



Ms Jo Brindley
HMRC

28 February 2006

Dear Jo,

**FLA RESPONSE TO HMRC CONSULTATION ON THE SALE OF LEASING
COMPANIES**

Thank you for coming to the FLA/HMRC meeting recently. We thought it worthwhile to record the FLA's views on the proposals on the sale of leasing companies.

As you know, the FLA is not taking issue with the principle of these proposals. What concerns our Members is that the legislation may catch transactions that are not motivated by tax avoidance. Indeed we understand that some transactions are already in trouble because of this concern, on the basis of the draft legislation.

As we discussed one problem is that the transaction may fall too close to the end of the accounting period of the vendor business to allow it to mitigate sufficiently the tax charge falling on the sale. It is impractical to move accounting periods to do this, because of the IFRS rules on changing accounting periods, and even if it were not I suspect tax inspectors would have difficulties if this became a common practice.

We understand why the draughtsmen find a motive test difficult. But in practice we believe that in most sales the industry and the Inspectorate will each recognise when a deal is tax-driven and when it is not. So one way forward would be for the legislation to be applied only if the Commissioners of HMRC issue a notice directing a company to take into account this legislation. This is the approach taken with the tax arbitrage rules in F(No 2)A 2005 and in conjunction with a clearance mechanism would be a practical solution to the problem.

Whether or not the above is adopted we would strongly recommend that the expense should be treated as a form of 'free depreciation', so that the balance of the expense that is not able to be utilised in the current period may be carried forward and treated as incurred in subsequent periods for group relief purposes. In this way the Purchaser will be more likely to pay full value for the expense to compensate the Vendor for the cost of the tax charge allowing commercial transactions to be unaffected.



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REGISTERED OFFICE: FLA, IMPERIAL HOUSE, 15-19 KINGSWAY, LONDON, WC2B 6UN
Tel: 020 7836 6511 Fax: 0207 420 9600 E-mail: info@fla.org.uk Web: www.fla.org.uk

One way of targeting tax driven sales would be to provide that the new provisions only apply where the purchase price for the leasing company has been increased on the basis of an assumption that the purchasing group will be able to surrender losses to it. This should work very well in relation to bank finance lessors, although the calculation may be rather more complicated and subjective in relation to other types of leasing businesses.

By providing that the new provisions only apply to finance leasing then the majority of commercially driven sales should not be affected. This could be achieved by either providing that the deemed income and deemed expense will only arise in relation to a leasing company's finance leases on a pro rata basis, or by providing that the new provisions do not affect leasing companies at all if they have not been a party to a specified amount of finance leases over a specified period. Companies carrying on operating lease businesses will not be affected even where they are sold to other loss-making groups. This seems right because it seems unlikely that someone would want to acquire an operating lease business purely for tax purposes.

One problem with the current provisions is that even a profitable purchasing group would be prejudiced if it does not have sufficient current year taxable profits to take advantage of the deemed expense. An alternative proposal could be that rather than having the deemed income and deemed expense arising at the time of the sale, the rents could be ring-fenced going forward (preventing group and sideways loss relief) so that the target leasing company will be fully taxed on those rents even if the purchasing group is making losses. This would mean that although commercially driven sales would still be prejudiced if the purchasing group makes losses after the sale, a profit making group would not be prejudiced simply because it does not have sufficient current year taxable profits to take advantage of the deemed expense.

One reason profitable purchasing groups are prejudiced if they do not have sufficient current year taxable profits to take advantage of the deemed expense is that once the expense has been carried forward it can't be group relieved. This could be remedied by allowing the leasing company to surrender the expense or part of the expense in subsequent accounting periods to other members of the purchasing group.

A second reason is that as the expense is carried forward it does not increase in value to take into account the time value of money. This could be remedied by increasing the value of any part of the deemed expense that it carried forward by a certain percentage - perhaps the temporal discount rate.

A more detailed point concerns the proposal to remove the ability to make an election under section 267 CAA 2001. We are not clear as to exactly how this could have been exploited but we do feel that the wholesale removal of leasing business from section 267 is going too far. Would it not be possible to introduce a more targeted restriction on section 267 which allows normal reorganisations within groups to proceed without penalty?

The legislation operates by splitting an accounting period into two at the time of the change of ownership. Whenever a short accounting period arises, capital allowances are always decelerated to some extent. The capital allowance claim for two consecutive six month periods is less than 23.5% instead of the full 25%. We think it would be fairer to pro-rate a full year's writing down allowance between the two deemed accounting periods.

The rules on changes of ownership of consortium companies and partnerships bite on the smallest of changes in shareholdings/shares. We see the policy objective in covering consortium-owned lease-tails but think that it should be subject to de minimis limits with trigger points based on cumulative changes in ownership, perhaps along the lines of Section 769 where only changes above a certain percentage within a testing period trigger the rules.

It is possible to taint a company such that it becomes a leasing company by acquiring assets on the day of change of ownership. There seems to be no equivalent ability to "cleanse" a company if the majority of its leasing assets are removed pre-sale. We recommend an even-handed approach by allowing transfers out to "cleanse" a company.

The basic amount of the income item is calculated by reference to the value of plant machinery whether or not subject to a lease and the aggregate of all pool tax written down values. We do not understand the intention to accelerate tax deferred on non-leased plant and machinery.

Where there is an avoidance motive the expense may not be group relief but is offset against a very narrow class of income - income from leases in place at the time of the change of ownership. We see this as unreasonably narrow and would suggest that it should at least be capable of relief against leasing of new items of plant and machinery. Otherwise there is a risk of no relief ever arising in the event of a commercial, for example if there is a credit or funding problem in the lease portfolio and the income item taxed on the change of ownership never turns into a real commercial taxable profit at a later date.

For "genuine" sales of leasing companies the ability to group relief the expense item in the purchaser may be of very little practical use. Bearing in mind the limits on group relief imposed by Section 403A Taxes Act 1988, it may very commonly be the case that insufficient profits will be available in the acquiring group, or indeed there may be no acquiring group at all. This further underlines the need for a motive test to avoid straightforward and substantial tax acceleration in cases where no avoidance motive exists.

Yours sincerely

Craig Pickering