Reviewing the draft rules on capital gains exit charges

The proposals in brief

Following extensive consultation, draft clauses for the simplification of the capital gains exit charge were published on 9 December.

The main proposals are:

- The charge will increase (or decrease) the gain in the vendor company, rather than creating a gain in the company being sold. Any reliefs or exemptions applicable to the sale by the vendor would therefore apply to the degrouping element of the gain;
- An amendment to the substantial shareholdings exemption (SSE) will permit companies to package up trades into new subsidiaries for sale;
- Degrouping charges are unchanged where there is no disposal; and
- There will be a just and reasonable escape clause from the degrouping charge.

Effect of the provisions

The new mechanism means that, where a transaction doesn’t prima facie carry a tax charge, the degrouping charge shouldn’t be a barrier to a wholly commercial transaction. This will be particularly useful where the reorganisation reliefs or the SSE are in point.

And if there is an exit charge on the transaction, the new facility to claim a just and reasonable adjustment should ensure that economic double taxation of such transactions is a thing of the past.

There are still, however, a number of problem areas.

Only applies to tangible assets

The new mechanism applies only to chargeable assets, not to intangible assets subject to the regime in CTA 2009 Part 8. Despite discussions with HMRC, there are no proposals to extend this simplification to intangible assets.

This will mean that the simplification is often rendered useless, as the major charge will arise from the exit charge for intangible assets.
This will particularly impact the proposal to permit the packaging of trades for sale, where the major asset is likely to be goodwill.

HMRC says that ‘the government is aware that this is a potential issue for future simplification work.’

This is, in my view, frankly not good enough!

The policy behind tax simplification is to make it easier for companies to carry out commercial transactions without distortions from the tax code.

The government has promised to improve tax policy making, reducing the frequency of changes and making the process more transparent, so to propose a rule that applies to tangible assets and not to intangible assets is contrary to these new principles: the proposals are inconsistent across the tax code.

No reason has been given for the lacuna and further changes will be required to amend the position.

**Paper for paper disposals**

The new rules will apply to the degrouping element of reconstructions, such as demergers by liquidation or by return of capital.

So, if the reconstruction is a no gain / no loss transaction under TCGA 1992 s 139, the degrouping element will not be chargeable (the interaction of the new rules with s 139 is clarified in the new draft legislation).

However, on a paper for paper disposal, where a vendor sells a company to another company in return for shares or debentures, TCGA 1992 s 135 imposes a ‘no disposal’ fiction (where the SSE doesn’t apply).

If there is no disposal, the old rules will prima facie apply and a charge will arise in the company that is leaving the group, despite the exemption from charge for the vendor.

Again, this was pointed out in the responses to consultation, so the retention of a degrouping charge in these cases would appear to be a matter of policy.

But it is not clear why HMRC considers that a degrouping charge should arise here, when there is already anti-avoidance legislation (at TCGA 1992 s 137(1)) to prevent abuse.

**Non-disposal degrouping and replacement of business assets**

TCGA 1992 s 179B allows degrouping gains on the deemed disposal and reacquisition of certain assets to be the subject of rollover claims on the acquisition of replacement business assets.

The new mechanism means that there will usually not be a gain to roll over, as the gain is added to the consideration for the share sale by the vendor, so s 179B is to be repealed.

But the new mechanism will not apply when a company has left a group without a disposal of shares, when the current rules will continue to apply.

I cannot see a policy reason for the repeal of s 179B in these situations, as it was enacted in 2002 to allow rollover claims in precisely these cases.

**Comments**

The proposals are a significant improvement on the current rules, which frequently apply to commercial transactions where no tax avoidance is intended and can lead to economic double taxation.

But there is a glaring lacuna, as the main proposals should be mirrored in the intangibles regime.
From a chargeable gains perspective it is clear that the consultation process has been broadly successful.

What a pity the opportunity for some joined-up policy making was missed.

Pete Miller, Partner, Powrie Appleby

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