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Tax Digest

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Including practical guidance on:

- amendments following the Finance Act 2010;
- the new regime for income tax and for corporation tax purposes;
- clearances;
- compliance; and
- counteraction and appeals.

Transactions in Securities

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Tolley's Tax Digest

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1 Introduction

This *Tax Digest* covers the transactions in securities legislation as amended by Finance Act 2010. The new regime applies for income tax purposes from 24 March 2010 and for corporation tax purposes from 1 April 2010. For details of the previous regime, see *Tax Digest* 81.

The legislation has been with us for 50 years now, having been enacted originally in Finance Act 1960. And, despite the changes, it remains as relevant as ever, with tax rates on some gains – at least on trading assets or shares – probably remaining materially lower than the rates on income.

1.1 Structure of the legislation

While there are now separate regimes for income tax and corporation tax, the basic structural features are common to both regimes. Essentially, HMRC can counteract a tax advantage that is obtained by a person if that tax advantage arose as a result of transactions in securities with tax avoidance motives, where the necessary, widely-drawn conditions are satisfied. However, there are 'escape clauses' or negative filters, which are essentially further conditions which, if satisfied, prevent HMRC from taking counteraction measures.

The transactions in securities legislation now comprises two separate regimes, one for corporation tax and the other for income tax. Each has its own set of 'filters' (to use the terminology of HMRC's discussion document *Simplifying Unallowable Purpose Tests*, published 31 July 2009): positive filters to bring transactions into the scope of the legislation, and negative filters to take them out. This approach to the anti-avoidance legislation is most apparent in the new income tax rules, as we shall see. Apart from the filters, however, both regimes still have very similar rules for counteraction, compliance, clearances and appeals.

For the purposes of this *Tax Digest* we will look at the filters in detail for each of corporation tax and income tax. We will then cover the common themes – counteraction, compliance, clearances and appeals – as they apply identically to both corporation tax and income tax. Before any of this, however, let's have a look at how we got to where we are now.

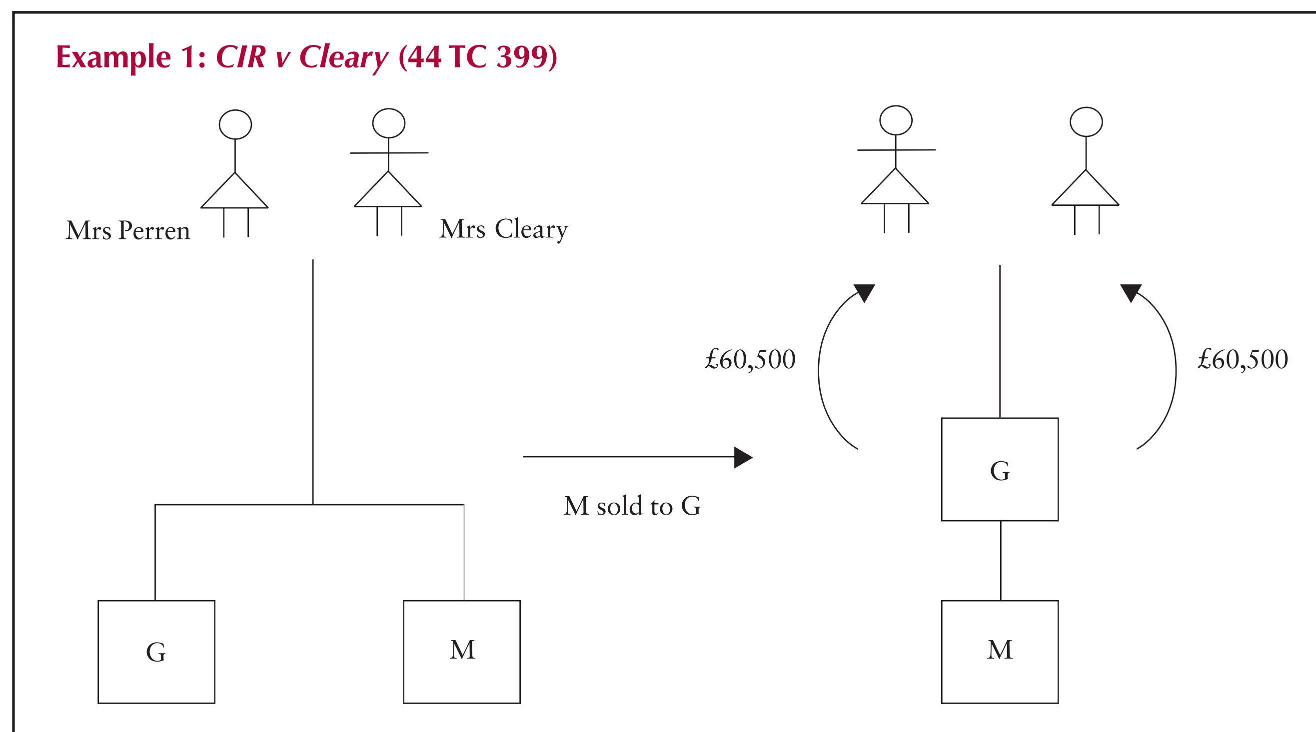
1.2 History

1.2.1 Background

One of the most important things to remember about this legislation is that it was enacted five years before the capital gains tax legislation that we are now very familiar with, and two years before the first attempt at taxing short-term gains, in 1962. So often the tax avoidance schemes that existed at that time were geared towards turning income profits, taxable at rates up to 98% in some cases, into capital gains that were not taxable at all.

Examples 1 and 2 are just two examples of avoidance schemes that were practised prior to the enactment of this legislation in 1960, and which it was designed to stop.

Example 1: *CIR v Cleary* (44 TC 399)



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Example 1: *CIR v Cleary* (44 TC 399) (continued)

Mrs Cleary and her sister, Mrs Perren, each owned 50% of the shares in each of G Ltd and M Ltd. G Ltd had accumulated distributable profits in excess of £180,000. If those profits had actually been paid out as dividends to the sisters, the amounts paid out would have been liable to both income tax and to surtax.

Instead, M Ltd was sold to G Ltd for £121,000, each sister receiving £60,500.

Absent the provisions for taxing certain transactions in securities as if the relevant consideration had been distributed as a dividend, the sisters would have received the £60,500 each as a capital gain and there would have been no tax to pay.

The impact of the 1960 legislation is that the sisters were caught by Circumstance D (see below) and the £60,500 was taxed on each of them as if it had been received as a dividend.

Example 2: *CIR v Greenberg* (47 TC 240)

L Greenberg Ltd was owned by Mr Greenberg and his son, Henry. The company was very profitable and in 1958 it was considered likely that the company would make at least £20,000 profits over the next five years. As in the *Cleary* case, dividends would have been taxed at very high rates, so the Greenbergs entered into a forward stripping arrangement, instead.

First, the Greenbergs subscribed for £100 of new preferred shares in the company, carrying preferred dividends amounting to £20,000 over the five years. The shares were then sold to Finsbury Securities Ltd., a company of share dealers, for £20,100. The intention was that the Greenbergs would have a £20,000 tax-free capital gain. Finsbury Securities would receive £20,000 preferred dividends over the five years and, as share dealers, they would also be able to claim tax deductions for both the cost of the shares of £20,100 and the loss in value of £20,000.

In the event, Finsbury Securities did not get the deduction they anticipated. This was denied under earlier legislation, although it would almost certainly have been denied under Circumstance B of the transactions in securities rules (see below).

And the tax position for the Greenbergs was also caught, this time by Circumstance C of the new rules, so that the £20,000 was charged to income tax.

During the 1950s Parliament enacted a number of statutory provisions aimed at specific tax avoidance devices, such as bond-washing. But there was still a constant stream of tax mitigation schemes, as can be seen from the examples throughout this *Tax Digest*. Many of these, such as bond-washing and dividend strips, were based on converting income chargeable to income tax into capital receipts not chargeable to tax at all, as there was no capital gains tax until 1965. Eventually, very general anti-avoidance legislation was introduced as FA 1960 s 28, effective from 6 April 1960. The legislation remains in effect to the present day.

The legislation is still relevant, 50 years after its enactment, as capital gains tax rates have often, as now, been lower than tax rates on income. At the time of writing, for example, for individuals, the main capital gains tax rate is 18%, whereas the income tax rate can be up to 50%. For companies, many chargeable gains are exempt (under the substantial shareholdings exemption, for example), while the main rate for corporate profits is 28% and many companies only pay 21%.

1.2.2 Recent changes

The legislation on transactions in securities was wholly rewritten as part of the Tax Law Rewrite Project, and was re-enacted in ITA 2007 for income tax purposes and in CTA 2010 for corporation tax. It was intended that the rewritten legislation should have the same effect as the previous version, albeit the opportunity was taken to 'clarify' certain aspects and to codify some of the jurisprudence.

In recent years there have been a number of changes in the tax environment, which have operated as drivers for change in the transactions in securities legislation. Probably the main factor has been the drive to simplification of the UK's tax code, as it has become more and more complex. The Anti-Avoidance Simplification Review was announced at Budget 2007, to identify anti-avoidance legislation which could be simplified and made more effective without any adverse impact on revenues. The transactions in securities legislation was identified as one area needing review and the FA 2010 changes came about as a result of extensive consultation (particularly the Consultation Document *Simplifying Transactions in Securities Legislation*, published 31 July 2009).

1.2.3 Current legislation

The income tax legislation is at ITA 2007 Ch 1 Pt 13, ss 682-713, and has effect for all transactions in securities

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that represent income tax avoidance and take place after 5 April 2007, regardless of when the tax advantage accrues. The new rules described in this *Tax Digest* have effect in relation to income tax advantages obtained on or after 24 March 2010.

The legislation applicable to corporation tax is at CTA 2010 Pt 15, ss 731-751, and has effect from 1 April 2010. The new rules described in this *Tax Digest* have effect in relation to corporation tax advantages obtained on or after 1 April 2010.

1.3 Interpretation

The general approach to these provisions is to interpret the words of the legislation as widely as possible. In the legislation itself, for example, it is clear that certain specific concepts are to be given a wide interpretation. Thus the definition of 'transaction in securities' in ITA 2007 s 684(2) / CTA 2010 s 751 is worded extremely widely. The term includes 'transactions of whatever description relating to securities' and, in particular the purchase, sale or exchange of securities, the issuing or securing the issue of new securities, applying or subscribing for new securities or altering or securing the alteration of the rights attached to securities.

The courts have also considered it necessary to interpret the provisions widely, in order that they might be effective as anti-avoidance rules. In *IRC v Greenberg* (47 TC 240) Lord Reid said:

> '…on the face of it any single act done by one person alone is a transaction in securities if it is one "relating to securities". This is a vague phrase, but I do not see how to stop short of giving to it a very wide meaning.'

And:

> '…if the courts find it impossible to give very wide meanings to general phrases the only alternative may be for Parliament to do as some other countries have done and introduce legislation of a more sweeping character.'

Lord Wilberforce, in *IRC v Joiner* (50 TC 499), noted that these rules require:

> '… a different method of interpretation from that traditionally used in taxing Acts … the scheme of [these provisions], introducing as they did a wide and general attack on tax avoidance, required that expressions which might otherwise have been cut down in the interest of precision were to be given the wide meaning evidently intended …'

This principle of a wide interpretation of anti-avoidance legislation is now well established as being necessary to give effect to the intention of Parliament, and is routinely applied across a wide range of other anti-avoidance provisions.

Some commentators have suggested that the typically wide interpretation of anti-avoidance provisions might be narrowed in the context of the recent changes to the income tax regime for transactions in securities, because that regime was designed to be a more tightly focussed set of rules. However, within the context of the focus, which is clearly delineated by the new legislation itself, it seems logical to assume that the courts will continue to interpret the legislation as widely as necessary.

1.4 Scope of the legislation

Despite the reasons for enacting this legislation, it was never restricted to a specific type of transaction, such as bond-washing or dividend- and asset-stripping transactions. This would have defeated the object, as stated in the Budget Resolution: ' … it will give [HMRC] protection against devices (outside the immediate dividend-stripping and bond-washing fields) which might be adopted in connection with stocks, shares and securities.'

There is judicial approval of this position, too, in a number of cases. For example, in *IRC v Parker* (43 TC 392), Lord Wilberforce said:

> 'I do not find it possible to discern in this Act any indication that it was the purpose of the Legislature to limit it to any specific kind of tax avoidance. The scheme and drafting … is far too general to admit of the suggested restriction, and I do not think that interpretation should seek to narrow this generality.'

And in *IRC v Joiner* (50 TC 449) he said:

> '… we must continue to give "transactions in securities" and "transactions relating to securities" the widest meaning: we can neither confine these expressions to the instances given in [CTA 2010 s s 751 / ITA 2007 s 684(2)], nor can we deduce from that enumeration any limitation upon their scope.'

2 Corporation tax

2.1 The filters

As mentioned above, HMRC has been looking at the so-called 'unallowable purposes tests', of which the transactions in securities rules are an early example.

The idea is to identify the required common elements of an unallowable purpose test and to structure new tests according to those requirements. Although the corporation tax rules for transactions in securities were written before this 'meta-codification' of anti-avoidance provisions, we can easily identify both positive and negative filters in the legislation.

The positive filter (or set of positive filters) is found at CTA 2010 s 733. A company is liable to counteraction by HMRC under the transactions in securities provisions if three conditions are satisfied:

- a company must be in a position to obtain, or must have obtained, a tax advantage (CTA 2010 s 733(1));
- the tax advantage must be obtained or obtainable by that company in consequence of:
  - a transaction in securities (CTA 2010 s 733(1)(*b*)(i));
  - the combined effect of two or more transactions in securities (CTA 2010 s 733(1)(*b*)(ii)); or
  - the combined effect of one or more transactions in securities and the liquidation of a company (CTA 2010 s 733(3)); and
- one of the three prescribed Circumstances C to E (in CTA 2010 ss 736-738) must be present (CTA 2010 s 733(1)(*a*)). (Circumstance B was repealed by FA 2008 and Circumstance A by FA 2010.)

The negative filter for corporation tax purposes is the so-called 'escape clause': even where all three of the above conditions are satisfied, HMRC may not take counteraction if the company can show that the transaction or transactions were carried out either:

- for genuine commercial reasons; or
- in the ordinary course of making or managing investments,

and, in either case, that none of the transactions had as their main object or one of their main objects to enable corporation tax advantages to be obtained.

We will now review each of these elements in more detail.

2.2 Obtaining a tax advantage

2.2.1 In a position to obtain a tax advantage

The first point to note is that, while the legislation refers to a company obtaining or being in a position to obtain a tax advantage, the second leg of this filter seems otiose. That is, unless a tax advantage is actually obtained, there is nothing to counteract. So there seems little point in the legislation targeting companies in a position to obtain a tax advantage.

2.2.2 What is a 'tax advantage'?

For corporation tax, a tax advantage is defined at CTA 2010 s 732 as:

- a relief or increased relief from corporation tax;
- a repayment or increased repayment of corporation tax; and
- the avoidance or reduction of a charge to corporation tax or the avoidance of a possible assessment to corporation tax, whether the avoidance or reduction is effected by receipts accruing in such a way that the recipient does not pay or bear corporation tax on them or obtains a deduction in calculating profits or gains.

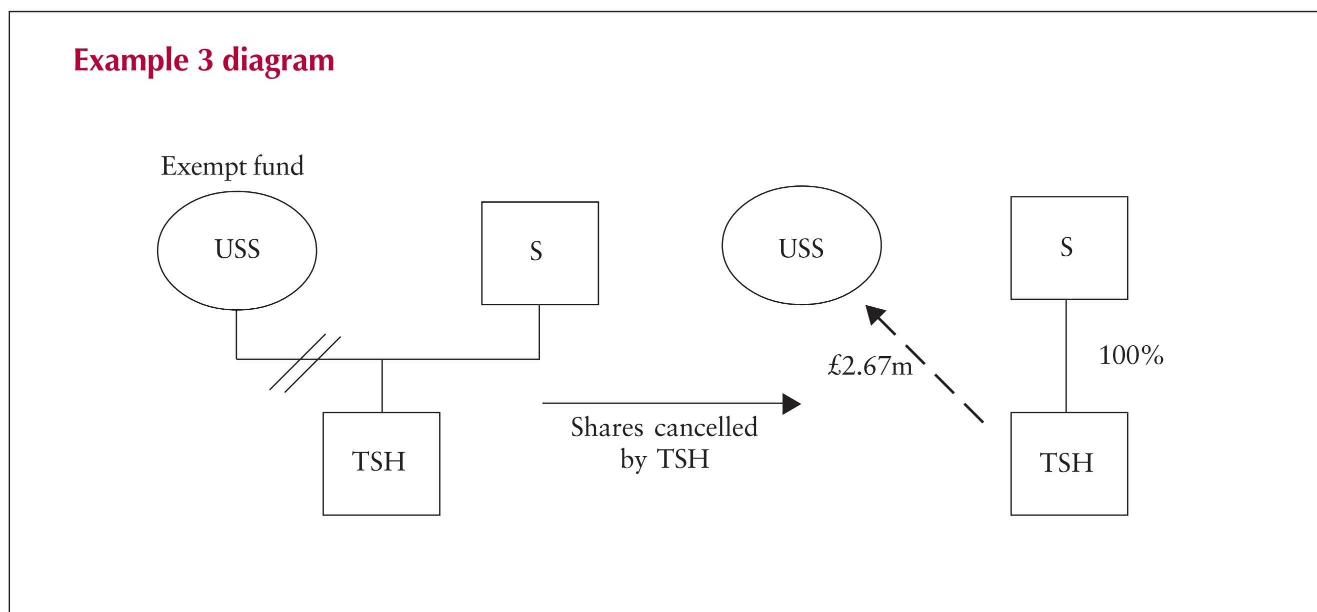
2.2.3 Avoidance or reduction of a charge to tax

One ingredient frequently seen in these cases is that the transaction that was carried out is much more complex than the alternative higher-tax transaction that HMRC might be suggesting is the proper comparator. So for many years it was thought that, for there to be a tax advantage, there must also be an alternative, usually simpler, transaction that would have achieved a similar result but with a higher tax bill.

For example, in *Cleary v IRC* (44 TC 399), a sale of shares from one private company to another was the 'more complex' arrangement, compared to the simple payment of a dividend. And in *IRC v Parker* (43 TC 396), instead of a dividend there was the capitalisation of reserves followed by the redemption of that capital. In the House of Lords, Lord Wilberforce said of the definition of tax advantage that it:

> '…presupposes a situation in which an assessment to tax, or increased tax, either is made or may possibly be made, that the taxpayer is in a position to resist the assessment by saying that the way in which he received what it is sought to tax prevents him from being taxed on it, and that the Crown is in a position to reply that if he had received what it is sought to tax in another way he would have had to bear tax. In other words, there must be a contrast as regards the "receipts" between the actual case where these accrue in a non-taxable way with a possible accruer in a taxable way, and unless this contrast exists the existence of the advantage is not established.'

It is also considered that the reference to 'receipts accruing in such a way that the recipient does not pay or bear tax on them' is not restricted to cash receipts but



includes acquisitions of property. Thus HMRC believes that assets distributed in the liquidation of a company, where the liquidation is part of a scheme involving a transaction in securities, may give rise to a tax advantage (Company Taxation Manual CTM36850).

2.2.4 Relief or increased relief from tax

The view that there must always be a comparative transaction carrying a higher tax burden is not universally true, following the decision in *IRC v Universities Superannuation Scheme Ltd* [1997] STC 1, Example 3), where the planning turned what would have been an exempt capital gain into an income distribution with a payment of the tax credit to the tax exempt body.

Example 3: *IRC v Universities Superannuation Scheme Ltd* [1997] STC 1

USS, an exempt pension fund, invested large sums of money in a property development project, part of which was in the form of shares in TSH, the company carrying out the development. USS had a put option whereby it could require S, the majority shareholder of TSH, to buy the shares for a sum that represented 7.5% of the profits of the development. When the option was exercised, the amount payable would have been £3,517,000.

S suggested, instead, that the TSH shares held by USS should be repurchased by TSH for £2,662,750 (See Example 3 diagram). For tax purposes, most of this sum was treated as a distribution (under CTA 2010 s 1000(1)B(*a*)) and, as an exempt fund, USS was able to claim a payment of the associated tax credit (under rules that have since been repealed).

The tax credit was £854,250, which meant that USS's total receipt was £3,517,000.

So, economically the transaction still left TSH as a wholly-owned subsidiary of S, but £854,250 of the consideration was effectively funded from the Exchequer.

Not surprisingly, HMRC refused the repayment under the transactions in securities legislation.

HMRC had long held the view that, where a person (eg a charity or a pension fund) is entitled to exemption from tax, and is therefore entitled to repayment of tax deducted at source or to payment of a tax credit attached to a distribution, that person has obtained relief from tax which can give rise to a tax advantage capable of being counteracted, where the necessary Circumstances are present.

USS contended, inter alia, that a tax advantage could not arise because there was no way in which the receipts could have accrued in a taxable form, so there was no contrast with an alternative transaction carrying a higher tax burden, as required by the definition of a tax advantage. But the High Court said that the definition of a tax advantage did not require such a contrast or comparison when considering the grant of relief, as opposed to the avoidance of an assessment. Where the grant of a relief is concerned, the comparison is, in effect, with a different transaction that does not result in the relief being or becoming available and so does not result in the payment or repayment of tax from the Exchequer, regardless of the fact that

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the body concerned is exempt from tax on either transaction. In the USS case, the comparison would have been between a direct sale of the shares to the other shareholder and a share repurchase that generated a right to a payment of a tax credit. In neither case would USS have had to pay tax on the transaction.

The court also noted that the meaning of 'relief' in this context had to be given a wide meaning, as was appropriate for anti-avoidance legislation. So, for example, a 'relief' cannot be distinguished from an 'exemption'.

So we have two approaches. For the reduction of a charge to tax or of an assessment, there must always be a comparison between the transaction carried out and an alternative transaction, which is usually also simpler, which carries a higher tax burden. But for the purposes of a relief or exemption from tax, or a payment or repayment, the comparison is between a transaction where relief or exemption is due and one where it is not, even if neither would result in a charge to tax.

2.3 'In consequence of'

Very few cases have considered in detail the question of whether a tax advantage has arisen 'in consequence of' a transaction in securities.

On one level, in order for a company to be able, for example, to sell shares or to receive a dividend, it must have acquired those shares in the first place. Whether the acquisition was by subscription, by purchase or by barter (eg a share-for-share exchange), this initial acquisition is usually going to be a transaction in securities. But is that transaction in securities one to which the anti-avoidance legislation can apply? That is, does the subsequent tax advantage arise in consequence of it? In general terms, the answer must be that it does not, unless it is itself part of the tax avoiding arrangements.

Indirect authority for this position is found in *Laird Group plc v IRC* [2003] STC 1349 where the company acquired a new subsidiary for normal commercial reasons. The subsidiary was able to pay a dividend in circumstances that gave rise to a tax advantage and Laird had been aware of this at the time of the purchase. However, the Tribunal held inter alia that the dividends were not paid in consequence of the original acquisition of the subsidiary.

In *IRC v Garvin* [1981] STC 344 there was a complex series of transactions and the House of Lords considered the similar words 'in consequence of a transaction whereby' as they appear in Circumstance C (CTA 2010 s 736). Lord Russell of Killowen said that:

> '… to treat the word [whereby] as introducing the concept that all that is required is that the transaction should be a causa sine qua non of the subsequent abnormal dividend goes in my opinion too far.'

Although the context is slightly different, it is further indirect judicial authority for the proposition that just because the legislation cannot apply if a person does not own shares does not mean that the initial acquisition of those shares is a transaction in securities in consequence of which a tax advantage arises. Indeed, in many cases the original acquisition of shares will have been for wholly commercial reasons, often years before there was any question of carrying out any tax planning.

In general, therefore, the phrase 'in consequence of' should normally be taken to mean that both the tax advantage and the transaction in securities must be part of the arrangements that HMRC might find offensive.

2.4 Transactions in securities

As we have seen, the legislation is all about transactions in securities. So what actually is a 'transaction in securities'? The expression 'transaction in securities' has a very wide definition, which is identical for both corporation tax and income tax purposes (CTA 2010 s 751 / ITA 2007 s 684(2)). It includes 'transactions, of whatever description, relating to securities, and in particular—

(a) the purchase, sale or exchange of securities;

(b) issuing or securing the issue of new securities;

(c) applying or subscribing for new securities; and

(d) altering or securing the alteration of the rights attached to securities.'

'Securities' for these purposes includes shares and stock, and an interest of a member of a company that is not limited by shares (CTA 2010 s 751 / ITA 2007 s 685(9)).

The examples in the legislation are not exhaustive, which is why the list is introduced with the word 'includes'. Various combinations of events and actions have been considered to fall within the definition, even though a layman might not consider them to be transactions in securities. For example, in *CIR v Greenberg* (47 TC 240) (see Example 2), it was decided that a dividend followed by a payment of the same amount as an instalment of capital together constituted

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a transaction in securities (even though the courts declined to decide whether the dividends alone were transactions in securities). And in *Williams v IRC* (54 TC 257) it was held that loans by a company to individuals who subsequently acquired the company were transactions in securities, even though the loans were not securities in the normal sense of the word.

2.4.1 Company liquidation

It was clear when the legislation was introduced that Parliament did not consider that a liquidation was a transaction in securities. The Attorney-General at the time said that a 'liquidation is not a transaction in securities any more than the payment of a dividend on shares'. However, it soon became clear that, if a liquidation were not a transaction in securities, there was a potential lacuna in the legislation. The 1962 addition of the words 'the combined effect of the transaction or transactions and the liquidation of a company' (CTA 2010 s 733(3)) indicate that the draftsman also did not consider that a liquidation was a transaction in securities. That said, this wording does not declare a liquidation to be a transaction in securities for the purposes of this legislation, so in fact it is arguably completely pointless and has, indeed, been omitted from the filters for income tax purposes.

HMRC's practice was not to apply the legislation to an ordinary liquidation, with no other elements. But Example 4 shows when the legislation can be applied.

Example 4: *CIR v Joiner* (50 TC 449)

A company was put into liquidation and the assets were distributed to the shareholders according to an agreement made between them before the liquidation. The trade was transferred to a new company and other assets were distributed to the shareholders, as capital receipts.

A tax advantage therefore accrued to the shareholders, as they had managed to extract assets from the company in capital form, while leaving the trade in a company. Their defence was that the tax advantage arose only from the liquidation, which was not a transaction in securities.

The courts decided that the pre-liquidation shareholders' agreement was a transaction in securities as it varied the rights of the shareholders in respect of their shareholdings, so the tax advantage arose as a result of the combined effect of the shareholders' agreement – a transaction in securities – and the liquidation of the company, and was squarely within the terms of what is now CTA 2010 s 733.

Notably, the courts declined to decide whether the liquidation per se was a transaction in securities. However, we might also see this decision as an example of the courts taking a wide view of the correct interpretation of this anti-avoidance legislation.

2.4.2 Payment of a dividend

As noted above, the Attorney-General in 1960 said that a 'liquidation is not a transaction in securities any more than the payment of dividend on shares'. But, once again, such a statement in Parliament does not necessarily make it so. The position was looked at in *Greenberg* (see Example 2). The issue here was that all the preliminary transactions in securities – the subscription for preferred share capital and the sale of those shares to the dealers – had taken place before 6 April 1960, when the legislation first came into force. However, the dividends were to be paid in tranches, as the profits were made and became distributable, so the only 'transactions' that occurred after 5 April 1960 were the dividends.

Fortunately for the Revenue, the payments of capital to the Greenbergs were also to be made in tranches, following the receipts of the dividends by the dealers. The courts decided that a dividend and the subsequent payment of an instalment of capital together constituted a transaction in securities. Again, we might see this as another example of the courts taking a wide view of the interpretation of this legislation. But the court stopped short of deciding whether a dividend per se was a transaction in securities.

Nevertheless, many people clearly took the view that a dividend was a transaction in securities, purportedly following *Greenberg*. For example, the TA 1988 s 706 Tribunal's judgment in *Marwood Homes No 3 v IRC* [1999] STC (SCD) 44 explicitly states that all parties agreed that the dividends were transaction in securities.

The position was finally resolved in *Laird Group plc v IRC* (75 TC 399). The company acquired all the share capital of S Ltd, a UK company carrying on a similar trade, and arranged that S Ltd paid a dividend of £3 million to Laird. Due to the operation of the (now repealed and unlamented) ACT regime, this allowed Laird to claim a repayment of corporation tax. HMRC contended, inter alia, that the tax advantage arose from the dividend, which was a transaction in securities. The House of Lords decided that there was no material difference between a distribution of profits in a liquidation and a distribution by way of dividend, as in either case this merely gave effect to the rights attached to the shares. Neither form of distribution was a

'transaction relating to securities'. Their Lordships asked rhetorically why a distribution to shareholders by a company that is still active and continuing to trade or carry on business should be a transaction in securities while a distribution to shareholders by a company that is being wound up is not? In other words, why should the intended continued activity of the company determine whether distributions in respect of shares should be a transaction in securities? The House of Lords felt that there was no reason for a difference and, therefore, upheld the company's view that a dividend is not a transaction in securities.

2.5 The Circumstances

As we have already seen, counteraction can only be taken under CTA 2010 s 746 where a tax advantage is obtained in one of the three Circumstances set out in CTA 2010 ss 736-738. To reiterate, Circumstance B was repealed by FA 2008 and Circumstance A (previously TA 1988 s 704A and which would have been CTA 2010 s 735) was repealed by FA 2010 from 1 April 2010.

If there is an appeal against counteraction, the onus is on HMRC to show that one of these Circumstances is present and that the tax advantage arises in consequence of the transactions concerned.

2.6 Circumstance C (CTA 2010 s 736)

This Circumstance applies where a company (A) receives, in a form not chargeable to corporation tax on income, a consideration which:

(a) is or represents the value of assets of a company available for distribution by way of dividend (or would be available apart from anything done by the company);

(b) is received in respect of future receipts of a company; or

(c) is or represents the value of the value of trading stock of a company.

The consideration must be received in consequence of a transaction under which another person subsequently receives, or has received, an abnormal amount by way of dividend.

The assets in (a) above do not include assets which represent a return of sums paid on the issue of securities, even if the law of the relevant country requires such assets to be available for distribution. In my view, this would exclude dividends of share capital by a UK unlimited company, although HMRC disagrees and insists that this qualification only relates to non-UK entities.

The significance of these elements of the consideration will be considered with Circumstance D.

2.6.1 Target of Circumstance C

Circumstance C is intended to apply to the vendor of shares in situations like that in the *Greenberg* case (Example 2). The brokers, Finsbury Securities, received an abnormal amount by way of dividend (and were caught by a precursor to the old Circumstance B), as dealers in shares. But the Greenbergs themselves were caught under Circumstance C. They had received tax-free (ie capital) consideration for the sale of the shares, in consequence of a transaction whereby Finsbury Securities received the abnormal dividends, and that consideration represented the distributable reserves of the company.

Once again, we no longer see the transactions that this Circumstance was originally aimed at. But we still have to consider it in other situations, such as in Example 5.

Example 5: International reorganisations

One area where I was often consulted was in the field of international reorganisations. In these cases, the planning related to the cost of repatriating foreign profits to the ultimate parent, which was often in the US, where the profits had to pass through a UK sub-holding company. Typically, a US group would have its EU subsidiaries held under a UK sub-holding company. The problem was getting the profits out of the EU subsidiaries without having to pay UK tax on the way back to the US ultimate parent.

One approach was to reorganise the group, so that the EU subsidiaries were transferred to a sub-holding company resident in a jurisdiction with a participation exemption or favourable Double Tax Treaties, that allowed the dividends to be paid tax-free through to the US parent. The UK sub-holding company would therefore sell the subsidiaries to the new sub-holding company and that transaction would generally be free of UK corporation tax on chargeable gains because of the UK's substantial shareholdings exemption for trading groups (TCGA 1992 Sch 7AC).

The concern here was that the UK sub-holding company would therefore receive tax-free consideration for the disposal, which is likely to represent in part the undistributed profits of the EU subsidiaries, and the new sub-holding company subsequently receives a dividend that might be argued by HMRC to be abnormal in amount.

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One argument we used here was about the relative complexity of the transactions. That is, it is as simple to sell the EU subsidiaries and then pay a dividend as it is to pay the dividend first, then transfer the subsidiaries. So the tax efficient transaction is not more complex than the comparator, which means that it would have been more difficult for HMRC to challenge the transactions as being motivated by tax avoidance.

Of course, since FA 2009 and the advent of the new rules for the taxation of dividends received (CTA 2009 Part 9A), this issue has largely gone away as, in most cases, there would now not be any UK tax charge on either a dividend – under the new exemption – or on any disposal proceeds, assuming that the substantial shareholdings exemption is available.

2.6.2 'In consequence of'

It is important to note that this phrase is used differently in Circumstance C than in the main charging provision in CTA 2010 s 733(1). For the corporation tax advantage to be obtained in consequence of transactions, it is only necessary that the advantage would not have been obtained if the transactions had not been carried out. But for the specific requirement in Circumstance C, that the taxpayer receives a consideration in consequence of a receipt of an abnormal amount by way of dividend, it is necessary for HMRC to be able to show that there was a causal connection between the transaction in securities and the abnormal amount by way of dividend. This distinction was drawn in the case of *IRC v Garvin* [1981] STC 344.

2.6.3 Abnormal amount by way of dividend (CTA 2010 s 740)

A dividend is abnormal if the appropriate authority is satisfied that it satisfies either of two conditions; the excessive return condition (CTA 2010 s 741) or the excessive accrual condition (CTA 2010 s 742). The appropriate authority means whoever is charged with the decision about whether a dividend is abnormal, ie an officer of Revenue and Customs, the Commissioners of HMRC or the First-tier Tribunal.

In the case of *IRC v Trustees of the Sema Group Pension Scheme* [2002] STC 276, it was determined that the amount to be taken into account in deciding whether the dividend was abnormal was the distribution only, and not the sum of the distribution and the tax credit. This is on the basis that 'distributions' were defined by CTA 2010 s 1000 (previously TA 1988 s 209) without reference to the tax credit. This decision overturned an earlier decision on this point in *IRC v Universities Superannuation Scheme Ltd* [1997] STC 1 (see Example 3).

A dividend is abnormal for the purpose of the excessive return condition if it substantially exceeds a normal return on the consideration given for the securities by the recipient company (CTA 2010 s 741(1)). The legislation requires that both the length of time the securities have been held by that company (and not, for example, by any related parties, fellow group companies and the like) and previous dividends or qualifying distributions should be taken into account. If the securities were derived from other securities acquired previously, the dividend will be abnormal if it substantially exceeds the consideration given for the earlier acquisition. If the consideration given for the securities was in excess of market value, or if no consideration was provided, they are treated as having been acquired at market value.

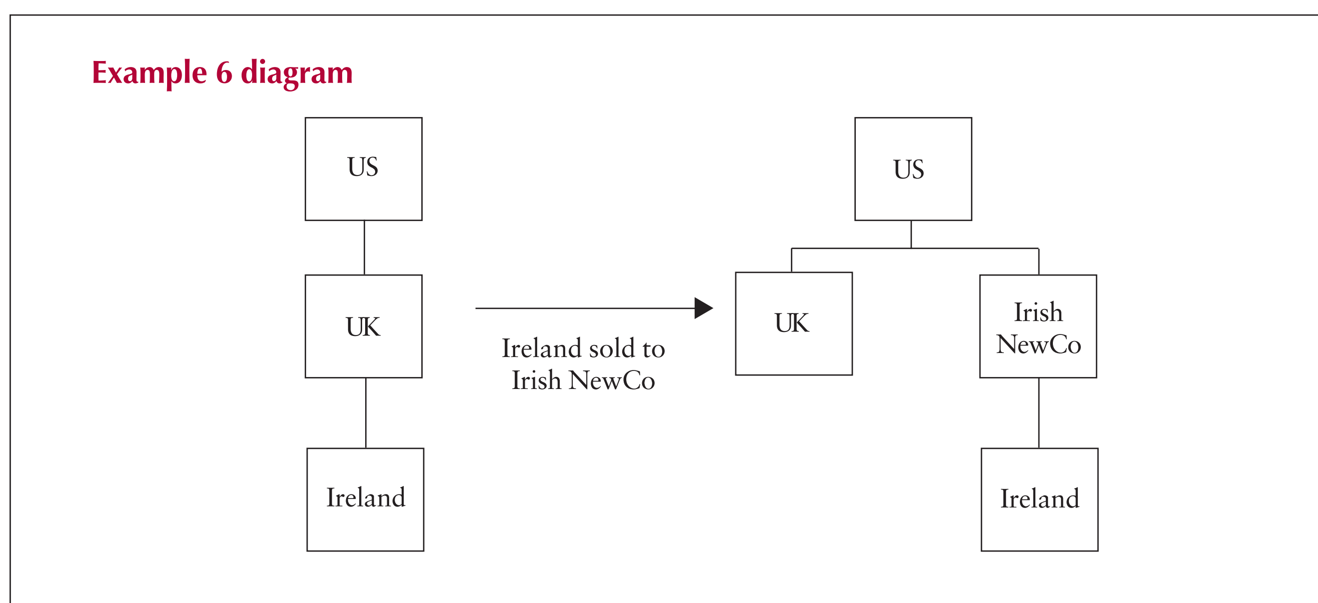
For the purpose of the excessive accrual condition, a dividend at a fixed rate is abnormal if it substantially exceeds the amount which would have been received if it had accrued from day to day over the time the securities were held (CTA 2010 s 742(1)). But a dividend is not treated as abnormal if the taxpayer does not sell (or acquire an option to sell) any of the securities concerned or any similar securities within six months of their acquisition. Similar securities means securities giving the same rights as to capital and interest against the same persons, regardless of the form in which they are held or the way in which they can be transferred.

A dividend is not abnormal just because it arises in unusual circumstances. This is demonstrated in the *Sema Group Pension Scheme* case, where a qualifying distribution that arose from a share buy-back was held not to be abnormal simply because the transaction itself was unusual. The case involved the shares of a listed company being bought back at a price set by the company itself. In essence, the court held that the qualifying distribution was offered on the same terms to all shareholders, so the return could not be said to be abnormal within its general context. The only question was whether the return was abnormal according to the statutory tests.

2.7 Circumstance D (CTA 2010 s 737)

Circumstance D applies where a company receives consideration (in money or money's worth), on which it does not pay or bear corporation tax on income, in connection with the distribution, transfer or realisation of assets of a 'relevant company' (defined at CTA 2010 s 739) (see 2.9) or the application of such assets in discharge of liabilities.

The consideration must (as in Circumstance C):



- be or represent the value of assets available for distribution by the company (or would be so available but for anything done by the company);
- be received in respect of future receipts of the company; or
- be or represent the value of trading stock of the company.

'Assets' here, as in Circumstance C, does not include assets which represent a return of sums paid on the issue of securities, even if the law of the relevant country requires such assets to be available for distribution.

2.7.1 Target of Circumstance D

It has been established that Circumstance D catches a variety of transactions which would not be considered as dividend stripping or stock stripping. The most obvious example of the effect of Circumstance D is in the *Cleary* case (Example 1), although this would not be relevant to most corporate transactions. We have also had to consider Circumstance D in cases of international group reorganisations (Example 6).

Example 6: Irish reorganisation

A US group had a UK trading subsidiary. They decided to start business in Ireland, too, and set up an Irish company under the UK subsidiary to carry out this business. A number of years later, the Irish business was extremely profitable but there was significant tax leakage on repatriation of the profits through the UK company. And there was no longer a commercial need to have the Irish company held through the UK. So the US parent decided to set up an Irish holding company to acquire the Irish trader from the UK company. Under the new structure, the Irish profits could be paid directly to the US parent with minimal tax leakage. (Under the new dividend rules in CTA 2009 Pt 9A, this should no longer be a problem.)

Since this was a trading group, the UK company would not suffer any corporation tax on the transaction, due to the substantial shareholdings exemption. So the transaction again looks very much like a *Cleary* transaction, with a person (the US parent) effectively selling a company it owned indirectly to another company it owned, for a tax-free consideration.

In the event, a clearance application (see 4 below) was made and HMRC was satisfied that the transaction was to be carried out for bona fide commercial reasons and that there was no intention to avoid tax, so the clearance was granted after some correspondence.

2.7.2 Consideration

In most cases, the consideration will be recognisably a payment of a tax-free sum or the receipt of assets (money's worth). But this is not a sine qua non for the legislation to apply. In *Williams v IRC* [1980] STC 53 the taxpayers were the shareholders of a property company, K Ltd, which had made a substantial profit. Following a complex sequence of transactions, including a distribution of profits by K to a new parent company, a third company made interest-free loans to the shareholders of the original company. It was held that the loans had been received by the taxpayers in connection with the distribution of the profits by K Ltd, demonstrating that the loans were, themselves to be

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considered as 'consideration' for the purposes of this legislation.

2.7.3 'In connection with'

Circumstance D only applies if consideration is received free of tax in connection with the distribution, transfer or realisation of assets of a relevant company. The phrase 'in connection with' is satisfied by a less definite causal link than the phrase 'in consequence of' in CTA 2010 s 733(1) or in Circumstance C: it involves a relationship between things one of which is bound up with or involved in or having to do with another.

There are a number of examples of this in the jurisprudence. In *Anysz v IRC* [1978] STC 296 a scheme was effected to extract a development profit from a property company, K Ltd. The scheme included the exchange by the taxpayers of their shares in K Ltd for shares in an investment company, P Ltd and a dividend from K Ltd to P Ltd. The Special Commissioners found that the purpose of the share exchange was to enable K Ltd to be stripped of its assets by the subsequent dividend, so the receipt by the taxpayers of the shares in P Ltd was 'in connection with' the payment of the dividend by K Ltd to P Ltd and accordingly Circumstance D applied.

Similarly, In *Williams v IRC* (see 2.7.2 above), it was held that the loans had been received by the taxpayers in connection with the distribution of the profits by K Ltd.

2.7.4 Assets available for distribution

Since the consideration for the sale of the shares of a company will usually come from a purchaser, it is clearly not necessary that the consideration giving rise to a tax advantage should come directly from the company itself. All that is necessary is that the consideration can be shown to represent reserves or assets of the company.

Nor does the statute concern itself with the identity of the company whose reserves are represented by the consideration. In *Cleary*, as we have seen, it was the transferee (purchaser) company that had reserves and it was those reserves that were held to have been represented by the consideration paid to Miss Cleary and her sister. In other cases, particularly in the private equity arena, HMRC has pointed to the reserves of the transferred company as the company whose reserves are represented by the consideration received by the shareholders, even though the consideration is provided by the new company, which typically has no reserves at the time of the transactions.

It is also clear from the judgment in *Addy v IRC* [1975] STC 601 that capital distributions are not excluded from counteraction under Circumstance D. In that case a company reconstruction was followed by the distribution of revenue and capital reserves in the liquidation of the original company.

2.7.5 Apart from anything done by the company

The requirement that the consideration represents assets available for distribution can be helpful, in that this generally means that the anti-avoidance legislation cannot be invoked in respect of a company that has no distributable reserves at the time of a relevant transaction in securities, perhaps through being loss-making, or because reserves have already been distributed up to shareholders. In such cases, any consideration cannot represent distributable reserves.

However, it was necessary to ensure that the Circumstances could not be circumvented by artificially reducing a company's reserves. For example, in *IRC v Parker* (43 TC 396), a company made a bonus issue of debentures which some years later were redeemed. The House of Lords held that the redemption of the debentures was a transaction in securities and a distribution of profit and that there was a tax advantage because, but for something done by the company (ie the bonus issue), the consideration could have been received by way of dividend.

HMRC has also invoked this proviso in circumstances where a commercial transaction that caused a reduction of reserves was not itself a taxable transaction (Example 7).

Example 7: Pension contribution.

A company made a large payment to the director's pension fund, so that the company claimed a tax deduction but the pension fund did not bear tax on the receipt. Subsequently, the company was to be subject to a management buy-out, and one of the purchasers was the director concerned.

Clearance under TA 1988 s 707 was refused, in part because an element of the consideration was considered by the inspector to represent an amount that would have represented the distributable reserves of the company, but for the fact that that amount had been contributed to the pension fund.

Generally, HMRC does not object where the reserves have been reduced by a taxable transaction, such as the payment of a dividend to the shareholders.

What is less clear is HMRC's attitude where a deduction is not available, perhaps because the

contribution is to an EBT, rather than an approved pension fund. There is still a reduction of the reserves available for distribution but, absent the tax deduction for the contribution, HMRC might not find this so offensive.

2.7.6 In respect of future receipts

Generally speaking, where a transaction generates cash consideration, this is held to potentially represent the reserves of the company – as in 2.7.4 above – or the trading stock – as in 2.7.7 below. Where the consideration is in the form of deferred cash, such as loan notes or redeemable shares, HMRC take the view that these are consideration in respect of future receipts of the company. Strictly, the legislation would appear to permit counteraction at the time the loan notes, etc, are issued. However, in these cases, HMRC has frequently stated in correspondence that counteraction will only be considered at the time the securities are redeemed, and any counteraction would be by reference to the distributable reserves of the company at that time. This would be consistent with the premise that the legislation is aimed at transactions that generate cash representing a company's reserves, not merely its receipts.

Conversely, immediate counteraction might be considered where the securities are convertible to cash in the short term. In particular, this is likely to apply where the instruments are short-dated loan notes, redeemable soon after issue. HMRC has been known to take a similar view of bank-guaranteed loan notes, too, as the bank guarantee means that the loan notes can be effectively be converted to cash, by using them as security for personal loans. In HMRC's view this looks like a receipt of consideration in money's worth.

In practical terms, if the later redemption of loan notes or shares is part of a later shareholder exit from the company, HMRC will usually decide against counteraction.

2.7.7 Is or represents the value of trading stock

This form of consideration is exemplified in *CIR v Wiggins* (Example 8).

Example 8: *CIR v Wiggins* (53 TC 639)

The company's trade was that of picture framers and, having bought a batch of old pictures for the frames, it was discovered that one of the pictures was an extremely valuable Poussin, potentially worth £130,000. Had the picture been sold as part of the trade, income tax would have been due at a high rate. Instead, there was a reconstruction and the trade was transferred from the original company, Wiggins, to a new company.

Wiggins was then sold for £44,447, with the painting, to a third-party purchaser as a capital transaction. It was held that this was a tax avoidance scheme and that Circumstance D applied, as the consideration received by the shareholders represented the trading stock of the company that was sold.

The reason for the discrepancy between the value of the painting and the disposal proceeds of the company is the very high rates of tax involved. Essentially, if the company had sold the painting for £130,000, the company would have paid tax on the trading profit and a distribution of the remaining proceeds would have been subject to both income tax and surtax. So the lower price for the 'tax-free' sale of the company itself was based on a sharing of the overall tax benefits.

Unfortunately for the shareholders, the counteraction was based on the £44,447 received, so that they paid both income tax and surtax, having already given up the bulk of the proceeds on the basis of the anticipated tax savings. So this case demonstrates something of a double whammy for the taxpayers.

Transactions to which this provision applies are generally rare (perhaps due to the deterrent effect?)

2.8 Circumstance E (CTA 2010 s 738)

Circumstance E applies where a company receives consideration (in money or money's worth), on which it does not pay or bear corporation tax on income, in connection with:

- the direct or indirect transfer of assets of a 'relevant company' (defined at CTA 2010 s 739, see 2.9); or
- any transaction in securities in which two or more relevant companies are concerned.

The consideration must consist of any share capital or security issued by a relevant company and it must be or represent the value of assets which:

- are available for distribution by a relevant company (or would be so available but for anything done by the company); or
- are trading stock of a relevant company.

'Share' includes stock and any interest of a member in a company (CTA 2010 s 738(8)).

If the share capital is not redeemable, this Circumstance only applies so far as the share capital is repaid, including distributions in a winding up or dissolution (see 2.8.2).

2.8.1 Target of Circumstance E

Circumstance E will apply to transactions whereby the tax-free consideration received is in the form of shares or securities, or other similar interests in a company. There is a high degree of overlap with Circumstance D (indeed, it is hard to conceive of a transaction within Circumstance E that would not also fall into Circumstance D).

Circumstance E will therefore catch a reorganisation of a family company where the trade and/or assets of one company are exchanged for shares or securities in another such company which results in the accumulated reserves of the first company being represented by capital of the other company.

2.8.2 Timing of counteraction

There is a vital difference in the timing of counteraction between two Circumstances D and E, however. Under Circumstance E counteraction is deferred where the consideration is in the form of non-redeemable shares until such time as the shares are repaid (CTA 2010 s 747).

In such a case the taxpayer is entitled to have the counteraction deferred even if Circumstance D could apply (see 2.8.3).

2.8.3 Interaction with Circumstance D

Where, in a particular case, the circumstances of the transactions in securities fall within both Circumstance D and Circumstance E, Circumstance E will take precedence and HMRC cannot have a second bite of the cherry. This is particularly relevant where the consideration received by the taxpayer consists of non-redeemable share capital: HMRC cannot prevent liability being deferred under Circumstance E by relying on Circumstance D alone or as an alternative to Circumstance E. The specific and particular circumstances described in Circumstance E restrict the more general description in Circumstance D and the two Circumstances are not to be regarded as distinct alternatives.

This was decided in *IRC v Williams* (54 TC 257). In the Court of Appeal Bridge LJ said that it was 'perfectly clear' that the intention of Parliament was that Circumstance E had priority over Circumstance D in such cases, as otherwise CTA 2010 s 738(5) would be 'totally ineffective'. (However, in that case, the issue of interest-free loans was held to be tax-free consideration for further transactions in securities to which Circumstance D applied, so HMRC's counteraction was deemed to be effective.)

2.9 Relevant company

The definition of a relevant company for corporation tax purposes (CTA 2010 s 739) is in some respects similar to that of a close company but it is important to recognise the points of difference. A relevant company is:

- one under the control of not more than five persons (the tests of control are those in CTA 2010 s 450);
- any other company whose shares are not listed in the Official List of the Stock Exchange and dealt in on the Stock Exchange regularly or from time to time.

This latter provision excludes debenture stock, preferred shares or preferred stock. It also does not include companies whose shares are traded on the Alternative Investment Market (Revenue Budget Press Release dated 28 November 1995, 'Cancellation of tax advantages from certain transactions in securities'). However, a company is not a relevant company if it is controlled by one or more companies which are not relevant companies.

In *IRC v Garvin* [1981] STC 344 it was held that the company must be a relevant company at the date of the relevant distribution of profits. This may be advantageous to taxpayers in private equity transactions where the private equity investor is a subsidiary of a UK listed group, such as the major clearing banks. In a number of cases, HMRC has conceded that transactions in securities involving such investors cannot be caught by this legislation, as the company being transferred is controlled by a listed company, so that Circumstance D cannot apply.

It is likely that the requirement that the company be listed on the London Stock Exchange is susceptible to challenge as being contrary to the EC Treaty and the rights to freedom of establishment and to the free movement of capital. That is, this provision may be seen as unjustifiably discriminating against companies listed on the exchanges of other EU Member States, and in favour of companies listed on the UK Stock Exchange. Such discrimination, if it cannot be shown to be both justified and proportionate, could be held to be a breach of the EC Treaty and hence unlawful. HMRC has clearly recognised this point, as one of the reasons given for changing the definition of a relevant company for income tax purposes was the possibility that the definition was non-compliant with the EC Treaty.

2.10 Escape clauses

This negative filter, at CTA 2010 s 734, operates so that even if a tax advantage is obtained in one of the

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Circumstances set out in CTA 2010 ss 736-738, HMRC cannot take counteraction if the taxpayer can show:

- that the transaction or transactions concerned were carried out either for genuine commercial reasons or in the ordinary course of making or managing investments; and
- that none of them had as their main objects, or one of their main objects, to enable tax advantages to be obtained.

It is important to note that these are separate tests and it is entirely possible that transactions are carried out for genuine commercial reasons or in the ordinary course of making or managing investments, while also having tax avoidance as a main object, as in *IRC v Trustees of the Sema Group Pension Scheme* (see Example 14).

Please also note that the phrase 'bona fide commercial reasons' was used until the enactment of CTA 2010 and this phrase is therefore found in much of the jurisprudence.

2.10.1 Burden of proof

On an appeal against counteraction, it is for HMRC to show that a tax advantage has been obtained in one of the prescribed Circumstances. However, the onus is on the taxpayer to establish the availability of the escape clause (in contrast to the revised tests for income tax, as we shall see) (see 3.2.3).

2.10.2 Genuine commercial reasons

The basic premise is that genuine commercial transactions should not be susceptible to counteraction, so long as those transactions were not entered into for tax avoidance reasons. This is clear from a reading of the Standing Committee debates on FA 1960 s 28. The question of what is a genuine commercial reason has been considered a number of times by the courts, although each case is decided on its own merits and views have changed as taxpayers and their advisers become more sophisticated. Examples 9 and 10 are cases where a genuine commercial reason was accepted for the transactions. They are useful cases but, if these cases were to be heard today, I suspect that the Tribunals or courts would concentrate on the tax saving and find that there was a tax avoidance motive.

Example 9: *IRC v Brebner* (43 TC 705)

The taxpayer and five others were the main shareholders in a public company trading as coal merchants. A take-over bid was made for all the shares of the company at a price of 40s 6d, well in excess of the then market price of 25s per share. The taxpayer and five principal shareholders formed a group to oppose the take-over bid for two reasons. They had interests in fishing companies which bought coal on favourable terms from the company. Further, the bidder intended to liquidate the company and the appellants did not wish to see employees lose their jobs. Eventually, in February 1959 the group offered to acquire the shares of the other shareholders at 45s per share, an offer which most shareholders accepted.

To finance the purchase £108,000 was borrowed from a bank on a joint and several undertaking by the group and on condition of early repayment. It was intended from the outset that cash should be extracted from the company to pay off the bank loan though that consideration did not affect the price offered. The company's share capital was therefore increased, partly from the revenue reserve, and the increased share capital was then reduced by a capital (hence tax-free) repayment.

On appeal against counteraction, the main contention of the taxpayer was that the transactions were entered into for bona fide commercial reasons (under the original wording of this filter) and did not have as one of their main objects the avoidance of tax. The Revenue contended that the extraction of cash had the gaining of a tax advantage as its main object. The courts found for the taxpayer. In a seminal speech, Lord Upjohn, in the House of Lords, said:

'My Lords, I would only conclude my judgment by saying, when the question of carrying out a genuine commercial transaction, as this was, is considered, the fact that there are two ways of carrying it out—one by paying the maximum amount of tax, the other by paying no, or much less, tax—it would be quite wrong as a necessary consequence to draw the inference that in adopting the latter course one of the main objects is, for the purposes of the section, avoidance of tax. No commercial man in his senses is going to carry out commercial transactions except upon the footing of paying the smallest amount of tax involved. The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence.'

He further stated that whether a main object is to obtain a tax advantage is a subjective matter of the intention of the parties. This is often the intention of the taxpayers, but it suffices if it is the intention of those in control of carrying out the relevant transaction.

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Example 10: *Clark v IRC* [1978] STC 614

One of the shareholders of a private investment company, Robin Clark, also ran a commercial farm. The opportunity arose to purchase a neighbouring farm which could be run profitably with his own. In order to finance the transaction, he sold his 50% of the company to another family company (similar to the *Cleary* transaction).

The Special Commissioners found that there were good commercial reasons for acquiring the farm and it followed that the sale of the shares was also carried out for bona fide commercial reasons but that those reasons were too remote from the activities of the company to qualify for the escape clause.

The High Court overturned this decision on the basis that the Special Commissioners had misdirected themselves in law and that the commercial reasons for the transactions did not need to be connected with the taxpayer's interest in companies concerned in or affected by the transaction. The High Court did not have a problem with the Special Commissioners' finding of fact, that the transaction was carried out for bona fide commercial reasons, only with the finding in law, which was inconsistent with the finding of fact. The legislation did not concern itself with whose commercial reasons were in point, only with the existence of bona fide commercial reasons at all.

In similar contexts, it has been accepted that retention of family control of a private company and its business can be a genuine commercial reason (*IRC v Goodwin*, *IRC v Baggley* [1975] STC 173, CA, [1976] STC 28). The courts accepted that the prosperity of a business could depend in part on the very fact that it was an old established family business and continued as such under family control and management, both in the context of company–customer relationships and of the employer–employee relationship.

These cases also demonstrate that the reasons for the transactions are essentially questions of fact for the First-tier Tribunal to determine. Where the Tribunal finds that the objects of transactions are genuinely commercial and that the obtaining of a tax advantage was not a main object, it is not open to the Upper Tribunal or the Courts to overturn the finding of fact unless it is a finding which the First-tier Tribunal, properly instructed in the law, could not reasonably have made.

It is also clear that a genuine commercial reason for a transaction does not imply that the transaction itself has to be obviously commercial, as we see from the *Trevor Lloyd* case (Example 11).

Example 11: *Trevor G Lloyd v HMRC* (SPC 00672)

Mr Lloyd sold his 38.2% holding in a private trading company to a company that he owned jointly with his wife and a family trust. The commercial reason he gave was that this was part of a scheme to ensure that the other two (unrelated) directors of the trading company would each hold one third of the shares of the trading company.

HMRC argued that there were simpler commercial ways to achieve that end result, so the transaction could not have been carried out for bona fide commercial reasons. The Special Commissioner said that his first question was 'whether the Transaction was carried out for bona fide commercial reasons; it is not whether it was a bona fide commercial transaction, which is more objective ... The fact that it seems to me today that the Transaction was unnecessary does not mean that the Appellant did not believe that it was, or that [the other directors] did not regard it as a step showing that the ultimate end was being pursued. Accordingly I find that the Transaction was carried out for bona fide commercial reasons.'

2.10.3 In the ordinary course of making and managing investments

This is the alternative escape clause from counteraction under the anti-avoidance legislation, although it is not incompatible with the genuine commercial reason filter. Nor is it restricted to investment businesses. We can see its application in *Clark v IRC* (see Example 10 and below):

Example 12 *Clark v CIR* revisited

After finding in favour of the taxpayer, Robin Clark, that there was a bona fide commercial reason for the transactions, the Special Commissioners were also required to look at the similar transactions carried out by Colin Clark, Robin's brother. Colin sold his shares as he didn't want to be left with 50% if Robin had sold his 50%, and also because selling the shares together might achieve a better price. Colin had no specific need for the funds and would not have sold had Robin not been selling his shares.

The Special Commissioners held that the sale of Colin's shares to another family company was done

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in the ordinary course of making and managing investments, so that the escape clause applied to Colin, too, and the Revenue's counteraction was not valid. In effect, while the circumstances were unusual, he was protecting the value of his investment in the best way possible, by realising the investment and reinvesting the proceeds.

Conversely, in *IRC v Wiggins* (Example 8), the sale of the picture-framing company was described by the Special Commissioners as not having been in the ordinary course of making and managing investments, as 'none of the Appellants was ordinarily concerned in making or managing investments'.

In *IRC v Universities Superannuation Scheme* (Example 3), USS realised an investment in shares by agreeing that the shares should be cancelled, rather than sold, so that, in effect, part of the price of the transaction was met by the Exchequer. USS contended that the transactions in securities rules could not apply as the transaction was in the ordinary course of making or managing investments. The Special Commissioner said 'USS took the transaction out of the ordinary course of making or managing investments and substituted a transaction which was in my judgment not ordinary. On the evidence before me I find that the second transaction … was not carried out for bona fide commercial reasons or in the normal course of making and managing investments.' As we have seen, USS also argued that they could not be subject to counteraction, as they were in any case an exempt fund, so no tax was being avoided. But the courts held that the arrangements whereby part of the transaction consideration was funded by the Exchequer amounted to tax avoidance.

Conclusions

There are a number of broad themes arising from the decided cases about genuine commercial reasons and the ordinary course of making or managing investments.

- Just because a transaction or series of transactions generates a tax advantage, does not of itself mean that the tax advantage was a main purpose of carrying out the transactions (*Brebner*).
- There is no rule that requires a connection between the commercial reason for the transaction(s) and the activity of the company whose shares or securities are being transacted in (*Clark*).
- A genuine commercial reason for carrying out a transaction is distinct from the question of whether a transaction is itself commercial (*Trevor Lloyd*).
- There is no escape for transactions in the ordinary course of making or managing investments where the parties concerned do not habitually make or manage investments (*Wiggins*).
- But this escape clause may apply, even for unusual circumstances, so long as the transaction is itself ordinary (cf. *Colin Clark* and *USS*).

2.10.4 Tax avoidance motive

The test here is that that none of the transactions in securities have as their main objects, or one of their main objects, to enable tax advantages to be obtained. So it is not just about tax avoidance being the only reason for entering into the transactions, the test is also about whether tax avoidance was the one of the major motives behind the transactions, as opposed to being wholly ancillary.

The question of whether there is a tax avoidance motive behind the transactions is theoretically separate from that of whether the transactions were for commercial reasons or in the ordinary course of making and managing investments. Indeed, in many of the cases described above, the taxpayers won on the latter ground but lost on the former.

We are fortunate in having some cases with identical or nearly identical facts that can be contrasted to show this test in operation (Examples 13 and 14).

Example 13: *Marwood Homes Ltd*

Marwood Homes, a member of a group of companies, was making heavy losses. In addition the group wished to consolidate the building and maintenance division, of which Marwood Homes formed part. A series of transactions was carried out and, in due course, the Inland Revenue challenged these and raised counteraction notices. The Special Commissioners noted that the tax advantage was very much in the mind of those who decided to undertake the transaction but that it would be wrong as a necessary consequence to draw the inference that one of the main objects of the transactions had been to obtain that tax advantage (following *Brebner*). The Commissioners found a decision to be very finely balanced indeed but concluded on balance that it was not the subjective intention of those in control of Marwood Homes that a main object of the acquisition by Marwood Homes of the four subsidiaries was to enable a tax advantage to be obtained (reported in *Marwood Homes v CIR (No 1)* 1997 SCD 37).

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The Inland Revenue required the case to be reheard by the Tribunal constituted under TA 1988 s 706 (now abolished). On the re-hearing by the Tribunal, reported in *Marwood Homes v CIR (No 3)* (1999) SCD 44, new evidence was produced, including a note of a meeting convened to discuss a letter to be sent to the Inland Revenue requesting a clearance (under what is now CTA 2010 s 748). The note stated that much of the meeting was spent 'beefing-up' the commercial rationale for the transactions. The Tribunal decided that this meant that the transactions had a main purpose of avoiding tax, effectively because they inferred that there was not originally an adequate commercial reason for the transactions. In their decision, the Tribunal stated that:

' … if one or more of the specified transactions can be explained as having its main objective (or one of its main objectives) the obtaining of a tax advantage, the obtaining of that tax advantage may disqualify the transactions … from the bona fide commercial limb of the escape clause.'

The Tribunal held that the transactions were only rational if the tax advantage was taken into account, and the obtaining of that advantage was the main reason, if not the only reason, for the transactions in question. The company was not entitled to the protection of the escape clause.

The key point in this case is that the evidence seen on re-hearing the case clearly demonstrated that the commercial bona fides for the transactions were secondary to the desire to reduce the tax burden on the Marwood Homes group, so that the escape clause was not available.

The *Marwood Homes* case is also an important demonstration of the need to take proper care in correspondence between advisers and clients. Meeting notes in the terms described in the evidence in *Marwood Homes* can clearly be prejudicial in legal hearings, even if what was actually meant was something far more innocent. Given HMRC's powers to require information (see 5.2 below), it must be assumed that every document relating to a transaction, except those covered by legal professional; privilege, may be seen by an inspector considering counteraction.

Example 14: The *Lewis* and *Sema Group* cases

In *Lewis (Trustee of Redrow Staff Pension Scheme) v IRC* [1999] STC (SCD) 349 and the very similar case of *IRC v Trustees of the Sema Group Pension Scheme* [2003] STC 95, the trustees of exempt pension schemes took advantage of an offer by the company to buy back its own shares. In both cases the transactions represented in large part a distribution (TA 1988 s 209(2)(*b*)) and the trustees claimed and received a tax credit in respect of those distributions. Subsequently, HMRC claimed that a tax advantage had been obtained by the sale of the trustees' shares to the companies instead of selling them on the open market.

In *Lewis*, the Special Commissioners accepted the claim by the trustees that the purchase was made in the ordinary course of making and managing investments. There was a requirement to reduce the pension fund's holding of shares in Redrow plc to 5% or less, in order that the company could be floated, and the trustees did not wish to incur the costs and extra work which would have been involved if they had sold their shares in the course of the flotation. Although the trustees were aware of the tax benefit, this was not a main object of the sale of the shares, it was merely 'the cherry on the cake'.

In contrast, in *Sema Group*, the trustees decided to accept the buy back offer at a price below what they had paid, because a material part of the consideration would be treated as a distribution and the associated tax credit payable to the exempt fund would give the trustees an aggregate profit on the investment. While the Special Commissioners again found that the trustees were acting in the ordinary course of managing investments, they also found one of their main objects of the sales had been to enable tax advantages to be obtained, so the Revenue's counteraction was valid.

The key implication in these decisions is that the escape clause is not available if the transaction would not have been carried out if there were no tax advantage.

Many of the published decisions, such as the original *Marwood Homes* decision, have made it clear that taxpayers are entitled to take tax into account in their decision-making, without such considerations necessarily tainting the transactions with a tax avoidance motive. Indeed, commercially it would be remiss of the directors of a company not to take tax into account in making their decisions. As we have seen in *IRC v Brebner*, it was noted that the legislation requires a distinction between the purpose of a transaction and its effect. Thus, just because the effect is a reduced tax

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burden it is not open to HMRC to necessarily infer that this was the purpose of the transaction. As Lord Pearce, in the House of Lords, said:

> 'Admittedly, an object of the carrying out of the broad scheme by way of the resolutions was a tax advantage. But that which had to be ascertained was the object (not the effect) of each interrelated transaction in its actual context, and not the isolated object of each part regardless of the others.'

Conclusions
Overall, there are no hard and fast rules in this area, and each case must be viewed on its own merits.

As noted in Example 14, the *Sema Group* case, when contrasted with *Lewis*, suggests that tax is a main motive for a transaction if the transaction would not have taken place without the tax advantage. This may be an extreme statement of the position. It is perhaps fairer to say that the escape clause may still be available in finely balanced cases, such as *Marwood Homes No. 1*, perhaps, where a positive tax outcome helps to tip the balance towards carrying out a transaction, or carrying it out in a particular way. But where a transaction would clearly not have been carried out, as in *Sema Group*, where the outcome would have been commercially unfavourable without the payable tax credit, then it is more likely that HMRC will challenge the application of the escape clause and, perhaps, more likely that a Tribunal or court will agree.

Finally, *Brebner* tells us (and HMRC) very clearly that purpose and effect must not be confused. Just because there is a tax advantage does not automatically mean that that advantage is a main purpose of the transaction(s).

2.10.5 Whose intention?

While individuals might have commercial purposes or might wish to avoid tax, it is a trite point that a company does not have a mind and cannot have a purpose of its own. This point was clarified in *Brebner*, where Lord Pearce said that:

> 'The "object" which has to be considered is a subjective matter of intention. It cannot be narrowed down to a mere object of a company, divorced from the directors who govern its policy or the shareholders who are concerned in and vote in favour of the resolutions … the company, as such, and apart from these, cannot form an intention.'

In *IRC v Addy* [1975] STC 601, another case involving a liquidation, Mrs Addy argued that she could not have had a tax avoidance motive, as she was not party to the decision to liquidate and took no part in the operations of the business, being only a minority shareholder. Mr Justice Goff in the High Court found this to be of no relevance, 'because what has to be applied is a subjective test of the intention of those in control'. He went on to suggest that 'those in control' might also include the professional advisers who had dreamed up the scheme. This theme was approved of by the Section 706 Tribunal in *Marwood Homes*, where the decision included the statement that the intention to be looked at is that of '… those who governed the policy of the company in the area where the transaction or transactions in question fall. This may involve looking at the intention of the directors, or the shareholders or, where appropriate, the professional advisers.'

This latter point causes some concern in that, if the advisers of a company are 'governing the policy of the company' in any area, it may be that they are acting as more than mere advisers and may be shadow directors. This should not be the case (and may even contravene company law), and perhaps a better formulation is that in some cases a company's policy is directed by the directors or shareholders but under the guidance of the advisers.

To reiterate, two principles are established by these decisions. First, as a company cannot have an intention, it is necessary to look at the intention of those making policy for the company, usually the directors or the shareholders. Second, ignorance of the scheme is not a defence for people such as minority shareholders. If the intention of the scheme is to avoid tax, then the anti-avoidance provisions can apply, even if individual shareholders have no such intention (this is similar to decisions based on the *Ramsay* doctrine, too).

2.11 Application to capital gains avoidance

The legislation was enacted in 1960, five years before the enactment of corporation tax and capital gains tax. And the corporation tax rulesonly refer to a 'corporation tax advantage', with no exclusion for the avoidance of corporation tax on chargeable gains. Most commentators nevertheless agree that the history of the legislation means that corporation tax rules for transactions in securities do not apply to the avoidance of corporation tax on chargeable gains, although HMRC has never been willing to confirm that the scope of the legislation has been limited in this way.

As to how HMRC deals with a transaction in securities which generates a liability to corporation tax on chargeable gains, the legislation only refers to a corporation tax advantage. So the tax advantage for a company would be measured by comparing the

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corporation tax liability with and without the planning to determine the measure of any counteraction, and no distinction is made as to how the corporation tax arises, ie from income or from chargeable gains.

3 Income tax

As noted, FA 2010 amended the regime for transactions in securities for income tax purposes. The changes have effect in relation to income tax advantages obtained on or after 24 March 2010. Note that this means that the legislation could potentially apply where the transactions in securities took place before that date, so long as the tax advantage arises on or after 24 March 2010.

3.1 The structure of the new rules

The filters for income tax were largely rewritten in FA 2010, following a lengthy consultation process. The structure of the new legislation is intended to reflect HMRC's view of the general structure of an unallowable purposes test, with both positive filters, bringing taxpayers within the scope of the legislation, and negative filters, taking them out. The negative filters are a welcome simplification to the way in which these unallowable purpose tests are intended to work. The intended benefit to taxpayers is, of course, to save them the time and effort of considering the specific unallowable purpose test at all, in cases where a negative filter clearly applies. And for HMRC, there is a clearly a material resource saving in not having to consider clearance applications that are within the safe harbour. This is very clear, for example, in the fundamental change of ownership test (see reference), which is based empirically on the fact that HMRC always granted clearance in cases that satisfied that test.

There are two positive filters in the income tax rules. The first is a general filter, the other is more technically specific and has two Conditions (imaginatively named A and B).

3.2 The general filter

The first filter, ITA 2007 s 684 ITA 2007, brings into the scope of the legislation any person where:

- the person is a party to a transaction in securities or two or more transactions in securities;
- the circumstances are covered by ITA 2007 s 685 (the specific technical filter) and not excluded by ITA 2007 s 686 (the fundamental change of ownership test, a negative filter);
- the main purpose, or one of the main purposes, of the person in being a party to the transaction in securities, or any of the transactions in securities, is to obtain an income tax advantage; and
- the person obtains an income tax advantage in consequence of the transaction or the combined effect of the transactions.

Although this looks similar to the old rules, and to the current rules for corporation tax, there are some fundamental differences to consider.

3.2.1 Party to a transaction

Under the new rules, the person against whom HMRC can take counteraction must be a person who was party to a transaction in securities. This is more tightly focussed than the old income tax rules, where the person only had to obtain a tax advantage in consequence of a transaction in securities: the person was not required to be a party to those transactions.

As discussed in 2.10.5, in *IRC v Addy* [1975] STC 601 Mrs Addy argued that she could not have had a tax avoidance motive, as she was not party to the decision to liquidate the company. The new income tax rule, which states that the person obtaining the income tax advantage must actually have been party to the transaction in securities, might have been of some help to Mrs Addy: since she was not party to the decisions to liquidate, and the liquidation itself is not a transaction in securities, as we have seen (reference), she would now be able to argue that she was not party to a transaction in securities and HMRC would be unable to counteract any income tax advantage she may have obtained.

3.2.2 The motive test

The legislation only applies if 'the main purpose, or one of the main purposes, of the person in being a party to the transaction in securities or any of the transactions in securities, is to obtain an income tax advantage'. In contrast to the old escape clause, this does not have a reference to a commercial purpose or to the normal course of making or managing investments. In the *Consultation Response Document* (published 9 December 2009), HMRC did not consider that a commercial purpose test would 'significantly improve the clarity or simplicity of the legislation'. So there is probably a slight widening of the scope for permissible transactions, in that they no longer need a commercial purpose, but it is hard to see any major practical difference here.

More importantly, the *Consultation Response Document* also made it clear that the existence of commercial reasons for carrying out a transaction would help to demonstrate that tax avoidance was not a main purpose of the transactions.

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While this is, arguably, a negative filter, it is unlikely to reduce the need to consider the test, any more than the previous version of the escape clause ever has. Taxpayers will continue to want certainty that HMRC is satisfied with the purpose behind the transaction, so it seems unlikely that the number of clearance applications will be reduced by this filter.

Since the wording of this test is so obviously similar to the old motive test, I would expect all the jurisprudence and practical guidance relevant to the motive test to continue to apply, as it does to the corporation tax test (see 2.10.4).

3.2.3 Burden of proof

There is a much more significant point here. Under the new income tax rule, it is clear that the burden of proof falls on HMRC to establish that 'the main purpose, or one of the main purposes, of the person in being a party to the transaction in securities, or any of the transactions in securities, is to obtain an income tax advantage'. This is a huge change: taxpayers will no longer be required to prove a negative – that they were not intending to avoid tax. Instead, HMRC will be forced to prove that there is a tax avoidance motive.

Under the old rules HMRC were required to prove that the positive filters apply, ie that there was a transaction in securities, within the prescribed Circumstances, etc. But the onus was on the taxpayer to establish the availability of the escape clause. Consider, for example, the words of CTA 2010 s 734(1), which say that the legislation 'does not apply to a company in respect of a transaction in securities or two or more such transactions if the company shows that the transaction or transactions [satisfy the escape clause]' (see also 2.10.1).

This, together with the amended escape clause, is a huge difference and should make it far harder to HMRC to counteract tax advantages in marginal cases, such as those where the commercial reasons for a transaction were not clear.

In practical terms, where HMRC believes that an income tax advantage was intended, they may use their new information powers under FA 2008 Sch 36 (see 5.2). For practical (and legal) purposes it is as important as ever to retain all relevant documentation relating to the transaction and the purposes behind it, so as to be able to refute any suggestion that the avoidance of income tax is a main purpose of the transaction. But it is now HMRC's responsibility to make their case, not the taxpayer's to prove the negative.

3.2.4 Transaction in securities

The expression 'transaction in securities' is defined at ITA 2007 s 684(2) (it was previously in ITA 2007 s 713) and is the same as for corporation tax purposes. It includes 'transactions, of whatever description, relating to securities, and in particular:

(a) the purchase, sale or exchange of securities;

(b) issuing or securing the issue of new securities;

(c) applying or subscribing for new securities; and

(d) altering or securing the alteration of the rights attached to securities'.

'Securities' for these purposes includes shares and stock, and an interest of a member of a company that is not limited by shares (ITA 2007 s 713).

3.3 The conditions

The unallowable purpose test itself applies if either condition A or condition B is met (ITA 2007 s 685). Given the relatively straightforward language used, it is appropriate to set out the legislation in full.

3.3.1 Conditions A and B

Condition A is that, as a result of the transaction in securities or any one or more of the transactions in securities, the person receives relevant consideration in connection with:

(a) the distribution, transfer or realisation of assets of a close company;

(b) the application of assets of a close company in discharge of liabilities; or

(c) the direct or indirect transfer of assets of one close company to another close company,

and does not pay or bear income tax on the consideration.

Condition B is that:

(a) the person receives relevant consideration in connection with the transaction in securities or any one or more of the transactions in securities;

(b) two or more close companies are concerned in the transaction or transactions in securities concerned; and

(c) the person does not pay or bear income tax on the consideration (apart from this Chapter).

3.3.2 Relevant consideration

For cases within (a) or (b) of Condition A, 'relevant consideration' means consideration which:

(a) is or represents the value of:

  (i) assets which are available for distribution by way of dividend by the company; or

(ii) assets which would have been so available apart from anything done by the company;

(b) is received in respect of future receipts of the company; or

(c) is or represents the value of trading stock of the company.

In these cases, the consideration is referring back to the company whose assets are transferred, distributed, realised or applied in the discharge of liabilities. Unlike the old income tax rules, the consideration does not refer to any relevant company. This is a restriction on the scope of the rules but is unlikely to be of practical significance in most cases.

Relevant consideration does not include a return of sums paid by subscribers on the issue of securities, even if under the law of the country in which the company is incorporated assets of that description are available for distribution by way of dividend.

For cases within (c) of Condition A or within Condition B, 'relevant consideration' means consideration which consists of any share capital or any security issued by a close company and which is or represents the value of assets which:

(a) are available for distribution by way of dividend by the company;

(b) would have been so available apart from anything done by the company; or

(c) are trading stock of the company.

In this case, where non-redeemable shares are issued as relevant consideration, the legislation only applies so far as the share capital is repaid (on a winding up or otherwise). But any distribution made in respect of any shares on a winding up or dissolution of the company is to be treated as a repayment of share capital. And counteraction can only be taken when the share capital is repaid (ITA 2007 s 700).

It is important here that the relevant consideration in the form of shares or securities must represent assets available for distribution by the company issuing those shares or securities. Under the old income tax rules the consideration was only required to represent assets available for distribution by any relevant company. So, once again, the new rules are more restrictive from HMRC's perspective as it is only the distributable reserves of the company issuing the shares or securities that we are required to look at. So, while the *Cleary* scenario (Example 1) might still be caught, the standard NewCo structure used in buy-outs may well not be within the scope of the legislation (as we shall see in Example 15), so this change may have great practical significance.

In all cases, consideration includes both money and money's worth.

3.3.3 Interaction between Conditions A and B

Conditions A and B look very similar the old Circumstances D and E. But Condition B is not a subset of Condition A in the way Circumstance E was of Circumstance D, despite the scope for considerable overlap between the Conditions.

It is not clear whether HMRC will be able to take cases under alternative Conditions in overlap cases, or whether the Tribunals and Courts will effectively invoke the spirit of *IRC v Williams* (54 TC 257) (see 2.8.3). The answer is probably that we will have to wait and see, although my instinct is that the structure of the legislation, requiring either of the Conditions to be present, would be read by the judiciary as permitting HMRC to consider either or both Conditions in most cases.

Example 15 demonstrates how the positive filters would work.

Example 15: Private equity transactions

Mr Simon owns 100% of the shares of 59th Street Ltd, a successful trading company, which is now worth £20 million. As the business is expanding, he realises that he needs substantial external financing to fund the expansion. Garfunkel Enterprises Plc, a private equity firm, agrees to provide funds. The deal is structured so that Garfunkel Enterprises sets up a new company, Simon & Garfunkel Ltd, funded with £60,000 equity and a £19.94 million debt. Simon & Garfunkel Ltd. then buys 59th Street Ltd for £5 million cash, issuing Mr Simon with £40,000 share capital, so that he owns 40% of Simon & Garfunkel Ltd, and issuing him £10 million in loan notes, to be paid off over 10 years.

We need to see if Mr Simon falls into the legislation through the filters. He is selling his company for cash, loan notes and equity, so he is a party to a transaction in securities. We would expect this to be prima facie a capital gains transaction with tax payable at 18% on the gain (that being the rate at the time of writing). This tax rate is likely to represent an advantage in comparison to the income tax rates.

As explained above, HMRC's first difficulty is that they now have to demonstrate that Mr Simon

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intended to obtain an income tax advantage. HMRC cannot now merely state that they consider it likely that Mr Simon intended to obtain an income tax advantage and leave him to prove that he did not, either to HMRC's satisfaction or to that of a Tribunal judge. As things stand, there is nothing to suggest that this is anything but a normal commercial transaction with no tax driver, so one would hope that HMRC would not consider counteraction.

We should also look at whether either of the Conditions A or B apply, for which we need to look at the components of the consideration separately.

Cash

We know that HMRC see this transaction as structurally similar to the transaction in the *Cleary* case (Example 1), and consider it to involve 'the distribution, transfer or realisation of assets of a close company'. (You might argue that the pure sale of a close company is not 'the distribution, transfer or realisation of its assets', but I suspect the jurisprudence from the old Circumstance D is against you there.) Mr Simon will have received the cash proceeds free of income tax since the proceeds received by Mr Simon are prima facie chargeable only to CGT. So Condition A is in point in respect of the cash receipt.

Loan notes

The loan notes are money's worth and could potentially represent distributable reserves of 59th Street Ltd, and they may be consideration that 'is received in respect of future receipts of' 59th Street Ltd, so they could also fall into Condition A.

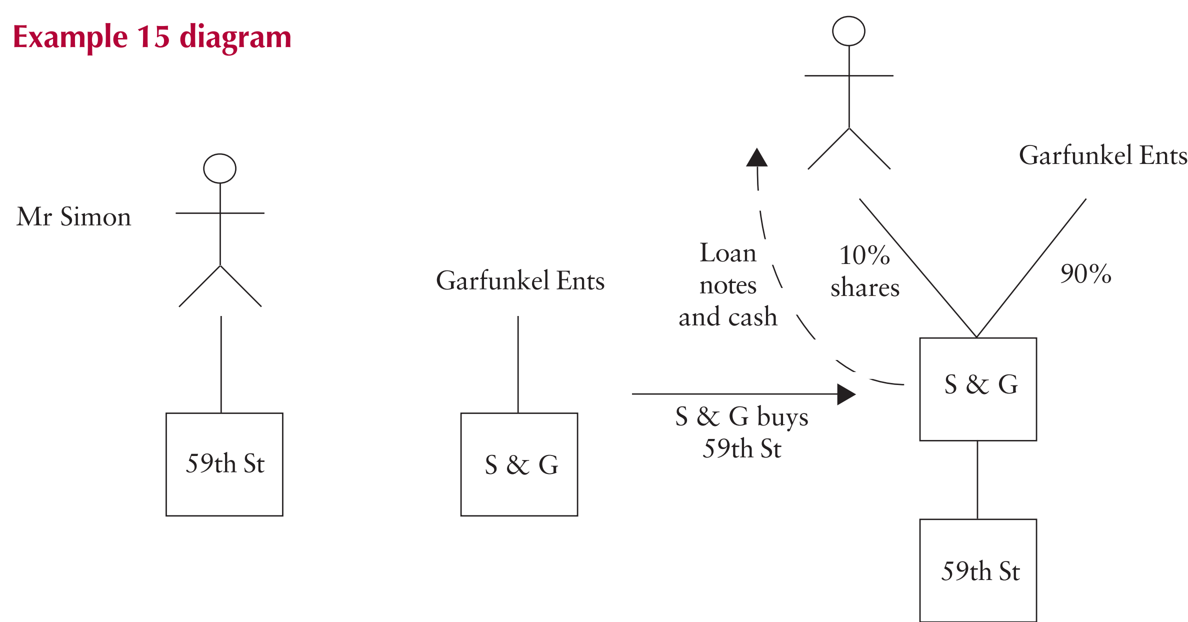
Insofar as the loan notes are received in respect of future receipts of the company, I would expect HMRC to consider the distributable reserves of 59th Street Ltd at the time that the loan notes are redeemed, as they did under the old Circumstance D (and as they still do for corporation tax purposes reference). But, unlike the old Circumstance D, HMRC cannot look at the reserves of Simon & Garfunkel Ltd, as the relevant consideration for Condition A (b) only refers to the future receipts of 59th Street Ltd.

As the loan notes are also a security issued by Simon & Garfunkel Ltd, we should consider Condition B, but only so far as the securities are consideration that represents the distributable reserves of Simon & Garfunkel Ltd. Since Simon & Garfunkel Ltd is a new company, it won't have any reserves, so Condition B is not in point.

Shares

The shares are money's worth and could potentially represent distributable reserves of 59th Street Ltd. HMRC has not hitherto tried to argue this point, mainly because Circumstance E has always previously trumped Circumstance D. Now that we have two new Conditions, it is not clear that one trumps the other, so Condition A may be in point in respect of the shares.

Example 15 diagram



Condition B is also likely to be in point, if the shares represent distributable reserves of 59th Street Ltd. But Condition B would not permit counteraction unless and until the share capital is repaid.

Conclusion

The new transactions in securities rules might technically apply to Mr Simon. But HMRC have to prove that he intended to obtain a tax advantage and that that was why he was party to the transaction. On the facts as presented, there is no evidence for a tax advantage motive, so Mr Simon should not be susceptible to counteraction.

In such a case, we would, of course, recommend that Mr Simon apply to HMRC for a pre-transaction clearance under ITA 2007 s 701.

3.3.4 How new are these Conditions?

If we compare the new Conditions to the old income tax rules or to the current corporation tax rules, we find that they are almost identical in scope and, indeed, wording, to Circumstances D and E. That is, (a) and (b) of Condition A, with the associated rules relating to relevant consideration, clearly correspond to Circumstance D; and (c) of Condition A with Condition B, with their rules for what is relevant consideration, correspond to Circumstance E.

As a practical result, I believe that the interpretation of these Conditions, and their practical application, should be as for the old income tax Circumstances D and E in many respects, and that the guidance at 2.7 and 2.8 on the corporation tax rules should apply mutatis mutandis to the new income tax Conditions.

3.3.5 Close companies

A major simplification is the application of the income tax rules only to close companies or companies that would be close if they were UK resident. This is helpful, as close companies are well understood, so this filter should reduce the number of pre-transaction clearance applications. In particular, most publicly-listed companies will now be outside the scope of the legislation, wherever they are listed. The definition of a close company is at CTA 2010 s 439.

Following *CIR v Garvin*, I assume that the test will apply at the time of the transaction in securities, just as it does for a 'relevant company' under the corporation tax rules (see 2.9).

Example 16: Private equity transactions, revisited

Let us revisit the previous example, but postulate that Garfunkel Enterprises Plc is not a close company. In that case, we need to review whether either of Condition A or B can apply.

Condition A

We are looking at whether the transaction is 'the distribution, transfer or realisation of assets of a close company'. On the facts as presented, 59th Street Ltd is the relevant company for the purposes of Condition A, and it is clearly a close company at the time of the transaction, as Mr Simon owns 100% of the shares so Condition A may still be in point.

Condition B

Here we are looking at whether two or more close companies are concerned in a transaction in securities. Only 59th Street Ltd is a close company, as we have postulated that Garfunkel Enterprises Plc is not close, so nor is Simon & Garfunkel Ltd (as it is controlled by a non-close company). So Condition B cannot apply.

3.4 The negative filter

As previously noted, a negative filter takes a person outside the scope of the legislation. As well as being helpful to taxpayers, there is a resource saving for HMRC, as they should no longer have to review so many clearance applications. The main negative filter in the new income tax rules for transactions in securities is the 'fundamental change of ownership' test, in ITA 2007 s 686.

3.4.1 The fundamental change of ownership test

In the fundamental change of ownership test, if 75% of the ordinary share capital of a company (carrying at least 75% of the rights to distributable profits and 75% of the total voting rights in the company) changes hands as a result of the transactions in securities, the transactions in securities legislation does not apply.

The person who beneficially owns the shares after the transaction must not be connected with the person who sold them and must not have been connected in the two years prior to the transaction. This is a welcome relaxation to the original proposal, which was that the person acquiring the shares must never have been connected with the person making the disposal. The fundamental change of ownership must continue for at least two years, so that it is not possible to get out of the provisions by a short-term change of ownership.

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For the purposes of this filter, ITA 2007 s 993 applies in determining whether persons are connected.

Example 17: Selling a company

Fred owns 100% of Ginger Ltd. As part of his retirement planning, he decides to sell part of his holding to his friend Busby. Fred and Busby are not related and are not otherwise connected (per ITA 2007 s 993). Therefore, if Fred sells at least 75% of his shares to Busby, the fundamental change of ownership test suggests that Fred cannot be subject to counteraction under the transactions in securities rules, even if he is deliberately avoiding income tax as a result of the transaction, falls within one of the Conditions, and so on.

There is an important caveat to this filter, which HMRC has been keen to emphasise: the 75% test is a clear safe harbour, but this does not mean that transactions where less than 75% of the share capital changes hands are tainted and will be subject to counteraction. All that it means is that any transactions that do not satisfy the fundamental change of ownership test will need a clearance application in the normal way. And in most normal cases, where there is no intention to avoid income tax, it is likely that clearance will be granted.

This is an empirical test, as HMRC consider that they would almost invariably have given clearance in the past when 75% of the shares of a company were disposed of to an unconnected person. As well as simple sales of companies, this filter may apply to MBOs and secondary buyouts where, typically, the management team hold less than 25% of the shares. They would swap their existing shares for shares in a new company set up by the new venture capitalist owners but would also receive some cash. If the management shareholders are not connected with the new venture capitalist owners, the fundamental change of ownership rule should apply to exclude the buyout from this legislation.

There is a slight twist to this: ITA 2007 s 993(7) says that persons are connected with each other if they are acting together to secure or exercise control of a company. So, if the old and new shareholders are acting together, this would suggest that they become connected as a result of the transaction in securities. Since the fundamental change of ownership condition must continue for at least two years after the transaction, does this mean that the test is automatically failed? This cannot be the right answer, as this would render the fundamental change of ownership test completely unusable if the vendor retains any shares, except for cases where the taxpayer can demonstrate that he is not acting together with the other shareholder(s) to control the company – either he or they would have to be completely passive investors, which seems unlikely.

This analysis appears to contravene the clear intention of this filter and I hope that HMRC will take a sensible view here in such cases.

3.5 The tax advantage

The new rules are much more explicit about the tax advantage. The old definition, which was very similar to the corporation tax definition at CTA 2010 s 732 has been repealed. Instead, we have a simple calculation in ITA 2007 s 687 that allows us to measure the quantum of the tax advantage.

The rule requires a comparison of the capital gains tax paid (if any) in respect of the transaction(s) in securities with the income tax that would have been payable by the person potentially obtaining an income tax advantage, if the relevant consideration had been a qualifying distribution by the close company. Any amounts that the close company would have been unable to distribute lawfully are left out of account. This is best illustrated by examples:

Example 18: Measuring the income tax advantage

Bob sells 50% of the shares in his company to a family trust, as part of a tax avoidance scheme, and receives £1m consideration. He pays £100,000 CGT, as entrepreneurs' relief is available. Had he received a distribution of £1m, he would have paid tax of £361,000 (at the top tax rate for dividends). Therefore, there is an income tax advantage of £261,000.

If the company had only had distributable reserves of £500,000, the tax on a distribution of that amount would only have been £180,500. The other £500,000 of consideration is left out of account as the company could not have made a lawful distribution of this amount. Therefore, in this case, the income tax benefit to Bob is £80,500.

If the company did not have any distributable reserves, no lawful distribution could have been made and there would have been no income tax advantage in this case.

This approach to measuring the tax advantage under these provisions enshrines in legislation what most

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practitioners had always considered to be the case. However, hitherto, HMRC has always been reluctant to confirm that this is the limit of the extent to which counteraction can be applied. More importantly, we now have a simple computational tool for calculating whether there is a tax advantage, which should reduce the number of pre-transaction clearance applications.

Arguably, this is not just a computational tool, it is also a negative filter, as the transactions in securities rules only apply if there is an income tax advantage. If, following the computational rules in s 687, there is no income tax advantage, the transactions in securities rules do not apply. Similarly, if the income tax advantage is small in comparison to the commercial or other advantages, this helps to establish a prima facie case that the income tax advantage was not a whole or main purpose of the transaction(s) in securities.

3.6 Interaction with other taxes

Since the legislation was enacted before the enactment of capital gains tax, and was never amended to cover capital gains tax, it is clear that the income tax rules relating to transactions in securities never applied to tax advantages arising from the avoidance of capital gains tax.

As regards the interaction of counteraction and any capital gains tax paid as a result of the transactions in securities, the new ITA 2007 s 687 now only permits counteraction up to the difference between the income tax that would have been paid on a lawful distribution and any capital gains tax in respect of the actual transactions in securities (see 3.5).

As regards any other taxes, at CTM 36860 HMRC's stated view is that the transactions in securities rules only apply to any income tax advantage which remains after the other legislation has been invoked. I am not aware of any specific provisions or jurisprudence to support this view, but it is clearly practical and sensible. And, we have judicial approval in, for example, in *Williams and ors v IRC* [1980] STC 535. Assessments to surtax had been made on the taxpayers on an apportionment of a company's income, but there was also a tax advantage via loans from the company. The courts held that HMRC was entitled to counteract the tax advantages, on the understanding that if the counteraction succeeded the surtax assessments would be cancelled.

4 Clearances

Given the concerns of Parliament in 1960, the legislation was enacted with the facility for taxpayers ascertain in advance whether the HMRC is satisfied that no counteraction is required. This facility for 'clearance' is now found at CTA 2010 s 748 / ITA 2007 s 701.

4.1 Form and content of the application

The application must be in writing (which includes email or fax, see below) and must give full details of the transactions to be carried out. Statement of Practice 13/1980 has some helpful information about the form and information required in any clearance application.

As a practical point, it is vital that the initial clearance application is complete in all material respects in order to avoid HMRC asking for further information, thus restarting the 30-day clock (see 4.5). Equally important is clarity in the clearance application. The best letters are those that tell the story clearly, concisely and logically, so the inspector has all the information required to grant a clearance without further ado. A badly-written letter invites queries and therefore creates delay.

While clearance applications should be comprehensive, it is frequently the case that the final details are not decided until relatively late in the process. In such a case, it is preferable to make a clearance application earlier rather than later, also making a point of detailing the area(s) where decisions are yet to be finalised, together with the likely outcome. If the final decisions are materially different from what was originally advised to HMRC, a supplementary letter may be required to get final sign-off. Strictly, such a letter is a new application for clearance, but in circumstances like this the inspector will usually expedite the clearance on the basis that there are only minor differences to consider.

Although the legislation refers to transactions carried out by the applicant, it is important that the application includes details of any associated transactions carried out by others which might affect the relevance of the anti-avoidance provisions.

The application should as far as possible keep separate the transactions in securities (which should be listed in numbered paragraphs), the background information and evidence of genuine commercial reasons or of the factors which indicate that the transactions will be carried out in the ordinary course of making and managing investments.

4.2 Disclosure

Should an application later be found not to have fully disclosed all the relevant facts, CTA 2010 s 749(4) / ITA 2007 s 702(4) provide that inadequate disclosure makes any clearance void.

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The importance of this was highlighted in the Special Commissioner's decision in the capital gains case of *Harding v HMRC* (SpC 608). Mr Harding had applied for and been granted a pre-transaction clearance. But the clearance application had failed to mention the crucial aspects of the transaction that made it attractive for tax planning purposes. As the Special Commissioner said, the 'letter to the Revenue was, to be charitable, wholly inadequate for its purpose'.

This case emphasises that it is vital to give HMRC all relevant information when applying for a clearance, otherwise that clearance is void. At least if a clearance is refused, a transaction can be restructured to try and achieve a better result. But a transaction that has been carried out under an invalid clearance is irrevocable.

4.3 Meaning of a clearance

CTA 2010 s 749 / ITA 2007 s 702 tells us that a clearance requires HMRC to notify an applicant if the Commissioners (of HMRC) are satisfied that no counteraction should be taken, given the facts and circumstances that have been disclosed. Where HMRC have given a clearance they are precluded from taking counteraction under CTA 2010 s 746 / ITA 2007 s 698 in respect of the transactions notified in the clearance application. However, the clearance does not extend to arrangements which include the notified transactions along with other transactions not included in the application. Hence the importance of full disclosure of any associated transactions.

Unlike clearances under, say, the capital gains reorganisation provisions (TCGA 1992 s 138, for example), such clearances do not specifically state that the Board is satisfied with the commercial reasons for the transaction, and so on. This can be helpful, as it allows applications for clearance to be made either on the basis that the transactions are carried out for genuine commercial reasons and not to avoid tax – the more usual escape clause – or where the taxpayer would like confirmation that the transactions do not technically fall into the provisions, perhaps because there is no transaction in securities, or none of the Circumstances is present.

4.4 How to apply

Clearances are dealt with by the HMRC Clearance and Counteraction Team, which also deals with, inter alia, clearances under the following provisions:

- CTA 2010 s 1091 (demergers);
- CTA 2010 s 1044 (company purchase of own shares); and
- TCGA 1992 ss 138 and 139 (company reconstructions).

Most of the comments here will be relevant to clearance applications under other provisions, too, so should be taken as being of general use.

Applications for clearance under any of the relevant statutory provisions should be sent to:

Clearance & Counteraction Team, Anti-Avoidance Group
1st Floor
22 Kingsway
London
WC2N 6NR

Applications can be sent by e-mail to reconstructions@hmrc.gsi.gov.uk or by fax to 020 7438 4409, as well as by post. However, only one method should be used to avoid confusion and double counting of applications.

If the transaction is market sensitive, it should be addressed to the Team Leader at the above address. You should telephone the Team Leader on 020 7438 6585 before you fax market sensitive information. HMRC regards information that could affect the price of a stock market quoted company and information concerning the financial affairs of well-known individuals as sensitive in this context.

There is a great deal of helpful information available from the HMRC website about clearances, particularly:

- http://www.hmrc.gov.uk/cap/index.htm which explains about a number of areas where advice and clearances may be available;
- http://www.hmrc.gov.uk/pdfs/cop10.htm which contains a copy of Code of Practice 10. This Code of Practice tells about the different ways that HMRC will give information or advice, including clearances; and
- Statement of Practice 13 of 1980 (SP13/80) which is strictly about demerger clearances under CTA 2010 s 1091 but which has some helpful information about the form and information required in any clearance application. This can be found at http://www.hmrc.gov.uk/practitioners/sop.pdf which has all the Statements of Practice on one Acrobat document.

Practitioners and taxpayers should read this guidance carefully whenever they are making an application for clearance under any of the statutory provisions.

In general, HMRC will deal with simple applications as quickly as possible, usually within a few days of receipt, and there will be no separate acknowledgment

of the application. HMRC will only issue a formal acknowledgement of an application if HMRC does not expect to deal with the application within a few days of receipt. This may happen if the Team is particularly busy or if the case is complex and requires more detailed thought. A letter of acknowledgement does not mean that HMRC is concerned about the application and wants to refuse clearance. It is just letting applicants know that their response may take a little time.

If you are enquiring about the progress of an application or making general enquiries, you may call HMRC on 0207 438 7474. But the website suggests that you allow ten days after receiving an acknowledgement before you contact HMRC to check progress.

4.5 Timing of clearances

The legislation gives HMRC the 30-days to give a substantive response to a clearance application, either be giving a decision or by requesting further information. If they request further information, the application technically lapses if that information is not supplied within 30 days. In practice, HMRC does not usually take this point and will reconsider the original application whenever the new information is received. After all, if it takes more than 30 days to supply the further information, the applicant can simply make a completely new application, including the further facts requested by the inspector. The decision must then be given within 30 days of HMRC receiving the information.

Given this timescale, it is important to consider clearance applications earlier rather than later when considering transaction timetables, to ensure that there is plenty of time to obtain clearance for a transaction before it is carried out. It is also important because it is not possible to rely on HMRC being willing to expedite a clearance for an imminent transaction, particularly at busy times when there are other clearance applications that may be getting close to the 30-day deadline.

If, exceptionally, HMRC fail to give a decision within 30 days of the application (or of the provision of further information) it should not be assumed that no counteraction can be taken. However, I am not aware of HMRC ever failing to give a substantive repose within the statutory 30 days.

Note that clearance applications can be made after the transaction has been carried out, as well as before, although one would generally assume that best practice would always be to seek clearance before carrying out a transaction.

4.6 Urgent applications

The most important thing about an urgent application is that it be clearly marked as urgent at the top of the front page of the letter. When clearance applications are initially received, they are allocated a reference number and passed to an inspector to deal with in date order. So no one will see a statement that the application is urgent at the end of the letter or hidden in the explanatory text until the inspector reads the letter in detail.

In my experience, the Clearance & Counteraction Team will always do its very best to comply with reasonable requests for urgent clearances, but it is also important to be aware of the other pressures on inspectors to process all applications within the 30-day time limit, particularly at busy times. So make sure your application really is urgent before taking this approach. If taxpayers or practitioners constantly demand quick turn-around times on what are essentially non-urgent cases, this is likely to be to the detriment of their relationship with the Clearance & Counteraction Team. This could make life very difficult for an adviser who regularly applies for clearance on behalf of clients.

Also, remember that inspectors are human too! There is nothing more annoying than being begged for an urgent clearance when it is clear that the transaction had been under consideration for some considerable time and the clearance application could and should have been made much earlier in the process.

4.7 Refusal of clearance

The legislation does not require HMRC to explain why an application for clearance has been denied. However, as a matter of practice, an applicant is always informed as to the area(s) of concern. This allows taxpayers to correspond with HMRC if clearance has been denied, in order to see if HMRC's concerns can be allayed. In practice, HMRC is usually willing to consider further comment or to opine on changes to the structure with a view to being able to grant clearance, whether on the originally proposed transaction or on a transaction that is less 'offensive'. Remember, however, as always, that HMRC's latitude is limited and also that their ability to respond swiftly is likely to depend upon how busy the inspectors are.

There is no formal route of appeal against a refusal of clearance by HMRC under the transactions in securities rules, in contrast to the procedure for demerger clearances (CTA 2010 s 1091) or capital gains (TCGA 1992 s 138 et seq).

The refusal of a clearance does not automatically mean that counteraction will be taken, but it is not the

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practice of HMRC to refuse clearance unless, on the information available, they would expect to give serious consideration to taking counteraction if the transactions were to be carried out as described in the clearance application.

5 Compliance

5.1 Interaction with self-assessment

Counteraction under the anti-avoidance provisions requires a notice to be issued by the Board of HMRC. As a result, liability (or potential liability) under the provisions cannot be a matter for self-assessment. This was confirmed in Tax Bulletin 46, which states explicitly that there is no requirement to self-assess liabilities under this legislation. Taxpayers are invited, however, to mention on their return any correspondence with HMRC about the provisions.

By the same token, the normal self-assessment time limits do not apply to the anti-avoidance provisions, which have their own longer time limits for seeking information from taxpayers and for counteraction.

5.2 Information powers

There are no longer specific information powers for the transactions in securities legislation. ITA 2007 s 703 and TA 1988 s 708 were both repealed by SI 2009/2035 on 13 August 2009 as no longer necessary. Instead, HMRC can now use the wide-ranging information powers in FA 2008 Sch 36.

6 Counteraction and appeals

6.1 Counteraction

I am sure that we all fervently hope that none of our clients will be subject to counteraction under these provisions. However, it clearly happens occasionally, so it is important to be aware of the process and of your clients' rights and obligations throughout.

The process of counteraction consists of a number of stages. Before all of these, of course, HMRC will have gathered the information required for making a decision about counteraction. They will either have used the information powers under FA 2008 Sch 36 or they will have got the information they need from a clearance application under CTA 2010 s 748 / ITA 2007 s 701.

6.1.1 Form of counteraction

HMRC has the power to counteract tax advantages under these provisions by making appropriate adjustments. The possible adjustments are specified in CTA 2010 s 746(4) for corporation tax and CTA 2009 s 698(4) for income tax, as:

- an assessment;
- nullifying a right to repayment;
- requiring the return of a repayment already made; and
- the calculation or recalculation of profits or gains or a liability to corporation tax.

6.1.2 Preliminary notification

Once all the information has been gathered and a decision made that counteraction is probably required, HMRC must issue a notice under CTA 2010 s 743 / ITA 2007 s 695. This is a preliminary notification that the person concerned is liable to counteraction and that a counteraction notice ought to be served.

This preliminary notification must specify the transaction or transactions concerned. However, there is no requirement to state which of the Circumstances or Conditions is present or why HMRC considers that counteraction may be appropriate. In *Balen v IRC* [1977] STC 148 the Revenue notified the plaintiff that they had reason to believe that this legislation might apply in respect of certain specified transactions which they listed. The notification did not specify HMRC's reasons for their opinion. The plaintiff argued inter alia that the preliminary notification was null and void on the basis that natural justice dictates that a party against whom an allegation was made should have clear notice of the case he had to meet.

The court decided that the notification what is now under CTA 2010 s 743 was merely a triggering mechanism to put the taxpayer on notice that HMRC required an explanation. There was no reason why fairness should demand that HMRC should be compelled at the outset to do more than specify those transactions which had excited their interest or to tie themselves to making good a particular case when by statute they were not obliged to make any case at all. The notification followed literally the words of the statute and specified with sufficient precision the transactions in respect of which the taxpayer's contentions were invited, and was unobjectionable.

There is no formal appeal against a preliminary notification, so strictly the taxpayer must follow the prescribed statutory declaration procedure. However, even at this late stage, it is to be hoped that the Clearance and Counteraction Team will be prepared to

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discuss their concerns about the transactions with the taxpayers, in order to reach an appropriate resolution.

6.1.3 The statutory declaration

CTA 2010 s 744 / ITA 2007 s 696 requires the taxpayer to oppose the notification by a statutory declaration. I note in passing that there is no obvious policy reason why the statement of opposition to the preliminary notice should be by statutory declaration and this is one of the areas where some of us involved in simplification of anti-avoidance legislation would like to see a change. And there have been some hints during the consultation process that the process might be streamlined.

The statutory declaration must 'state the facts and circumstances' whereby the taxpayer does not believe that they are liable to counteraction. It must be sent to the officer of HMRC who issued the preliminary notification, within 30 days of the issue of that notification.

If HMRC takes no further action, the person ceases to be liable to counteraction.

6.1.4 Submission to the First-tier Tribunal

If HMRC still wishes to proceed with a counteraction notice after receiving a statutory declaration from the affected person, the inspector is required to send to the Tax Chamber of the First-tier Tribunal a certificate to that effect, along with the statutory declaration (CTA 2010 s 745 / ITA 2007 s 697). HMRC may also send a counter-statement, which one assumes will explain why they wish to proceed with the counteraction and why HMRC disagrees with the taxpayer's statutory declaration. There is no requirement for HMRC to let the appellant see this counter-notice.

The function of the Tribunal in this respect is to take into account the declaration and the counter-statement and to determine whether there is a prima facie case for proceeding. If the Tribunal decides that there is no prima facie case for proceeding, HMRC cannot take counteraction.

HMRC has no right of appeal against the decision of the Tribunal. However, that decision only applies to the transactions that were the subject of that decision. HMRC is still entitled to consider counteraction in respect of arrangements which include some or all of the specified transactions if they also include one or more other transactions.

Strictly, the Tribunal has no authority to seek or consider information not in those documents, nor may the taxpayer or the Board address further arguments to them. This was challenged in *Wiseman v Borneman* (45 TC 540) as being contrary to natural justice and that the taxpayer should be given the opportunity to deal with the counter-statement or to address the Revenue's arguments. The House of Lords unanimously dismissed the taxpayer's appeals, on the ground that the procedure laid down by statute was not in all the circumstances unfair to the taxpayer. However, a majority of their Lordships indicated that in the proper circumstances the Tribunal had power, if it saw fit, to take appropriate steps to eliminate any unfairness in an exceptional case where material has been introduced of such a character that it would be unfair to decide upon it ex parte. That said, I am not aware of ever seeing this obiter tested in any later cases.

6.1.5 Formal notice of counteraction

Where a notification has been issued to a taxpayer and either he has not made a statutory declaration or the Tribunal has found a prima facie case for proceeding, CTA 2010 s 746 / ITA 2007 s 698 requires the HMRC officer to issue a formal notice of counteraction. The legislation does not appear to give the inspector any discretion at this stage.

The counteraction notice must specify the adjustments which are to be made to counteract the tax advantage and the basis on which they are made. The adjustments permitted are detailed in 6.1.1.

Once again, there is no requirement for the notice to specify the Circumstance that applies or the grounds for HMRC's view that counteraction is required.

The HMRC officer will arrange for any necessary assessments or amendments to assessments to be made. No assessment may be made more than six years after the chargeable period (in the case of income tax, the year of assessment and in the case of corporation tax, the accounting period) to which the tax advantage relates.

6.2 Appeals

When a notice of counteraction has been issued to a taxpayer, he has the right to appeal within 30 days, under CTA 2010 s 750 / ITA 2007 s 705. The appeal may be on the grounds that the legislation does not apply to him in respect of the transaction or transactions in question, or that the proposed adjustments are inappropriate.

6.2.1 Internal review

Since the counteraction notice is an appealable decision, the taxpayer is also entitled to request HMRC to review the decision to issue the notice, or HMRC may of their own accord offer a review. This is under the statutory internal review process detailed in TMA 1970 ss 49A-49I.

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If the taxpayer requests a review HMRC will then have 30 days to give their 'view' and a further 45 days to conduct the internal review and issue a decision on whether to uphold the counteraction notice. If HMRC offer a review of their own accord, they will just have the 45 days to conduct the review. The taxpayer would then have a further 30 days to notify an appeal against the counteraction notice to the Tax Chamber of the First-tier Tribunal.

Of course, if the individual or company concerned does not want an internal review, they can simply make the appeal directly to the First-tier Tribunal, within 30 days of the counteraction notice (see reference).

6.2.2 Appeal to the First-tier Tribunal (Tax Chamber)

The procedure as regards an appeal is in general similar to that for an appeal against an assessment. The general principle is that the appeal will be heard by the Tax Chamber of the First-tier Tribunal. There is scope in certain circumstances for appeals to be transferred directly to the Upper Tribunal, but this is not discussed in detail here, as it is assumed that almost all appeals against counteraction notices will be dealt with by the First-tier Tribunal. If you are involved in a case where it is suggested that the appeal should be heard by the Upper Tribunal, you are advised to seek advice from a tax litigation specialist (as, indeed, you should in any appeal to either Tribunal).

Appeals to the First-tier Tribunal are categorised according to their complexity. The categories are 'default paper', 'basic', 'standard' or 'complex (a full discussion of these categories is beyond the scope of this Tax Digest but more information is available from the Tribunals Service website, http://www.tribunals.gov.uk). Default paper hearings usually do not require a hearing, and an appeal against a counteraction notice is unlikely to fall into this category. Basic cases only require an informal hearing and, again, an appeal against a counteraction notice is unlikely to fall into this category. So appeals against counteraction notices are most likely to be categorised as standard or complex.

As noted above, HMRC will not have previously been required to share any of its concerns with the taxpayer. The exact level of disclosure by HMRC will depend on the category to which the case is allocated. As most cases involving Transactions in Securities will fall in the 'standard' or 'complex' categories, the taxpayer will be provided with a Statement of Case setting out HMRC's case. The taxpayer will then be able to file a 'reply' addressing the issues raised in this.

On an appeal, the Tax Chamber has the power to affirm, vary or cancel the counteraction notice under CTA 2010 s 746 / ITA 2007 s 698 or to affirm, vary or cancel any assessment made in accordance with that notice. However, appealing against the notice does not affect the validity of anything done in consequence of that notice pending determination of the appeal. So it is necessary to make a separate appeal against any assessment which may have been made as part of the counteraction.

There is no appeal from a determination by the Tax Chamber on a question of fact, only on a point of law.

6.2.3 Appeal to the Upper Tribunal (Tax and Chancery Chamber)

After a determination by the Tax Chamber of the First-tier Tribunal, the taxpayer or HMRC officer may declare dissatisfaction with the determination on a point of law. They may, within 56 days of the determination, request leave to appeal to the Upper Tribunal. If permission is not given by the First-tier Tribunal, a request for leave to appeal can be made to the Upper Tribunal within one month of the First-tier Tribunal refusing permission to appeal.

While appeals to the Upper Tribunal are pending, tax must be paid in accordance with the determination of the Tax Chamber of the First-tier Tribunal. If the amount payable is reduced by the order of the Upper Tribunal, the tax, and interest determined by the Tribunal, must be repaid. If the amount due is increased, HMRC must issue a notice of the further amounts to be paid. Payment is then due within 30 days of the date the notice is issued.

6.2.4 Appeal to the Court of Appeal and the Supreme Court

Appeals against a decision of the Upper Tribunal lie to the Court of Appeal, with permission from the Upper Tribunal or the Court of Appeal Appellate Committee. Similarly, appeals to the Supreme Court require the permission of the Court of Appeal or of the Supreme Court Appellate Committee.

6.2.5 Scotland and Northern Ireland

The new unified tribunals system applies to the whole of the UK. However the (English) Court of Appeal usually only hears appeals on English matters. The legislation requires the Upper Tribunal to determine which of the Court of Appeal in England and Wales, Court of Session in Scotland or Court of Appeal in Northern Ireland is the most 'appropriate' to hear the appeal and to send the appeal there. Appeals from any of these courts go to the Supreme Court.

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7 The future of the legislation

The Government and HMRC remain committed to eradicating what they see as tax avoidance. It seems likely, therefore, that these provisions will remain in force for some time to come, particularly while the rates of tax on some gains remain lower than those on income. However, there are some areas where further change is likely.

7.1 Corporation tax changes

During the consultation process, HMRC stated on a number of occasions that they expected any changes to the income tax rules to be mirrored in revised corporation tax rules. It may be that the reason that the corporation tax rules were not changed in line with the income tax rules in FA 2010 is that HMRC ran out of time to fully consider all the relevant issues for corporation tax. In that case, we may see extensive changes to the corporation tax rules very soon.

Another suggestion during the consultation process was that the rules for corporation tax might be completely repealed. This would require an extensive analysis of the various avoidance options that might be reopened if the legislation were repealed. But the revised rules for the taxation of distributions received by UK companies, in CTA 2009 Pt 9A, will be an important factor. These new rules mean that any distributions received as a result of tax avoidance arrangements are likely to be taxable, rather than exempt as under the pre-FA 2009 regime. So schemes that might have relied on companies receiving tax-free distributions may now fail on that fundamental point, rendering the corporation tax version of the transactions in securities rules unnecessary.

7.2 Streamlining the process

Another subject raised during the consultation process, is the complexity of the counteraction process (see 6.1), which is very much a legacy of the original FA 1960 rules. There has been talk of streamlining the process, perhaps removing the number of steps required before HMRC can raise a counteraction notice. While this may seem like a removal of checks and balances on behalf of taxpayers, most people involved in the consultation process are in favour of simplifying a cumbersome and time-consuming process, which is out of line with the rest of the tax code.

7.3 Appeals against the refusal of clearance

As noted in 4.7, there is no right of appeal against a refusal of clearance, in stark contrast to a number of other commonly used statutory clearances. Many people have been pushing for such a facility for some years, simply on the grounds of fairness to taxpayers. In recent informal discussions there were some signs that the idea was not looked upon completely unfavourably, although I personally do not expect a change any time soon.

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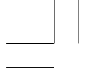
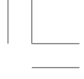

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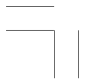
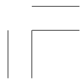

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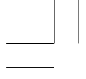
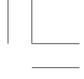

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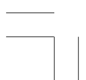
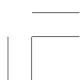

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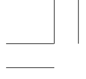
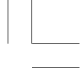

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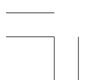
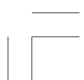

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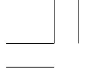
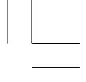

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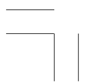
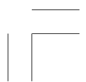
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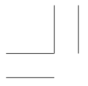
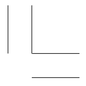
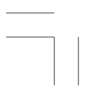
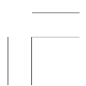

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