CONVERSIONS: A REPLY TO THE PREFACE

Julian Ghosh

A reply to a preface to an article, all in the same issue, is not a relaxing way to start the New Year. It is always disheartening to be introduced as an acknowledged expert, or have ones arguments described as "sophisticated" because that usually prefaces an observation that the arguments are wrong. In his preface to my article, Robert Venables QC makes some interesting points. However, I do not agree with all of his points and I think I should say why that is so.

Firstly, the strategy suggested by Mr Venables QC of gifting loan notes to a company to avoid tax, making use of a TCGA 1992, section 165 hold-over claim will not work, irrespective of whether the gift results in a conversion or not. The company will, as I say in my article, have, in this case, a nil base cost for corporate debt purposes and will suffer a Schedule D Case III charge under FA 1996 on the full redemption amount, on redemption; it will have no allowable expense under section 84 and will lose the benefit of even the small base cost which the assignor had in his hands. The loan relationship provisions do not allow for the company to obtain a market value loan relationship base cost on the gift: see FA 1996, Schedule 9, paragraph 11.

Secondly, I quite appreciate that in many cases a company will often be indifferent to whether there is a conversion or not (see the first paragraph of my article); however, as the example in my article shows, the question can be critical. There are other examples of when the question is critical; what if a company acquires, for a value, equal to the redemption value of the loan note, an equitable interest in a trust fund which includes a loan note which is a non-QCB in the hands of the trustees but which would be a QCB in the hands of the company? What happens if the trustees, having claimed hold-over relief, appoint the loan note to the company, which then redeems it? There would be no accounting profit in the hands of the company; nor would there be a loan relationship profit (because the company has paid full value for the equitable interest in the trust fund which it finds to be replaced with an absolute interest in the loan note, on the appointment); the "conversion point" is the Revenue's only hope of obtaining tax. That is why the question is important (and why I wrote the article). As it happens, the question is also very important in the corporate tax sphere, for example where a non-UK resident company assigns a loan relationship to a UK resident company, but I will not deal with that question any further here.