The Office of Tax Simplification has just produced its final report on the elimination of a number of tax reliefs and has announced that its next target will be simplification of the tax code for small businesses. But there is another task that has never been tackled and would, in the author’s view, be of greater benefit to UK plc: the removal of glitches in existing legislation, thereby reducing uncertainty and, in some cases, eliminating the need for complex solutions to routine issues. Continuous improvement of this kind would also help HMRC to move away from informal concessionary practice, in keeping with another theme that has emerged in recent years.

HMRC has made real progress over the past few years towards a more business-friendly corporate tax regime. There is typically extensive consultation before significant new measures are introduced; HMRC is usually willing to take a pragmatic approach to large scale dispute resolution; and reform of the CRC rules, perhaps the last major issue for large corporate taxpayers, appears to be going in the right direction (if not quite at the right pace). And all this in the context of ever greater pressure on resources.

There is though one long-standing issue which HMRC has never been keen to tackle but which imposes needless costs on taxpayers and can put HMRC itself in a questionable position.

I refer to glitches in the tax code, some of which have been apparent for many years. The result can be that cumbersome mechanics need to be bolted on to perfectly standard commercial arrangements to avoid a tax pitfall, that difficult due diligence is required on corporate sales to deal with exposures that should not exist at all, or that the high level of comfort required for (say) a securitisation cannot easily be provided; or it may be that HMRC has to adopt a Nelsonian approach, ignoring points which are plain enough on the face of the legislation, or that companies simply have to accept material tax risks from normal transactions.

The glitches come in a number of forms. The largest category is probably legislation which from the outset clearly goes further than Parliament can have intended or which HMRC decides to apply on a concessionary basis as a result of practical experience. The problem often results from over-enthusiastic anti-avoidance rules.

Besides the practical difficulties just noted, this first category raises an important matter of principle. As Walton J famously said in Vestey v IRC ([1977] STC 414, at 439): “One should be taxed by law, and not be untaxed by concession”. (Walton J then refers to the long period of time “without the Revenue authorities taking one of the numerous opportunities which they have, at least once a year, to put the matter right”, which I suppose sums up in less than a sentence the proposition that I am putting forward in this article.) The taxpayer finds not only that the
The last piece in the jigsaw?

The legislation does not provide a reliable guide to the tax treatment of its transactions but that, at least in the view of HMRC and the FTT (as evidenced in the *Hanover* case last year), it cannot safely rely on obvious sources of HMRC guidance either.

Nor is it clear that HMRC has the authority to draw the sting from legislation in this way. Certainly, HMRC seems to have concluded on the basis of *Wilkinson* that there are strict limits to its concessionary powers, and it has of course launched a review of extra-statutory concessions for that reason.

As a second category I would identify legislation which simply seems unfair. Anti-avoidance is almost always the driver here.

Finally, there is legislation which falls behind commercial developments or, as happens on occasion, other changes to the tax code. The statutory code for demergers is a good example. (There are also statutory provisions which are barely intelligible without explanatory aids – the interaction of the SSE with sections 116, 135 and 171 comes to mind – but efficacy must be a greater priority than clarity.)

The underlying problem in all cases appears to be an understandable reluctance on the part of HMRC to revisit existing legislation except to close perceived loopholes. But now is a good time for a change in attitudes: the collaborative (and iterative) approach has been widely adopted as a means of honing new legislation and there is an Office of Tax Simplification which could sift through suggested changes with a view to producing recommendations.

The remainder of this article contains a few examples in the first two categories. The selection is not scientific nor of course remotely comprehensive, so I apologise to readers who scour this article in vain for their favourite statutory solecisms.

**PROPERLY TARGETED LEGISLATION**

**Employment-related securities**

Part 7 ITEPA 2003, dealing with the taxation of employment-related securities, is notoriously convoluted. Indeed, Lord Walker ended his judgment in the *Gray’s Timber* case last year by making a direct appeal for a review of these “complex and obscure provisions”.

But the most regrettable feature of Part 7 is the principle established by section 421B(3): “A right or opportunity to acquire securities … made available by a person’s employer, or by a person connected with a person’s employer, ... is to be regarded … as available by reason of an employment of that person ...”.

I have sympathy for HMRC’s difficulties in an area which has generated so many schemes over the years. But the legislation should not deem securities issued by an employer to be acquired by reason of employment. The principle perhaps has a place in Chapter 10 of Part 3, which contains the sweeper provisions for taxing benefits in kind; one might take the view that there will only rarely be another reason for providing such a benefit to an employee. That is simply not the case as regards shares and other securities.

Section 421F ITEPA 2003 recognises that employees might obtain shares in their employing group for reasons unconnected with their employment and sets out an exclusion for public offers. However, this is narrowly drawn and does not cover an issue of (for example) convertible bonds. HMRC’s answer is, I believe, that the deeming rule will usually be ignored in such circumstances. The same problem, and in some cases the same fudged solution, can
be encountered if an employee sells shares in return for loan notes or other shares (provided immediately or under an earn-out).

The solution here is easy enough: the deeming principle, in section 421B(3) ITEPA 2003 and similar provisions in Part 7, should be deleted.

Before moving on from employment income, I am bound to note that the draft “disguised remuneration” rules published in December are an egregious example of the same syndrome. But HMRC acknowledged the problem at its Open Day on 24 January and one must hope that the legislation will instead prove to be a triumph for the collaborative approach.

Section 75A FA 2003
The SDLT code is another fertile source of examples, and notably section 75A FA 2003. This contains what one might see as a statutory incarnation of the “step transaction” doctrine for SDLT, introduced a little over four years ago. It was too broadly drafted from the start, in particular because it lacks a motive test.

The problem was exacerbated last year when the Stamp Office lost patience with the use of partnerships as a means of avoiding SDLT on the transfer (or grant) of interests in land. FA 2010 accordingly removed a critical provision which modified the application of section 75A to partnership transactions (section 75C(8)(b) FA 2003, before its repeal). As a result, on a natural reading of section 75A one has to conclude that it will apply to most transfers of UK land into (or out of) a partnership, overriding a special regime that mitigates the charge where there is a transaction between a partnership and one of its partners.

This consequence has of course been pointed out to the Stamp Office. While acknowledging the problem, its only response to date has been to issue revised guidance. This says very little about the critical technical detail of section 75A but now blithely states that the section “is an anti-avoidance provision” and that “HMRC therefore takes the view that it applies only where there is avoidance of tax”.

That cannot be the answer. In other circumstances the Courts have without hesitation rejected taxpayer arguments founded on the heading given to a statutory provision (see for example Page v Lowther (CA), [1983] STC 799 at 807), or indeed on an apparent intention that it should apply only in the case of avoidance. If avoidance is the crux (as it surely should be), what good reason can there be not to amend the section accordingly?

Other examples
Space does not permit me to give further illustrations of my first category. But if only to show that the problem is not confined either to anti-avoidance provisions or to those of recent vintage, I will mention two other examples very briefly.

The question whether shares are issued in proportion to existing holdings, “or as nearly as may be” in proportion, continues to cause difficulties in relation to CGT reorganisations and a few stamp duty reliefs; the difficulty may arise due to the involvement of shareholders in certain overseas jurisdictions, or simply because of the subscriber shares in a newly formed company. This is an issue of very long standing, but still a regular source of wasted man hours.

Newcos can also constitute a heffalump trap in the area of tax grouping, as strictly they can only join a group once they have acquired a source of income (and therefore an accounting period).
FAIRER LEGISLATION

SDLT degrouping
My first example here is, again, drawn from the SDLT code. Three years ago, the Stamp Office added a paragraph 4ZA to supplement the provisions in Schedule 7 FA 2003 dealing with SDLT group relief. It did so because the rather basic degrouping rules in paragraphs 3 and 4 of that schedule were being widely exploited.

The result is that there is a degrouping charge in a number of situations where it is hard to see any mischief. In particular, if the transferor of UK land leaves a group there is no charge, but a subsequent takeover of that group will trigger a change in the control of the purchaser and – even if it is entirely unrelated – will constitute a degrouping event. It is almost as if the draftsman was unaware of section 170(10) TCGA 1992, which recognises that when one group becomes part of another, previously unconnected, group it is not appropriate for the (otherwise more stringent) CGT degrouping rules to operate. (Paragraph 4ZA also illustrates my first category of glitches: it relies on the very wide definition of "control" now contained in section 450 CTA 2010 and the Stamp Office has therefore had to publish guidance mitigating the strict effect of the provision.)

Value-shifting
For my second example, I cannot resist citing a statutory provision which is still in draft form and therefore the subject of current comment. Sara Luder described HMRC’s proposed alternative to the main value-shifting rules in TCGA 1992 in a Tax Journal article two months ago. She expressed the hope that, failing an amendment to the drafting itself, guidance would extend the scope of the envisaged exclusion for arrangements that "consist solely of the making of an exempt distribution".

Sadly, the draft guidance published on 24 January appears to confirm that this formulation is indeed intended to target (inter alia) standard borrowings made to fund pre-sale dividends.

This may or may not be "fair"; certainly, it appears to be a significant departure from HMRC’s very long-standing practice. Does it also mean that a company which has no cash because it has lent its surplus to another group member cannot safely fund a pre-sale dividend by calling in the loan?

SSE
The substantial shareholdings exemption, virtually unchanged since enactment in 2002, provides my last example in this second category. An earn-out forming part of a transaction that falls squarely within the SSE will not itself be covered by the exemption. HMRC are aware of this lacuna and will not I suspect be quick to take the point, but the taxpayer cannot safely ignore it.

CONCLUSION

I hope this article makes a persuasive case for the benefits to be gained in many areas of the tax code if the OTS aimed for improvement as well as simplification. Indeed, it would be good to see part of each year’s Finance Act devoted to such amendments; if this became a routine matter, any perceived opprobrium would surely disappear.

The one certain winner would be UK plc.

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