

Loan relationships: debts becoming held by connected company

Who is likely to be affected?

Companies that are subject to the corporation tax rules on loan relationships held between connected companies.

General description of the measure

This measure will amend legislation that applies to debts becoming held by a connected company. It will introduce a targeted anti-avoidance rule to counter arrangements that are entered into in order to avoid or reduce a deemed release where a connected creditor company acquires discounted or impaired debt, or where companies that are party to impaired debt become connected.

Policy objective

This measure will support fairness in the tax system by protecting the Exchequer from loss of tax as a result of avoidance arrangements intended to circumvent the provisions on deemed releases in the corporation tax rules on loan relationships. It will support HM Revenue and Customs' anti-avoidance strategy to protect revenues and deter and counter tax avoidance.

Background to the measure

This measure was announced by Written Ministerial Statement on 27 February 2012.

Detailed proposal

Operative date

The amended legislation applies with effect from 27 February 2012, subject to a provision for retrospective effect in relation to arrangements entered into between 1 December 2011 and 27 February 2012.

Current law

Section 358 of the Corporation Tax Act 2009 (CTA) normally exempts a company that is party as debtor to a loan relationship from a credit on the profit arising on the release of that debt by a connected creditor company. There are exceptions to this where the release is a 'deemed release' or a 'release of relevant rights'. A deemed release will arise either under section 361 CTA, where a company that is connected to the debtor company acquires the debt from a third party, or under section 362 CTA where unconnected companies that are party as creditor and debtor to the loan relationship become connected.

Under section 362 CTA the amount of the deemed release is the amount of impairment recognised in the creditor company's accounts before it became connected with the debtor company.

Proposed revisions

Legislation will be introduced in Finance Bill 2012 to amend section 362 CTA and to insert a new section 363A CTA.

The amendment to section 362 CTA will change the way that the deemed release is calculated. With effect from the operative date it will be the higher of

- the amount of impairment that would have been recognised by the creditor company if accounts had been drawn up immediately before it became connected with the debtor company, or
- the amount by which the carrying value of the debt in the debtor company's accounts exceeds the carrying value in the creditor company's accounts.

New section 363A CTA will apply where arrangements are entered into by any party on or after the operative date that have as their purpose the avoidance or reduction of a deemed release under section 361 or 362 CTA.

The measure also makes retrospective provision for arrangements entered into at any time such that a creditor company becomes party to a loan relationship and later becomes connected to the debtor company, between 1 December 2011 and 27 February 2012. In such a case the deemed release rules in section 361 are treated as applying.

Summary of impacts

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17
	This measure is expected to increase receipts by approximately £385 million in the first year, declining after that. This measure also supports the Exchequer in its commitment to protect revenue. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2012.				
Economic impact	This measure is not expected to have any significant economic impact because it will only affect a limited number of users of these avoidance arrangements.				
Impact on individuals and households	This measure only applies to companies and will not have any impact on individuals and households.				
Equalities impacts	This measure only applies to companies and is not expected to impact on any equality group.				
Impact on business including civil society organisations	This measure addresses avoidance which would constitute an unfair advantage and in removing that there will be no impact on the normal commercial transactions of businesses and civil society organisations. There will be no additional administrative burden on businesses undertaking normal commercial transactions.				

Operational impact (£m) (HMRC or other)	HMRC will not incur any additional operational costs implementing this measure.
Other impacts	None.

Monitoring and evaluation

HMRC will monitor corporation tax returns made by companies to ensure that the legislation operates as intended.

Further advice

If you have any questions about this change, please contact Tony Sadler on 020 7147 2608 (email: tony.sadler@hmrc.gsi.gov.uk) or Mark Lafone on 020 7147 2602 (email: mark.lafone@hmrc.gsi.gov.uk).

Declaration

David Gauke MP, Exchequer Secretary to the Treasury has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.

1 Loan relationships: debts becoming held by connected company

- (1) Chapter 6 of Part 5 of CTA 2009 (loan relationships: connected companies and impairment losses and releases of debt) is amended as follows.
- (2) In section 362 (parties becoming connected where creditor's rights subject to impairment adjustment) –
 - (a) in subsection (1) –
 - (i) omit paragraph (c) (impairment in pre-connection carrying value of creditor's loan relationship), and
 - (ii) omit the "and" before that paragraph and, at the end of paragraph (a), insert "and",
 - (b) for subsections (3) and (4) substitute –
 - “(3) The amount treated as released is whichever is the greater of the following amounts –
 - (a) the amount (if any) that the pre-connection carrying value in C's accounts would have been adjusted for impairment if a period of account had ended immediately before the companies became connected, and
 - (b) the amount (if any) by which the pre-connection carrying value in D's accounts exceeds the pre-connection carrying value in C's accounts.
 - (4) In subsection (3) “the pre-connection carrying value”, in relation to C's accounts or D's accounts, means the amount that would be the carrying value of the asset or liability representing the loan relationship in the accounts if a period of account had ended immediately before the companies became connected.”, and
 - (c) in the title, at the end insert “etc”.
- (3) After section 363 insert –

“363A Arrangements for avoiding section 361 or 362

- (1) This section applies in any case where arrangements are entered into and the main purpose, or one of the main purposes, of any party in entering into them (or any part of them) is –
 - (a) to avoid an amount being treated as released under section 361 or 362, or
 - (b) to reduce the amount which is treated as released under section 361 or 362.
- (2) The arrangements (or part of the arrangements) are not to achieve that effect (so that an amount, or a greater amount, falls to be treated as released under section 361 or 362).

- (3) In this section “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).”
- (4) The amendments made by subsection (2) have effect in relation to any case where the companies become connected on or after 27 February 2012 (as defined by section 363 of CTA 2009).
- (5) The amendment made by subsection (3) has effect in relation to –
 - (a) arrangements entered into on or after 27 February 2012, or
 - (b) arrangements entered into before that date where the amount is treated as released, or would have been treated as released, on or after that date.
- (6) But subsection (5)(b) does not apply if the amount is treated as released, or would have been treated as released, pursuant to an unconditional obligation in a contract made before 27 February 2012.
- (7) An “unconditional” obligation is one which may not be varied or extinguished by the exercise of a right (whether under the contract or otherwise).
- (8) The conditions in section 361(1)(a) to (c) of CTA 2009 are treated as met (and the remaining provisions of that section have effect accordingly) in any case where –
 - (a) arrangements are entered into by any party at any time,
 - (b) directly or indirectly in consequence of, or otherwise in connection with, those arrangements a company (“C”) becomes a party to a loan relationship as creditor,
 - (c) the time at which C becomes a party to the loan relationship falls on or after 1 December 2011 but before 27 February 2012,
 - (d) directly or indirectly in consequence of, or otherwise in connection with, those arrangements C subsequently becomes connected with another company (“D”) which is a party to the loan relationship as debtor, and
 - (e) that subsequent time falls before 27 February 2012.
- (9) For the purposes of subsection (8) –
 - (a) “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and
 - (b) the reference to C becoming connected with D is to be read in accordance with section 363 of CTA 2009.
- (10) Subsections (8) and (9) are to have effect as if they were contained in Part 5 of CTA 2009 (and the cases in which section 361 of CTA 2009 has effect in accordance with subsection (8) include any case where C or D is a member of a firm which is a party to the loan relationship and in that case references to C or D (other than references to the connection which C or D has with a company) are references to the firm).
- (11) For the purpose of applying section 361 of CTA 2009 in accordance with subsection (8) no account is to be taken of anything done on or after 27 February 2012.
- (12) If section 361 of CTA 2009 has effect in accordance with subsection (8), section 362 of that Act does not apply.

EXPLANATORY NOTE

LOAN RELATIONSHIPS: DEBTS BECOMING HELD BY CONNECTED COMPANY

SUMMARY

1. This clause modifies the corporation tax rules on loan relationships that apply when the parties to a loan relationship become connected. The clause changes the circumstances in which companies that become connected with pre-existing debt bring in a deemed release in respect of that debt, and the calculation of the amount of that deemed release. It also inserts a new anti-avoidance rule to ensure that the existing rules relating to deemed releases can not be circumvented. This rule will apply where arrangements are entered into where the main purpose, or one of the main purposes, of the arrangements is to avoid or reduce a deemed release that would otherwise have arisen under the existing rules. It further inserts a retrospective provision in relation to particular arrangements circumventing the existing rules where a company becomes creditor to a loan relationship on or after 1 December 2011 and before 27 February 2012.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for the loan relationships rules in Chapter 6 of Part 5 of the Corporation Tax Act 2009 (CTA) to be amended. The amendments are to section 362 of CTA under which a debtor company brings in a deemed release when the debtor and creditor companies become connected and the debt is impaired.
3. Subsection (2)(a) amends section 362 of CTA so that it applies to all cases where previously unconnected parties to a loan relationship, as debtor (D) and creditor (C) respectively, become connected. Currently section 362 only applies where the creditor's rights under the loan relationship are subject to an impairment adjustment.
4. Subsection (2)(b) substitutes new subsections 362(3) and 362(4).
5. New subsection 362(3) changes the calculation of the amount treated as released to the greater of two amounts. The first amount is the same as currently arises under section 362(1)(c) of CTA. The second is the amount by which the pre-connection carrying value (PCCV) of the debt in D's accounts exceeds the PCCV of the debt in C's accounts.
6. New subsection 362(4) extends the current definition of PCCV in section 362(4) of CTA, which only covers the PCCV in C's accounts, to include the PCCV in D's accounts.

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7. Subsection (2)(c) amends the title of section 362 of CTA as the new section no longer only applies to debts where the creditor's rights are subject to an impairment adjustment.
8. Subsection (3) inserts a new section 363A in CTA which will apply to nullify the effect of arrangements that are entered into where the main purpose, or one of the main purposes, of the arrangements is to avoid or reduce an amount treated as released under section 361 or 362. 'Arrangements' are defined in new subsection 363A(3).
9. Subsections (4) to (7) set out the commencement provisions. The amendments made to section 362 of CTA will have effect where companies become connected on or after 27 February 2012. New section 363A of CTA will have effect where arrangements are entered into on or after 27 February 2012 or, where the arrangements are entered into before that date, in relation to deemed releases arising after that date.
10. Subsections (8) to (12) comprise an anti-avoidance rule applying where arrangements are entered into which lead directly or indirectly to, or in consequence of which, company "C" becomes party to a loan relationship as creditor on or after 1 December and before 27 February 2012 and C becomes connected to the debtor before 27 February 2012. 'Arrangements' are defined in subsection (9). Where this rule applies the conditions at 361(1)(a) to (c) of CTA will be deemed to be met. Thus section 361 of CTA will apply to C at the point it becomes party to the loan relationship.
11. Subsection 10 ensures, in particular, that the normal loan relationship rules for partnerships involving companies apply.
12. Subsection 11 prevents anything done after 27 February 2012, for example a change or a decision to change partnership profit shares or accounting dates, affecting the application of section 361 in accordance with subsection (8).
13. Subsection 12 prevents double taxation. If 361 of CTA applies to a case as a result of subsections (8) to (10) then 362 of CTA will not also apply at the point that C becomes connected to D.

BACKGROUND NOTE

14. The rules that apply to loan relationships work on the principle that amounts taxed and relieved as credits and debits under those rules are the profits and losses arising in amounts drawn up in accordance with generally accepted accounting practice. When a debt is impaired or written off by a creditor company its expense will normally be allowable as a loan relationship debit. When a debtor company is released from a debt it owes, its profit will be taxable as a loan relationship credit.

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15. Where a debt exists between connected companies, such credits and debits are not normally brought into account for tax purposes. Specific rules prevent exploitation of this exception when debt is acquired by a new creditor connected to the debtor or when previously unconnected creditors and debtors become connected. This is achieved by imposing a deemed release on the debtor if the debt has been purchased at a discount by a connected creditor or the debt is impaired when the creditor and debtor become connected.
16. HMRC have become aware of arrangements that have been entered into to avoid the tax charge that would normally arise in these circumstances. The changes to the rules both prevent these and similar arrangements achieving this effect from 27 February 2012 and in relation to the particular arrangements retrospectively to 1 December 2011.