Transactions in securities – where are we now?

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Ray McCann answers the question so many are asking

Even by today's standards when anti-avoidance legislation seems to be more and more radical, the Transactions in Securities rules (TIS) were widely seen as condemning tax avoidance transactions to history with some early judicial comment describing them as making tax avoidance no longer possible. As is now clear, this was true only so far as the tax avoidance was within their scope and over the intervening years the Revenue found that the scope of these provisions was very limited indeed. So much so that in the cases of Kleinwort Benson, Sema Group Pension fund and Laird Group, arrangements that the Revenue could reasonably believe were fairly within the cross hairs of the TIS rules escaped. Thus it is clear that where they did apply their impact was severe, so much so that even fifty years on no other provision operates quite like them, but they did not apply very often.

A brief history

The TIS rules were introduced by the Finance Act 1960. They became S460 ICTA 1970 then S703 ICTA 1988 and are now found in S682 ITA 2007. From the outset they were intended to tackle two main types of tax avoidance:

- the receipt in a “non-taxable” way of an amount that could otherwise have been received as income (most typically as a dividend);
- the recovery by way of repayment of tax that had previously been deducted at source or had been paid on other income against which a loss (created by the TIS) could be offset.

Understanding how the rules were supposed to work was much easier if those two broad categories were understood since the statutory provisions were largely structured along these lines.

The unprecedented nature of the TIS provisions lay in the fact that where the Revenue was able to successfully counteract any tax advantage they could levy income tax not on the actual transaction but instead upon a fictional transaction that in the view of the Revenue the taxpayer *could have done*. All of the business, company law and tax consequences that otherwise arose as a result of the transaction, as carried out, were left undisturbed. In the majority of such cases this fiction meant that the Revenue would compute the additional tax typically on the basis that the taxpayer had received a dividend and the majority of counteractions taken over the years by the Revenue have been of this sort. Counteraction of a repayment has been less common although the pension fund share buy-back schemes of the late 1990s were a notable exception (see for example the *Sema Group Pension Fund* case).

To further understand the origin of these rules it is also necessary to recognise that from the viewpoint of the Exchequer transactions in securities exploited the very different tax position of capital receipts when compared with income. Today HMRC would assert fairness as the key driver and whilst this is perhaps always a consideration, at the time of Finance Act 1960 there was no capital gains tax as we understand it today and banks and other financial concerns enjoyed a very privileged tax position whereby interest and other returns from corporate bonds held by the bank were not taxable at all despite losses on such holdings being allowed against profits. This meant that converting income to capital could be hugely advantageous since depending upon your mix of income the rates of tax on that income could be close to 100%! The very significant structural changes in the years following the introduction of the TIS rules including the introduction of CGT and Corporation Tax, the reform of banking taxation rules and the introduction of the imputation system in relation to dividend in 1973 meant that the TIS rules were reduced to eking out a continued existence as the main statutory safeguard against

what was generally referred to as a “Cleary transaction” (basically selling shares in a company you own to another company you own for cash) and even today a transaction of this sort is the most common situation in which it would be expected that the TIS rules would be invoked by HMRC. It is also the basis upon which HMRC refuses to give clearance in the majority of such cases as are refused each year.

Advance Clearance

Indeed in view of the narrow scope of the TIS rules it is advance clearance requests that have typically kept HMRC busy and not counteractions as each year thousands of clearance requests are made with the numbers seemingly on the increase. This has been despite the introduction of CGT, the later alignment of CGT and income tax rates, the reduction in the very high top rates of income tax and reductions in corporation tax. Of course as we know the rate of tax is one thing, what tax will actually be paid is another and no doubt the attraction of initially Taper Relief and more recently Entrepreneurs Relief has meant that the differential between the top rates of income tax (45%) and CGT (now 20% reduced to 10% where Entrepreneurs Relief is available) has kept the HMRC clearance team busy.

The Tax Law re-write

More recently, as part of the Tax Law rewrite programme S703 ICTA 1988 became a redrafted S682 ITA 2007 with separate, now redundant provisions applying to companies. The main objective of the redrafted provisions was a desire on the part of HMRC to replicate as closely as possible in statutory form the way HMRC understood the TIS rules had in broad terms being applied over the years by the Courts but also in part to enact some of the practices HMRC itself applied but which were often hidden from public view. The most obvious area where this approach could be seen was the introduction of a “fundamental change in ownership” test that would apply where the taxpayer disposed of shares (even in a Cleary situation) in circumstances where an unconnected party acquired at least 75% of the ordinary share capital going forward.

The 2016 changes

As is well known, significant changes to the taxation of dividends were announced in 2015 and came into effect from 6 April 2016 – see comments from Pete Miller in his article above. Also from April 2016 the rate of CGT was reduced to 20% for disposals other than residential property. The dividend changes reduce what was clearly a significant incentive to owner managed businesses to pay dividends rather than salaries and no doubt the Government anticipated that some taxpayers would be increasingly tempted to extract income profits from a company in a capital form perhaps by winding up a company and other transactions. Thus in what was clearly a defensive move by the Government, following a separate consultation, significant changes are included in the Finance Bill 2016 that amend the TIS rules and introduce somewhat oddly a TAAR designed to target transactions that result in companies being wound up but the trade or business previously carried on being continued or recommenced within a two year period. Given that the TIS rules can apply in many such situations (only HMRC seem to think they do not most likely due to confusion as to when a liquidation may be caught) having a separate provision from the main TIS rules will inevitably increase uncertainty and confusion and inevitably make lfe more difficult for HMRC itself. And having a separate provision that is outside of the existing clearance arrangements is very short sighted since here and elsewhere the challenges facing HMRC are not simply with individuals who carry out abusive transactions per se but with individual who carry out abusive transactions and do not disclose them to HMRC!

Largely for that reason over the years HMRC counteraction activities have been confined almost exclusively to those transactions that have come to its notice due to the clearance arrangements in place and the ongoing complexity of these rules means that the majority of front line HMRC Inspectors stand little chance of identifying transactions potentially within their scope.

The introduction of the TAAR has been described as targeted at “Pheonixism” but plainly goes much wider since in future the TAAR will potentially apply regardless of whether the trade or business is carried on in corporate form. HMRC’s fundamental difficulty with such transactions from the TIS perspective is that where the business was wound up, shareholders were generally regarded by HMRC as protected from TIS by a combination of long standing HMRC practice and the motive test, which again emphasised the extent to which HMRC relied upon Cleary.

Some of the changes tidy up aspects of the TIS provisions that over the years have caused some uncertainty but will most likely mean that there is no significant

practical change. In particular the TIS rules will now apply where a tax advantage arises as a result of a TIS even where that advantage is enjoyed by a person who is not party to the transaction. This restores the position that the Revenue generally considered was the way S703 worked albeit HMRC hardly ever took the point!

Perhaps the most significant changes are the amendment of the counteraction procedures. These appear to, in part, attempt to align the counteraction process more closely with what would be expected with a self assessment enquiry but it still leave TIS outside of the self assessment framework. More wide reaching change was required here since there is now no specific reason why TIS should remain outside of self assessment. As proposed HMRC can open an enquiry in relation to a TIS up to six years after the year of assessment in which the TIS took place and once that enquiry is open it can go on forever unless HMRC give up or are told to give up by the Tribunal. It is not obvious why HMRC should be given this very generous leeway or in particular what policy justification allows taxpayers potentially impacted by them the same protections as are afforded by the discovery provisions and behaviour related time limits available in almost every other situation.

Similarly and for reasons that have been explained and which verge on bizarre, the existing clearance arrangements that apply to TIS will not apply to the TAAR. Given that the TAAR is for all practical purposes an extension of the TIS provisions and some of the transactions expected to be engaged by the TAAR are arguably also caught by the TIS rules, the reasons given in the consultation response make little sense if for no other reason than currently it is likely that many such transactions are already subject to advance clearance requests and the members of the clearance team will be the most skilled in identifying possible transactions within the scope of the TAAR. It also misses quite an important tactical point; in the past the fact that the taxpayer was able to apply for advance clearance usually worked against him in any situation where the Revenue sought to counteract a tax advantage and he had not done so!

As part of rebalancing the tax system much “tried and tested planning” is coming under scrutiny as the Government looks to increase tax revenues. At the same time expanding the significant differential between the taxation of capital and income will no doubt mean that the TIS rules will be a concern for some time yet!