

## Company Purchase of Own Shares – Multiple Completion Contracts

### Spring Budget 2023 Representation by the Chartered Institute of Taxation

#### 1 Executive Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 In early 2022, HMRC clarified their position on the purchase of own shares (POS) legislation at s1033 Corporation Tax Act (CTA) 2010 in circumstances where the transaction is effected through a multiple completion contract, and whether the seller remains connected with the company immediately after the purchase, in particular their view that the word ‘possesses’ in s1062(2) CTA 2010 refers to legal, as opposed to beneficial, ownership.
- 1.3 HMRC provided the CIOT with a note to explain their rediscovered interpretation of the meaning of the word ‘possesses’ which we published on our website on 21 February 2022<sup>1</sup>. HMRC said that they appear to have overlooked the ‘possession’ of issued share ordinary share capital limb of s1062(2) when granting a number of recent POS clearance applications under s1044. This is likely to have resulted in POS clearances being granted where the seller was still connected with the company by virtue of retaining legal ownership of more than 30% of the issued share capital immediately after the POS contract was executed. In their note, HMRC stated that they would not treat such clearances as void purely on the basis of retained legal ownership of the shares. However, going forward HMRC would apply their rediscovered interpretation of the connection test which may result in some applications being rejected.
- 1.4 We continued to correspond with HMRC on this issue during the first half of 2022 as we sought to explore the technical position with them and make further representations. The topic was also the subject of an article in Taxation magazine on 31 March 2022 (paywall) by Pete Miller and Stephen Burwood, who are members of

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<sup>1</sup> See <https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/c0957d52-b133-4b2c-9743-88ba49b443f8/220218%20HMRC%20note%20on%20PoS.pdf>.

the CIOT's Owner Managed Business technical committee<sup>2</sup>. In the article the authors suggested some alternative interpretations of the legislation. HMRC considered our representations and the alternative interpretations but concluded they did not change their position.

- 1.5 While we accept that HMRC have to follow the law as (HMRC believe) it is written, there is no obvious policy reason why the connection test should have been intended to refer to legal, rather than beneficial ownership in this way. Certainly, judging by the fact that clearances were given for many years on the basis that the test was of beneficial, rather than legal, ownership, it does not appear that there was any suggestion within HMRC that multiple completion transactions were in any way offensive, abusive or merely contrary to the intended policy. The fact that the legislation operated perfectly well under the 'incorrect' interpretation for many years suggests that as a matter of tax policy it makes sense to amend the legislation.
- 1.6 With regard to a possible amendment to the legislation, HMRC indicated that it would be helpful to know the scale of the issue and any reasons why alternative structures cannot be used to achieve the same result. Since then, the CIOT has been seeking the views of its members to understand how HMRC's rediscovered view is affecting commercial transactions in practice. We have received feedback that using alternative structures to achieve the same result is not ideal due to the additional costs and time involved and is prohibitive where the taxpayer concerned is a small business without the funds to meet the additional costs involved.
- 1.7 The purpose of this Budget Representation is to ask that a legislative amendment should be considered, particularly since, as seems probable, there is no obvious policy reason why the s1062 connection test should refer to legal rather than beneficial ownership (which is consistent with how HMRC had been interpreting the legislation for many years). Amending the legislation would help to put the matter beyond doubt. We explore three suggested solutions below in paragraph 4.
- 1.8 Following the Government's decision to abolish the Office of Tax Simplification, and to embed simplification in HM Treasury's and HMRC's tax policy work going forward, we would urge the Government to consider amending the legislation in this area so as to produce a simpler operation of the POS rules and clearer, more certain and fairer outcomes for businesses affected by them.

## **2 About us**

- 2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 2.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

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<sup>2</sup> The topic was also explored in a Tax Adviser magazine article by Peter Rayney in March 2022 which also examined some alternative structures to achieve the same result - see <https://www.taxadvisermagazine.com/article/multiple-completion-contracts-company-share-buy-backs>.

- 2.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.
- 2.5 Our stated objectives for the tax system include:
- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
  - Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
  - Greater certainty, so businesses and individuals can plan ahead with confidence.
  - A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
  - Responsive and competent tax administration, with a minimum of bureaucracy.

### 3 Background

- 3.1 In order for capital gains tax treatment to apply on a company purchase of own shares, s1042 CTA 2010 imposes a condition that the seller must not, immediately after the purchase, be connected with the company making the purchase (or any other company which is a member of the same group). S1062(2) CTA 2010 sets out when a person is connected with a company for these purposes<sup>3</sup>, in particular that:

*A person is connected with a company if the person directly or indirectly possesses, or is entitled to acquire, more than 30% of–*

*(a) the issued ordinary share capital of the company,*

*(b) the loan capital and the issued share capital of the company, or*

*(c) the voting power in the company.*

- 3.2 HMRC's rediscovered 2022 view is that the word 'possesses' refers to legal, as opposed to beneficial, ownership. When shares are subject to a sale under a multiple completion contract, the seller may (depending on the terms of the contract) lose beneficial ownership of all the shares on the date of the contract. However, the legal ownership of the shares is retained until the sale of those shares has completed. This is the case even if those remaining shares are converted to so-called deferred shares with no voting or economic rights in the company on completion of the first tranche.
- 3.3 Therefore, so long as the seller remains a legal owner of so many non-completed shares that exceed the 30% limit, they will remain connected with the company by virtue of s1062(2)(a) (possession of ordinary share

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<sup>3</sup> We note that similar language is used in s170 Income Tax Act 2007 in relation to Enterprise Investment Schemes and persons interested in the capital etc of a company for the purpose of identifying when a person is connected with the issuing company.

capital). In such circumstances, the seller would not qualify for capital treatment under s1033 CTA 2010 and HMRC will reject POS clearance applications where the connection test is not met.

#### 4 Suggested legislative amendments

- 4.1 Our first suggestion is that consideration might be given simply to substituting the word ‘possesses’ in s1062, with ‘owns’. The taxation of capital gains principally follows beneficial ownership and the word ‘ownership’ has more of the flavour of beneficial ownership than the word ‘possesses’. Indeed, s1048(3) states that where s1033 to s1047 refer to the owner of shares it means ‘beneficial ownership’ except in some limited circumstances. We suggest that the direction in s1048(3) could be extended to s1062.
- 4.2 Our second suggestion is that consideration might be given to adding the word ‘beneficially’ before ‘possesses’ (and before ‘entitled to acquire’) in order to make it clear that possesses in this sentence means beneficial, not legal ownership.
- 4.3 Our third suggestion concerns the interpretation of the word ‘possesses’. During discussions with HMRC, it was mentioned that the term ‘possesses’ is also used in the close company definition of ‘control’ in s450 in the sense of it referring to ‘legal ownership’. It was suggested that this might be influencing HMRC’s interpretation of ‘possesses’ in s1062. If this is the case, the problem with the legislation may be that ‘possesses’ in s450 probably does refer to legal ownership, but s 451(3) (while tending to confirm that interpretation of the word ‘possesses’) tells the reader in effect to look to beneficial ownership instead in applying the ‘control test’ in s450 by attributing the rights or powers to another person (A) where a person possesses them on A’s behalf.

*s451(3) If a person—*

*(a) possesses any rights or powers on behalf of another person (a)<sup>4</sup>, or*

*(b) may be required to exercise any rights or powers on A’s direction or behalf,*

*those rights or powers are to be attributed to A.*

- 4.4 In the case of s1062 there is no obvious equivalent of s451(3). If that is right the obvious correction is to insert a s451(3)-equivalent provision into s1062, the effect of which should be to attribute the rights or powers over the ordinary share capital of the exiting shareholder (the person who legally possesses them) to the company which is purchasing their shares.
- 4.5 We favour our first suggestion over the second and third. The second one proposes a qualification to the meaning of the word ‘possesses’ which potentially introduces a new legal concept and additional complexity into the legislation. The third one is more complex and, because it introduces further tests to the rules for company purchase of own shares, could have unforeseen effects. Our first suggestion of simply changing one word for another whose meaning is well understood could and should resolve the problem entirely.

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<sup>4</sup> It is likely that the legislation should refer to ‘A’ here not ‘(a)’, to be consistent with the rest of the section.

## **5 Acknowledgement of submission**

- 5.1 We would be grateful if you could acknowledge safe receipt of this representation. We would welcome the opportunity to discuss this issue and the legislative solutions we have proposed with HMRC in more detail.

The Chartered Institute of Taxation

30 January 2023