Slavica Owen
HM Revenue and Customs
Counter-Avoidance Directorate
3C/04
100 Parliament Street
London
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Dear Ms Owen

Strengthening the Tax Avoidance Disclosure Regulations

We are writing on behalf of the British Private Equity and Venture Capital Association (the "**BVCA**"), which is the industry body and public body advocate for the private equity and venture capital industry in the UK representing the interests of members of the industry. More than 500 firms make up the BVCA members, including over 250 private equity, mid-market, venture capital firms and angel investors, together with over 250 professional advisory firms, including legal, accounting, regulatory and tax advisers, corporate financiers, due diligence professionals, environmental advisers, transaction services providers, and placement agents. Additional members include international investors and funds-of-funds, secondary purchasers, university teams and academics and fellow national private equity and venture capital associations globally.

This letter has been formulated by the BVCA's Taxation Committee, whose remit is to represent the interests of members of the industry in taxation matters. The BVCA welcomes the opportunity to submit comments on the proposals to make changes to the Disclosure of Tax Avoidance Schemes ("**DOTAS**") regime as set out in the Consultation Document published on 31 July 2014 (the "**Consultation**").

Introduction

While the BVCA fully supports the Government's steps to prevent unacceptable tax avoidance, it believes that it is important to ensure that any changes made to the DOTAS rules are proportionate and do not result in an impediment to the operation of legitimate business structures. In this regard, our concerns are principally around the proposals for the new Financial Product Hallmark.

It is clear from Chapter 2 of the Consultation that HMRC has concerns that insufficient disclosures are being made and accordingly changes to the existing Hallmarks are proposed. In addition, the Financial Product Hallmark seems to have been deliberately very widely drawn both in terms of the financial products covered, and in terms of the other three conditions that must be satisfied for a disclosure obligation to arise. Our concern, put simply, is that as drafted the Hallmark could be seen as requiring a wide range of legitimate structures that have nothing to do with tax

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avoidance. It cannot be correct that the "plain vanilla" business structures used by our members could be within these rules as that possibility will inevitably add an administrative burden and impede investment. One can take two examples, but there will be many more.

Our members' business is to make investments into private companies so that those companies may develop and grow. The form of the investment will typically involve both debt and equity. While there will be a number of considerations that influence the form of investment, many of which will not be tax related, it is also the case that the tax position of the investee company will often be a relevant factor. Since interest paid on debt will generally be deductible for the investee company (subject to existing provisions in the loan relationships rules, transfer pricing rules, worldwide debt cap, etc), arguably there is a "tax advantage" to the investee company which may be seen as a "main benefit" of the decision to fund it by way of debt, thereby potentially satisfying Condition 2 of the new Hallmark.

While Condition 3 would appear to offer some additional protection, in practice we question how this might operate. For example, the rules around deductibility of interest contain a number of requirements as to the loan under which the interest is paid; for example, interest may not be deductible where a loan has "equity like" features. From a purely commercial perspective it may desirable for a loan to have just such elements in it, but they will not be included to prevent the interest paid under the loan from being non-deductible. Conceivably, therefore, it could be said that the loan contains a term which it would not have done "were it not for the tax advantage".

To take another, more specific, example. An investment will typically involve the establishment of a new company ("**NewCo**") to acquire an existing company ("**OldCo**"). Often the commercially agreed terms agreed will involve some form of "roll over" for existing investors in OldCo (including key personnel whose ongoing participation in the business is important to its success), to enable them to exchange their investment in OldCo for one in NewCo. Under sections 135 or 136 of the Taxation of Chargeable Gains Act 1992 ("**TCGA**") this can be achieved without triggering a disposal for tax purposes.

Where an exchange involves the issue of debt securities to the original investors it is usually considered important that those securities are not so-called "qualifying corporate bonds" ("**QCBs**") as defined in s117 TCGA. This is because under section 116 TCGA the effect of rolling over into QCBs is effectively to "freeze" any gain on the original holdings. When the QCBs are finally redeemed that gain comes into charge, *irrespective of the actual redemption proceeds received with no allowance for the actual loss suffered*. Thus, even if the NewCo were to become insolvent such that the QCBs became valueless, the earlier gain would still be taxable.

To deal with this the debt securities are drafted so as to fall outside the definition of QCB in the legislation so that an unfunded tax charge does not arise. This is often achieved by providing for the possibility of redeeming the securities in a currency other than sterling, since a bond which can be redeemed in another currency will not be a QCB.

This mechanism is well recognised and understood by HMRC and, since it avoids an unfair tax result, we understand is not considered to be remotely objectionable. However, we are concerned that if the Hallmark were to be introduced in its current form, this sort of structuring would seem to require disclosure.

Exactly the same sorts of concerns would arise in many other contexts. For example, employee participation in equity of an investee company is almost invariably considered beneficial to an investee company and indeed is something that government policy has recognised through the introduction of various incentives to encourage employee shareholder participation. From an employee perspective, one of the attractions is that they can often expect capital gains tax treatment for their shareholdings. However, to achieve this tax treatment it is necessary to ensure that the arrangements comply with the requirements of the employment related securities rules in the Income Tax (Employment and Pensions) Act 2003. Structuring to fall within these rules, could well trigger a disclosure obligation.

While we can certainly appreciate the attractions of a "precautionary" approach to DOTAS, i.e. one that errs on the side of requiring too much, rather than too little, disclosure, as the Financial Hallmark is drafted it would result in a number of very real practical problems. These are as follows.

The Basic Compliance Burden

The administrative burden of making disclosure of a wide range of transactions is likely to be very onerous for our members. Potentially private equity fund managers may find themselves having to make a significant number of disclosures every year, even though they are generally comparatively small organisations with limited resources to deal with extensive administrative obligations. If, every time a new transaction was contemplated or undertaken a disclosure exercise had to be undertaken, this would be unduly burdensome.

In this regard, we note that paragraph 5.9 of the Consultation refers to HMRC's acknowledgement in its response to responses received on the earlier "*Lifting the Lid*" consultation that, as originally drafted, the proposed filters "would not, in isolation, be sufficient to ensure appropriate targeting of the proposed hallmark". Specifically, the Consultation acknowledges that banks and securities houses could be disproportionately affected by the new Hallmark. Presumably this is on the basis that those institutions deal with financial products on a daily basis; indeed, it is their business to do so.

However, exactly the same can be said of other financial services organisations, including our members who, we would note, generally do not have the same sort of internal resources and infrastructure to support a significant increase in their tax compliance burden as compared to the banks. Accordingly, we would ask that some form of additional filter could be identified that did not rely upon the Banking Code of Conduct, to which our members are not subject. We have included some suggestions at the end of this letter.

Government Procurement

Pursuant to the Government procurement process as set out in the Procurement Policy Note: *Measures to Promote Tax Compliance- Action Note 03/14* dated 6 February 2014 and the Public Contracts Regulations 2006 SI 2006/5, a taxpayer will be disqualified from participating in Government procurement if their tax returns have been found to be incorrect as a result of

> "the failure of an avoidance scheme which the supplier was involved in and which was or should have been notified under the Disclosure of Tax Avoidance Scheme (DOTAS)."

On the face of it, since a taxpayer will only be disqualified where an "avoidance scheme" which is or should have been disclosed under DOTAS, has failed, the fact that a far greater number of transactions will have to be disclosed should not be relevant as "innocent" transactions are not going to "fail". However, it is possible for a tax return to be subject to challenge by HMRC without any degree of culpability on the part of the taxpayer; perhaps simply because HMRC takes a slightly different view of the facts. For example, going back to the debt funding of an investee company, HMRC could challenge the level of tax deduction at the company level on transfer pricing grounds. Would this then mean that a tax "avoidance scheme" had "failed"?

Implications for Investors in Private Equity Funds

Private equity funds obtain their finance from third party investors. The majority of these investors are large institutions including pension funds, listed companies, sovereign entities, etc. These institutions are often subject to their own strict rules around corporate responsibility and it is increasingly common for such investors only to invest in funds on condition that the funds do not engage in activities that would breach their own (i.e. the investors') guidelines. These guidelines may prohibit being involved in tax avoidance and where that is the case, the investors concerned will often impose contractual obligations on the fund manager not to engage in it.

If, pursuant to the new Hallmark, a fund manager were required to make a disclosure under DOTAS for a structure which (again on any reading) is "plain vanilla", this may nevertheless give rise to considerable concern on the part of its investors who, if they are not UK entities will almost certainly not appreciate the nuances of the UK's DOTAS regime. Indeed, we are aware that in some jurisdictions, the term tax avoidance is more closely aligned with tax fraud and therefore a DOTAS disclosure could be capable of being misinterpreted within codes of conduct applying to foreign investor groups. With inward investment into the UK being important for tax raising and for the economy generally, any measures that could discourage the inward investment that the PE industry relies upon, should be considered very carefully.

As a minor practical suggestion, we wonder whether going forward DOTAS might be better named as disclosure of tax "advantaged" schemes rather than tax "avoidance" schemes, or should include other appropriate clarification within the DOTAS guidance that any required disclosure does not necessarily assume inappropriate or aggressive planning has taken place, such that any required disclosure of "plain vanilla" arrangements does not send the incorrect message to investor groups.

Suggested Solutions

As noted at the start of this letter, the BVCA is fully supportive of the Government's desire to prevent unacceptable tax avoidance, but any steps taken in this regard should not unnecessarily impact upon the efficient operation of legitimate businesses. Accordingly, if it is felt that a new Hallmark is required, the BVCA believes that an additional condition is required.

The BVCA appreciates HMRC's sensitivity around a solution based upon "grandfathering", and would therefore suggest that if such an approach would not be acceptable then a more focused definition of tax avoidance may be appropriate. In this regard, two obvious solutions present themselves, but there may well be others.

First, rather than limiting the Banking Code of Conduct carve out to entities which are actually subject to the Code, it would be possible to replicate the operative provisions from the Code itself into the new Hallmark. Thus a disclosure would only be required where the outcome of a transaction was contrary to the legislative intent of Parliament.

Second, it may be appropriate to incorporate some equivalent to the "double reasonableness test" from the General Anti-Abuse Rule.

In addition, there are a number of areas where more specific carve outs from the disclosure obligation may be also be useful; both to taxpayers and HMRC. For example, any arrangement which has been subject to a clearance from HMRC (e.g. under section 138 TCGA) should not require additional disclosure under DOTAS.

Undoubtedly, there will be other specific areas where clarification that no disclosure is required may be helpful, although we would stress that in our view it is unlikely to be possible to focus the new Hallmark sufficiently around specific areas and the need for a new condition remains. In this regard, we would be very happy to input further into the drafting of an appropriate additional condition to the proposed hallmark if that would be helpful.

Proposed New Hallmark on Disguised Remuneration

Finally, we also note that it is proposed to introduce a Hallmark based around avoidance of the disguised remuneration provisions in Chapter 7A of the Income Tax (Pensions and Employment) Act 2003. Clearly, more detail on those proposals will be needed before it is possible to comment specifically. However, we would like to make one preliminary observation. The disguised remuneration rules are extremely complicated and extensive. It is therefore very important that that complexity is not further exacerbated by anything done in the context of DOTAS, since this would risk making an already very difficult set of rules operationally almost impractical for any taxpayer to negotiate.

As mentioned above, if a meeting would be helpful to allow further input into how matters can be taken forward, please contact Michael McCotter (michael.mccotter@doughtyhanson.com), and he will be happy to arrange.

Yours sincerely

Steven Whitaker

Chairman BVCA Tax Committee