18 September 2013

Cameron Wilson
HMRC Business Investment Relief Advance Assurance Team
HMRC
100 Parliament Street
London SW1A 2BQ

via e-mail: cameron.wilson@gsi.gov.uk

Dear Cameron

Business Investment Relief (BIR)

The Chartered Institute of Taxation (CIOT) is writing to explain why, in our view, the take up of BIR is poor and what needs to be done to improve matters.

We are aware from the consultation that led to BIR that ministers wanted a user-friendly relief that would encourage non-domiciliaries to invest in the UK. The core features of BIR are consistent with this objective; most notably:

- The wide range of trading and property investment companies which qualify;
- The complete lack of restriction on the size of shareholding or loan which qualify; and
- The fact that it is immaterial whether the investor works for the investee company and/or already owns shares in it.

Extraction of value rule

Unfortunately as the legislation went through successive drafts it became hedged about with various anti-avoidance rules. The cumulative effect of these, and in particular the uncertainty they generate, has been to deter investors from using the relief and advisers from recommending it. Ministers no doubt understand that there is a trade-off between anti-avoidance measures and investment incentives and that if the former are too great the latter will not be achieved.

There are three principal anti-avoidance rules in ITA 2007:

- The purpose test in section 809VA(7);
- Condition B in section 809VF, which denies relief if related benefits are obtained or expected; and
- The extraction of value rule in section 809VM(1)(C).

Of these rules, the last is much the biggest deterrent. This is for the following reasons:

1 If value is extracted, all the relief is clawed back unless the entire holding is sold and the entire proceeds reinvested or removed abroad. Such is the result even if the value extracted is minimal;
2 The pooling rules in section 809VN mean that where the investor has made multiple investments qualifying for BIR in the same company or group, claw back affects all investments unless all are sold and the proceeds removed abroad or reinvested;
3 The definition of 'involved company' in section 809VH(4) means that value counts as extracted if extracted from any company connected with the BIR investee company, regardless of whether that company had anything to do with the BIR investment or indeed is UK resident;
4 Two or more companies are connected for these purposes not merely if the BIR investor controls all of them, but also if he controls one and close family or trusts settled by him control the other (ITA 2007 section 993);
5 A company can also count as controlled by the BIR investor even if he is a minority shareholder if he and others act together to secure or exercise control (see ITA 2007, section 993(7) and *Foulser v McDougall* [2007] STC 973);
6 The arm's length rule preventing a receipt from counting as value extracted if it is paid in the ordinary course of business only applies if what is received is income for UK tax purposes (section 809VH(3)); and
7 The rule stating that value does not count as extracted if the extraction is a disposal applies only where what is disposed of is part of the holding ie the shares in or loans to the BIR company itself or other companies in its group.

The combined effect of these provisions may be illustrated by an example:

- Mr X, a Chinese national, invests £100,000 in A Ltd, a UK company which he controls and claims and is granted BIR.
- His son living in China controls a Chinese property company B Ltd.
- A Hong Kong trust of which Mr X is settlor owns a Hong Kong trading company, C Ltd.

Should any of the following occur, the extraction of value rule will be breached and Mr X's entire BIR on the £100,000 will be clawed back:

1 B Ltd pays Mr X's son a dividend. This is an extraction of value because it is not on arm's length terms.
2 B Ltd is put into member's voluntary liquidation and its assets distributed to Mr X's son.
3 C Ltd makes a £1,000 gift to Mr X's son in recognition of Mr X's son's efforts in facilitating a contract in China. This was quite unsolicited but entirely proper as ratified by the trust shareholder.

Many more examples can be given.

Recommendations

Our view is that, if the unhelpful features of the extraction of value concept were stripped away the end result would be similar to the related benefit rule (Condition B) in section 809VF. We therefore suggest the latter should be extended to cover benefits received after the BIR investment has been made and claw back the relief to the extent of the benefit. If this is done, we believe the extraction of value rule can and should be repealed.

Condition B

We also consider that Condition B renders unnecessary the purpose test in section 809VA(7). That test is a potential deterrent as nobody can say with certainty what kind of transaction a particular officer of Revenue and Customs, or an individual judge, will view as avoidance. We acknowledge there is a clearance procedure but this is non-statutory and informal and cannot provide the certainty investors want.

Recommendation

We would urge removal of section 809VA(7), particularly now that the GAAR has been enacted.

Other areas

There are certain other points about the BIR legislation that have occasioned criticism and should, if opportunity presents, be clarified. We would mention the following:

1. In section 809(VA) it is not clear whether an investor who subscribes for the target's shares or loan abroad attracts the relief. In such a case the bringing of funds to the UK is by the target and so is not a relevant event;
2. It would be helpful if the term 'disposal' were defined. Presumably it is meant to have the same meaning as in TCGA 1992; and
3. The claim procedure is unsatisfactory where the investor is not the remittance basis user himself. In some cases the remittance basis user may not know about the transaction until it is too late.

We would be happy to attend a meeting to discuss and elaborate the points in this letter.

Yours sincerely

John Barnett
Chairman, CGT & Investment Income Sub-Committee

The Chartered Institute of Taxation

The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. 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. 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.

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. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 16,800 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

HM Revenue & Customs

H M Revenue & Customs
High Net Worth Unit S1278
PO Box 202
BOOTLE
L69 9AL

Phone 03000 527416
Mon-Fri 8.30am -5.00pm

Fax 03000 527402

Email cameron.wilson@hmrc.gsi.gov.uk

Web hmrc.gov.uk

John Barnett
Chartered Institute of Taxation
Artillery House
Artillery Row
LONDON
SW1P 1RT

Date 20 December 2013
Our ref
Your ref

Dear John

Business Investment Relief (BIR)

I refer to your letter dated 18 September 2013 in which you set out a number of concerns held by CIOT about BIR and, in particular, the operation of the extraction of value rule. I have discussed your letter with our technical and policy advisors and this response summarises our view.

The first thing to say is that we do not understand the basis on which you might have concluded that the take up of BIR is poor. The vast majority of tax returns likely to contain claims will probably not be filed until close to 31 January, although I do appreciate that your members will have been seeing investments as they are made. The indications thus far, judging by the level of enquiries received by our Advance Assurance Team (AAT) in Bradford, is that the level of interest is increasing. Another point that one needs to consider is that BIR is a narrowly targeted relief that only affects those customers who use the remittance basis so the question isn't merely one of numbers; one has to look also at the amounts being invested. You may be interested to know that our AAT very recently signed off an advance assurance request involving an investment of around £80M which, according to the agent acting, would never have been made without BIR.

We do not accept that the effect of the anti-avoidance features within BIR legislation has been to deter those genuine investments that BIR is intended to facilitate. We have, regrettably, seen a number of cases where the proposed investment was clearly not what the relief is intended to cover and the anti-avoidance provisions are serving us well in that regard. That said, we do agree that potential investors need to give careful thought to whether their transaction is likely to qualify and that is the very reason why we have an AAT in place. The AAT are actively reviewing applications and, where they identify potential problems, are working with agents to overcome them to ensure that BIR can be made available wherever possible.

In paragraph 6 on page 2 of your letter, you refer to the arm's length rule (s809VH(3)) and appear to misunderstand its meaning. You say that it only applies "if what is received is income for UK tax purposes" and this appears to form the basis of your conclusion in relation to example 1. (Mr X's son receiving a dividend). Section 809VH actually says;

"(3) But the extraction of value rule is not breached merely because a relevant person receives value that—

(a) is treated for income tax or corporation tax purposes as the receipt of income or would be so treated if that person were liable to such tax, and

(b) is paid or provided to the person in the ordinary course of business and on arm's length terms."

There is nothing to suggest that the dividend paid to Mr X's son might not be treated for income tax purposes as the receipt of income if the son were liable to such tax. Furthermore, your example seems to assume that Mr X's son is a minor (unless you regard him to be a relevant person in some other way) and/or that the payment of a normal dividend might not be the ordinary course of business, so we do not understand why the extraction of value rule might be breached.

Your second example (Mr X's son receiving a distribution on liquidation) does not seem to us to be a case where the extraction of value rule would necessarily apply either, for the same reasons as I mention in relation to example 1.

The third example might be one where the extraction of value rule applied but that again depends on Mr X's son being a minor. Having said that, the circumstances you describe of an unsolicited gift in recognition of the son's efforts in securing a contract in China are pretty unlikely to arise in reality and, if they did, there would be many other factors to consider so it is perhaps too complex an example to demonstrate any weakness or defect in BIR itself.

Turning to the specific recommendation on page 3 of your letter, our responses are as follows;

Stripping away features of the extraction of value rule

We have seen no evidence that this has acted as a significant deterrent to the making of claims. It has caused some people to spend time considering the possible implications of their actions but that is not the same as them deciding not to invest. You have suggested that Condition B could be extended to cover benefits received after the BIR investment has been made but it already does so. The definition within s809VF(3) clearly says that a related benefit can include one after the investment is made.

Condition B and s809VA(7)

We have seen no evidence that the purpose test within s809VA(7) has acted as a deterrent to any genuine investment that ought to qualify for BIR. On the other hand, we have examples where it has been able to deny relief for investments that plainly were not intended to qualify.

You have gone on to comment on some other areas in paragraphs 1 to 3.

1. We have seen a couple of examples where advisors have not appreciated that s809VA requires that a subscription for shares in a non-UK target company be made in the UK because BIR is only available where there is an investment by virtue of which a remittance occurs. Problems arise where there is payment into a (non-UK situs) target's foreign bank account. The same problem arises where the investment is by way of loan. The simple solution is to ensure that the investment is made into a UK bank account held by, or for the benefit of, the target. Our AAT have, where relevant, pointed this out to agents who have made advance assurance requests and the funding routes have been easily modified to ensure that relief is available. If CIOT would be interested in issuing a guidance note to members clarifying the point, then we would be happy to help with drafting.

2. The definition of the term "disposal" is not necessarily the same as in (say) TCGA92 if, by that, you mean there would only be a disposal if s21 TCGA92 applies. Section 809VC(3) provides that shares **and rights under a loan** forming the subject of the investment are referred to as "the holding". A potentially chargeable event occurs where the relevant person who invested disposes of all or part of "the holding" (s809VH(1)(b)) and this includes loan repayments. So, it can be seen that the term "disposal" also captures the simple repayment of a loan to which TCGA92 does not apply. It might be helpful if you could outline why you thought it necessary to define the term because we are not aware that it has caused any difficulty so far.

3. There may be an issue in the unlikely event the investor is unaware of a transaction by another relevant person . However, the underlying cause of this is not BIR *per se* because the same problem arises where any "relevant person" brings the other party's income/gains to the UK for any purpose. This is simply the way that the basic remittance basis legislation operates in that it requires remittance basis users who transfer their foreign income and gains to others to have controls in place to identify potential remittances.

Yours sincerely

Cameron Wilson
Customer Relationship Manager

To learn more about your rights and obligations go to hmrc.gov.uk/charter

Chartered Institute of Taxation
Excellence in Taxation

3 April 2014

Cameron Wilson
HMRC
High Net Worth Unit S1278
PO Box 202
Bootle
L69 9AL

via e-mail: cameron.wilson@hmrc.gsi.gov.uk

Dear Cameron

Business Investment Relief (BIR)

We refer to your letter dated 20 December 2013 responding to our letter of 18 September.

BIR take-up

We are pleased the Advance Assurance Team (AAT) is reporting that the level of interest is increasing. We would however reiterate that those practitioners to whom we have spoken consider that the features highlighted in our earlier letter, and in particular the extraction of value rule, are a deterrent. One adviser has mentioned a single transaction worth £300m where the client was put off by these issues (he did not want to apply for an advanced assurance as he felt that his foreign business interests were of no concern to HMRC). We are copying to Jane Page of HM Treasury.

Guidance note

We support your idea of an agreed guidance note in connection with the method of funding and suggest it covers some of the other points raised in this correspondence, most notably the definition of disposal. Here it is useful to have confirmed that the simple repayment of a loan is a disposal.

The extraction of value rule

This of course is at the heart of our concerns.

We note two important points from your letter:

1. Condition B does cover benefits received after the investment is made, a point which, as we see it, strengthens the argument that there is no need for an additional extraction of value rule; and

2. You agree with our list of reasons (points 1 – 7) as to why investors should be wary of the extraction of value rule and therefore why it acts as a deterrent, but take issue with our example.

We agree our example is not as apposite as it could be for reasons you state. We rephrase the example below. However, it is worth reiterating the key generic points of difficulty which are, in our members' experience, acting as a deterrent. These are:

- There is no de minimis to the level of benefit. An investor in a British film production who receives a special presentation DVD of the film signed by the stars of the film (therefore having re-sale value) will potentially lose relief, even though these benefits are trivial.

- Not only is there not a de minimis, but the extraction of value rule is all or nothing and disproportionate to the amount extracted. An investor in a football club who receives a free (transferable) ticket to one match (worth perhaps £50) loses all relief potentially worth millions.

- Worse still, these points apply not just to the investee company, but to other companies which fall within the technical definition of 'involved company' which - because it includes 'connected' companies' - includes all companies under the same control. Our previous example of Mr X, a Chinese national, was designed to illustrate how Mr X might invest in a UK company, but have an entirely separate company in China which was nothing at all to do with the BIR company. We cannot see the policy rationale for extraction of value from companies (often foreign companies) which are entirely unrelated to the BIR investment triggering a complete withdrawal of BIR.

To rephrase our previous example to make this point better, assume:

- Mr X, a Chinese national, invests £100,000 in A Ltd a UK company which he controls and is granted BIR.
- Mr X owns and controls a Chinese property company, B Ltd, entirely unrelated to A Ltd.
- A trust of which he is settlor and his children and grandchildren are beneficiaries controls a Hong Kong trading company C Ltd, entirely unrelated to A Ltd.
- Some of his children/grandchildren are minors.

On this scenario, we would say the extraction of value rule would be engaged should any of the following occur:

1. B Ltd pays a large dividend to Mr X. The dividend is above market rates and therefore is probably not on arms' length terms. However, it is entirely unrelated to A Ltd.

2. The same analysis would apply if C Ltd paid a similar dividend to the trust.

3. B Ltd is liquidated and the liquidator distributes the surplus assets to Mr X. This would be prevented from being an extraction of value by ITA 2007 section 809VH (2)(c) were B Ltd part of the same holding as A Ltd. However, it is not (see section 809VN).

4. The same analysis would apply if C Ltd were to be liquidated and the surplus distributed to the trust.

5. At the request of the trustees, C Ltd sends funds to a 17 year old child beneficiary to pay for travel outside China. This may be income, but it is not at arm's length.

Our concern in giving these examples is to show that the extraction of value rule applies in circumstances where one would not expect it to do so and where, we would suggest, there is no policy reason for it to do so. In the main this is because the rule is engaged if the value extracted is from a company which has nothing to do with the BIR company (albeit connected under the very wide anti avoidance definition). Further it then claws back the whole BIR relief and not just an amount equal to the value extracted, even if the latter is very modest. These features, surely, are disproportionate and counter intuitive and we remain of the view they should be addressed.

We would welcome a meeting to discuss this further, and our recommendations as set out in our letter of 18 September 2013.

Yours sincerely

John Barnett
Chairman, CGT & Investment Income Sub-Committee

cc: Jane.Page@hmtreasury

The Chartered Institute of Taxation

The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. 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. 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.

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. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

HM Revenue & Customs

H M Revenue & Customs
High Net Worth Unit S1278
PO Box 202
BOOTLE
L69 9AL

Phone 03000 527416
Mon-Fri 8.30am -5.00pm

Fax 03000 527402

Email cameron.wilson@hmrc.gsi.gov.uk

Web hmrc.gov.uk

John Barnett
Chartered Institute of Taxation
Artillery House
Artillery Row
LONDON
SW1P 1RT

Date 12 May 2014
Our ref
Your ref

Dear John

Business Investment Relief (BIR)

I refer to your letter dated 3 April 2014 which I have discussed with our Policy and Technical leads, so I can now respond appropriately.

BIR take-up

Whilst I realise from my own regular conversations with tax advisors that they frequently find themselves considering whether the "extraction of value rule" (EOVR) might be engaged in particular scenarios presented to them by clients, I have yet to see any clear evidence that goes as far as to cause genuinely commercial investments not to be made. The types of issue most commonly encountered have been;

- share offerings in tranches where participation in the first tranche qualifies investors for a discount on subsequent purchases – with advisors wondering if this amounts to a benefit

- Payments of salary and dividends – advisors concerned that these might be treated as benefits

I have yet to see an example where there has been any doubt that these are clearly being offered in the ordinary course of business so I have not refused clearance on any occasion. Having said that, advisors and their clients do need to have clarity as to how they will be treated.

The only difficulty we have had with what was obviously a commercial investment, but with potential to trigger the EOVR, was a case where an investor was offered free membership of the club he was investing in (which he didn't want anyway). The advisor asked for advance assurance and pointed the membership offer out to us. We were able to speak with them and agree that simply declining the membership offer avoided the problem and we were therefore able to give clearance. This investor went on to make many further BIR investments and has in fact now made more advance assurance applications than any other customer.

In essence, what I am saying is that although the EOVR clearly does cause advisors, their clients and HMRC to carefully consider what is proposed, the difficulties that are identified in genuinely commercial scenarios all seem capable of being resolved quickly, and the advance assurance process is a key part of that. With hindsight, those who suggested that we provide the advance assurance process secured something that has proved very worthwhile and helpful.

I am very disappointed to read of a case where an investment of £300M was apparently not made because of the EOVR. Without more specific detail as to why the individual might consider the EOVR to be relevant despite the investment being a genuinely commercial one, there is not much I can say. However, given that there is no requirement for the individual's foreign business interests to have been disclosed when applying for advance assurance, his apparent reluctance to seek it is a little difficult to understand. I have no recollection of an advisor asking me even informally on the telephone for a view about an investment of that amount. HMRC's guidance on what is required for advance assurance is clearly set out in Annex B of CAP1 which is well publicised and I would point out that, as a matter of policy, we only ask for the total amount of the investment so do not even enquire as to the levels of foreign income or gains involved. That said, I repeat that it is disappointing to find an example of a potential investment of this size not having been made. I am more than happy to speak to the advisor representing this client to try and find out if we can accommodate his concerns and perhaps revive the investment opportunity, so please feel free to pass on my contact details.

Your letter goes on to make a number of further detailed points and we agree that it would be useful to discuss these at a meeting. We do need to look in more detail, particularly, at your concerns around;

- lack of a *de minimis* level of benefit
- what HMRC would view as an "above market rate" dividend
- when HMRC would accept that a transaction can be treated as being "in the ordinary course of business and on arm's length terms".

These areas do all have the capacity to cause disputes about whether the EOVR is engaged so it is in all parties' interests that we explore ways of avoiding that, whether it be by reviewing the legislation itself or improving guidance. Myself and HMRC's Policy and Technical advisors (Richard Davey and Martin White) would be more than happy to come and meet you to discuss this. Possible dates based on our current calendars would be; 20 May or 2, 6, 9, 16 or 17 June. If those dates don't suit you, if you let me have a few alternatives, I will try to see if we can manage one of those.

Yours sincerely

Cameron Wilson
Customer Relationship Manager

To learn more about your rights and obligations go to hmrc.gov.uk/charter

Ref: CGTII

29 May 2014

Cameron Wilson
HM Revenue & Customs
High Net Worth Unit S1278
PO Box 202
Bootle
L69 9AL

via e-mail: cameron.wilson@hmrc.gsi.gov.uk

Dear Cameron

Business Investment Relief (BIR)

Thank you for your letter of 12 May 2014 to John Barnett. I have recently succeeded John as Chair of the Capital Gains Tax & Investment Income Sub-committee. John remains a member of the Sub-committee.

We note your comments on the case described in our letter of 3 April where a large investment was not made because of concerns around the 'extraction of value' (EOV) rule. We will pass on your comments to the advisor in question and see if they wish to take you up on your offer to discuss the case further.

However, we think that the main point that you have not yet addressed relates to 'involved companies'. The definition is so wide that it includes companies that have no 'involvement' at all (in the everyday sense of that term) in the business investment. An EOV from any involved company causes relief to be lost even if that company is entirely outside the UK and has nothing at all to do with the UK company. It is also in this respect that the pre-clearance procedure – which we agree is otherwise helpful – falls down. An investor (such as the one we mentioned) is, as you say, not required to disclose generally his offshore assets, but if his very question is about whether another company in his 'empire' is an involved company then this confidentiality is inevitably overridden.

Hopefully we can discuss this when we meet on 17 June.

Yours sincerely

Aparna Nathan
Chairman, CGT & Investment Income Sub- committee

The Chartered Institute of Taxation

The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. 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. 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.

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. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

Note of Business Investment Relief (BIR) meeting on 17 June 2014 at Artillery House

Attendees:

Aparna Nathan – CIOT (CGT & II Chair)

John Barnett – CIOT

Giles Clarke- CIOT

Emma Chamberlain – CIOT

Cameron Wilson – HMRC Cameron Wilson| Customer Relationship Manager | HMRC High Net Worth Unit

Martin White – HMRC Senior Technical Adviser on BIR

Ellen Roberts – HMRC Policy Adviser | Assets and Residence Policy | Specialist Personal Tax

Sue Pennicott – HMRC

Hugo Gillibrand – HMT

In attendance Kate Willis – CIOT (Technical Officer)

The meeting was to consider the matters raised in the CIOT/HMRC correspondence on the barriers to BIR dated 18 September 2013 (CIOT), 20 December 2013 (HMRC), 3 April 2014 (CIOT), 12 May 2014 (HMRC), 29 May 2014 (CIOT).

The question of whether the purpose test in s 809VA(7) was necessary, particularly following the introduction of the GAAR, was put to HMRC. HMRC's initial response was that there is no general policy of removing targeted anti-avoidance rules following the GAAR. This statement was challenged by CIOT reps in that one of the purposes of the GAAR was to remove/simplify existing avoidance provisions. In this case if the purpose test was breached at any time, relief would be lost altogether. The definition of what is "avoidance" may change over time. Consequently the fear of its uncertain application added to the unwillingness to risk investment. If the Government wished to increase take-up of the relief, removing the purpose test would be a positive step. The further anti- avoidance test in Condition B section 809VF renders it unnecessary in any case. CIOT reps thought that HMRC were probably unaware of this deterrent to using the relief in actual situations via the advance clearance procedure because it is not something upon which clearance would be likely to be sought or be readily given.

HMRC referred to scenarios where clean capital is extracted by way of loan with untaxed income/gains used to repay the loan. Such a scenario is a common reason for refusal of clearance and the purpose test backs up s809VF if for any reason it is not caught by the latter provision. They are reluctant to take out the existing armoury of anti-avoidance provisions so soon after enactment. (CIOT reps thought that the guidance should highlight that clean capital cannot be substituted in this way.)

However CIOT noted that it is the extraction of value (EOV) rule, more than the purpose test that is the real blocker to taking up the relief. The EOV is a problem in various respects: the tax charge is not levied on the amount extracted but on the whole of investment (contrast with other anti avoidance measures where generally it is the prohibited benefit that is taxed) and the breadth of the 'involved company' provision. HMRC recognise the problem but queried whether it was actually acting as a deterrent. CIOT referred to examples of very significant levels of potential BIR investment that had been deterred, the amounts involved potentially far exceed the total BIR investment to date (c £275m according to HMRC). The UK's loss is the gain of other jurisdictions offering low tax regimes.

HMRC asked how in principle EOV could be improved/ replaced. CIOT thought that the main problem is the definition of involved company encompassing every related entity including those controlled in the ex parte Newfields wider sense such that every involvement with an involved company has to be considered and documented throughout the life of the investment in the target. That process is simply impossible. Possible solutions might include 1) restricting the amount charged to what is actually extracted in the case of a disposal 2) restricting the involved company definition to the same group or possibly some form of commercial association test(eg to cover loans between related companies) akin to the taper relief definition 3) advance assurance to be provided on EOV. (Even if the position is monitored, it is the possibility of a world–wide enquiry into longstanding overseas businesses set up years before the BIR investment that operates as a major disincentive.) 4) a de minimis for benefits.

HMRC commented that the advance assurance process had already gone beyond Condition A (as originally proposed) and the unit is as helpful as it can be because it wants to facilitate investment and has been instructed to do so. CIOT said the problem is that where investors are deterred, it will not even reach the point of application for clearance, particularly for very high profile investors. There is also an element of the snowball effect – if enough UHNW investors are happy to invest more will follow and vice versa.

HMRC thought it would be difficult to define or quantify a de minimis benefit. CIOT reps thought that if EOV is restricted this point would not be such an issue.

HMRC will give further thought to what has been said. They are wary of what they have seen in terms of some clearance applications that are in breach of the avoidance provisions and need evidence to present to ministers, especially given that the case will need to be made to amend relatively new legislation. CIOT pointed out that the original consultation process was rushed at the end.

The EOV rule is not breached where the value is taxable as income (or would be if were liable to tax) <u>and</u> paid in the ordinary course of business. HMRC say dividends should be regarded as payable in the ordinary course of business (assuming compliance with rules re:distributable reserves etc) but CIOT reps asked about HMRC's view of the treatment of a distribution in the course of liquidation or share buy- back that is treated as capital. In effect liquidation of an involved company is then not possible without contravening the EOV. S809VH only protects the target company not the involved company. The fact that dividends should meet the test should be made clear in the guidance, similarly the treatment of a repayment of an interest free loan. Although the repayment of an interest free loan is not a benefit within Condition B it is, in HMRC's view, an extraction of value.

CIOT reps emphasised that the wider deterrent problem cannot be solved through guidance alone.

HMRC asked for a paper with anonymised examples to indicate the scale of non- investment and the sticking points. CIOT reps pointed out that evidence of deterred investment is difficult to provide because of sensitivities but the scale of the problem is apparent on the face of the legislation. HMRC said that the case is more compelling if there <u>is</u> a problem rather than there <u>could</u> be a problem. CIOT reps thought it would be equally helpful to understand HMRC's concerns over avoidance scenarios that they had seen in applications put to them via the assurance process.

Kate Willis

27June 2014

As amended

Aparna Nathan

1 July 2014