylor Wessing)
Alex Jupp (Skadden)
Stuart Sinclair (Bingham McCutchen)
David Boneham (COIT / Deloitte)
Lara Okukenu (Deloitte)
Graham Williams (PwC)
Andrew Seagren (KPMG)
Jonathan Richards (Ernst & Young)
May Lam (Prudential / ABI Rep)
Tim Lowe (Linklaters)
Lydia Challen (Allen & Overy)
Catherine Linsey (ECI Partners)
Barnaby Levy (Freshfields Bruckhaus Deringer)
Shital Sham (FTI Consulting)
Adam Fraiss (BDO / BVCA)
Tom Cartwright (Pinsent Masons)
Adam Blakemore (Cadwalader)

(collectively the “**group**”)

Tony Sadler (HMRC) - **Chairman**
Andrew Scott (HMRC)
Stephen Harrop (HMRC)
Mark Lafone (HMRC)
Liz Ward-Penny (HMRC)
Richard Daniel (HMRC)

(collectively “**HMRC**”)

1. Introductions and background

HMRC opened the meeting by clarifying some administrative items and summarising the intention of the day’s meeting as follows:

- The meeting will be minuted and circulated to the working group for their review and comment.
- The smaller WG2 groups meetings (i.e. partnerships and transparent entities and group continuity treatment) have not been minuted however for the benefit of the wider group, the aim is to summarise the progress and action points of those meetings as part of the current meeting.
- Meeting notes for the initial meetings are now available at the following web address with subsequent meeting notes to be added as they become available:
<https://www.gov.uk/government/publications/modernising-the-taxation-of-corporate-debt-and-derivative-contracts-working-group-minutes>
- The purpose of the day’s meeting was to:
 - Provide an update on the general themes arising from the Consultation responses received;

- Provide an update on the progress and action points arising from the smaller working party groups i.e. partnerships and transparent entities and group continuity treatment; and
 - Discuss a practical way forward for remaining focal points of the WG2 agenda items i.e. connected party debt and debt restructuring.
- With apologies, it was also noted that the 11 December (as a proposed date for one of the next WG2 meetings) was no longer possible and would need to be rescheduled.

2. Consultation responses

HMRC provided a general update on the Consultation responses received:

- c.50-60 responses have been received many of which were extensive in scope.
- Of the responses received, the general sentiment seemed to be a wish to avoid a wholesale change to what is considered a highly complex area. In particular, it was felt that an overhaul of such an extremely complex area would result in uncertainty.

More specifically, it was felt that changes to broad concepts such as the targeted anti avoidance legislation and fairly represents would be unwelcome whilst the concept of tax following the profit and loss and the merging of Part 5 and 7 CTA 2009 was generally welcomed.

- Views on the timing of the proposed changes were mixed. Some parties share a preference for deferring the changes to avoid the uncertainty, errors or unintended consequences. Equally however, some parties shared a preference for accelerating the changes to avoid the uncertainty which could arise from rewriting and repealing legislation piecemeal.

It was noted that outside of the Consultation responses, concerns around timing had also been the forefront of discussions in WG1.

HMRC noted that ultimately the timing of Consultation process will be subject to ministerial consent.

- A summary of the response to the Consultation document is expected to be published around the time of the Autumn statement.

3. Smaller working party group : Partnerships

HMRC summarised (with input from those individuals present at the partnership smaller working party group meeting) that the main key themes focussed on had been:

1. That the current partnership regime does not explicitly set out the approach for dealing with partnerships in a number of particular areas and that elsewhere the position is not directly addressed but instead inferred from the application of more general partnership principles and how they fit with the overall legislative regime e.g. the group continuity rules.

The question was therefore whether the amended Chapter 9 Part 5 could consolidate the rules which would apply across the regime, in one place.

2. Whilst there is an underlying rationale to treat each partner as holding a share of the loan relationship or derivative contract, the mechanism in section 381 CTA 2009 is to treat each partner as having done everything done by the partner, with the partner taxed on "its share"

of the resultant profit or loss, as determined by reference to the partnership agreement (which the partners have the ability to agree between themselves).

The question was therefore whether the amended Chapter 9 Part 5 could better align the mechanics of section 381 CTA 2009 with the underlying rationale e.g. the partner would actually be deemed to become a party to the loan relationship by virtue of its interest in the partnership.

It had been decided that the most practical way forward was for HMRC to produce draft legislation which would seek to consolidate the partnership rules applying across the regime. This draft legislation would not for the time being address the mechanics of section 381 CTA 2009 or the points raised in respect of the profit sharing ratio.

It was noted that there remained a concern over the timing of the partnership rule changes (anticipated to take effect from 6 April 2014) on the basis that whilst the changes envisaged may be small, their impact may be large, and there had been very little time for all affected business sectors to comment on the proposals. HMRC acknowledged this concern.

HMRC commented that they hope to have a credible draft of the proposed legislation to share within the next few weeks.

4. Smaller working party group : Group Continuity

HMRC summarised (with input from those individuals present at the group continuity smaller working party group meeting) that in general, there had been a strong preference for minimal changes in this area.

Both the smaller working party group and wider group felt that the key to understanding what (if any) changes should be made to the group continuity rules was for HMRC to articulate:

- (i) what they consider to be the policy intention of the rules (e.g. is it ensuring neutrality, is it ensuring that gains and losses end up in the right entity etc); and
- (ii) to illustrate examples of scenarios where they do not consider the policy intention of the legislation is satisfied.

HMRC agreed to pull together a paper setting out their thoughts in addressing the areas set out above.

5. Connected Party Rules

HMRC noted that again the general preference (as per the Consultation responses) seemed to be for minimal change of the connected party rules. However, it was noted that opinion here was more divided than for group continuity.

There was general support amongst the group for streamlining the definition of 'amortised cost basis of accounting' such that it became closer aligned to the accounting definition of the term.

HMRC commented that if such alignment did take place, this may result in a difference in the tax position of the debtor and the creditor meaning that there would still be a need to address neutrality using some other mechanism (e.g. group mismatch schemes).

HMRC suggest that the connected party rules could be another area that would benefit from a smaller working party group akin to Partnerships and Group Continuity.

The group agreed with this approach and members of the group volunteered to form part of this group (see next steps and timing).

6. Debt restructuring

HMRC noted that the general response to the Consultation document was that both Option 1 and 2 of the Debt restructuring chapter were restrictive. There was however a slight preference for option 2.

As a reminder, it was noted that Option 1 broadly suggests the following changes:

- (i) **Section 322:** The exemption for the credit arising from a debt for equity swap in section 322(4) would be explicitly related to corporate rescues.

This would be remodelled along the lines of the exemption in section 361A for cases where it is reasonable to suppose that one of the insolvency conditions in sections 322(6) and 323 CTA 2009 would be met within the specified period.

It would be neutral as to the form of a debt restructuring, and would apply whether or not there was an issue of shares;

- (ii) **Section 362:** Introduction of an equivalent exemption in section 362 to that of section 361A for corporate rescues; and

- (iii) **Section 361A:** An amendment to the change of ownership condition in section 361A to reflect better the requirement that this should reflect control of the company.

Whereas Option 2 would propose to keep section 322(4) in its current form but with the introduction of a specific arm's length requirement and also to propose the amendments to section 362 and 361A (as set out under Option 2).

Section 322 - General

The general view from the group was that whilst the reliefs afforded under Condition A cases ("statutory insolvency arrangement") and Condition C ("insolvency conditions") work well, Condition B ("debt for equity swaps") create a number of issues on in the context of consensual debt restructurings that do not form part of an insolvency arrangement.

In particular, most none-HMRC members of the group were of the view that the scope of section 322(4) should be broad enough to cover bona fide corporate rescue arrangements despite it not being commercially feasible for the lender to hold equity.

Lack of clarity and clearance applications

HMRC commented that efforts had been made to improve guidance around section 322 et al however HMRC also acknowledged (as indicated by the number of clearance applications) that this remained an area of the legislation that gave some taxpayers uncertainty.

The group also noted that whilst in some cases, clearance applications were sufficient in providing comfort that the commercial corporate rescue arrangement should indeed fall within the scope of section 322, clearance applications were not always commercially practical given time constraints.

Future of UK GAAP

The group noted that as currently drafted, section 322 only operates to exclude certain "release" credits. It was therefore questioned whether this should be expanded to include certain other credits, particularly in light of the forthcoming changes to UK GAAP.

The particular concern expressed was that with effect for period of account beginning on or after 1 January 2015), an increasing number of companies will be required to transition from UK GAAP to of either IFRS or FRS 101 or 102 (the new UK GAAP accounting frameworks).

The result of this, is a likely increase in the number of circumstances whereby credits arise from the derecognition or restatement, for accounting purposes, of financial liabilities following an amendment and restatement of the underlying contractual terms.

To the extent that such credits also constitute credits triggered as a result of bona fide corporate rescue arrangements, it was suggested that the scope of section 322 should also be extended to include such credits.

Way forward

The general consensus seemed to be for a redrafting of section 322 to include an additional exemption that would allow for more bona fide corporate rescue arrangements to be dealt with under this section. The group also proposed the inclusion of other credits within this scope (such as the aforementioned restatement credit).

As a way of moving things forward, it was agreed that members of the group (see next steps and timing) would liaise to draft a note collecting together certain suggestions for the reform of the rules relating to corporate rescue arrangements with a view to fuller discussion in the next meeting.

7. Next steps & Timing

Partnerships

HMRC to produce draft legislation which would seek to consolidate the partnership rules applying across the regime.

Subject to Parliamentary drafting, HMRC hope to have something credible to share within the next few weeks.

Group Continuity

HMRC to produce draft paper setting out their thoughts on what they consider to be the intention behind the group continuity rules including examples of scenarios where they do not consider this intention to be satisfied.

Connected party rules

The following participants volunteered to form part of a smaller working party group for which a meeting was to be held on Monday 14 October 2013 to discuss the connected party rules in more detail:

- David Boneham (Deloitte/ CIOT)
- Lydia Challen (Allen & Overy / Law Society)
- Graham Williams (PwC)

Debt restructuring

The following parties volunteered to liaise to draft a note collecting together certain suggestions for the reform of the rules relating to corporate rescue arrangements with a view to fuller discussion in the next meeting:

- David Boneham (Deloitte/ CIOT)
- Kathryn Hiddleston (R3/ GT)
- Jonathan Richards (EY)
- Andrew Seagren (KPMG)
- Graham Williams (PwC)
- Vincent Maguire (Clifford Chance/ LMA)