Doing good by stealth?


ESC D33

Fair administration?

Simon McKie explains HMRC's restriction to relief given by ESC D33 for gains arising on the disposal of rights to take court action

Everybody involved in taxation agrees that the simplification of the tax system would be a good thing. But tax is getting more complex, and one cause of this is how the tax system is used to manage opinion for political ends. A recent change illustrates how political considerations can cause unnecessary complexity.

Tax relief restricted

I recently wrote in *Tax Adviser* ('Fair Administration', p 32, July 2014) about HMRC's announcement in January that the relief provided by ESC D33 – for gains arising on the disposal of rights to take court action – was to be restricted to the first £500,000 of such gains. Although HMRC said in its announcement that it would consider claims for relief in excess of £500,000, it was also made plain that HMRC intended to allow such claims only rarely.

A right to take court action for compensation or damages is an asset for CGT purposes. However, I explained in the article that gains for compensation or damages would not normally represent a real economic gain. In fact, the effect of the January announcement was to impose a charge on amounts that were designed merely to place a person, who had been wronged and suffered damage, in the position that he would have been in originally, had he not been wronged.

On 29 May 2014, the CIOT made representations, utilising the examples in my article, recommending that:

'… the concession is restored to its previous wording immediately and the amendments treated as never having had effect'.

HMRC amends its guidance

On 23 June 2014, HMRC amended its guidance on ESC D33 in paragraph CG13024 of the *Capital Gains Tax Manual*, saying that it will allow a claim for relief beyond the first £500,000 of gains where:

1. the right of action was acquired in connection with goods or services that the payer – or a connected person (CG14580 *et seq*), associated company (CTM03530) or person acting in an intermediary capacity for the payer – has provided as part of their trade, profession or vocation;
2. the first condition shall be considered to be met in all cases where the right of action relates to misselling of a financial product and the person who provides that financial product is regulated by the Financial Conduct Authority;
3. the payee did not acquire the right of action by means of a husband or wife's or civil partner's transfer (CG10790) or by a transfer within a group (CG45300+); and
4. the payee did not acquire the right of action from another person for consideration (CG14500).'

It is evident that most gains arising on disposals of rights of action which are not otherwise exempt will be exempt under this revised practice provided a claim is made. Certainly, Brenda Broxwood and David Dabinett, the characters in the examples in my article, would qualify for relief on this basis. As readers of my article will recall, it is right that they should do so. There may be circumstances where gains arise in respect of actions which are not in connection with goods or services provided as part of a trade, profession or vocation; for example, tortious liability in respect of some statements by experts. Such circumstances must surely be very rare and I cannot imagine any circumstances in which it would be fair or appropriate to impose a CGT liability on such gains.

As I have said, however, for most people that transfer their rights of action to another, the position has been restored to that which existed before HMRC's January announcement. There are, however, the restrictive conditions of (3) and (4) above to be considered.

Unnecessary caveats?

Why is there an exclusion for rights of action transferred within a group or between spouses? Any such transfers will be rare. In the few cases where one spouse transfers the beneficial ownership of a right of action to the other, it is likely to be so that the other spouse can manage the claim more effectively. Similarly, a group may wish to deal with all its claims in one subsidiary for reasons of efficiency.

In either case, it is difficult to think of a reason why doing so should create a tax liability on a right to an amount designed merely to repair the damage inflicted by a wrong. One might think that it is understandable that a person who acquires a right of action for consideration should be taxable on his profit. In almost all situations, however, such a person would be subject to income tax on his profit as a profit of a trade, or of an adventure in the nature of the trade.

It may be that HMRC has some specific avoidance technique in mind in creating these exceptions to the relief, but it is beyond my ingenuity to imagine what these techniques might be. Perhaps these complications have been made to assuage the general sense of suspicion that any relaxation may be exploited, in some unknown way, for tax avoidance. There may, however, be another reason.

Is it unduly cynical to suggest that the government dislikes admitting that it has been wrong and that therefore, in this case, it has disguised a reversal of policy by creating unnecessary exceptions, along with a burdensome and purposeless requirement for the relief to be claimed? That explanation, it seems to me, is likely to be correct. And another complexity has been created – and another administrative burden imposed on taxpayers – for no better reason than to spare HMRC from embarrassment.

In my previous article I concluded:

'All in all, the Revenue's notice of this revision of the concession is an object lesson in the poor formulation and execution of tax policy and of its inadequate communication to the public.'

That applies as much to the government's effective reversal of the change to ESC D33 as it does to its original January announcement.

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