

Minutes of WG2 Meeting

2pm – 4pm Monday 23 October 2013

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

Attendees

Ann Brennan (GE / BBA Rep)
Vincent Maguire (Clifford Chance)
Alex Jupp (Skadden)
David Boneham (COIT / Deloitte)
Lara Okukenu (Deloitte)
Graham Williams (PwC)
Andrew Seagren (KPMG)
May Lam (Prudential / ABI Rep)
Tim Lowe (Linklaters)
Lydia Challen (Allen & Overy)
Catherine Linsey (ECI Partners)
Susan Bell (Freshfields Bruckhaus Deringer)
Paul Baldwin (FTI Consulting)
Kathryn Hiddleston (Grant Thornton)
Adam Blakemore (Cadwalader)
Paul Miller (Ashurt)
Sophie Donnithorne-Tait (Bigham McCutchen)

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

(collectively “**HMRC**”)

Apologies

Andrew Hastie (LBG)
Nikol Davies (Taylor Wessing)
Jonathan Richards (Ernst & Young)
Stuart Sinclair (Bingham McCutchen)
David Haworth (Freshfields Bruckhaus Deringer)

(collectively the “**group**”)

1. Introductions and background

HMRC opened the meeting by summarising that the intention of the day was to briefly recap on the progress and actions points arising from the four WG2 agenda items (i.e. group continuity, connected party debt, partnerships and debt restructuring) with a particular focus on:

- (i) The draft partnership discussion paper prepared by HMRC; and
- (ii) The draft debt restructuring note prepared by certain members of the group.

The meeting would again be minuted and circulated to the working group for their review and comment, following which it will be made available online.

2. Group Continuity

HMRC noted that generally the sentiment in this area remained a strong preference for minimal change.

HMRC commented that notwithstanding this general sentiment, they felt it too soon to completely close off discussions on group continuity; particularly given that there remain a number of problematic areas including part loan transfers, portfolio transfers etc.

HMRC acknowledged that the next step was with HMRC to produce a 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. This could then be discussed at the next working party group.

3. Connected Party Rules

HMRC noted that a smaller working party group had been held on Monday 14 October 2013 and that (as with group continuity), the general sentiment was a strong preference for minimal change.

HMRC were keen however to continue exploring this area and in particular not to close off option 2 as set out in the consultation document.

HMRC commented that whilst option 2 involves a substantial overhaul of sections 354 to 359 CTA 2009 including their repeal so far as they relate to debt releases, this would permit amounts recognised on debt releases to be taxed in accordance with the accounts, thereby achieving neutrality but in a different manner than currently and with less computational adjustments.

There were no specific objections raised by the group, however it was acknowledged that being a Finance Bill 2015 matter, this was not an area requiring immediate attention.

4. Debt restructuring

The main focus of this part of the meeting was to discuss the draft note prepared by David Boneham (Deloitte / CIOT) in discussion with Kathryn Hiddleston (R3/ GT), Jonathan Richards (EY), Andrew Seagren (KPMG), Graham Williams (PwC) and Vincent Maguire (Clifford Chance/ LMA).

Main proposal

For the benefit of those who had not yet had a chance to digest the draft note, a member of the working group summarised that the main proposal was for an additional exemption (Condition D) to be introduced.

The objective of this additional condition was to establish a bright line test of bona fide corporate rescue arrangements which a majority of transactions in practice would fall within. It was felt that this would provide greater certainty in practice with consequential administrative savings for distressed companies, lenders and HMRC.

Definition of corporate rescue arrangements

The draft note highlighted that in order for Condition D to operate effectively this would require a clear and operable definition of the term 'corporate rescue arrangement'.

The definition advanced by the Association of Recovery Professionals had been suggested as an appropriate starting point. This definition includes a two-pronged test: a 'main purpose' test; and a subjective judgement test regarding a hypothetical state of affairs i.e. that of probable emerging insolvency.

A member of the group questioned whether such a definition would create a concern amongst directors of companies potentially having to comment on the solvency of the company.

HMRC commented that thought would have to be given as to whether the proposed Condition D and subjective definition of corporate rescue arrangements could lead to another form of HMRC clearance application.

Members of the group commented that this concern could be alleviated through HMRC published guidance on typical factors (i.e. hallmarks) which tax payers and HMRC could use to test the probability of an emerging solvency. As set out in the note it was commented that such hallmarks could include for example, actual or probable future covenant breaches, pre-emptive action taken to avoid the incidence of extreme financial distress, the timescale of consensual debt restructurings etc.

Amendment/ extension credits

A member of HMRC commented that consideration would need to be given as to whether it was in fact appropriate to include amendment and restatement credits arising on the transition to new UK GAAP within the scope of 'release credits' for the purposes of the debt restructuring rules.

In particular, it was noted that in some senses, such an amendment / extension did constitute a profit to the company on the basis that the company was essentially being released from its obligation to make payment. It was also commented that this was, however, also true of release credits in the context of troubled debt restructuring. Government policy was not to subject such credits to tax in order to foster a rescue culture. The same policy, arguably, should therefore inform the corporation tax treatment of amendment/ extension credits.

The tax treatment of the credit would depend however on whether the amendment and extension took place in the comparative year or before the date of transition. If the comparative year, the credit would likely be spread over a period of 10 years by virtue of the interaction of section 316 CTA 2009 and the change of accounting practice regulations. If before the date of transition, restatement would not be required.

Certain members of the group commented that it seemed counterintuitive that a company on the verge of insolvency should be subject to a potentially large taxable credit (whether spread or not) simply by virtue of amending terms so as to avoid insolvency. It was also questioned whether the company ever obtained a reversal (i.e. relief) for this taxable credit.

A member of HMRC suggested that such relief may be obtained through the higher interest charge likely to be suffered by the company as a result of the amendment.

Certain members of the group noted that this did not work in the favour of a company which, depending on the timing of the debt restructuring, could suffer an upfront taxable credit with the offsetting deduction for increased interest charges being relieved over a period of time.

A member of HMRC pointed out that this issue must not be a new one on the basis that there are at present companies applying IFRS. It was pointed out that most troubled debt restructurings hitherto had occurred in the context of "old" UK GAAP accounting. Furthermore, the issues had been encountered where debt restructurings occurred in the context of IFRS.

Members of the working group agreed noting that the forthcoming accounting changes would simply seek to increase the awareness amongst taxpayers of this issue, which could in itself lead to changes to the way in which commercial negotiations are held.

Both HMRC and members of the working group agreed that careful consideration would need to be given as to how (if at all) to address this issue, particularly as any proposed changes would likely lead to a mismatch in the tax treatment between taxpayers depending on when they chose to transition to new UK GAAP. It was possible that such credits might be brought within Regulation 3C of the Change of Accounting Practice Regulations, depending upon the scope of the Treasury's powers in their respect.

A member of the group also suggested that it may be worth considering whether amendments and extensions/restatements to derivative contracts should also be brought into scope. There were no direct objections to such consideration being made.

General consensus

HMRC sought confirmation from the room that the paper constituted a reasonable consensus of the group such that this was now in a position for HMRC to take away and consider in further detail. HMRC clarified that the reason for asking this was that the consultation responses received to date had not formed a clear consensus.

A member of the group suggested that this may be due to the fact that the consultation proposed for a repeal of section 322(4) CTA 2009 in its present form whereas what was being

suggested here was for the provision of a specific general exemption alongside the continuance of section 322(4) as currently drafted. HMRC noted that this was probably a fair conclusion.

The wider group also confirmed that the note represented a reasonable consensus of the group.

Ann Brennan noted that it would be useful to seek comment from the BBA on the draft debt restructuring note. HMRC confirmed that such comments would be welcomed.

HMRC committed to take the note away and consider it in further detail.

5. Partnerships

HMRC noted that they had for this meeting hoped to share draft legislation but that it had proved too difficult given the timings.

The main focus of this part of the meeting was therefore instead to discuss the draft partnership discussion paper prepared by HMRC which they felt conveyed the kind of language considered appropriate for when drafting actually commenced.

Main proposal

For the benefit of those who had not yet had a chance to digest the note, a member of HMRC summarised that the essence of what was proposed in the discussion paper was for the repeal of Chapter 9 of Part 5 and other provisions which deal specifically with partnerships and their replacement with principles on how the loan relationships rules would apply for all purposes of Part 5 and instead of section 1259.

In particular, the discussion paper set out three broad principles. HMRC were keen at this meeting to discuss whether the working party group broadly agreed with these principles. The principles were summarised as follows:

1. That any question as to the operation of any provision of Part 5 would be determined as if each of the partners in the firm separately (rather than the firm) stood in that position as respects the debt to the extent of that partner's appropriate share.
2. That anything done by or in relation to the firm in connection with the money debt is treated as done by or in relation to the partner.
3. That the calculation of credits and debits to be brought into account for a company partner are by reference to the firm's accounts (and not the partner's accounts).

Reference to the firm's accounts

A member of the group questioned whether bringing credits and debits into account by reference to the firm's accounts was the most appropriate method and sought comment from the room on the basis that it was neither the deemed single company fiction of section 1259, CTA 2009, nor was it complete transparency along the lines provided in respect of guarantors pursuant to the transfer pricing rules.

In particular, they noted that referencing the firm's accounts in some ways contradicted the deeming of full attribution to the partners.

They also noted that in applying the guarantee rules, the deeming provision, deems the debt to have been issued by the guarantor (not the guarantee). Paralleled to the partnership rules this would be the equivalent of deeming the partners to stand in the position of creditor or debtor as regards the debt with credits and debits calculated by reference to the partners accounts.

The member of the group gave two specific scenarios of where following the firm accounts could provide a result counterintuitive to the principle of full attribution:

- (i) Where the functional currency of the firm's accounts differed to that of the partners accounts, therefore giving rise to taxable foreign exchange.
- (ii) Where the firm's accounts applied fair value accounting but the partner's accounts did not, therefore giving rise to taxable far value profits and loss.

HMRC acknowledged the points made but questioned whether these were conceptual points or actually relevant in practice.

Another member of the group also commented that referencing the partners accounts could lead to a large compliance burden as the partners would then be required to draw up their own individual set of accounts as opposed to following a single set of accounts drawn up by the firm.

The member of the group who highlighted the potential concerns to referencing the firm's accounts agreed to consider further (outside of the meeting) practical examples of where following the firm's accounts may not result in the better answer.

HMRC clarified that one implication of the first general principle was that a change of profit sharing relationship would entail deemed acquisitions and disposals of loan relationship and derivative contracts by UK resident corporate partners. This also would create a compliance obligation. HMRC confirmed that the paper that they had circulated did not address the question of payments in respect of such acquisitions and disposals outside the framework of the partnership accounts. However that this area would need to be addressed.

It was agreed that in the meantime (and whilst acknowledging the comments made), HMRC would proceed with circulating a draft of the proposed legislation on partnerships.

6. Next steps & Timing

Group Continuity

HMRC to produce a 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.

Debt Restructuring

Ann Brennan to seek comment from the BBA on the draft debt restructuring note.

HMRC to consider draft debt restructuring note in further detail.

Partnerships

Member of the working party group to consider practical examples of where following the firm's accounts may not result in the better answer.

HMRC to circulate a draft of the proposed legislation on the partnership rules for this to be considered in greater detail in due course.