New Guidance published by HMRC regarding the application of roll-over relief

Background

The Taxation of Chargeable Gains Act 1992 ("**TGCA**") contains several 'relieving' provisions which apply in the context of company reorganisations. Those relevant for the purposes of this article are the provisions colloquially known as the "*roll-over relief*" provisions. These apply

(i) in the context of corporate takeovers where all, or a proportion, of the sale consideration is in the form of shares or loan notes (share for share exchanges (*section 135*)); and

(ii) schemes of reconstruction such as demergers where the business of one of more companies is demerged into two or more new companies which issue shares/securities to the shareholders of the original company/ies (*section 136*).

In both these scenarios, holders of shares in the company or companies being acquired or reconstructed ("**Original Holding**") become holders of shares and/or loan notes in the acquiring company or companies ("**New Holding**").

As a result of "roll over relief", the shareholders are treated as *not* having disposed of their Original Holding or as having acquired the New Holding for the purposes of capital gains tax ("**CGT**"). Instead, the New Holding is, in effect, treated as having been acquired on the same date and for the same price as the Original Holding such that, on a future disposal of the New Holding, the cost to be considered in computing any chargeable gain is the cost of the Original Holding.

However, for shareholders with a holding of greater than 5%, this relief is only available if the share exchange or reconstruction is:

(i) effected for bona fide commercial reasons ("**Commercial Test**"); and

(ii) does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is the avoidance of liability to CGT or corporation tax ("**Main Purpose Test**")

(*section 137(1) TGCA*).

Pursuant to section 138 TGCA, advance clearance may be sought from HMRC (and usually is) confirming that they are satisfied that section 137 does not apply to a particular transaction.

New guidance published by HMRC (CG52632 and CG52633) (the "**Guidance**") sets out its views on the two parts to section 137, but as we shall see, it is not particularly useful.

The Guidance was issued subsequent to the taxpayer "friendly" Court of Appeal decision in *HMRC v Delinian Ltd (formerly Euromoney) [2023]* (the "**Euromoney Case**"). A summary of the facts of the Euromoney Case and of the salient points of the decision made are set out below for reference.

Euromoney Case Facts

E plc ("**PLC**") sold its shares in a 50% subsidiary company to another unconnected company ("**DTL**"). The consideration of approximately $80m was satisfied by the issue of ordinary shares and 21m $1 redeemable preference shares in DTL. It had originally been intended that the transaction should be

for a combination of ordinary shares and cash. However, PLC's tax director suggested the substitution of the preference shares for the cash. He accepted in evidence that the purpose was a 'tax saving one'. For technical reasons, the sale to DTL did not qualify for the substantial shareholding exemption ("**SSE**"). However, by substituting preference shares for the cash, the intention was that the entire gain on the sale would be rolled over (pursuant to section 135 TCGA) and then, on a redemption of the preference shares after 12 months, the gain thereby triggered would qualify for SSE (by virtue of the ordinary shareholding in DTL).

HMRC issued a closure notice denying relief under section 135 TCGA for the entire transaction on the basis that the Main Purpose Test was not met - ie., that the exchange formed part of a scheme or arrangements of which the main purpose, or one of the main purposes, was the avoidance of liability to tax. It was common ground at this point that the transaction was for bona fide commercial reasons (ie. the Commercial Test was satisfied).

The First Tier Tax Tribunal ("**FTT**") had allowed the DTL's appeal, and the Upper Tribunal had upheld that decision.

Court of Appeal Decision

Before the Court of Appeal, the central issue was the requirements of the Main Purpose Test.

HMRC had contended that, when determining whether the Main Purpose Test was satisfied, one should identify a scheme or arrangements from any number of possible "candidate" schemes or arrangements: this would, of course, have enabled HMRC to focus on the issue of redeemable preference shares, which, it was accepted, were indeed included for tax reasons. However, the Court of Appeal rejected this interpretation of section 137(1) TCGA and concluded that the scheme or arrangements to be considered are *the whole of* the scheme or arrangements undertaken by the taxpayer, not a selected part or parts of them. It was not necessary to sift through every permutation or combination of elements of a scheme to find one which has a main purpose of tax avoidance, as was the position taken by HMRC. It had already been found at Tribunal stage that tax was not the main driver of the transaction as a whole, and so HMRC lost their appeal.

Although not needed to determine the appeal, the court went on to consider the taxpayer's argument, made in its respondent's notice, that, taking advantage of a statutory relief i.e. the SSE was not tax avoidance so that the Main Purpose Test never became relevant. This argument was rejected. Section 137 TCGA provides that the right to defer tax under section 135 TCGA would be lost if it was used to avoid tax altogether. If the scheme or arrangements in question led to the non-payment of tax that would otherwise have to be paid, even if deferred, that would be tax avoidance for these purposes.

Guidance on Purpose (CG52632)

So, we come to the new guidance.

As one might expect, HMRC draws attention to its "win" on the cross appeal (see preceding paragraph). However, and more importantly from the taxpayer's point of view, the guidance does not make any reference to those aspects of the Court of Appeal's decision which deals with the determination of what is the relevant scheme or arrangements or of whether tax avoidance constituted a main purpose – where HMRC lost…

In this respect, HMRC states as follows:

"*Where there is any element of avoidance in such a scheme or arrangement then the question of whether that amounts to a main purpose is one of fact and degree. That is not always a question that can be answered through the clearance process. HMRC will not provide clearance under section 138 TGCA where a degree of avoidance of a charge is disclosed in or is apparent from an application and where, based on the information provided, HMRC cannot be satisfied that avoidance is not a main purpose or one of the main purposes. If the transaction proceeds, then HMRC will assess the risk and enquire if appropriate and any dispute can be resolved through the appeal process*."

It therefore appears that HMRC are not particularly willing to take the "whole scheme or arrangements" approach adopted in the Euromoney Case judgment to determine whether tax avoidance is a main purpose. Indeed, the wording of the guidance perhaps demonstrates the opposite and a potential hardening of approach, such that clearance will be denied where *any* element of tax avoidance may (in the eyes of HMRC) be present.

Where clearance is denied, HMRC seem to envisage a post transaction appeal process – which is not an attractive prospect. Instead, timetable permitting, a taxpayer could consider using the right contained in section 138(4) TCGA to require the FTT to review any clearance application which is refused by HMRC. It may well be that the FTT would be more likely to follow the Court of Appeal in the Euromoney Case in its approach to determining what is the relevant scheme or arrangements and whether tax avoidance is a main purpose for the purposes of section 137(1) TCGA.

Guidance on the 'Commercial Test' (bona fide commercial reasons) (CG52633)

This new guidance states:

"*HMRC will not give statutory clearance to arrangements that seek to avoid a criminal, civil or regulatory risk or liability. This is because HMRC consider that the "bona fide commercial reasons" test expressly requires genuine, "good faith" commercial reasons for undertaking the exchange or scheme of reconstruction*.

Where an applicant is aware of a specific risk or liability of this nature HMRC consider this to be material information. Failure to disclose this in a clearance application could result in the resulting notification being considered void."

Presumably, the targets here are "bad hats" seeking to avoid liabilities. However, the above statement is much broader than that and has the potential to cause difficulties for regulated groups and structures such as "propco/opco" structures where reorganisations are implemented with the intention of ringfencing risks for legitimate business reasons.

Looking back at some of the section 138 TCGA clearance applications we have made over the past 5 to 6 years, ring fencing of properties and related risks, isolating litigation risks, EIS relief preservation inter alia have all been used as, and accepted by HMRC as, commercial justifications/rationale for the reorganisation in question. This guidance potentially limits considerably what will be considered as a bona fide commercial reason for a transaction.

Unfortunately, the only example provided in the guidance does not provide any elucidation in this respect:

"*the X group has subsidiary Y that faces potential prosecution under Health and Safety legislation. The arrangements involve transferring the business of Y to a new company, Z, incorporated by the shareholders of X. X and Y will then be liquidated. This is potentially a scheme of reconstruction within TCGA92/S136*."

The implication appears to be that these facts do not involve "good faith" but gives no indication of what might be acceptable. Hopefully, further guidance will be forthcoming to include examples which fall on the right side of the "line" – and that these will take a realistic and not overly restrictive approach to what will constitute "genuine, "good faith" commercial reasons" for the purposes of section 137 TCGA and the obtaining of clearance under section 138 TCGA.

Conclusion

While the decision in the Euromoney Case should have been helpful for taxpayers, HMRC's guidance seems to be going in the opposite direction and raises more questions about section 137 and section 138 TCGA clearances than it answers.

Taking appropriate legal advice at an early stage and ensuring any clearance application takes due account of these developments may therefore assist in avoiding future difficulties.

Christine Ward

RW Blears LLP

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