Minutes of WG2 Meeting

10am – 11.30am Monday 15 May 2014

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

Attendees

Ann Brennan (GE / BBA Rep)
Lara Okukenu (Deloitte)
Andrew Seagren (KPMG)
Catherine Linsey (ECI Partners)
Lydia Challen (A&O / Law Society)
May Lam (ABI / Prudential)
David Gregory (Grant Thornton)
Jonathan Richards (Ernst & Young)
Stuart Sinclair (Bingham McCutchen)
Andrew Hastie (LBG)
Vincent Maguire (Clifford Chance)
Tom Cartwright (Pinsent Masons)

(collectively the "**group**")

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

(collectively "**HMRC**")

Apologies

Alex Jupp (Skadden)
Nikol Davies (Taylor Wessing)
David Boneham (CIOT / Deloitte)
Paul Baldwin (FTI Consulting)

1. Introductions and background

HMRC confirmed that the main intention of the meeting was to focus on the draft legislation on a new corporate rescue exemption (circulated on 25 April 2014).

HMRC had also circulated draft revised guidance for the Corporate Finance Manual on partnerships on 25 April 2014. Time permitting this could also be picked up as part of the meeting. Alternatively, comments were welcomed outside of the meeting.

HMRC also made the following observations:

a. Amendments to the de-grouping provisions in sections 345-346 and 631-632 CTA 2009 were agreed as part of the Public Bill Committee debate on 6 May 2014. Draft revised guidance for the Corporate Finance Manual on the application of the legislation after 1 April 2014 was circulated on 7 May 2014. This was due to be published in the CFM following Royal Assent.

b. A new Condition D in section 322 CTA 09 (exempting credits in respect of debt releases arising from the exercise of Banking Act 2009 stabilisation powers) also went through Public Bill Committee.

c. As per the draft working paper (circulated on 25 April 2014) summarising proposed changes to Chapters 5 and 6 Part 5 CTA 2009, there was also some work to do on the connected company rules, albeit such changes were not considered substantial.

As an administrative matter, HMRC proposed to cancel the next two scheduled meetings and instead to reconvene on 25 June 2014. This would allow time for the respective parties to digest the material circulated and draft any additional material required. The group agreed with this approach.

2. Corporate rescue exemption

HMRC commented that whilst the case for a new corporate rescue exemption remained compelling, in practice it was proving hard to draft. In particular, HMRC expressed the following concerns:

- Length of the drafting - Section 322 CTA 2009 (as currently drafted) is considered a succinct / concise piece of legislation. To the contrary, the new corporate rescue exemption (as currently drafted) is at least half a page of text.

- Language & definitions - There are a number of phrases and defined terms including "appears to be reasonably likely that", pre-rescue debts" and "rescue time" which HMRC feel create an element of uncertainty - unlikely to be resolved by CFM guidance alone.

- Policy objective - In HMRC's view, their policy objective is to ease situations where companies are shoe-horned into, for example, the debt for equity provisions. The intention is not to extend the scenarios where credits are not taxed. HMRC expressed concern that the current draft did not ensure a clear divide between genuine financial distress and general liability management exercises.

  HMRC considered the "amend and extend" provisions [in section 323A CTA 2009?] which would also exempt credits could be differentiated from the new corporate rescue exemption, as unlike the new corporate rescue exemption, the "amend and extend" provisions would also disallow any unwind debits.

HMRC's expressed concern that the existing draft would simply increase uncertainty to the taxpayer in an area where HRMC already receives a great deal of clearances (notwithstanding the published guidance), and was not entirely consistent with the objective of making the legislation clearer, more certain and more robust.

HMRC proposed a more straightforward approach would be to link the new corporate rescue exemption to the existing 'insolvency conditions'. For example, the new corporate rescue exemption would instead apply where *'it is reasonable to assume that, but for the release, the company would meet one of the insolvency conditions'.*

HMRC felt that this would remove a significant degree of subjectivity and remove the need to question the purpose of the debt restructuring.

The group acknowledged the concerns raised by HMRC, however had reservations about abandoning the approach pursued to date, and in particular, that HMRC's proposal did not seem to address what they had understood the policy objective of aligning the rules with commercial reality.

In practice, there may be a number of ways to consensually restructure the debt of a company in financial distress (none of which would involve an insolvency process). Based on HMRC's proposal such a commercial restructuring would fall foul of the new corporate rescue exemption, unless it would be reasonable to assume that one of the insolvency conditions were impending. HMRC's proposal therefore seems to favour the companies who choose to "stick their head in the sand". The group felt this to be a perverse incentive for companies to wait until their financial situation deteriorated before acting.

HMRC commented that in their view, if the restructuring process was sufficiently far in advance of any insolvency proceedings, then it should provide sufficient time in which to restructure into one of the other corporate rescue provisions (e.g. debt for equity).

The group commented that this seemed to contradict HMRC's suggestion that the new corporate rescue exemption would circumvent the need to structure into a debt for equity deal. It also didn't acknowledge the commercial constraints which prevented the issuance of equity e.g. where the lender does not want to consolidate the borrower or where the lender is prohibited from holding equity positions altogether.

The group commented that in their view HMRC's proposal would not circumvent the need for clearance applications, and as HMRC is unable to take a view on insolvency, this proposal would represent a form of clearance that HMRC would be unable to provide.

Additionally, the group felt that HMRC's proposal would place the directors of companies in difficult situations i.e. that seeking the benefit of a tax relief that is available only where it is reasonable to assume that insolvency would be imminent may increase the risk of being found to be "wrongfully trading".

HMRC acknowledged the comments made by the group and agreed to digest these and consolidate their views in a working paper for discussion at the next meeting. HMRC suggested that when the core principles of the new corporate rescue exemption were agreed, it would revisit the drafting of the legislation.

3. Next steps & Timing

The next meeting was due to be held on 25 June 2014. In advance of that meeting, HMRC committed to circulating a draft discussion paper to which the group were welcome to provide comments.