Mr James Driver and Ms Sue Pennicott
HM Revenue & Customs
Specialist Personal Tax
Personal Tax Policy
100 Parliament Street
London
SW1A 2BQ

e-mail: PTIConsultation.Specialistpersonaltax@hmrc.gsi.gov.uk

1 October 2012

Dear Mr Driver and Ms Pennicott

Consultation document published on 30 July 2012 regarding the attribution of gains to members of closely controlled non-resident companies and the transfer of assets abroad

About the BVCA

This response is submitted on behalf of the Tax Committee of the British Private Equity and Venture Capital Association ("BVCA"). The BVCA is the industry body and public body advocate for the private equity and venture capital industry in the UK. More than 520 firms make up the BVCA membership, including more than 250 private equity, mid market and venture capital firms, together with 250 professional advisory firms. In 2010, the ongoing number of people employed by UK private-equity backed businesses was 810,000 on a full-time equivalent basis.

The BVCA Tax Committee includes amongst its objectives the shaping of policy and the implementation of policy to ensure that it accommodates the needs of the British venture capital and private equity community.

In relation to the above consultation, the BVCA has the following comments.

Gains Attributed to Members of a Closely Controlled Non-Resident Company: Section 13 TCGA

Questions 1 and 2

Section 13 creates special difficulty for investors in private equity for two reasons. The first is that private equity investors tend to participate through funds and thus to have little visibility over the affairs of investee groups. Second, the nature of private equity investment means that there are normally holding companies in a number of different jurisdictions. Most private equity investments are made in businesses outside the UK.

For these reasons it is in practice very difficult for private equity investors to comply with section 13 and anything which prevents the gains of the target companies being bought unnecessarily within the regime is valuable. In this context:

(a) we note your comment at paragraph 2.22 to the effect that treaty practice will be reviewed. Currently, international private equity funds make investments in many European targets through Luxembourg acquisition vehicles. At the moment reliance is placed on treaty protection to keep those Luxcos outside section 13. To strip away that treaty protection without putting something equally efficacious in place would result in chaos;

(b) we note your suggestion at 2.14 that active management companies should qualify. It seems to us that this should be extended to any group holding company (i.e. any company whose main interest is to invest in controlling interests in other unquoted companies). We would suggest that the definition of "establishment" is extended to cover this;

(c) we would also mention that the new section 13A(5) appears to cut active investment management companies out of the exemptions at 13(2)(ca) despite what is said at 2.14. However "active", the business remains investment management.

Question 3

The motive test certainly seems helpful, particularly as it will exclude companies put in place in the course of foreign tax structuring. We cannot understand, however, why it should be alternative to, rather than additional to the suggested business establishment test. Clearly, companies which satisfy the motive test should be excluded and clearly companies which satisfy the genuine economic activity test need to be excluded to comply with European law. Surely the answer is to include both exclusions.

Question 4

We would welcome an increase in the de minimis participation to 25 per cent which would of course bring section 13 into line with the CFC legislation. There is another point here, however. As you know, much investment in private equity is made through limited partnerships which typically take control of the group acquired. As things stand, the fact that partners are regarded as connected persons or associates means that section 13 applies even though there are many investors (so that but for the partnership, the target group would not be close) and each of them participates as to much less than 10 per cent (so that but for the partnership each would fall below the de minimis). This is anomalous as participants in funds would not normally have any influence over structuring or indeed the information to analyse the fund's investments. We suggest, therefore, that both in relation to the close company test and the de minimis test as applied for section 13, the fact that investors are linked through

partnership structures should be ignored. This might be done by borrowing the definition of "CIS Limited Partnership" from section 376(5) CTA 2009.

Question 5

See above.

Question 6

Not relevant to private equity.

General point

While we are discussing the reform of section 13, there is a further point which should be made. The three year limit on credit against distributions of proceeds imposed by subsection 5B undermines the credit mechanism where that distribution takes a capital form.

Imagine that £100m is invested in a foreign investment company ("Holdco") and that Holdco realises a gain of £10m. Also assume that Holdco makes no other profits or losses (either realised or not) but distributes the £10m gain to investors as capital – i.e. as consideration for a repurchase of shares or on a partial liquidation.

The aggregate capital gain realised by investors on their Holdco shares when the £10 million is distributed will be far less than £10 million. That is because the base cost available to set against the £10 million proceeds received by investors is $10 x \frac{100}{110} =$ £9m, giving a gain of only £1m. In fact the rest of the capital gain on Holdco shares reflecting Holdco's £10 million gain will probably not emerge until Holdco is wound up. If that is more than three years after the original gain, credit relief will be lost. We would suggest that the three year limit be removed to make the legislation more "proportionate".

Transfers of Assets: Chapter 2 Part 13 ITA

Question 7

We think that the additional exemption proposed at paragraph 3.3 would be useful but we do not think it clear that the draft legislation achieves it. As we understand it, the proposal is that where money is transferred to an overseas company for, and is used for, genuine commercial operation, chapter 2 should not apply. On this basis it is the use which is made of the money rather than how it is injected into the company which is important. We are concerned that as the drafting stands it is unclear which transactions have to fall within section 742A(3). The relevant transactions should be those which the company carries on in the course of its activity but not the injection of the money into the company which, particularly on refinancing, may well not be on arm's length terms (e.g. a discounted rights issue or capital contributions). That could

be made clear in the guidance or alternatively by replacing the word "attributed" by the words "calculated by reference" in section 742A(2).

Question 8

It will be interesting to see whether the definition of "economically significant activities" is really usable in practice.

Questions 9 and 10

See above.

Question 11

We are not aware of problems in practice.

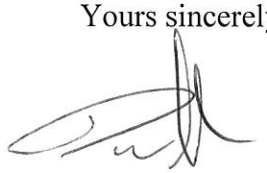
Questions 12 and 13

In order to simplify the sections and avoid double tax charges, we would suggest expanding section 743(4) to exclude income from sections 720 and 727 if, within 12 months of the year of assessment in which it arises, amounts derived from it are received as taxable income for either income tax or corporation tax purposes.

Question 14

No comment.

Yours sincerely



David Marks
Chairman, BVCA Taxation Committee