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Analysis - Bamberg & transactions in securities

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Speed Read: M Bamberg v HMRC illustrates some interesting points regarding the transactions in securities legislation. The Tribunal judge decided not to interpret the provisions widely, and held HMRC to be wrong in its long-held interpretation of the 'foreign law clause'. The judge also decided that the transfer of a trade to a company with negative reserves could not be counteracted. It also seems likely that the results would have been the same under the new rules applicable to income tax.

The case of Marcus Bamberg v HMRC (TC00618) considers the application of Circumstance D of the transactions in securities legislation. The legislation that applied to Mr Bamberg was the old legislation at ICTA 1988 ss 703-709, rewritten to ITA 2007 Pt 13 Ch 1, as the transactions occurred between 2000 and 2004.

Transactions

Mr Bamberg owned a company called The Trade Exchange Limited (TTEL), a profitable company with distributable reserves of around £2 million. White Clover Limited (WCL) was an independent company with £15 million negative distributable reserves, a liability to repay loan stock of £15 million and no other assets. Mr Bamberg acquired the loan stock for £237,000 and the shares for a nominal sum. The shares were then sold to TTEL, so that WCL became a wholly owned subsidiary.

TTEL loaned various sums of money to WCL, some of which were then applied in repaying the loan stock. Mr Bamberg received £349,000 in repayments of loan stock by this route in 2000/2001 and £150,000 the following year.

Subsequently, the trade of TTEL was hived down to WCL for a consideration which was the market value of the assets transferred. Between 5 July 2002 and 5 January 2004, a further £1,651,000 of the loan was repaid by WCL to Mr Bamberg.

Transactions in securities

The case report does not specify the transactions in securities which HMRC found offensive. Mr Bamberg's acquisition of loan stock and shares, and the transfer of the shares to TTEL, were transactions in securities, but potentially too remote from the tax advantage. But the repayments of the loan stock were also transac-

tions in securities, clearly related to the tax advantages obtained by Mr Bamberg, who received the repayments free of tax.

Tax advantage

Again, the case report does not detail the tax advantage obtained by Mr Bamberg. However, the counteraction assessments raised by HMRC show that Mr Bamberg paid no tax on the repayment of the loan stock, as the loan stock was a qualifying corporate bond, exempt from CGT under TCGA 1992 s 115, so that the counteraction treated the repayments as if they had been qualifying distributions.

Legislation

The Tribunal Judge, Mr Avery Jones, summarised *Circumstance D*, as follows: 'In connection with the distribution, transfer or realisation (including application in discharge of liabilities) of profits, income, reserves or other assets of a company to which this paragraph applies, the person in question so receives that he does not pay or bear tax on it as income consideration in money or money's worth that either (i) is, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend ...'

Arguments and decisions

The first argument put by Counsel for Mr Bamberg, Mr Thornhill, was that the repayment of loan capital was excepted from the scope of this legislation. This is because 'the assets [available for distribution] ... do not include assets which (while of a description which under the law of the country in which the company is incorporated is available for distribution by way of dividend) are shown to represent a return of sums paid by subscribers on the issue of securities' (ICTA 1988 s 704C(2)). Since the repayment of loan stock is 'a return of sums paid by subscribers on the issue of securities', Mr Thornhill argued that the repayments of the loan stock were thus exempted from the scope of the legislation. HMRC argued that this provision applied only to the repayment of capital subscribed for foreign securities, based on this provision often being referred to as the 'foreign law clause' (following *Megarry J in IRC v Brown* 47 TC 217).

The Judge agreed that the provision was not restricted to non-UK securities. But this didn't help Mr Bamberg, as the Judge said this provision just restricted the amount of distributable reserves that should be considered in terms of counteraction; it did not exempt from the scope of the legislation the repayment of the capital subscribed for the securities. Put another way, if a company has a choice between paying distributions or repaying capital subscribed, and it chooses to repay the capital as being more tax efficient, the transactions in securities legislation can apply to the repayment of capital, but the quantum of counteraction would be restricted to the distributable reserves that do not represent subscribed capital.

Mr Thornhill's second argument was that the loans by TTEL to WCL did not diminish the distributable reserves of TTEL. He distinguished *Bamberg* from *IRC v Williams* (54 TC 257), where the loans would never have been repaid, so that they were effectively outright payments, and from *IRC v Cleary* (44 TC 399), where the buying company parted with cash as if a dividend had been paid to the shareholders. HMRC noted that *Circumstance D* only required a transfer of assets of a company, which could include the making of loans between TTEL and WCL. Judge Avery Jones agreed with HMRC that Mr Bamberg 'received in the form of repayment of WCL's loan stock tax-free consideration that represents assets that were available to TTEL for payment of dividend having been lent by TTEL to WCL'. Therefore, *Circumstance D* could apply to the loan stock repayments out of the loans from TTEL.

Mr Thornhill's final argument was that, following the hive down of the trade, the profits were made by WCL and were not available for distribution as the company had negative reserves. HMRC argued that the profits would have been made by TTEL, but for the hive down, so the repayment of loan stock represented assets available for distribution by TTEL but for something done by that company. The Judge agreed with Mr Thornhill that this provision did not apply to a company that has transferred its trade, so that a different com-

pany is now making the profits. Looking at WCL, the company now carrying on the trade, the profits cannot be distributed because of the negative distributable reserves, not because of anything done by WCL to render the profits undistributable. So the repayments of loan stock following the hive down of the trade were not within Circumstance D, and HMRC's counteraction must fail.

Result

On this basis, HMRC's counteraction in respect of loan stock repayments prior to the hive down was sustained and Mr Bamberg's appeal in respect of these repayments was dismissed. But, following the hive-down, WCL had no distributable profits and Mr Bamberg's appeal for the later years was successful. At the time of writing, it is not known whether the decision will be appealed.

Comments

This case raises a number of interesting issues. Firstly, there is the so-called 'foreign language clause'. The clear wording of the legislation does not restrict this exception to non-UK companies: a reduction of capital by way of dividend by a UK unlimited company would clearly fall within the exception, as the return of amounts subscribed, even though UK law allows these sums to be distributed as dividends. While the Judge agreed, he also held that this merely restricts the potential counteraction, rather than exempting returns of capital from the scope of the legislation.

Another interesting issue is how widely the legislation should be interpreted. Early cases were partly decided on the basis that the legislation should be given a wide interpretation. In Bamberg, however, the Judge referred to *IRC v Laird Group* (75 TC 399), where the Lord Millett interpreted the transactions in securities legislation by way of the 'ordinary meaning of language', without an especially wide approach. Mr Avery Jones decided, therefore, to 'give the section its ordinary meaning in so far as such a section has an ordinary meaning.'

Application of the new rules

Under the new rules that apply for tax advantages obtained on or after 24 March 2010, instead of the old Circumstances, there are two new Conditions at ITA 2007 s 685. A full analysis of the new legislation is outside the scope of this article but it seems appropriate to consider whether the planning would fall into the new Conditions.

The first two parts of Condition A requires a receipt of 'relevant consideration' in connection with the distribution, transfer or realisation of assets of a close company, or the application of assets of a close company in discharge of liabilities. 'Relevant consideration' must be received by the taxpayer in non-taxable form, and includes consideration which is or represents the value of assets available for distribution by way of dividend by the company, or which would have been so available apart from anything done by the company, subject to the same caveat as in the old legislation, that this does not include the return of sums subscribed on the issue of securities. (Readers will note that this description is very similar in structure to the old Circumstance D.)

In Bamberg, the loans to WCL were a transfer of assets from TTEL, and Mr Bamberg received non-taxable consideration, which was susceptible to counteraction. But the post-hive-down repayments were not, as WCL did not have any distributable reserves. Given the similarity of the new legislation to the old, it seems likely that a Tribunal would find that the new income tax rules for transactions in securities are similarly applicable to the loan stock repayments prior to the hive-down of the trade but not to the repayments made by WCL when it, itself, was carrying on the trade.

The final part of Condition A and Condition B require the 'relevant consideration' to be an issue of securities (as in the old Circumstance E). But the consideration in Bamberg was the redemption of securities for cash, so the final part of Condition A and Condition B are not in point.

Conclusions

While Bamberg was decided under the old legislation, it appears likely that the new rules would have given a similar result. This goes some way towards demonstrating that the filters in the new rules are a rewriting of the old filters, and not really new at all.

Unless the decision is overturned on appeal, the hive-down planning appears to work. So it seems odd that HMRC didn't take the opportunity of the new rules to cover this sort of planning, unless they assumed that they would win the case.

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Cases: *M Bamberg v HMRC* (Alan Dolton, 13.9.10)

FA 2010 analysis: *transactions in securities* (Pete Miller, 3.5.10)

Budget comment: *transactions in securities* (Philip Ridgway, 5.4.10)

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