

(Targeted Anti-Avoidance Rule (TAAR) for Capital Losses)

**CITY OF WESTMINSTER AND HOLBORN LAW SOCIETY
Revenue Committee**

Please reply to:

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Dear Roger

Proposed TCGA 1992, s.16A

I write with reference to your email of 22 May.

I do not think that I am alone in finding the formulation of what Guidance represents, in the Economic Secretary's speech to the Finance Bill's Public Bill Committee on the morning of 17 May (col. 223), somewhat novel.

On the basis stated, it seems to me that it is important that, in relation to each example (either way), exactly how the result has been arrived at is set out by reference to the exact statutory wording, at any rate except where the transactions in question are clearly totally artificial, such as e.g.s

- 1 [the creation of a loss by means of transactions in a life policy]; and
- 2 [artificial share subscription].

Which said, I do accept that, in the draft of 1 May, some logical reasoning has been attributed for all the examples.

The starting point

Section 16A starts from the proposition that *real* losses in the *Ramsay* sense are deductible because it operates by way of restricting the concept of "allowable loss". It then goes on to assume that a non-allowable loss will only arise from a series of multiple events. That is clearly a reasonable pre-condition because otherwise any sale which resulted in an actual loss being

realised would be within the scope of the section. It then goes on to require that one of the main *purposes* of these events is to create a loss (including one to take effect in the future or for somebody else) in various guises.

What is “purpose”?

The problem which has been identified is the use, and therefore the meaning, of the word “purpose”. Although this has to be interpreted in context, and that context would normally involve enquiring into motivation, the possibility exists that the absence of *overt* motivation in relation to a particular series of events might not be sufficient to disapply the critical subsection (1)(b).

Scheme of the tax as a whole

The question also arises as to whether that context should not also include the scheme of the tax as a whole, so that where particular transactions are provided for, these should also be taken into account in the construction of section 16A(1)(b).

Applying this to the examples which have been adopted to date:

- (a) It was accepted, in BN 31 (and also 1 May), e.g.s 10 and 11, that the rules of EIS should prevail.
- (b) It is quite clear, in relation to BN 31 (and also 1 May), e.g. 13, that the restrictions in Schedule 4B also needed to be taken into account.
- (c) It appears to have been accepted in the reformulation of 1 May [vide e.g.s 5B and 6] that, in relation to repurchases, the limitations of s.106A needed to be taken into account.

But, in relation to s.58, surely this should be allowed to apply subject only to the timing limitations in *Craven v. White*?

- ◆ Provided that the transfer of the loss-pregnant holding to the other spouse, to form a composite holding, takes place outside the timescale which would bring *Furniss v. Dawson* into operation.
 - However, although I would not dissent from the conclusion drawn in the final analysis in e.g. 4A of 1 May, I do have considerable doubt as to whether a single transaction can, in principle, come within section 16A(1)(a).
- ◆ And, in relation to e.g. 4 of 1 May, it would be of assistance if it could be explained generally, in the context of the interpretation of the statutory word *purpose*, the extent to which *knowledge* (i.e. motivation) is considered to be a relevant factor in relation to the wife’s action purely because it was within the husband’s s.106A period.
 - As was indicated in the analysis, the husband’s loss was a real one [as, indeed, would be that of the taxpayers in e.g.s 7 and 8] and it should therefore be just as much outside the scope of section 16A as a matter of principle as was the scenario in e.g. 12; and
 - when one applies this to e.g. 5 (and indeed to the position of the trustees in e.g. 14 – especially if they made only one distribution of assets and selected an offsetting mixed

- bag of gains and losses), does one not have to arrive at the opposite conclusion from that drawn?
- In which case the distinctions which have had to be discussed in e.g. 5A would not need to be considered.
 - But if e.g. 5A does fall within the prima facie scope of section 16A, then the apparent distinction between *purpose* and *motive* seems to need to be analysed.
- ◆ And if one applies this to e.g. 14, one must, surely, have to conclude that the principal reason for any second distribution must have been the desire of the trustees to increase the wealth of the beneficiary in question.
- Against that background, how can appointing loss-generating assets be “a main” purpose?

Share portfolio management

The matter which appears to be giving rise to most concern is the extent to which the concept of *purpose* might be brought to bear on the end result of normal investment portfolio management risk mitigation tools, as could well be the case in e.g. 3.

- ◆ By their very nature, these are designed to reduce the risk of financial loss by putting in place the means of limiting this through a related transaction.
- ◆ Clearly the activation of such arrangements will involve multiple transactions which are, in consequence, prima facie within section 16A(1)(a).
- ◆ The problem which will then arise, in relation to (b), is that those responsible for activating the arrangements in question are very unlikely indeed to be unaware that doing so will have had tax consequences.
 - But the “economic reality” (the phrase used in the current analysis) will, in these circumstances, have been the protection of the value of the portfolio.
 - It seems unlikely that Parliament should be presumed to have intended the section to be capable of being invoked in these particular circumstances.
 - It would therefore be of assistance if the revised Guidance could cover this particular issue and indicate where the dividing line is to be drawn, if indeed it is intended to be, between the various currently-accepted “market” techniques for portfolio loss limitation.
- ◆ The reasoning given will be of considerable importance to practitioners in judging upon which side of the line the additional financial instruments and techniques (which seem to be being developed by the investment banking industry all the time) ought to fall.

Yours sincerely

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Chairman