Adrian Morton,
HM Revenue and Customs,
1 Ruskin Square, Croydon
CR0 2LX
By email: uncertaintaxtreatmentconsultation@hmrc.gov.uk

26 August 2020

Dear Sirs,

Re: BVCA response to HMRC's consultation document: Notification of uncertain tax treatment by large businesses

We are writing on behalf of the British Private Equity and Venture Capital Association, which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 750 firms, the BVCA represents the vast majority of all UK based PE/VC firms, as well as their professional investors and advisers. Over the five-year period 2014-2018, BVCA members invested over £38bn into nearly 2,800 companies based in the UK. Our members currently back around 4,330 companies, employing close to 1.6 million people on across the world, including 843,000 in the UK.

We are grateful for the continued engagement on the areas raised in the consultation on uncertain tax treatment by large businesses. Set out below are our detailed comments to the questions in the consultation document and we look forward to discussing these further with you.

Summary feedback

- There should be no aggregation of portfolio companies with each other or the Fund partnership/fund manager when considering the threshold limits.
- The rules should not apply to collective investment scheme limited partnerships.
- Aligning the test to that included in the accounting standard, IFRIC 23, of "whether it is probable that a taxation authority will accept an uncertain tax treatment" would be preferable from having a different test for this notification given as it is already familiar to large businesses and would avoid duplication of work.
- Given the complexity of tax law the threshold for reporting should be significantly higher than £1m.
- The notification requirement should not apply to new (or existing legislation) until clear HMRC guidance has been published.

Question 1: Do you think the suggested threshold criteria are suitable for the requirement to notify?

We have concerns surrounding HMRC's proposal that the threshold criteria will be "modelled" on the Senior Accounting Officer ("**SAO**") and Publication of Tax Strategies ("**PoTS**") regimes. Will this lead to one combined test and how will the two different thresholds and definitions interact with each other?

Our primary concern, however, is the how the rules will apply to Private Equity/Venture Capital Fund partnerships and the portfolio companies that they own. Neither of the tests are drafted specifically with partnerships in mind and it is important to avoid unintended consequences.

It is fundamental that the portfolio companies owned by the Fund should not be aggregated together when considering these rules simply due to the common ownership by the Fund. These are independently run businesses that operate autonomously and they should be considered separately when applying the threshold.

If there were to be such an aggregation of portfolio companies, many small unsophisticated companies that are not the intended target of these rules, could breach the threshold criteria and be required to notify which would be a significant burden.

Similarly, we do not think that the portfolio companies results should be aggregated with either the Fund partnership or the fund manager when considering the thresholds. The Fund partnership is a transparent entity that simply pools the ownership of the independent portfolio companies whilst the manager's results are separate and distinct from the Fund entities or investments.

We have outlined below some more detailed considerations to assist your review.

Application to portfolio entities

The PoTS regime includes LLPs and general and limited partnerships in its scope, but uses accounting standards i.e. consolidation rules to determine whether the thresholds are breached, similar to the tests for the CbCR regime. In a venture capital and private equity context, to the extent that the fund partnership undertakes fair value accounting in relation to the portfolio company investments, this typically means it should not require other entities to be consolidated. In principle, therefore underlying investments should not be inadvertently aggregated under the PoTS rules as the rules currently stand.

However, in contrast, although the SAO regime is narrower in scope in the sense it is focussed on corporate entities and its 51% subsidiaries, the method of aggregation means its application is wider. Furthermore, as these proposals will apply to LLPs and partnerships, in a venture capital and private equity context, the results of a fund and its 51% owned portfolio companies could be aggregated in order to establish its 'size' for this measure. This would place a disproportionate burden on SME businesses if they were to be aggregated under this method.

While on the face of it these two regimes use similar thresholds, in reality they produce quite different answers. A test that aggregates small, unrelated businesses solely due to their common ownership by a fund does not appear to us to meet the aims of this proposed legislation. In our view, this consultation appears to be focussed at large businesses that are making decisions regarding the tax treatment of their group activities, rather than the activities of Fund investment partnerships which are transparent for tax or their portfolio company investments which are different businesses and are run autonomously and independently.

We understand why these tests would be the starting point for a homogenous corporate group, and indeed many of the largest underlying portfolio companies may be brought into scope in their own right. However, it would be an enormous burden if small and medium unrelated portfolio companies or the Fund itself were inadvertently swept into the regime as a result of an artificial aggregation exercise that does not reflect the economic reality that each portfolio company is an independent business.

We believe that the right outcome could be achieved using the tests established under the PoTS regime but the final threshold test requires careful consideration.

We would caution that the CbCR consolidation methodology (as used by the PoTS regime) is currently under consultation by the OECD, therefore we would be concerned if this was directly referenced in these proposals, as any subsequent change to the CbCR rules may potentially have a material impact on the way these rules would work for funds. It could result in a very different test that may not be appropriate for use in this context and brought in without the oversight or consent of Parliament.

Application to fund partnerships

We understand that the legislation will apply to partnerships and LLP's as well as UK incorporated companies, therefore an investment fund partnership could be within the regime if it has turnover and or balance sheet assets above the threshold. However, it is not clear whether this is intended. By and large a fund partnership will not have any tax liability itself and its investors will predominantly be non-resident institutions with no UK tax liability and therefore we query whether it is a worthwhile exercise in this instance to include investment fund partnerships. We have repeatedly stressed to HMRC and HMT that increasing compliance burdens on UK fund partnerships places the UK at a significant disadvantage when it comes to fund managers choosing fund domiciles and runs contrary to the government's stated policy aim of developing the UK as an asset management centre. Clearly, there will be circumstances where there is a valuable public benefit to be obtained by imposing reporting or other obligations on fund partnerships, and no one could sensibly suggest that fund partnerships should be exempt from all new legislation, but we do consider that compliance burdens which do not create a real benefit should be avoided. We believe that this is such a case and so we would suggest a targeted exclusion for diversely owned collective investment scheme limited partnerships.

Application to fund manager

There will be instances where the fund manager is considered large enough or part of a large corporate group to pass the gateway threshold in its own right, based on its own turnover or Balance Sheet.

As discussed above, we do not believe that the financial data of the portfolio companies or the funds should be aggregated with the manager when considering the thresholds. While a fund manager manages the fund, it receives a management fee for that activity and the underlying investments are not economically part of the manager's business; the value of the portfolio companies belongs to the fund investors.

Question 2: Do you think there are any other areas that should be excluded from the notification regime?

We note that one of the potential exceptions to the notification requirement will apply to businesses with a Customer Compliance Manager (CCM) and an agreement with them that no reporting is necessary. This does seem to place an additional burden (and a subsequent cost) on those businesses that may meet the criteria but have not had a CCM appointed.

Difficulties can arise as the scope and application of new legislation is determined. Inconsistencies created within legislation can make it very hard to determine the expected treatment as there can be a number of reasonable interpretations depending on the specific facts.

Dealing with uncertain tax positions in relation to new legislation without guidance will result in a disproportionate number of notifications, therefore we would suggest that reporting should not commence unless and until there is clear guidance published to enable taxpayers to understand whether HMRC will take a different approach. Without clear guidance it will be difficult for many taxpayers to establish if they do have an uncertain tax position that is contrary to HMRC's view.

We note that receiving agreement from HMRC, perhaps in the form of a statutory clearance, should remove the obligation for reporting under this regime, however we would recommend that there is a formal exclusion from the requirement to notify where a clearance for the tax treatment in question has been obtained from HMRC or HMRC have responded to a statutory clearance application indicating they do not consider there to be any uncertainty. Given that the courts have been unwilling to read wording into legislation, it is not sufficient for HMRC to confirm in guidance that businesses in such a situation "will be able to assume that there is no uncertainty in relation to the specific clearance given". We see no reason not to write this into the legislation.

Question 3: Do you think the definition and principles in IFRIC23 are appropriate to be used for the requirement to notify?

The IFRIC definitions and principles are accounting provisions that apply in different situations so their application would require careful consideration but could be helpful if appropriately implemented, given their familiarity to large businesses.

In our view the IFRIC threshold for disclosure (i.e. "whether it is probable that a taxation authority will accept an uncertain tax treatment") would provide a more reasonable test for disclosure. It would also avoid duplication and avoid yet more additional work for businesses that are already familiar with the IFRIC provisions.

In our view a test based on whether or not HMRC would challenge an interpretation will lead to legislation that is extremely uncertain and difficult for taxpayers and their advisers to interpret. How can taxpayers identify and determine what HMRC is "likely to challenge" in this context?

For instance, there are a number of pieces of HMRC guidance which contain inconsistencies or require judgements to be made. Placing an additional burden on taxpayers to make annual notifications in this circumstance feels disproportionate.

To us, this places a particularly difficult interpretation burden on taxpayers. Our preference is for the legislation to be clear and unambiguous regarding the requirement to notify.

Question 4: Do you think there would be any problems with the person considering whether notification is required, being someone other than the SAO.

For the majority of partnership entities they are unlikely to be within the SAO requirements so would require a different mechanism if included. We have already explained why it would be wrong to aggregate portfolio companies when deciding whether individual companies (or a fund partnership) cross any relevant size threshold. To the extent companies owned by fund partnerships are included in the regime, it should be made clear that they are each responsible for their own compliance with the regime and the fund manager cannot be expected to take

responsibility for this. Fund portfolio companies are separate businesses with significant autonomy and a fund manager will not be in a position to supervise portfolio companies' detailed tax compliance.

Q5. Do you think the proposed de minimis threshold of £1m is reasonable for the notification of uncertain tax treatment?

In our view given the complexity of the tax legislation and the pace of change the threshold of £1m will place a significant burden on entities to identify and consider multiple transactions and should be set at a significantly higher level. As partnerships do not generally have a tax liability, measuring whether an investment fund partnership has crossed the de minimis threshold will be next to impossible as it would require a fund manager to understand investors' private tax affairs which are unlikely to be shared with him.

Q10. Do you agree with the proposed examples and do you have any others which you consider would be helpful?

Given the broad nature and inherent subjectivity of the definition of an uncertain tax treatment, we agree that any guidance should include a specific list of indicators of uncertainty, in order for business to have a clearer understanding of the sort of the transactions that should be reported. The examples listed in paragraph 3.21 are reasonable given they each clearly go against HMRC's view but this again highlights the importance of clear published guidance. Those examples given in schedule 3.22 however appear very broad and the reporting requirements could become significant unless they are more specific.

Q11. Do you think the SAO certification process is appropriate for the notification requirement?

See comments in question 4.

Question 13. What alternative person could be responsible to make the notification for large partnerships?

The annual partnership return is typically approved by the nominated partner so they are likely to be the most appropriate person.

Question 14: [W]hat process (other than SAO) could be used for a single, annual notification?

Our preference would be for the annual tax return to be used. The current position is that any uncertain positions may be disclosed in the white space. This measure is intended to extend that by requiring disclosure, and as such the annual tax return would appear the most appropriate place to do so.

In addition, there is very little timing difference between the proposed date of notification under these rules and the date on which the annual tax return must be submitted. Creating an additional "notification" document due only three months before the return is an unnecessary additional compliance burden with no real benefit when compared with submitting as part of the return.

Any tax technical issues are often finalised on submission of the relevant corporate or partnership tax return. These returns are not due until 12 months after the period end, or on 31 January of the following year. Given this, it seems unnecessary to require this notification to be made either 6 or

9 months after the end of the accounting period, as the tax return may not have been filed by this point potentially difficult issues may not have been identified (and so legally, no tax treatment will have been applied).

Question 18: Regarding the penalty in 6.3.2, who do you think should be liable to a penalty, the person liable to notify the entity, and, if more than one (legal) person, in what circumstances, and to what quantum, would these persons be culpable/liable?

Our view is that no individual should be liable to a penalty for failure to report. A company (or group) is responsible for its tax affairs and when it is delayed in submitting a return, or paying tax, it is the company that suffers a penalty.

Individuals should only be liable for the actions of companies in extremely restricted circumstances (such as insolvency matters). We see no reason to do so for this measure.

Given the uncertainty discussed above and the subjective nature of many of the provisions we welcome the inclusion of reasonable excuse provision. In particular were the rules to be drafted in a way that potentially aggregated independently managed entities owned by a Fund it would be very important to be clear on how a Fund partnership should discharge its responsibility.

We would be grateful for an opportunity to meet and discuss the feedback provided in this letter. Please let us know if you have any comments or questions in the meanwhile.

Yours faithfully,

Mark Baldwin
Chairman of the BVCA Taxation Committee