

Transactions in securities case (Lecture P1439 – 13.11 minutes)

The 'transactions in securities' legislation (Ss.682 – 713 ITA 2007) first saw the light of day in 1960 at a time when CGT did not exist, but, in the years since 1965, the ability to realise capital gains at lower tax rates than income has meant that HMRC have been more than ready to use these rules to counteract arrangements which have been structured to give shareholders a non-commercial tax advantage.

This regime applies where the following conditions are met in relation to a shareholder:

- he must be a party to a transaction in securities – this means that the person must receive 'relevant consideration' (see s.685(4) and (5) ITA 2007) in connection with the distribution, transfer or realisation of assets of a close company;
- he cannot take advantage of the 'fundamental change of ownership' exemption in s.686 ITA 2007 which was introduced in March 2010; and
- a main purpose (or one of the main purposes) underlying the transaction is to obtain an income tax advantage (which must actually be obtained).

Note that the 'income tax advantage' requirement was widened on 6 April 2016 to include *any* person seeking to obtain such an advantage (and not merely the selling shareholder).

These provisions have spawned a multiplicity of case law over the years, but it is still helpful to examine the leading decision of the House of Lords in *CIR v Cleary (1967)*, given that it demonstrates as clearly as anything the main principles used by HMRC in their application of the rules.

The *Cleary* case involved two sisters (Mrs Cleary and Mrs Perren) who needed cash and who each held 50% of the shares of two companies:

1. Gleeson Development Co Ltd; and
2. MJ Gleeson Ltd.

Gleeson Development Co Ltd had cash reserves of over £130,000 and, in 1961, the sisters sold most of their shares in MJ Gleeson Ltd to Gleeson Development Co Ltd for £121,000, with each receiving £60,500. This represented the proper market value of the shares.

However, the tax authorities subsequently issued a counteraction notice to the sisters under what is now s.684 ITA 2007, charging the entire sale proceeds of £121,000 on a grossed-up basis to income tax.

They considered that the three preconditions for the legislation to apply had been satisfied, namely that the:

- sale of the shares was a transaction in securities;
- sale fell within the prescribed condition in what used to be s.689 ITA 2007 – the company was under the control of five or fewer persons and the sisters had received consideration which would have been available for distribution by way of a dividend (had it not been applied in acquiring the shares in MJ Gleeson Ltd);

- there was a tax advantage, given that income tax had been avoided (and CGT did not exist until 1965).

The House of Lords agreed with the tax authorities. The sale of the shares in MJ Gleeson Ltd had come within the strict wording of the anti-avoidance legislation. The sisters therefore lost their case on the basis that the capital sums received represented amounts which could otherwise have been paid out as taxable dividends.

It should be mentioned that the *Cleary* case would still be caught by the 'transactions in securities' rules today. In particular, the sisters would not have satisfied the 'fundamental change of ownership' let-out since they subsequently remained connected with MJ Gleeson Ltd through their control of Gleeson Development Co Ltd.

Contributed by Robert Jamieson