

FINANCE BILL 2011

## Tax Briefing Note 2

# Value shifting - targeted anti avoidance rule



### Background

- HMRC has repealed several of the value shifting provisions in the TCGA 1992 and replaced them with a more targeted one designed to defeat a particular scheme (a “drain out dividend scheme”) which is what the legislation was intended to target in the first place!
- The general value shifting provision in Section 29 is unaffected. The new provision contains a motive test, and is only likely to apply when there are some reasonably complex pre-sale arrangements pursuant to which money that would otherwise have been subject to tax as chargeable gains on the selling for a company is taxed as exempt dividend income.
- You will remember that for a corporate, it is better to convert capital to income (unless you get the substantial shareholding exemption) whereas for individuals it is usually better to have income treated as capital.
- Whilst I appreciate it is unlikely that you will be giving any tax advice in association with the arrangements mentioned below, if you are involved with them, you will just need to check that somebody is advising on tax, since the consequences of the value shifting provisions applying could be a bit of a facer!
- So P owns S. S has an asset worth £70m with a base cost of £20m. P wants to sell S.
- S sets up New sub co. New sub co borrows £70m from P, and buys the asset from S for £70m. This is no gain no loss, but S has made an accounting profit of £50m which it distributes to P as a dividend. The dividend is tax free.
- S is now sitting on cash of £20m, but its shares in New sub co are worthless, since although New sub co owns an asset worth £70m, it is subject to a debt of £70m to P. P then sells S to the third party for £20m. On the basis that P had a base cost of £20m in S, (since it subscribed for shares to enable S to buy the asset in the first place), there is no gain on P.
- The purchaser acquires S with cash of £20m and it then procures that New sub co repays the £70m debt to P; so the purchaser has effectively shelled out the £70m which repays the original loan. P has received £70m for its interest in S (ie. £20m from the direct sale and £50m by way of the inter group dividend).
- So, if you get involved in a transaction where these sort of restructurings are contemplated, think anti avoidance.
- The legislation doesn't apply to normal pre-sale dividends (which are treated as exempt and thus excluded under statute).

### 2011 changes

- The new regime is designed to defeat the drain out dividend scheme mentioned above, or transactions which have a similar effect. These schemes involve generating reserves by internal transfers, distributing up those reserves, and then selling the shares in the company that has just paid up the reserves (by way of an exempt dividend) for a lower price than would have been the case had the pre-sale arrangements not occurred.
- It is worth setting out how these schemes work in a bit of detail since it will make it much clearer for you to understand whether or not you fall foul of the rules.
- HMRC's guidance also suggests that they won't consider normal pre-sale transactions, which reduce the value of target company as being struck down, provided that a disposal consideration for the shares is a “*true measure of the value passing from the vendor group*”.
- HMRC's bulletin gives a number of examples where the legislation will and won't apply, but that's probably enough to be going on with!

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