Minutes of WG2 Meeting

10am – 11.30am Monday 25 July 2014

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

Attendees

Ann Brennan (GE / BBA Rep)
Lara Okukenu (Deloitte)
Lydia Challen (A&O / Law Society)
David Gregory (Grant Thornton)
Jonathan Richards (Ernst & Young)
Andrew Hastie (LBG)
Paul Baldwin (FTI Consulting)
David Boneham (CIOT / Deloitte)
Nikol Davies (Taylor Wessing)
Alex Jupp (Skadden)
Vincent Maguire (Clifford Chance)
Gavin Little (KPMG)

(collectively the "**group**")

Tony Sadler (HMRC) - **Chairman**
Mark Lafone (HMRC)
Richard Daniel (HMRC)
Roger Bath (HMRC)
Scott Hutford (HMRC)

(collectively "**HMRC**")

Apologies

Kathryn Hiddleston (Grant Thornton)
Andrew Seagren (KPMG)
Adam Blakemore (Cadwalader)
Paul Miller (Ashurst)
Graham Williams (HMRC)

1. Introductions and background

HMRC confirmed that the intention of the meeting was to focus exclusively on the debt restructuring discussion paper circulated by HMRC on 9 July 2014.

As an administrative matter, HMRC proposed to cancel the next scheduled meeting on 11 August 2014 and instead to reconvene on 28 August 2014.

2. Corporate rescue exemption

HMRC confirmed that in drafting their paper they had sought to distil and encapsulate the key points raised from earlier meetings. HMRC were clear that this paper should not be taken as definitive drafting at this stage but more so a means by which to progress discussions.

Two variants

HMRC's paper presented two draft variants which were broadly similar but for the following main differences:

- "would" vs "could": The first variant imposes a lower threshold, referring to "could" as opposed to "would" e.g. "*It is reasonable to assume that, but for the release, modification or replacement, there <u>could</u> be a time within the foreseeable future that the company would be unable to pay its debts so far as then due but unpaid*." HMRC expressed concerns that this might admit too wide a range of circumstances and welcomed thoughts on this.

- "purpose": The second variant uses the concept of 'corporate rescue' defined by reference to 'arrangements' and their 'sole purpose' e.g. "*The release, modification or replacement is part of a <u>corporate rescue</u> . . . A 'corporate rescue' means arrangements whose <u>sole purpose</u> is to ensure that once they have been implemented the debtor company is in a position in the future to pay its debts as they fall due."*

HMRC commented that the intention was not for each variant to be mutually exclusive and were open to them being mixed and matched. In doing so, HMRC asked the group to bear in

mind the consultation objective of simplification and hope for succinct as opposed to elaborate drafting.

As a general observation, the group commented that the threshold in variant two appeared higher due to the requirement that the company "would" be unable to meet its debts as they fall due and that this be the "sole purpose" of the arrangement.

Insolvency conditions

HMRC acknowledged that one of the key concerns raised previously was the close link to the insolvency conditions in section 322(4) CTA 2009. The current drafting proposed to address this by instead referring to the concept of a company being unable to pay its debts within the meaning of the Insolvency Act.

The group agreed this seemed a better approach. For clarification, a member of the group commented that their understanding was that the Insolvency Act required one to look forward and determine whether the company would be unable to meet its debts as they fall due at a particular point in time. They questioned how this would be applied to a company able to service interest but not principal repayment.

The general response (both from the group and HMRC) was that based on the current proposal, if the company was unable to pay debts falling due within 12 months then they would be within the intended ambit of the proposal. If not, then the company would not be within the intended ambit unless say, there were a breach of covenant which could then arguably invoke the reasonableness test within the definition of 'foreseeable future' i.e. *means one year from the date of the release, modification or replacement, or such longer period as is reasonable having regard to all the circumstances.*

Would vs could

HMRC were more inclined to use of the word "could" in variant one, the view being that this created less ambiguity and seemed to encapsulate many of the clearances received to date.

The group generally agreed with this sentiment and suggested that this drafting could be supplemented by HMRC guidance giving taxpayers further certainty. Additionally it was noted that use of the word "could", would likely ease director sensitivities around any perceived admission to wrongfully trading.

12 month

HMRC commented that both variants retained the 12 month time limit. HMRC did note that the "cliff edge effect" should be mitigated through the definition of 'foreseeable future' and reference to *"or such longer period as is reasonable having regard to all the circumstances"* and that this would be something they would seek to apply in practice.

HMRC were not however inclined to push the boundaries further than 12 months on the basis that this would lead to uncertainty between true financial distress and general liability management exercises.

The group pointed out that the effect of this will be for a number of commercial debt restructurings not to be caught e.g. the so called zombie companies which can function for a long period of time without being in default, simply by virtue of their debts not being due for a long period of time but the company being able to service the high interest costs in the interim.

HMRC acknowledged this but commented that for such companies there are other avenues (exemptions) available to the company. This view was supplemented by the fact that HMRC don't see many clearances for longer term issues – presumably because time affords the ability to restructure differently.

Amend and extend

HMRC commented that both variants combined the exemption for a release with that for amend and extend type scenarios.

A member of the group commented that one issue that commonly arose was the need to novate a debt up to the top of corporate group so as to facilitate a debt for equity swap at that level and questioned whether this should also be within the ambit of the proposed draft. The effect of this novation is typically the recognition of a derecognition credit due to the intercompany payable due from subsidiary to parent being recognised at fair value for accounting. This doesn't pose a problem under "old" UK GAAP or for UK-UK transfers (as group continuity should apply) but does pose a problem for cross border transactions.

One member of the group queried whether the requirement to recognise the debt at "amortised cost" as defined for tax purposes would not deal with this issue given its starting point is "cost". This was acknowledged but it was noted that this definition itself may change in the near future.

HMRC's initial view was that the "amend and extend" provisions are intended to deal with the requirement to derecognise existing debt (as a result of a modification) not where the debt was replaced in its entirety.

The group member commented that this approach may render the UK uncompetitive when compared to its European pears that have sufficient provision to deal with this issue.

HMRC agreed to give this further thought but noted if statute was required, this would likely be kept distinct from the current proposed draft for amend and extends.

3. Next steps & Timing

Generally, it was agreed that variant one of the discussion paper offered a better approach on the whole. With this in mind, HMRC proposed to follow up with HMRC guidance using variant one as a basis.

The next meeting was scheduled for 28 August 2014.