**Modernising the taxation of corporate debt and derivative contracts**

**Minutes of Working Group 2 Meeting**

**9.30 - 11.30 am Tuesday 23 July 2013**

**HMRC, Right Auditorium, 1 Horse Guards Road, London, SW1A 2HQ**

**Attendees**

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| Ann Brennan (GE / BBA Rep)  Andrew Hastie (LBG)  Vincent Maguire (Clifford Chance)  Nikol Davies (Taylor Wessing)  Alex Jupp (Skadden)  Stuart Sinclair (Bingham McCutchen)  Paul Miller (Ashurst)  Kathryn Hiddleston (Grant Thornton)  Leon Cane (Deloitte)  Lara Okukenu (Deloitte)  Graham Williams (PwC)  Paul Baldwin (FTI Consulting)  Andrew Seagren (KPMG)  Jonathan Richards (Ernst & Young)  May Lam (Prudential / ABI Rep)  Dominic Winter (Linklaters)  Lydia Challen (Allen & Overy)  Philip Shuttleworth (ECI Partners)  Barnaby Levy (Freshfields Bruckhaus Deringer)  (collectively the “**group**”) | Tony Sadler (HMRC) - **Chairman**  Roger Bath (HMRC)  Judith Diamond (HMRC)  Mark Lafone (HMRC)  Liz Ward-Penny (HMRC)  Andy Stewardson (HMRC)  Richard Daniel (HMRC)  Andrew Gribble (HMRC)  (collectively “**HMRC**”) |

1. **Introductions and background**  
     
   HMRC opened the meeting by clarifying the working party meeting guidelines and objectives as follows:

* The meeting will be minuted and circulated to the working group for their review and comment. With this in mind, attendees were asked to introduce themselves.
* HMRC emphasised that the purpose of the working group is to discuss ideas and to test the practical impact of proposals and early drafts of legislation. HMRC therefore encouraged the group to make discussions as open and consultative as possible so as to promote fully informed discussions.
* HMRC noted the heavy presence from HMRC and explained that this was due to the potential for the wider group to be broken down into smaller groups to discuss specific topics. With this in mind, HMRC encouraged group members to indicate whether they had any specific areas of interest.
* HMRC noted that the intention was for WG2 to focus on the modernisation of the loan relationship and derivative contract rules as regards the connected party rules, group continuity treatment, partnerships and transparent entities and debt restructuring.

There was comment from the group that a degree of overlap may arise between WG2 and WG1 given that for the most part WG2 topics focus on areas where the legislation departs from general principles (a WG1 discussion topic). HMRC acknowledge this and expressed no immediate concerns.

1. **General points**

*Simplification*

HMRC commented that the consultation is being carried out in light of various responses over the years regarding the complexity of the loan relationship and derivative contracts rules. One of the main objectives for the consultation is therefore simplification.

Whilst acknowledging this, the group expressed the view that at present, there is a general feeling of fatigue amongst taxpayers towards further change. In particular, it was felt that a radical change of the connected party and group continuity rules would be unnecessary given that the principles and mechanics of these rules are (in the majority of cases) well understood.

The group also noted HMRC’s policy objective of ‘minimising the scope for abuse’ and expressed the view that this objective did not call for wide scale reform, as in their view this perceived abuse had already been substantially reduced (e.g. through the use of TAARs).

HMRC commented that their initial impressions from the group seemed to be to avoid change and stick to what is already known and understood. The group clarified that to the extent any proposed changes do indeed allow for simplification; then these would be welcomed, however any proposed changes would need to be carefully considered and understood and where the objective of simplification is not ultimately met, change should be avoided.

*Main areas of interest/ focus*

The group felt that the main subject of interest / focus would be in the area of debt restructuring. This was felt to be the area where individuals are most often required to form judgements as to the meaning / intention of the legislation and / or to seek clearance from HMRC.

The group reiterated the general sentiment that a less radical reform should be required for connected party and group continuity rules. It was suggested a better approach may therefore be to instead focus on streamlining certain definitions.

Partnerships and transparent entities appeared the area of least interest / focus amongst the group. There was however some acceptance that the partnership rules did need to be revised. HMRC emphasised that this area would require focussed consideration in order for the proposed FB 2014 deadline to be met.

*Departing from the accounts*

The general view from the group was that the starting point for tax should be the accounts (i.e. as is currently the case). Whilst the group acknowledged that there will always be a need to depart from the accounts in certain circumstances, it was felt that the focus should be on defining and clarifying those circumstances and the policy intention for any departure.

The group emphasised the importance of avoiding the introduction of a concept / provision that requires taxpayers to “follow the accounts” except where doing so does not result in the taxation of ‘true economic profit’ (considered to be a nebulous term).

1. **Connected party**

*Fair value accounting*

HMRC commented that the connected party rules are one of the examples where the loan relationship rules depart from the “follow the accounts” approach, instead imputing a statutory fiction.

HMRC sought comment from the room on the feasibility of repealing sections 354 to 359 CTA 2009 and reverting back to core “follow the accounts” loan relationship principles (i.e. option 2 of the ‘connected party debt’ section of the Condoc). HMRC noted that this proposal would require placing reliance on other rules to ensure symmetry between parties, and sought comment as to what this rule should be e.g. the group mismatch rules or a bespoke provision. HMRC clarified that the policy intention of the connected party rules are to prevent the cascading effect of double counting losses within a group.

HMRC commented that such a proposal may help ease administrative burden where for example two companies both apply a fair value basis for accounting. In this case following the accounts could (in most cases) give an acceptable answer for tax purposes. HMRC sought comment on this and whether the group felt this example would become more prevalent as a result of the new accounting changes (which require use of fair value accounting except in the context of simple loans).

The general view from the group was that in practice this proposal would not achieve simplification. The need to rely on a separate rule to avoid asymmetries would necessarily require a departure from the “follow the accounts” principle, making the objective for a ‘simple’ regime harder to achieve in practice.

Furthermore, whilst the group generally agreed that the accounts give the best measure of profit it was felt unlikely that impending accounting changes would result in fair value accounting becoming a ‘norm’ for companies. (This was considered a ‘norm’ typical more for financial institutions).

The group suggested that a better approach to reforming the connected party rules would be to focus on streamlining certain definitions (e.g. amortised cost basis, release etc.)

*Amortised cost basis*

One member of the group highlighted the reference in the Condoc to the statutory definition of amortised cost basis and that this does not precisely align with the IAS 39 and FRS 26 accounting requirement to recognise amounts at fair value.

This individual drew upon this reference as an example of why HMRC should trust the accounts in determining profit and not seek to develop their own extensive list of accounting concepts for tax.

1. **Debt restructuring**

The group felt that the rules on debt restructuring called for the most attention as this was considered to be the main area where individuals are often required to form judgements as to the meaning/intention of legislation or to seek clearance from HMRC.

In particular, the group noted it would be useful to understand the policy driver behind sections 361 and 362 CTA 2009 i.e. clarification as to what situations HMRC considers these rules are intended to catch.

*General principles*

The group felt that the key focus around debt restructuring should be tax neutrality. Furthermore, the group felt clarity was required on where the line should be drawn between tax neutral restructuring and the application of sections 361 and 362 CTA 2009.

A select number of group members commented that as currently drafted the legislation operates to bring into account amounts arising on a release with relatively few exceptions. It was suggested that consideration be given as to whether this is the correct starting point for tax, or whether the legislation should instead operate to disregard a release credit unless prescribed circumstances apply.

Whatever the final proposal, the group commented that the legislation would also need to reflect taxpayer fairness as well as protection for the Exchequer. HMRC agreed with this sentiment.

1. **Small companies**

HMRC sought comment from the room as to whether the views expressed reflect the sentiments of smaller businesses, particularly where smaller business using more straightforward loans to fund their business.

The group noted that in their view smaller businesses are not necessarily more straightforward. For the most part, the group considered the views expressed reflective of SMEs. In particular, advisors within the group noted that in their experience smaller businesses readily understood the connected party and group continuity rules and mainly sought advice around uncertainties within the debt restructuring rules.

1. **Next steps**

*Smaller working groups*

HMRC suggested the wider group be sub-divided into smaller groups to discuss specific topics. The proposal would then be for these smaller groups to feed back into the wider group once sufficient progress had been made.

A member of the working group queried whether this was the best approach. HMRC noted that in their view this approach would facilitate more detailed, practical discussions, however if once tested it was felt that this objective was not being met, then the approach could be revisited.

The wider group suggested this approach be applied to the group continuity and (separately) the partnership rules. The group was keen to continue discussions on the connected party and debt restructuring rules as part of the wider working party group as it was felt these two topics to be inevitably interlinked. Cross over in membership of the smaller groups was encouraged by both HMRC and the group.

The following individuals expressed an interest in each of the two groups.

*Group continuity -* Ann Brennan (GE / BBA Rep)

* Andrew Hastie (LBG)
* Graham Williams (PwC)
* Andrew Seagren (KPMG)

*Partnerships -* Catherine Lynsey (ECI Partners) – nominated by

Philip Shuttleworth

* Andrew Hastie (LBG)
* Alex Jupp (Skadden)
* Jonathan Richards (Ernst & Young)
* David Boneham (Deloitte) – nominated by Leon Cane

*Debt restructuring paper*

The group committed to producing a short debt restructuring paper. This would be in bullet point form and not expected to be longer than one to two pages.

HMRC and the group agreed that the intention of this paper would be to facilitate a more frank and open discussion in the area of debt restructuring. In pulling together views, HMRC encouraged the group not feel bound by proposals set out by HMRC in the Condoc.

HMRC and the group identified the following potential areas for consideration in the discussion paper:

* Whether the basic principle of taxing companies on a release credit should be revisited. If this were the case, then defining the prescribed circumstances where a company should be taxed?
* Providing examples / case studies of instances where it was felt the legislation (as currently drafted) fails to operate effectively.

It was suggested here that HMRC could also draw on their experience from clearance applications.

* Providing examples of how debt releases are treated in other European jurisdictions.

HMRC encouraged group members to discuss the relevant issues around debt restructuring within their organisations and with those of relevant experience. This should increase the breadth of views and also allow the group to identify areas where judgement is often required to be made.

1. **Timing**

*Smaller working groups*

HMRC to set up meetings for the smaller working party groups for early September.

*Debt restructuring paper*

Jonathan Richards to circulate for comment the debt restructuring paper with a view to coordinating responses by early September.

*Partnerships*

HMRC noted that the operation of the loan relationship and derivative contracts rules in the context of partnerships will run alongside the separate and more wide ranging review of partnership taxation announced in the Budget 2013.

Those changes will take effect from 6 April 2014. HMRC expressed that they are keen for the loan relationship and derivative contract partnership rules to align with this deadline.

*Other areas generally*

A group member queried whether there is scope to include further legislative changes within the 2014 Finance Bill. HMRC confirmed that this may be possible but will depend on the ability to give due consideration to the proposed changes, particularly given the compressed timetable.

HMRC confirmed that the response to the Condoc should be made available around the time of the Autumn statement but that to the extent they become available earlier, the working groups could be given access in advance of this date.