A PREFACE TO JULIAN GHOSH'S 'LOAN RELATIONSHIPS AND TCGA 1992: CONVERSIONS'[1]

Julian Ghosh has, at a comparatively young age, become an acknowledged expert on the loan relationship provisions, introduced by Finance Act 1996, which apply for the purposes of corporation tax. In his article in this issue, 'Loan Relationships and TCGA 1992: Conversions' he discusses an important but difficult point on the interrelationship between these provisions and the capital gains tax legislation as it applies to non-corporation tax payers, such as individuals. As some readers of this *Review* will be principally engaged in personal taxation and consequently less familiar with corporation tax, this note is intended to provide them with some orientation.

The rights of the holder of a security which is a debt-claim, such as bond or debenture, can constitute a chargeable asset for capital gains tax purposes, provided it is not a "qualifying corporate bond" as defined. An individual who holds such bonds can therefore be liable to capital gains tax on their sale or redemption. One situation in which a gain of a sizeable amount is likely to arise is where the bonds were acquired in exchange for shares and Taxation of Chargeable Gains Act 1992 section 135 applied to the exchange. In that case, the base cost of the bonds is the base cost of the shares for which they were exchanged.

One possible strategy is for an individual holding such bonds to gift them to a UK resident company, within the charge to corporation tax, and to elect for hold-over relief pursuant to Taxation of Chargeable Gains Act 1992 section 165, assuming such an election to be available in the circumstances. If the strategy is successful, the held-over gain will not be brought into charge to tax as the bonds will in the hands of the company constitute "qualifying corporate bonds" which are not chargeable assets. Provided matters are properly arranged, the company will ultimately be charged to corporation tax on the difference between the value of the

---

1 Robert Venables QC, Consulting Editor.

bonds at the time it acquires them and the amount it receives on their disposal. In other words, the held-over gain will escape tax completely.

In my view, this strategy works in principle, subject to the appropriate fine-tuning and ensuring that the *Ramsay* doctrine is not called into play. In his article, Julian Ghosh deals with an argument that the Revenue might adduce to prevent this loss of tax, which can hardly have been intended and which results from the failure of the draftsman of the loan relationship provisions properly to have considered their interaction with the capital gains tax rules. He considers whether the assignment to the company could be said to be a "conversion" of a security, within the meaning of Taxation of Chargeable Gains Act 1992 section 132. The simplistic argument is that it is, as it is the "conversion of a security which is not a qualifying corporate bond into a security of the same company which is such a bond", within the meaning of section 132(3)(a)(ia), on the grounds that, although nothing has happened to the security, it was not a qualifying corporate bond in the hands of the individual but has become such in the hands of the company.

The equally simplistic reply is (a) it is an abuse of English to say that there has been a "conversion" of the bond at all, as it is precisely the same bond after as before the assignment and (b) the bond still is a non-qualifying corporate bond for the purposes of capital gains tax, even if it is a qualifying corporate bond for the purposes of corporation tax: see Taxation of Chargeable Gains Act 1992 section 117(A1).

Julian Ghosh discusses some much more complex arguments on both sides of the issue.

The reader might enquire as to the relevance of the assignment being a conversion. This is not directly dealt with in Mr Ghosh's article. My own view, which I shall set out briefly, is that it has no relevance. It must be borne in mind, however, that I have not had the benefit of Mr Ghosh's reasoning and he may well have some sophisticated argument the force of which I have not appreciated.

Section 132 is found in Taxation of Chargeable Gains Act 1992 Part IV Chapter II "Reorganisation of Share Capital, Conversion of Securities etc". Section 132 provides that sections 127 to 131 are to apply with any necessary adaptations in relation to the "conversion" of securities as they apply in relation to a reorganisation. The key section is section 127, which provides that, in general, a reorganisation is not to be treated as involving any disposal of the original shares or any acquisition of the new holding or part of it, but the original shares and the new holding are to be treated as the same asset acquired as the original shares were acquired. To my mind, that can apply only where the same person owns the new holding as owned the original shares. Section 132 cannot therefore come into play unless the same person owns the converted securities both before and after their conversion, which is not the case here, even if the assignment is a "conversion".

If I am wrong on that point, we must next consider Taxation of Chargeable Gains Act 1992 section 116, which is to have effect only where a transaction[2] occurs of such a description that, apart from section 116, sections 127-130 would apply[3] and only where, inter alia, the original "shares" would not constitute a qualifying corporate bond, but the new holding would. I find it difficult sensibly to apply section 116 on the footing that different people own the original shares and the new holding, which simply reinforces my argument on the first point. Let us, none the less, make the effort.

Section 116(5) provides that so far as the relevant transaction relates to the old asset and the new asset, sections 127-130 shall not apply to it. This takes the Revenue no further. We are back in the same position as if there had not been a "conversion" within section 132.

Section 116(6) provides:

> "(6) In accordance with subsection (5) above, the new asset shall not be treated as having been acquired on any date other than the date of the relevant transaction or, subject to subsections (7) and (8) below, for any consideration other than the market value of the old asset as determined immediately before that transaction."

That is of no consequence. It is accepted that the company acquires the asset and the individual disposes of it on the date of the relevant transaction, i.e. the date of the assignment/conversion, and for a consideration equal to the market value of the old asset as determined immediately before the assignment. This, of course, is without prejudice to a claim for hold-over relief under section 165. Nor would it help the Revenue to argue that even if an election for hold-over relief were made, the company would still, by virtue of section 116(6) be deemed to acquire the securities for a market value consideration.

Section 116(7)provides:

> "(7) If, on the relevant transaction, the person concerned receives, or

---

2 Section 116(2) makes it clear that a conversion of securities within section 132 is a "transaction" for the purposes of section 116(1).

3 This condition will not be satisfied if I am right on the first point.

> becomes entitled to receive, any sum of money which, in addition to the new asset, is by way of consideration for the old asset, that sum shall be deducted from the consideration referred to in subsection (6) above."

I note that it is not easy to ascertain the identity of "the person concerned" where the disposer of the old asset and the acquirer of the new asset are not the same person and this is further ammunition in support of my first point. In this case, the acquiring company will clearly not receive any sum of money which is in addition to the new asset. Nor will the individual, as he will not receive the new asset at all.

Section 116(8) provides:

> "(8) If, on the relevant transaction, the person concerned gives any sum of money which, in addition to the old asset, is by way of consideration for the new asset, that sum shall be added to the consideration referred to in subsection (6) above."

Similar considerations apply, *mutatis mutandis*, as in the case of subsection (7). The company gives money, but not in addition to the old asset. The individual does not give any sum of money.

Section 116(10) looks more promising from the Revenue's point of view. It provides:

> "(10) Except in a case falling within subsection (9) above,[4] so far as it relates to the old asset and the new asset, the relevant transaction shall be treated for the purposes of this Act as not involving any disposal of the old asset but:
>
> (a) there shall be calculated the chargeable gain or allowable loss that would have accrued if, at the time of the relevant transaction, the old asset had been disposed of for a consideration equal to its market value immediately before that transaction; and
>
> (b) subject to subsections (12) to (14) below, the whole or a corresponding part of the chargeable gain or allowable loss mentioned in paragraph (a) above shall be deemed to accrue on a subsequent disposal of the whole or part of the new asset (in addition to any gain or loss that actually accrues on

---

4 Which is not in point.

that disposal); and

(c) on that subsequent disposal, section 115 shall have effect only in relation to any gain or loss that actually accrues and not in relation to any gain or loss which is deemed to accrue by virtue of paragraph (b) above."

The Revenue might just be able to run a tortuous argument on the following lines:

> "If the individual had disposed of the security for a consideration equal to its market value, that would have involved his realising a very substantial gain. He is deemed to realise that gain when the company disposes of the securities. It is irrelevant that the securities will then be qualifying corporate bonds in the hands of the company, as section 115 will not apply to exempt the gain from tax."

There are in my view several answers to such an argument, which it is beyond the scope of this note to rehearse.

It might be asked whether the Revenue could argue that the individual is taxable immediately on the actual cash proceeds he receives for the assignment, by virtue of section 116(12), which provides:

> "(12) In any case where;
>
> (a) on the calculation under subsection (10)(a) above, a chargeable gain would have accrued, and
>
> (b) the consideration for the old asset includes such a sum of money as is referred to in subsection (7) above,
>
> then, subject to subsection (13) below, the proportion of that chargeable gain which that sum of money bears to the market value of the old asset immediately before the relevant transaction shall be deemed to accrue at the time of that transaction."

The short answer is that the consideration for the old asset does not include "such a sum of money as is referred to in subsection (7) above", because that is a sum which is received "in addition to the new asset" and the individual does not receive the new asset at all.

In conclusion, it must be remembered that the purpose of this note is purely to put Mr Ghosh's article in perspective. It is unlikely to be the last word on the subject, even from myself!