

Minutes of WG2 Meeting

10am – 11am Thursday 2 December 2013

HMRC, 2/39, Chancellors Room, 100 Parliament Street, London, SW1A 2BQ

Attendees

Ann Brennan (GE / BBA Rep)
David Boneham (CIOT / Deloitte)
Lara Okukenu (Deloitte)
Graham Williams (PwC)
Andrew Seagren (KPMG)
Catherine Linsey (ECI Partners)
Paul Baldwin (FTI Consulting)
Nikol Davies (Taylor Wessing)
Jonathan Richards (Ernst & Young)
Stuart Sinclair (Bingham McCutchen)
Andrew Hastie (LBG)
Tom Cartwright (Pinsent Masons)
Paul Miller (Ashurts)
Kathryn Hiddleston (Grant Thornton)
Adam Blakemore (Cadwalader)
Tim Lowe (Linklaters)
Adam Frais (BDO / BVCA)
Graham Iversen (Slaughter and May)

(collectively the “group”)

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

(collectively “HMRC”)

Apologies

Alex Jupp (Skadden)
Vincent Maguire (Clifford Chance)

1. Introductions and background

HMRC opened the meeting by summarising that the intention of the meeting was to focus on the debt restructuring paper circulated by HMRC on 29 November 2013.

In advance of this, HMRC made the following update comments in the context of the remaining three WG2 agenda items:

- i. **Group Continuity** – HMRC had no specific comments other than that they acknowledge the general sentiment for minimal change and had specific points e.g. exit charges that they wanted to consider further.
- ii. **Connected Companies** – HMRC thanked those who had provided responses to the connected company debt discussion paper so far. The general sentiment appeared to be for little change. HMRC confirmed they will discuss the responses internally and revert in due course.
- iii. **Partnerships** – HMRC apologised once again for the delay in producing draft legislation; a result of the difficulty in freeing up parliamentary counsel. HMRC commented that ideally they would have hoped for draft legislation ready for the Autumn statement but that January now seemed like a more realistic timeframe. HMRC confirmed that the paper would first be sent to WG2 members with the hope being to discuss it more fully at the next WG2 meeting (scheduled for 10 January 2014). Some members of the group expressed reservations about the timing of proposal change, given the absence of draft legislation. HMRC indicated that it was the government’s intention to proceed but that there would be opportunity to discuss the proposals before they become law.

2. Debt Restructuring

Turning to the debt restructuring discussion paper, HMRC commented that in drafting this they had drawn extensively from the paper produced by members of the group. As a result, they hoped it reflected a balanced view and welcomed comments if this was not felt to be the case.

Although the paper had sought to draw on many themes following response to Chapter 11 of the Consultation Document, HMRC had focussed their efforts on 6 main themes:

- A new 'corporate rescue' exemption;
- An alternative proposal being the exemption of releases generally, instead providing specific instances where they are to be taxable;
- Amendment, extension and restatement and credits;
- The operation of section 352 CTA 2009;
- Partial debt releases; and
- Fair value hedges of connected party debt / initial recognition at fair value

3. A new 'corporate rescue' exemption

[Please note the amendment to para 17 of debt restructuring discussion paper: After the word 'bringing' insert the word 'together'.]

HMRC felt there was merit in exploring further the potential for a new 'corporate rescue' exemption i.e. a new Condition D which would address releases arising from bona fide corporate rescue arrangements.

HMRC commented that the new Condition D would prevent the need for companies to always structure into section 322(4) but that section 322(4) would continue to be available as present.

A BBA representative member of the group commented that the proposal had been welcomed by the BBA, although it was noted that it would be extremely important for supporting HMRC guidance, particularly regarding the hallmark indicators required to illustrate and explain the bright line test of bona fide corporate rescue arrangements.

HMRC agreed with the importance of guidance and commented that it would likely be an evolving process.

HMRC sought confirmation that the definition of a corporate rescue, advanced by the Association of Recovery Professionals ('R3'), constituted an appropriate starting point in defining this term. Members of the group generally agreed.

The following additional points were also made:

- One member of the group queried whether thought should be given to the interaction between the proposed new corporate rescue exemption and the proposal for the non-taxability of foreign exchange (except in the context of property or trading businesses).

In response, some members of the group commented that they considered that only the relevant release should be within the scope of the debt restructuring exemption. There was a possible interaction where (for example) exchange losses were also recognised for accounting purposes in respect of a release. The interaction with foreign exchange would therefore need to be addressed.

- In addition to this point, members of the group also commented on the wider need to consider generally what credits were intended to be within the ambit of the new corporate rescue exemption. In particular, it was noted that some members of the group had had experience of HMRC challenging release credits in relation to interest and that it would be useful if as part of this consultation, guidance clarified that release credits in relation to interest were within scope.
- HMRC commented that the definition of the term “arrangements” would need some further thought i.e. where do the arrangements start and end?

4. An alternative proposal was the exemption of releases generally, instead providing specific instances where they are to be taxable.

HMRC commented that this alternative had been included in the discussion paper on the basis that this alternative was “not as radical as it seems” (a quote from a member of the group).

A member of the working party group commented that whilst this may be the case (and is in line with the treatment of trade debts), there was generally (and should be) more support for the introduction of a new corporate rescue exemption. The group generally agreed with this sentiment, provided section 322 (4) continued to, as at present, provide a potential solution for “boundary cases”.

5. Amendment, extension and restatement credits.

HMRC reiterated the need to consider generally what credits were intended to be within the ambit of the new exemption for corporate rescues. It was felt this was brought to light in the context of amendment, extension and restatement credits.

HMRC summarised that under IFRS and the ‘new’ UK GAAP frameworks, it appeared that there will be many more cases where credits arise from the accounting derecognition or restatement of a financial liability where there is a substantial modification of the underlying contractual terms but without a release arising.

In addition, whilst this may relate to the easing of the contractual terms, it was likely that some troubled debt element restructuring reflected.

HMRC noted that the group had proposed that such credits should be within the scope of the new exemption for corporate rescues.

The group argued that such credits should be within the scope of the underlying government policy on the basis that the “amend and extend” of loans is often an integral pre-emptive element of bona fide commercial restructurings and therefore such credits would only be exempted in the context of bona fide troubled debt restructurings.

HMRC commented that a further provision would also be needed to ensure that if the credit arising on the refinancing is not taxable, the debits arising as the financial liability accreting up to face value at maturity are not be deductible.

A member of the group questioned whether this was necessarily appropriate i.e. if HMRC makes a decision not to tax the credit, should this automatically result in a claw back of any unwind debits?

HMRC responded by noting that if it did not, this could result in an advantage at the hands of the taxpayer in the case where the credit is exempted and subsequent debits relieved without the economic outflow.

6. The operation of section 352

HMRC commented that section 352 applied to related transactions in general, not merely the impairment element of for example a loss on disposal.

Effectively HMRC were aware of cases where section 352 CTA 2009 had misfired but invited the group to submit additional examples of such anomalies.

7. Partial debt releases

HMRC referred to example set out in the discussion paper i.e. whereby a debt with a face value of 100 / fair value of 60 is acquired by a company that is initially unconnected with the debtor, where the creditor and debtor subsequently become connected through a debt equity swap under which 30 of the par value of the debt is released in exchange for ordinary shares. In such a scenario, the interaction with section 322(4) needs to be considered.

HMRC commented that in this context, whilst various arguable approaches existed, (depending in part on the technical accounting analysis of the approach to be adopted under the amortised cost basis of accounting), their preference was for a “top slicing approach” (as set out in the paper they had articulated before the meeting).

HMRC felt that this was an issue that could be dealt with in HMRC guidance. The wider group agreed.

8. Fair value hedges of connected party debt / initial recognition at fair value

HMRC explained the example set out in the discussion paper intended to illustrate the tax impact of allowing fair value movements in the context of the release of a connected party debt in respect of a designated fair value hedge.

Generally, the group agreed with the tax treatment in applying option 1 of the Consultation Document in the context of the specific example set out in the discussion paper, however concern was expressed that this illustration formed a small part of the wider discussion.

In particular, it was felt that the follow that accounts principle and the treatment of releases of connected company debt still required further consideration particularly in light of the fundamental areas for consideration raised in the last WG2 meeting. The group was therefore mindful of commenting on the illustration in isolation.

9. Next steps & Timing

HMRC noted that this was the final meeting for 2013 and that the next meeting would be on 10 January 2014.

In the context of the forthcoming meeting, HMRC felt that the main priority would be to discuss the draft proposed legislation on the partnership rules which they hoped to publish in advance of that meeting.