IBC'S CAPITAL GAINS TAX – ESSENTIAL PLANNING AFTER THE PBR:

"MY GREATEST GAIN I COUNT BUT LOSS" – CAPITAL LOSSES & THE CREDIT CRUNCH

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SECTION I

INTRODUCTION

1.1.1 The value of capital assets has fallen somewhat recently so that realising an allowable capital loss has become much more common than in recent years. Not every disposal of an asset which has fallen in value, however, will give rise to an allowable loss. A capital gain, albeit reduced from what was expected a year or so ago, may still be realised on the disposal even if that disposal is prompted by the necessity of realising liquid funds in hard times. So the whole question of relief for losses has increased in importance.

1.1.2 This lecture will review the major provisions relating to relief for allowable losses under Capital Gains Tax and some related issues. The analysis of losses in respect of ss.13, 86 and 87 will not be repeated as they are covered by Jeremy Woolf.

SECTION II

THE BASIC LOSS RULES

INTRODUCTION

Deduction from Aggregate Gains

2.1.1 The basic rule is that Capital Gains Tax is charged on the total amount of chargeable gains accruing to a person in the year of assessment, after deducting:-

(a) Any allowable losses accruing to that person in that year of assessment; and

(b) So far as they have not been allowed as a deduction from chargeable gains accruing in any previous year of assessment, any allowable losses accruing to that person in any previous year of assessment (not earlier than the year 1965/1966).[1]

The Capital Payments Charge

2.1.2 The basic rule is modified where gains are treated as accruing to the taxpayer by virtue of ss.87 or 89(2) (the Capital Payments Charge). In that case, losses may be deducted only from the aggregate gains of the year excluding the gains accruing under ss.87 and 89(2). This restriction was first introduced in 1997/1998 because the Government considered it too hard to draft rules taking account of the fact that Taper Relief would

[1] Section 2. All references are to the Taxation of Chargeable Gains Act 1992 unless otherwise stated

have been deducted in calculating trust gains under s.87(2). In spite of the fact that Taper Relief has now been abolished the unrestricted offset of personal losses against s.87 and s.89(2) gains has not been restored.

NON-RESIDENTS

2.2.1 A loss accruing to a person during no part of which he is resident or ordinarily resident in the UK is not an allowable loss unless, under, s.10 (UK branch or agency) or s.10B (Permanent Establishment), he would be chargeable to tax in respect of the chargeable gain if there had been a gain instead of a loss.[2]

2.2.2 The provision relating to temporary non-residence in s.10A can have the result that net losses realised in a non-resident period are treated as accruing to the taxpayer in his year of return.[3]

INTERACTION WITH THE ANNUAL EXEMPTION

2.3.1 Losses brought forward are only deducted from the net gains for the year to the extent necessary to reduce those net gains to the amount of the annual exemption. Any excess of losses over that amount are carried forward to the next year. Current year losses, however, can reduce net gains to below the amount of the annual exemption.[4]

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[2] Section 16(3)
[3] Section 10A
[4] Section 3(5A) – (5C)

Example One

Mr Kingston-Black and Mr Dabinett have the following capital gains, current year losses and losses brought forward.

	MR KINGSTON-BLACK	**MR DABINETT**
	£	**£**
Gains in 2008/2009	20,000	20,000
Losses in 2008/2009	5,000	15,000
Unrelieved brought forward losses	15,000	5,000

Mr Kingston-Black's Capital Gains Tax computation for 2008/2009 is:-

	£	**£**
Gains in year		20,000
Less:-		
Current year losses	5,000	
Losses brought forward	5,400	
		<10,400>
		9,600
Annual exemption		<9,600>
Amount chargeable to Capital Gains Tax		0

Losses carried forward:-

£15,000 - £5,400 = £9,600

Mr Dabinett's Capital Gains Tax computation for 2008/2009 is:-

	£	£
Gains in year		20,000
Less:-		
Current year losses	15,000	
Losses brought forward	0	
		<15,000>
		5,000
Annual exemption		<9,600>
Amount chargeable to Capital Gains Tax		Nil

Losses carried forward: £5,000

COMPUTATION

2.4.1 Except as otherwise expressly provided, the amount of the loss accruing on the disposal of an asset is computed in the same way as the amount of a gain and all the provisions of the Taxation of Chargeable Gains Act distinguishing gains which are chargeable gains from those which are not, or making part of a gain chargeable also apply to distinguish losses which are allowable losses and to make part of the loss an allowable loss.[5]

ADMINISTRATION

2.5.1 For 1996/97 and subsequent years a capital loss is not an allowable loss unless the amount is quantified and notified to HMRC on or before the fifth anniversary of the 31st

[5] Section 16(1) and (2)

January following the year of assessment in which the loss arises. The Taxes Management Act 1970 ss.42 and 43 apply to such a notice as if it were a claim for relief.

SECTION III

LOSSES IN THE YEAR OF DEATH

SECTIONS 61(2) AND (2A)

3.1.1 The excess of allowable losses over chargeable gains in the year of death can be carried back and set off against chargeable gains in the three preceding tax years. Gains accruing in a later year must be relieved before those of an earlier year except that gains are not to be reduced below the amount of the annual exemption.

3.1.2 Losses carried back under s.62(2) cannot relieve gains arising under the Capital Payments Charge under ss.87 and 89(2).

3.1.3 Under TMA 1970 Schedule 1B (claims for relief involving two or more years) the tax saving resulting from a claim to carry back losses under s.62(2) is computed by reference to the facts for the tax year or years to which the loss is carried back but it is then treated as a reduction or repayment of tax for the tax year in which the loss is incurred. Thus, repayment supplement will only be due from the 31st January following the year of loss rather than the year to which the loss is carried back.

SECTION IV

SECTION 16A – A MINI GAAR[6]

4.1.1 FA 2007, s.27 inserted a new s.16A into TCGA 1992 providing that a person's loss is not an allowable loss if:-

> "(a) It accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements and,
>
> (b) The main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.[7]"

4.1.2 'Arrangements' is widely defined as including "any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)." The definition of a 'tax advantage,' which is based on that in ICTA 1988 s.709(1), is also very wide.

4.1.3 It will be noticed that the securing of a tax advantage does not have to be the main purpose of the arrangements but only a main purpose.

4.1.4 This legislation denies loss relief to much ordinary tax planning.

6 This section is reproduced from Private Client Business 2007 Issue 6 where is was entitled "Should Humpty Dumpty be your guide?"

7 TCGA 1992 s.16A(1)

Widespread Criticism

4.1.5 The legislation was first published in a draft on 6th December 2006 and it has been criticised by all of the major taxation bodies as denying loss relief to many ordinary tax planning transactions. HMRC has consistently denied that this is the case, issuing successive drafts of 'guidance' on the legislation (issued in a final form on 19th July 2007) which has itself been criticised as misleading and inaccurate.

4.1.6 On 9th February 2007, in a paper by the CIOT supported by STEP, The Law Society and the ICAEW's Tax Faculty, the CIOT said that HMRC's guidance:-

> "… does not reflect or explain the legislation. Indeed … in some places the guidance contradicts the legislation … New rules must be implemented by legislation and not by extra-statutory concession or guidance notes … While guidance notes are helpful, they are not a substitute for proper legislation."

4.1.7 The paper concluded:-

> "In its unamended form, the legislation is likely to catch a range of transactions that most taxpayers would consider to be 'normal tax planning' rather than tax avoidance. We do not think it is acceptable that taxpayers must rely simply on HMRC guidance to say that they are not caught…"

4.1.8 When the Finance Bill was published with the legislation unchanged the professional bodies made similar representations; and substantial criticisms were made by both main

opposition parties in the Finance Bill Committee Debates. In spite of the overwhelming weight of informed opinion, the Government enacted the provisions published in December 2006 in the Finance Act 2007 without any change whatsoever.

Inaccurate Examples

4.1.9 HMRC's Guidance contains eighteen examples of how the legislation applies to various situations. Its analysis reaches the correct conclusion for the correct reasons in only five of those eighteen examples. In four, it reaches the correct conclusion for the wrong reasons and in nine its conclusions are simply wrong. In those nine, the Guidance asserts that the legislation will not apply in circumstances where it clearly does. Why is the Guidance so consistently wrong? On 1st June 2007, the CIOT commenting on the final draft of the Guidance, said:-

> "In our view clause 27 of the Finance Bill (in its present form) [which inserted s.16A] is perfectly clear. Our difficulties are not with the meaning of the legislation, but with its width … this is a clear case where the proposed guidance is likely to be ineffective because we believe that it is (improperly) attempting to concede by concession relief from losses which clause 27 has not granted."

4.1.10 The paper identified the source of the Guidance's errors:-

> "You appear to be of the view that "main purpose" here is an objective test rather than a subjective one. You also appear to be of the view that, if the transaction is carried out in a straightforward way and/or has a genuine economic outcome, then

the transaction cannot be said to have gaining a tax advantage as one of its main purposes.

We think that this view is fundamentally wrong."

<u>The Guidance's Treatment of the Main Purpose Test</u>

4.1.11 The Guidance nowhere says that the "main purpose test" is "objective" but the CIOT are certainly correct as to the paper's methodology.

4.1.12 The Guidance says (at para 11):-

> "The purpose of the arrangements is determined by the purpose of the participants in entering into the arrangements."

4.1.13 Here, the Guidance is almost but not quite correct. In *Snell v Revenue & Customs Commissioners*,[8] which concerned the purposes of arrangements under TCGA 1992 s.137, the Court accepted that the purposes of the taxpayer who planned and undertook arrangements were the "relevant" information from which to determine the purposes of these arrangements. In the leading case on the purposes of trading expenditure, *Mallalieu v Drummond (Inspector of Taxes),*[9] Lord Brightman stated that:-

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8 *Snell v Revenue & Customs Commissioners* ChD [2006] EWHC 3350

9 *Mallalieu v Drummond (Inspector of Taxes)* HL [1983] STC 665

> "The [relevant statutory tests did] not refer to 'the purposes' of the taxpayer … They refer to 'the purposes' of the business which is a different concept, although the 'purposes' (i.e. the intentions or objects) of the taxpayer are fundamental to the application of the paragraph … To ascertain whether the money was expended to serve the purposes of the taxpayer's business it is necessary to discover the taxpayer's 'object' in making the expenditure … As the taxpayer's 'object' in making expenditure has to be found, it inevitably follows that … the Commissioners need to look into the taxpayer's mind at the moment when the expenditure is made."

4.1.14 Thus in determining the purposes of a transaction one looks at the objects of the person or persons who undertook that transaction and that involves determining the state of that person's mind at the relevant time. It is thus a purely subjective test (see also *John Pimblett & Son's Ltd v Customs & Excise Commissioners*[10], *Vodafone Cellular Limited v Shaw*[11] and *Coffee Republic v Commissioners of HMRC*[12]).

4.1.15 Para 11 goes on:-

> "If any participant who has entered into the arrangements has done so with a main purpose of achieving a tax advantage, that will constitute a main purpose of the arrangements."

[10] *John Pimblett & Sons Ltd v Customs & Excise Commissioners* [1988] STC 358

[11] *Vodafone Cellular Limited v Shaw* [1997] STC 734

[12] *Coffee Republic plc v Commissioners for HMRC* [2007] LON/2006/0756

4.1.16 This is an important error. As we have seen, one determines the purposes of arrangements from the objects of the participants. Because one participant has an object of avoiding taxation that does not, of itself, result in that being a main purpose of the arrangements if the participant's involvement in the arrangements is peripheral. What is required is to determine whether a purpose of the arrangements is a main purpose, not whether an object of a participant is one of his main objects.

4.1.17 What is clear is that s.16A can apply where the tax avoidance purpose is that of a third party. In their February paper the CIOT gave the following example:-

> "A (who is UK domiciled and resident) sells a non-UK situs asset at a loss to an unconnected person, B (who is UK resident but not domiciled). B – who could have purchased a similar UK situs asset instead – has a main purpose of enabling future gains to be taxed on a remittance basis. This purpose may be unknown to A."

4.1.18 Here, were it not for s.16A, an allowable loss would have accrued to A. The sale is an arrangement within the statutory definition because it is a transaction. In considering the purpose of that arrangement one considers the objects of the persons who entered into it. B's object in entering into the transaction must be of equal weight to A's. Therefore B's object of avoiding tax on future gains is a main purpose of the arrangement. One of the main purposes of the arrangements, therefore, is to secure a tax advantage. The result is that A does not realise an allowable loss.

4.1.19 At paragraph 12 the Guidance goes on to say:-

> "There is no one factor that determines whether the obtaining of a tax advantage is a main purpose of an arrangement. All the circumstances in which the arrangements were entered into need to be taken into consideration. The circumstances might include:
>
> - the overall economic objective: this should be considered not only from the perspective of individual participants in the arrangements, but also from any wider perspective, such as that of the settlor or beneficiaries of a settlement whose trustees were participants; for these purposes an economic objective does **not** include tax motivated reasons;
>
> - whether this objective is one which the parties involved might ordinarily be expected to have, and which is genuinely being sought;
>
> - whether the objective is being fulfilled in a straightforward way or whether the introduction of any additional, complex or costly steps would have taken place were it not for the tax advantage that could be obtained."

4.1.20 Determining the purposes of arrangements from the objects of the participants in entering into the arrangements involves determining the state of the participants' minds at a particular time. That is an enquiry of fact to be determined upon evidence. The

factors listed in paragraph 12 should be no more than examples of evidence which may be relevant to determining the state of the participants' minds at the relevant time. They are clearly not the only evidence which one might consider and in many cases one will have more direct and more relevant evidence. For example, one might have correspondence between a taxpayer and his advisers setting out why particular transactions or actions were to be adopted as was the case in *Snell v HMRC*. Nonetheless, if the factors set out in paragraph 12 are merely examples of the sort of evidence which HMRC will consider in determining participants' objects in entering into the arrangements then they are unobjectionable.

4.1.21 In fact, in the Guidance, they appear to be alternative or further tests in addition to, or in substitution for, the statutory purpose test.

4.1.22 The examples in Boxes 1 and 2 at the end of this section reproduce Examples 4 and 15 in the Guidance although with my analysis rather than HMRC's. In relation to the example in Box 1 the Guidance says:-

> "It is … necessary to consider whether securing a tax advantage was a main purpose of those arrangements, and to do so it is necessary to take account of all the circumstances in which the arrangements were entered into, including the participants' overall economic objective, and whether that objective is being fulfilled in a straightforward way, or whether additional, complex or costly steps have been inserted. Mrs H's decision to acquire shares in S Plc was unconnected with Mr H's disposal of similar shares, and Mr H has simply taken advantage of

the statutory relief for capital losses in section 2(2) in a straightforward way. Moreover, Mr H has incurred a real economic loss on a genuine disposal to a third party. Mrs H has made a genuine purchase on arm's-length terms. These factors suggest there was no main purpose of obtaining a tax advantage, so these transactions do not fall foul of the TAAR."

4.1.23 It is not necessary to have regard to whether the participant's economic objective "has been fulfilled in a straightforward way, or whether additional complex or costly steps have been inserted" in this example because we are told as a fact that Mr H "sells shares in a company … in order to crystallise a loss which can be set against his chargeable gains arising in a year." His object in the transaction is to obtain a tax advantage. Whether that is done in a straightforward or complex way is simply not part of the statutory test.

4.1.24 Commenting on a similar example in a previous draft (which omitted the irrelevant information in relation to the wife's transactions) the CIOT commented:-[13]

> "We cannot see why the new legislation, as drafted, does not apply here. Are there arrangements? Yes. There is a 'transaction' (the sale of the shares in [S] … plc). Is there a 'tax advantage'? Yes, [Mr H] obtains relief from tax. Is securing that relief one of the main purposes of the transaction? Yes, [Mr H] would not have sold the shares in [S] plc were it not for the ability to offset the loss."

[13] In a paper dated 9th February 2007 at para 6.2

4.1.25 Similarly, in relation to the example in Box 2, the Guidance says:-

> "To decide what J's main purpose was in entering into these arrangements, it is necessary to consider the overall economic objective of the arrangements, and whether that objective is being fulfilled in a straightforward way, or whether additional, complex or costly steps have been inserted. J has made a real disposal of a capital asset in a straightforward way, and has incurred a genuine economic loss. There have been no additional, costly or complex steps inserted into the transactions. The fact that the disposal has been made with a view to using the proceeds to invest in shares which fall within the EIS tax regime does not mean that the arrangements have been entered into with a main purpose of securing a tax advantage, because the straightforward use of a statutory relief does not of itself bring arrangements within the TAAR. Hence the TAAR does not apply."

4.1.26 In this example, we are told as a fact that J makes his investment "with a view to securing income tax relief". That is plainly, therefore, a main purpose of the transaction and one does not need to look for further evidence as to the transaction's purpose. The fact that the investment is straightforward does not mean that J has not made it with the object of obtaining Income Tax relief.

4.1.27 In commenting on the example when it first appeared in an earlier draft the CIOT agreed with the analysis above and said[14]:-

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[14] In a paper dated 2nd April 2007 at paras 24-26

> "Whilst we agree that it is right the legislation should not apply in these circumstances, again we cannot follow the logic …
>
> The conclusion that the transaction is not caught does not appear consistent with the explanation of when the legislation applies, given in paragraphs 7 to 14 of the revised guidance.
>
> We would stress that we agree with the conclusion reached in Example 10 of the revised guidance that the loss should, as a matter of principle, be allowable, but on the basis of the actual legislation suggest it is not …"

4.1.28 If HMRC had wanted the evidential categories in paragraph 12 of the Guidance to be part of the statutory test, the Government could have enacted the legislation in that form. Indeed, in Committee the Opposition put forward various amendments to restrict the scope of the section including amendments designed to restrict it to artificial or complex transactions. The Government rejected the amendments on the basis that they would allow some tax avoidance which they wished to be caught to escape the ambit of the section. It is clear that the Government have intentionally made a provision which will apply to much standard tax planning in order to ensure that it will catch all of the transactions which it considers objectionable. In the words of the CIOT the taxpayer is to be "taxed by law" but "untaxed by concession". The Government refuses to acknowledge this. The then Economic Secretary to the Treasury, "Ed" Balls said in Committee that "The Guidance is not concessionary, as alleged by the CIOT." As we have seen the CIOT stuck to its guns saying on 1st June 2007:-

"in our view this is a clear case where the proposed guidance is likely to be ineffective because we believe that it is (improperly) attempting to concede by concession relief from losses which clause 27 has not granted."

What Should Advisers Do?

4.1.29 It would not be safe for taxpayers and their advisers to rely on the Guidance for a number of reasons.

4.1.30 First, the Guidance is rarely expressed with sufficient precision for a taxpayer to clearly show that he falls within its terms. For example it says[15]:-

"In particular it is unlikely that individuals with a normal portfolio of investments who make disposals in the ordinary course of managing their portfolio would be affected by these new rules …"

4.1.31 It does not define what is meant by a "normal portfolio" or "disposals in the ordinary course of managing" that portfolio.

4.1.32 Secondly, the Guidance is hedged around with caveats. For example, paragraph 26 explains that:-

15 HMRC Guidance at para 3

> "Examples of how the legislation will apply in particular circumstances are set out below. These examples are intended to show how different factors will be taken into consideration in deciding whether or not the TAAR applies in a given set of circumstances. They are not designed as templates for deciding whether a loss is or is not caught by the TAAR in any particular case. That can be determined only in the light of all the actual facts and circumstances."

4.1.33 So it would appear that even if a taxpayer's situation exactly matches an example it would be possible for HMRC to reach a different conclusion on the application of s.16A.

4.1.34 Thirdly, as the CIOT has pointed out, it is inevitable that the examples will leave gaps allowing the legislation to be applied differently to cases involving facts differing only slightly from those in an example.

4.1.35 Even if the taxpayer were able to show that his circumstances were exactly covered by the Guidance, would HMRC be bound by it? The Guidance is not binding on the Special Commissioners or the Courts (see *Gaines-Cooper v HMRC*[16]).

4.1.36 It is unlikely that the remedy of judicial review will be available. It is clear that the Revenue do have the power to make extra statutory concessions but only in:-

> "…the interstices of the tax legislation, dealing pragmatically with minor or transitory anomalies, cases of hardship at the margins or cases in which a statutory

[16] *Gaines-Cooper v Revenue & Customs Comrs* [2007] STC (SCD) 23

rule is difficult to formulate or its enactment would take up a disproportionate amount of parliamentary time."[17]

4.1.37 It is the opinion of the professional bodies that s.16A is a provision of the widest possible application and that the Guidance purports to restrict its application radically. Even if the Court were to agree that HMRC had held itself out as applying a concessionary treatment it is likely to find that concessionary treatment to be ultra vires.

4.1.38 Even if it were possible for the taxpayer to enforce the application of the Guidance through judicial review that remedy is discretionary, highly uncertain, expensive and subject to onerous time limits.

4.1.39 In completing their self assessment returns, can taxpayers safely take advantage of losses which are disallowable in law under s.16A but which they suspect, on the basis of the Guidance, HMRC may be willing to allow?

4.1.40 It would be foolhardy to do so. *Jones v Garnett*[18] showed that HMRC are happy to reverse the practice of years in an attempt to establish a strained and artificial construction of taxation legislation where there is substantial tax at stake. How much more likely are they to reverse an overgenerous interpretation of this legislation?

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[17] *R (on the application of Wilkinson) v Inland Revenue Commissioners* [2005] UKHL 30

[18] *Jones v Garnett (Inspector of Taxes)* [2007] All ER (D) 390

4.1.41 One approach might be for the taxpayer to use the white space to disclose that he has taken advantage of a loss which is not allowable under the relevant tax legislation on the basis that it seems to be in accordance with the Revenue's published views in the Guidance. That might be an example of a rare occasion where a taxpayer's disclosure fulfils the criteria set out in the case of *Veltema v Langham*[19] providing protection against a discovery assessment under TMA 1970 s.29.

Box 1 – Sale of shares to realise a capital loss

The Facts

Mr H sells shares in a company, S Plc, in order to crystallise a loss which can be set against his chargeable gains arising in the year. Unbeknown to Mr H, his wife Mrs H, buys shares of the same class in S Plc a few days later, at the same price as Mr H sold the original holding.

The Correct Analysis

Mr H has obtained a tax advantage because he has obtained a relief from tax. His disposal of the shares constitutes arrangements because 'arrangements' include "any… transaction". The loss resulting from the disposal falls within the new s.16A(1)(a) because it accrues to Mr H "directly … in consequence of … [the] … arrangements."

Section 16A applies and Mr H's loss is therefore not an allowable loss.

[19] *Veltema v Langham* CA [2004] STC 544

His wife's transactions would only be of any relevance to the matter if they provided evidence as to Mr H's purpose in making his disposal. As Mr H is ignorant of his wife's transactions they do not do so.

Box 2 – Investment in EIS Shares

The Facts

An individual, J, invests in shares under the Enterprise Investment Scheme with a view to securing Income Tax relief. In order to fund the purchase of the shares J sells the capital assets which are standing at a loss to a third party.

The Correct Analysis

The sale of the shares and the purchase of the Enterprise Investment Scheme shares are clearly arrangements because they are a series of transactions planned and undertaken by reference to each other. We are told as a fact that the purpose of J's investment in the EIS shares was to secure Income Tax relief. A main purpose of the arrangements is therefore to secure a tax advantage. What would otherwise be an allowable capital loss accrues to J "directly … in consequence of … [the] … arrangements." Section 16A therefore prevents J's capital loss from being an allowable loss.

SECTION V

TRANSACTIONS WITH CONNECTED PERSONS

5.1.1 Where a loss accrues on a disposal to a connected person, it is not deductible except from a chargeable gain accruing on the disposal of an asset to the same disponee.[20] This rule does not apply on a disposal into settlement if the gift and the income thereon are wholly or primarily applicable for educational, cultural or recreational purposes and the persons benefitting from that application are not persons all or most of whom are connected with the disponer.[21]

Example Three

Mr Duffin owns a shareholding in a major clearing bank which he wishes to give to his son. The holding's market value is £250,000 less than its base cost. Were he to give it directly to his son his loss of £250,000 could only be offset against gains on disposals to his son made either in the current or future fiscal years. Instead, he sells the shares in the market and, on the same day, his son buys the same number of the same shares in the market. Mr Duffin gives the proceeds of the disposal plus an additional amount equal to the transaction costs of the transaction (including Stamp Duty at half a percent) and the difference between the buying and selling prices to his son. His son is now in the position he would have been in had he received the shares as a gift and the loss arising to Mr Duffin is unrestricted.

[20] Section 18(2)
[21] Section 18(4)

Or is it? Consider the application of s.16A. On the wording of that section, the Duffins' transactions are clearly caught. Will HMRC apply the legislation? Example 6 in HMRC's examples of the operation of s.16A[22] where they consider the section applies, is quite close to the facts in this example but the Duffins' transaction is not circular in the same way as in HMRC's example.

5.1.2 Where the asset which is the subject of the disposal is an option to enter into a sale given by the person making the disposal, a loss accruing to the person acquiring the asset is not an allowable loss unless it accrues on a disposal at arms length to a person not connected with the disponer.[23]

[22] Capital Gains Tax Manual App.9
[23] Section 18(5)

SECTION VI

LOSSES ON SHARES IN TRADING COMPANIES

6.1.1 ITA 2007 chapter 6 (ss.131-151) allows a person who has incurred an allowable loss for Capital Gains Tax purposes on shares in certain unlisted trading companies, to set the loss against his general net income for the year of loss or for the previous tax year or for both. Where the claim is made in relation to both tax years, it must specify the year for which a deduction is to be made first.

6.1.2 The claim must be made on or before the first anniversary of the normal self-assessment filing date for the year of the loss.

6.1.3 Share loss relief only applies if a disposal of shares is:-

(a) under a bargain made at arm's length; or

(b) under a distribution in the course of dissolving or winding up the company; or

(c) under a negligible value claim.

6.1.4 The relief is available on shares:-

(a) to which EIS Relief is attributable; or

(b) that are shares in a qualifying trading company which have been subscribed for by the individual.

6.1.5 A qualifying trading company for this purpose is one which meets each of four conditions, A to D. Those conditions are analogous to the conditions which must be satisfied to be a qualifying company for the purposes of EIS Relief.

6.1.6 Condition A is that the company either meets each of four sets of requirements:-

(a) being:-

(i) the trading requirement;

(ii) the control and independence requirement;

(iii) the qualifying subsidiaries requirement;

(iv) the property managing subsidiary requirement; or

(b) has ceased to meet any of these requirements at a time which is not more than three years before the date of the claim and has not, since that time, been an excluded company, an investment company or trading company.

6.1.7 Condition B is that the company either has met each of these requirements for a continuous period of six years or has met each of those requirements for a shorter continuous period ending on the relevant date and has not, before the beginning of that period, been an excluded company, an investment company, or a trading company.

6.1.8 Condition C is that the company:-

(a) met the gross assets requirement, both immediately before and immediately after the issue of the shares in respect of which the loss relief is claimed; and

(b) met the unquoted status requirement at the time of issue of the shares.

6.1.9 Condition D is that the company has carried on its business wholly or mainly in the United Kingdom throughout the period between its incorporation or, if later, twelve months before the share issue in question and the date of the disposal.

6.1.10 So much of the loss arising on the disposal that is not deducted in calculating an individual's net income remains an allowable capital loss.

SECTION VII

DEFERRED UNASCERTAINABLE CONSIDERATION

SECTIONS 279A – 279D

7.1.1 A right to an amount of consideration which is unascertainable at the time the right is acquired is a chose in action. Under the principle in *Marren v Ingles* [24] when the amount of the consideration is subsequently ascertained and becomes payable there is a disposal of that chose in action which can give rise to a gain or a loss.

7.1.2 Typically, this situation arises when a business is sold for a fixed sum (the "Cash Consideration") plus an additional amount (the "Additional Consideration") calculated by reference to the profits of the business for a fixed period after the disposal. The amount of the Additional Amount is unascertainable at the time of the disposal of the business because it depends upon future events. The disponer's consideration to be brought into his Capital Gains Tax computation will be the amount of the Cash Consideration plus the current market value of the right (the "Earn Out Right") to be paid the Additional Consideration when it is ascertained. That value will obviously depend upon a hypothetical evaluation by the market of the probable amount of the future payout and of its risk.

[24] *Marren v Ingles* HL [1980] STC 500

7.1.3 When the Additional Consideration is actually paid (or the Earn Out Right lapses) there will be a disposal of the Earn Out Right resulting in an allowable loss if the amount paid proves to be less than the value which the market would have put on the Earn Out Right at the time of the disposal of the business.

7.1.4 The difficulty with that is that, apart from the year of death, it is not possible to carry back a capital loss and therefore, unless the taxpayer has other gains against which to relieve the loss, he may find himself paying tax on the original gain by reference to the market value of the Earn Out Right at the time of the disposal and having an unrelieveable loss (the "Earn Out Loss") in a later year.

7.1.5 For that reason an election is provided by ss.279A -279D for the Earn Out Loss to be treated as accruing in an earlier year. The loss may be treated as arising in the "first eligible year". An eligible year for this purpose is a year before the year of loss but not earlier than 1992/1993 in which a chargeable gain accrued to the taxpayer on either the original disposal, an earlier disposal of the original asset or a later disposal of the original asset in an earlier year than the year of the disposal of the Earn Out Right. There is also an eligible year where the gain on the original disposal has been relieved under EIS or VCT relief and is then brought back into charge. The loss relieves the gains of the first eligible year first and then later eligible years on a FIFO basis.

Example Four

Mr Broxwood-Foxwhelp sells all of his shareholding in Bittersharp Limited on the 30th June 2008 for the following consideration:-

(a) £10,000,000 in cash payable immediately;

(b) An amount equal to one third of the aggregate profit before tax of the company in the three years ending 30th June 2011 to be calculated by, and paid on, 31st December 2011.

He had acquired the shareholding for £5,000,000 some years before.

At the time of the disposal the Earn Out Right had a market value of £5,000,000. Profits after the disposal are disappointing and only £1,000,000 is paid in respect of the Earn Out Right. Mr Broxwood-Foxwhelp has no other gains and losses.

No election under s.279A

Without an election under s.279A Mr Broxwood-Foxwhelp's Capital Gains Tax computations would be as follows:-

2008/2009

Disposal of shares

Consideration (£10,000,000 + £5,000,000)	15,000,000
Cost	<5,000,000>
Gain	10,000,000

2011/2012

Consideration	1,000,000
Cost	<5,000,000>
Unrelieved loss carried forward	<4,000,000>

With an election under Section 279A

<u>2008/2009</u>

Disposal of shares

Consideration (£10,000,000 + £5,000,000)	15,000,000
Cost	<5,000,000>
Gain	10,000,000
Less allowable loss treated as accruing in year under s.279A	<4,000,000>
Chargeable gains	6,000,000

SECTION VIII

DEBTS

SECTION 251

8.1.1 TCGA 1992 s.251 provides that where a person incurs a debt to another, no chargeable gain shall accrue to that person, the original creditor, or his personal representative or legatee on a disposal of the debt except in the case of a "debt on a security".

8.1.2 Under s.251(4) a loss accruing on the disposal of a debt acquired by the person making the disposal from the original creditor or his personal representative or legatee at the time when the creditor (personal representative or legatee) is connected with the person making the disposal is not an allowable loss. These provisions are extended to situations where the debt has been acquired through chains of connected persons.[25]

8.1.3 There is nothing in sub-section 4 to suggest that it does not apply to all debts, including debts on a security.

8.1.4 HMRC's Capital Gains Tax Manual says, however, that "although the word 'debt' is not qualified, in the Revenue's view TCGA 1992 s.251(4) does not apply to debts on a security". They do not give their reasoning for having arrived at this view. It seems merely to be an over generous construction of the law.

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[25] Sub-section (5) extends the provision to trustees and makes appropriate modifications

RELIEF FOR LOANS TO TRADERS

8.2.1 Where a person makes an unsecured loan to a person carrying on a trade, profession or vocation and that loan proves irrecoverable, s.251(1) would, if there were no other provision, prevent an allowable loss arising. Section 253 therefore provides a special relief for loans to traders. A qualifying loan under these provisions is a loan in the case of which:-

(a) the money lent is used by the borrower wholly for the purposes of a trade carried on by him, not being a trade which consists of, or includes the lending of money; and

(b) the borrower is resident in the United Kingdom; and

(c) the borrowers debt is not a debt on a security.

8.2.2 For the purposes of (a), money used by the borrower for setting up a trade which is subsequently carried on by him is treated as used for the purposes of that trade. A trade for this purpose includes a profession or vocation. A person may make a claim when:-

(a) the outstanding amount of the principal of the loan has become irrecoverable; and

(b) the claimant has not assigned his right to recover that amount; and

(c) the claimant and the borrower are not each other's spouses, civil partners or companies in the same group when the loan was made, or at any subsequent time.

8.2.3 The use of the past tense in condition (c) indicates that it applies to the period from the making of the loan until the claim. A subsequent marriage or civil partnership cannot lead to a withdrawal of the relief.

8.2.4 Where a claim is made, a loss is deemed to accrue to the claimant equal to the amount of the principal on the loan that has become irrecoverable.

8.2.5 The time at which the loss accrues is the time of the claim except that the claim may specify an earlier time of up to two years before the beginning of the year of assessment in which the claim is made if the amount was also irrecoverable at that earlier time.

8.2.6 Relief is also given where a person makes a payment under a guarantee of a loan which would be a qualifying loan.

8.2.7 For the purposes of this relief, a commercial letting of furnished holiday accommodation in the United Kingdom is treated as a trade.

8.2.8 Where a person has had loss relief, either on a loan becoming irrecoverable or on a guarantee payment being made, and the taxpayer recovers all or part of the loan or an amount in respect of his guarantee, a chargeable gain is deemed to accrue to him at the time of the recovery, equal to so much of the allowable loss as corresponds to the amount recovered. An amount is not treated as having become irrecoverable for the purposes of s.253 where it has become irrecoverable in consequence of the terms of the

loan or of any arrangements of which the loan formed part or of any act or omission by the lender (or the guarantor as appropriate).

RELIEF FOR DEBTS ON QUALIFYING CORPORATE BONDS

8.3.1 Section 254 gave relief for losses on certain qualifying corporate bonds. The section was repealed by FA 1998 s.141 with effect in relation to loans made after the 16th March 1998 but continues in force in respect of loans made on or before that date.

SECTION IX

FOREIGN CURRENCY

9.1.1 A balance on a bank account is a debt owed by the bank to the holder. As such it is an asset. A disposal of that asset would, without further provision, lead to chargeable gains or losses. As we have seen, s.251 specifically provides that no chargeable gain will accrue on the disposal of a debt by the original creditor except in the case of a debt on security which plainly a bank account is not. This exemption does not apply, however, to a bank account which is not in sterling except accounts representing currency acquired by the holder for the personal expenditure outside the United Kingdom of himself, his family or dependants.[26]

9.1.2 An article in Private Client Business entitled "Pecuniae Obodiunt Omnia" which appeared in Issue 5, 2006 sets out reasons for considering that withdrawals of less than the whole balance of a bank account are not disposals. Although the arguments for that view are strong, it is clearly not accepted by HMRC who regard transfers from foreign currency bank accounts as part disposals which are chargeable.[27]

9.1.3 With the recent catastrophic falls in the value of sterling against most currencies it may well be that transferring moneys from a foreign currency account may give an

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[26] Section 252

[27] Capital Gains Tax Manual para 78330

opportunity to realise substantial capital losses. One must be aware, however, of s.16A.[28]

[28] See Section IV

SECTION X

UNRELIEVED SETTLEMENT LOSSES

10.1.1 Under s.71(1) where a person (the "Beneficiary") becomes absolutely entitled to any settled property as against the trustee, the trustee is treated as if he had disposed of the asset for market value and immediately re-acquired it as bare trustee for the Beneficiary. If a loss arises on this deemed disposal it is first allowed against "pre-entitlement gains" but to the extent that those gains do not reduce the loss to nil the remaining portion is treated as accruing to the Beneficiary. The loss deemed to accrue to the beneficiary can then only be set against:-

> "gains accruing to the beneficiary on the disposal by him of –
>
> (1) the asset on the deemed disposal on which the loss accrued; or
>
> (2) where that asset is an estate, interest or right in or over land, that asset or any asset derived from it."[29]

10.1.2 A pre-entitlement gain means a chargeable gain accruing to the trustees, either on the deemed disposal under s.71(1) or on disposals by the trustee before that deemed disposal but in the same year of assessment.[30]

10.1.3 For this purpose, allowable losses arising on the deemed disposal under s.71(1) are treated as being deducted first.

[29] Section 71(1) and (2)
[30] Section 71(2A)

Example Two

The Trustees of the Masters Settlement advance a shareholding in Malus Limited on 30th June 2008 to a beneficiary, Harry Masters, and are deemed to realise a loss of £200,000 under s.71(1). In the fiscal year 2008/2009 the Trustees have the following other gains and losses. They all arose on transactions with third parties.

	£
30th May	100,000
15th June	<50,000>
31st December	200,000

Harry Masters regularly makes substantial gains on his investment portfolio and continues to do so in the succeeding years. In 2012/2013 he disposes of the Malus Limited shareholding realising a gain of £50,000.

The loss on the advance to Harry is set against the pre-entitlement gain on the 30th May in priority to the loss arising on the 15th June. The unrelieved balance of £100,000 (£200,000 - £100,000) can only be set off against the gain of £50,000 on Harry's disposal of Malus Ltd shares in 2012/2013. The remaining balance of the loss of £50,000 (£100,000 - £50,000) remains unused.

The Trustees' Capital Gains Tax computation for 2008/2009 is as follows:-

	£
Gains (£200,000 + £100,000)	300,000
Losses (£50,000 + (£200,000 - £100,000))	150,000
Chargeable gains before the deduction of the Annual Exemption	150,000

SECTION XI

THEATRE ANGELS

11.1.1 Theatre angels are individuals who invest in theatrical productions. They may make their investments in the normal course of a trade of doing so. If they do not, it is HMRC's view that their profits are charged under the residual category of "annual payments not otherwise charged" under ITTOIA 2005 s.683. HMRC's view is also that where the investor loses part of his original investment he suffers an allowable capital loss. In what they consider to be a concessionary treatment, however, they will accept that the losses may be treated as "miscellaneous losses" computed under ITTOIA s.872 which may be deducted from miscellaneous income.[31] "Miscellaneous income" is a rag-bag category created in the rewrite project which has effectively replaced income within Schedule D Case VI.

[31] ESC A94

SECTION XII

THE REMITTANCE BASIS: SECTIONS 16ZA – 16ZD

SECTION 16ZA

12.1.1 Unless an individual who is domiciled outside the United Kingdom makes an election under s.16ZA, foreign losses accruing to him in:-

(a) the relevant tax year; or

(b) any subsequent tax year except one in which he is domiciled in the United Kingdom

are not allowable losses.

12.1.2 Section 16ZA provides that the election may be made in "the relevant tax year". The relevant tax year is the first year for which:-

(a) a claim for the Remittance Basis is made; and

(b) the individual is not domiciled in the United Kingdom.

12.1.3 If no election is made in the relevant tax year it cannot be made in respect of subsequent years. There is, however, a long period to decide whether or not the election should be

made because the time limit is the standard one in TMA 1970 s.43, being five years after the 31st January next following the year of assessment to which it relates.

12.1.4 Note that this would disallow losses even in a year in which a taxpayer has not made the Remittance Basis election.

SECTION 16ZB

12.2.1 Where the election is made, s.16ZB has the effect that losses cannot be set off against foreign chargeable gains which have arisen in a previous tax year but which are treated as accruing in a later tax year by reason of their remittance.

12.2.2 This is so whether or not the individual has made a Remittance Basis election for the year concerned.

SECTION 16ZC

12.3.1 Section 16ZC applies to an individual for a tax year if:-

(a) the individual has made an election under s.16ZA;

(b) the Remittance Basis applies to the individual for that tax year; and

(c) the individual is not domiciled in the United Kingdom in the tax year.

12.3.2 Where the section applies, a series of steps are specified for the purpose of calculating the amount on which an individual is to be charged to Capital Gains Tax for the tax year. Under those steps, allowable losses are deducted first from foreign chargeable gains accruing to the individual in the tax year which have been remitted in that year. Secondly, they are deducted from foreign chargeable gains accruing to the individual in that year to the extent that they have not been so remitted. Thirdly, they are deducted from other chargeable gains accruing to the individual in that year. In arriving at a taxpayer's gains chargeable to Capital Gains Tax for the year, however, the losses deducted from foreign chargeable gains accruing to the individual in that year which have not been remitted in the year are ignored.

12.3.3 The result is that losses set against foreign chargeable gains which are not remitted in the year are regarded as having been used and therefore cannot relieve other gains and, in particular, chargeable gains on disposals of UK situated assets.

AN EXAMPLE

Example III

Mr Nehou makes the following gains, losses and remittances. His foreign income is sufficiently large so that it is clear that it will be advantageous for him to make the Remittance Basis election in 2008/2009 and 2009/2010. His income is less in 2010/2011 so he needs to determine his capital gains tax position in order to determine whether or not to make the Remittance Basis election. He makes an election under

TCGA 1992 s.16ZA. His capital gains, losses and remittances of gains in the years 2008/2009 – 2010/2011 are as follows.

Year	Gains		Losses		Remittances of Gains realised in:		
	UK	**Foreign**	**UK**	**Foreign**	**2008/09**	**2009/10**	**2010/11**
2008/09	100,000	0	0	200,000	0	N/A	N/A
2009/10	0	500,000	400,000	0	0	0	N/A
2010/11	0	500,000	0	0	0	500,000	200,000

No election under Section 16ZA

2008/2009	**£**	
Capital Gains (UK)	100,000	
Allowable losses	0	(foreign losses are not deductible)
	100,000	

2009/2010	**£**
Capital Gains	0

2010/2011	**£**
Capital gains (500,000 + 200,000)	700,000
Less losses brought forward	<400,000>
	300,000

Election under Section 16ZA

2008/2009

Section 16ZB does not apply because foreign chargeable gains have not accrued on or after the relevant tax year (2008/2009) but before the applicable tax year (2008/2009). Section 16ZC applies.

Capital Gains	100,000
Foreign losses deducted from non-foreign chargeable gains	<100,000>
	0

2009/2010

Section 16ZB does not apply because foreign chargeable gains have not accrued on or after the relevant tax year (2008/2009) but before the applicable tax year (2009/2010). Section 16ZC applies.

Apply steps in s.16ZC(2).

	Foreign chargeable gains arising and remitted in year (a)	**Other foreign chargeable gains accruing in the year (b)**	**Other gains accruing in the year (c)**
Step I	**£**	**£**	**£**
Gains	0	500,000	0

Losses deducted

Foreign losses BF (200,000 – 100,000) UK losses of the year (400,000)	<0>	<500,000>	0

Step II

The chargeable amount is equal to aggregate chargeable gains (£0) less losses deducted under (a) and (b) above (£0). So the chargeable amount for the year is nil.

2010/2011

Section 16ZB and Section 16ZC apply.

Step I

	Foreign chargeable gains arising and remitted in year	**Other foreign chargeable gains accruing in the year**	**Other gains accruing in the year**
	£	**£**	**£**
Gains	200,000	300,000	0
Losses offset	0	0	0

Unremitted gains carried forward are £300,000 of the gains arising in 2010/2011.

If he does not make the Remittance Basis election he will be taxed on the full £500,000 of foreign gains which arose in the year. By making the election he is taxed on only the £200,000 of those gains which were remitted in the year.

Mr Nehon is taxable on the aggregate of:-

		£
(a)	The adjusted taxable amount	200,000
(b)	The relevant gains (the gains realised in 2009/2010 were reduced by the set off of losses in 2009/2010 under Step I of s.16ZC(2))	0
	Amount on which Capital Gains Tax is chargeable	200,000

	Without Election	With Election
	£	£
Aggregate gains on which CGT is chargeable in 2008/2009 – 2010/2011	400,000	200,000
Allowable losses carried forward at 6th April 2011	0	0
Realised but unremitted gains at 6th April 2011	300,000	300,000

Making the election allows the foreign losses made in 2008/2009 to be utilised. One might not make the election in circumstances where one wants losses to be set-off against UK gains rather than unremitted gains.