



HM Revenue
& Customs

Legislating Extra Statutory Concession D33

Summary of Responses
November 2015

Contents

| | | |
|-------|--------------------------------|---|
| 1 | Introduction | 2 |
| 2 | Responses | 3 |
| 3 | Next steps | 4 |
| Annex | List of stakeholders consulted | 5 |

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1. Introduction

- 1.1 In July 2014 HM Revenue & Customs (HMRC) published a consultation document “Legislating Extra-Statutory Concession (ESC) D33”, as ESC D33 had been identified as going beyond the scope of HMRC’s administrative discretion.
- 1.2 ESC D33 is primarily concerned with capital sums received as compensation or damages, which in certain cases can be liable to Capital Gains Tax (CGT) in the hands of non-corporates or Corporation Tax on Chargeable Gains (CTCG) in the hands of corporates. References to CGT in this document should be read as being references to CGT and CTCG. It sets out when such compensation is liable to CGT. It also considers personal compensation or damages and indemnity payments and sets out HMRC’s approach to such payments.
- 1.3 In January 2014 an amendment was made to the concession for capital sums where there is no underlying asset. The amendment introduced a limit so that only the first £500,000 of a compensation payment is automatically exempt from CGT. Under this amendment a claim can be made in writing to HMRC for the amount of compensation above £500,000 to also be exempt.
- 1.4 The consultation sought views on raising that limit to £1 million, but that it should be an absolute limit with amounts in excess of this liable to CGT. It also sought views on whether to legislate other aspects of ESC D33, specifically whether the exemption should apply to:
 - Compensation paid to an individual for wrong or injury suffered in their trade or employment.
 - Compensation paid to persons other than the individual who suffered the wrong or injury, such as relatives.
 - Compensation for emotional distress caused by the death of another person.
 - Compensation for loss of financial support provided by the injured person.
 - Indemnities.

It also asked for views on the impacts of legislating.
- 1.5 The consultation received 16 written responses from professional firms and representative bodies, mostly in the fields of accountancy and law. HMRC also held a meeting with one of the representative bodies concerned. A small number of respondents made suggestions for other legislative changes which fell outside the scope of the consultation.
- 1.6 This document summarises the responses received and the next steps.

2. Responses

General comments and summary

- 2.1 Respondents agreed that the effects of ESC D33 should be given statutory authority. However, most disagreed with the proposal to limit the amount of any receipt which is exempt from CGT to £1 million. Many argued that the 'uncapped' exemption afforded by the ESC before it was amended in January 2014 should be reproduced in legislation.
- 2.2 There was widespread concern that it would be unfair to charge tax on an award which was intended merely to restore a loss or compensate for a disadvantage, rather than create a gain in the recipient's hands.
- 2.3 Many respondents were concerned that the possibility of an award of compensation or damages being taxed in the hands of the recipient would complicate the work of advisers, advocates, arbitrators and judges etc. who are involved in determining the amounts of any payments.
- 2.4 Specialist practitioners in particular were concerned by the implication for funds available for distribution to creditors in insolvency cases where liquidators could be liable to tax on amounts they recovered e.g. from former officers of the failed company.
- 2.5 All respondents who expressed a view agreed that the following aspects of ESC D33 should be legislated-for:
 - Sums received by individuals for wrong or injury suffered in their trade or employment should be exempt from CGT.
 - Compensation or damages paid to persons other than the individual who suffered the wrong or injury, or for emotional distress caused by the death of another person, or compensation for loss of financial support provided by the injured person should be exempt from CGT.
 - Payments made under an indemnity should be treated as contingent liabilities in the same way as warranties and representations, so that the payer can claim an adjustment to the CGT computation.

Limiting the exempt amount of any receipt

- 2.6 As set out in the consultation document, it is proposed to introduce an absolute limit of £1 million exemption from CGT for compensation derived from a right of action where there is no underlying asset. Any amount received above £1 million will be chargeable to CGT.

Question 1: is £1 million the right level of exemption? If not, what would be a more appropriate amount and why?

Question 2: are you aware of any cases which would be taxable under the proposed changes which would result in hardship?

Summary of responses

- 2.7 None of the respondents agreed with this proposal. Most suggested that any limit would be, to some degree, arbitrary and several disagreed with the principle of taxing compensation and damages at all.
- 2.8 Some respondents said that, even if the concessionary treatment exceeded HMRC's permitted discretion following the Wilkinson case, Parliament was not so constrained and can and should legislate to reproduce the effect of the unlimited concession which applied before January 2014.
- 2.9 There were fewer direct comments on the subject of possible hardship, but a number of respondents pointed out that because (in their view) any tax charge on compensation would be unfair, hardship (or at least injustice) was likely in many cases.
- 2.10 Many respondents were concerned that the process of determining the amount of any compensation or damages payable would be complicated by the need to take account of any tax which the recipient might have to pay. This might lead to claims and awards being 'grossed-up' in order to leave the claimant with a certain amount after payment of tax, and this in turn could complicate and extend negotiation or legal proceedings and involve advisers and judges etc. in unfamiliar areas of tax law.
- 2.11 One firm of solicitors mentioned complications caused by the amendment of ESC D33 in January 2014, and which would be perpetuated by the present proposals, to claims under the Inheritance (Provision for Family and Dependents) Act 1975. The possibility that claims may be not be within the exemption afforded by ESC D33 has made settlement negotiations more difficult and increased costs in some cases.
- 2.12 One response from a representative body, and two from accountancy firms, raised concerns about how the proposals might impact upon creditors of insolvent companies. Insolvency practitioners may make substantial claims against officers of the company, professional advisers or others and if tax were to be charged on sums received under such claims this could reduce amounts available for distribution to creditors and effectively bestow a preference on HMRC in relation to other creditors. One of these responses suggested an unlimited exemption specific to insolvency cases.

Personal compensation or damages – extending the exemption

- 2.13 There is at the moment a statutory exemption for compensation or damages for wrong or injury suffered by an individual either personally or in their profession or vocation. ESC D33 extends this exemption, by concession, to certain cases which do not fall within the wording of the statute. The government proposes reproducing the effects of these concessions in legislation.

Question 3: should the exemption in section 51(2) TCGA include compensation paid for any wrong or injury suffered by an individual in their trade or employment?

Question 4: should the exemption in section 51(2) TCGA include compensation paid:

- **to a person other than the individual who suffered the wrong or injury, such as relatives or personal representatives of a deceased person**
- **for emotional distress caused by the death of another person**
- **for loss of financial support?**

2.14 All respondents who replied to these questions (more than two-thirds of the total) supported the proposals. 3 respondents were concerned that the existing legislation applied only to damages for physical injury and not damages received for distress, embarrassment, loss of reputation, slander etc.

Payments under indemnities

2.15 No allowance is made in computing a chargeable gain for any contingent liability on the seller in respect of a warranty or representation made on a disposal by sale or lease of property other than land. But if, after the sale, the seller makes a payment under a warranty or representation then his or her CGT liability may be adjusted on the making of a claim and a corresponding adjustment made to the purchaser's acquisition cost.

2.16 ESC D33 extends these treatments to indemnities and payments under indemnities, and the government proposes reproducing this effect in legislation.

Question 5: do you agree that section 49(1)(c) TCGA should include indemnities?

2.17 All respondents who replied to these questions (more than two-thirds of the total) supported the proposal.

2.18 Three respondents further suggested that similar adjustments should be available where a vendor makes payments to a person other than the purchaser, for instance where cash is introduced to the company whose shares were sold in order to make good a shortfall in the value of that company's assets.

Impacts of the proposals

2.19 The consultation document included a table of impacts on the Exchequer, on the UK economy, and on groups such as individuals and businesses.

Question 6: do you have any comments on the assessment of equality and other impacts?

2.20 Several respondents remarked on the fact that the measure is expected to have a negligible impact on the Exchequer and no significant economic impacts. From this they argued that there was no financial or economic justification for the proposed £1m limit on the exemption, and there should be an unlimited statutory exemption (see 'Limiting the exempt amount of any receipt' above).

- 2.21 Two respondents were disappointed that no attempt had apparently been made to quantify the cost to the Exchequer of legislating the unlimited exemption originally afforded by ESC D33. One also pointed out that the proposals would have an adverse impact on individuals who received sums in excess of £1 million (presumably given the assumption that any ‘grossing-up’ on account of tax payable was inadequate).
- 2.22 A representative body thought that there would be an impact on advisers and practitioners due to increases in their professional indemnity insurance premiums, likely to be necessary to cover payments increased by ‘grossing-up’ on account of the recipient’s liability to tax. The same response drew attention to the fact that the proposals would create a favourable tax treatment for individual recipients when compared to corporate recipients.

Other comments

- 2.23 One respondent expressed concern that HMRC might seek to revisit tax treatments previously agreed under ESC D33 as it applied at times before any legislation takes effect. The government can confirm that this would not be the case.
- 2.24 The same respondent argued that the provisions of ESC D33 (or statute which replaces it) should apply also to capital payments received under a policy of insurance used as a commercial alternative to either a warranty or an indemnity. This is beyond the scope of this consultation and the government has no plans to pursue this at the present time.
- 2.25 One respondent called for any exemption limit to be linked to inflation and regularly reviewed.
- 2.26 Two respondents observed that whilst the consultation took place under Stage 2 of the Government’s Tax Consultation Framework, the first stage (Setting out objectives and identifying options) had apparently been omitted and that, had Stage 1 been observed, it might have avoided the shortcomings perceived in the proposals.
- 2.27 A representative body suggested that the only risk to HMRC lay in a possible mis-match between the treatment of a payment in computing the payer’s taxable profits and the treatment of the same payment as a receipt in the hands of the recipient, i.e. if the former was relieved for tax purposes whilst the latter was not taxed.
- 2.28 It was suggested that there are concessionary aspects in paragraphs 9 and 12 of ESC D33 and that these should be explicitly legislated. Paragraph 9 extends the application of the normal part-disposal rules in section 42 TCGA in certain circumstances and paragraph 12 provides a gloss on the phrase ‘in his person’ as used in section 51.
- 2.29 There was concern over the commencement arrangements of any statutory provisions which limit the amount of compensation etc. which is tax-exempt.

3. Government response and next steps

- 3.1 The government wishes to thank those who responded to the consultation document and recognises the time and effort that went into the comments and contributions.

Questions 1 and 2 – limiting the receipt

- 3.2 Before addressing Questions 1 and 2 a number of respondents expressed concerns about taxing compensation, on the grounds that such payments simply put the parties back in the position they would have been in but for the negligent action. On this basis they considered it wrong to tax claims for damages for any amount.
- 3.3 The government agrees that many claims to compensation or damages are simply intended to put the claiming party back in the position they would have been in, if it were not the negligent action, for example compensation paid where a solicitor due to his negligence allows a claim for personal injury to be time barred.
- 3.4 However, the government does not agree that it is appropriate or right to exempt from CGT all payments badged as damages or compensation. This can be illustrated by two examples.

Example 1: B wishes to purchase a building from A, which it will sell immediately to C for a gain. Due to the negligence of B's adviser the sale falls through. If B sues the adviser, it is difficult to see why some, or all, of the compensation received should not be attributable to the lost profit. In the government's view it is this lost profit that B is seeking to recover from its adviser.

Example 2: A disposes of a right of action against B to C. C successfully sues B and receives the damages. C will have acquired the right of action in a commercial transaction to make a profit from the exercise of the right and it does not seem unreasonable to tax the gain.

- 3.5 Nonetheless, as many of the respondents raised points about this and other aspects of the ESC, before determining the next course of action it is the government's intention to discuss the issues in more detail with those respondents to ensure that the concerns they raised are fully understood.

Questions 3 to 5 - sections 49 and 51 TCGA

- 3.6 These were universally supported. The government will consider legislating as part of the overall exercise to legislate ESC D33.

Question 6 - impacts

- 3.7 Further discussions will enable the full impacts of legislating the ESC to be determined.

Annex List of stakeholders consulted

AVN Venus Tax LLP
Association of Accounting Technicians (AAT)
Association of Business Recovery Professionals (R3)
Chartered Institute of Taxation (CIOT)
City of London Law Society
Deloitte LLP
Hogan Lovells International LLP
ICAEW
ICAS (Institute of Chartered Accountants Scotland)
M^cKie & Co (Advisory Services) LLP
KPMG
The Law Society
Mishcon de Reya
PwC (PriceWaterhouse Coopers)
STEP (Society of Trust and Estate Practitioners)
Wilson & Co