

EXPLANATORY NOTE

LOAN RELATIONSHIPS: REPEAL OF PROVISIONS RELATING TO LATE-PAID INTEREST ETC

SUMMARY

1. Clause [X] repeals provisions in Part 5 of Corporation Tax Act 2009 (CTA 2009), which determine the timing of relief for deferred interest and discounts on debt issued to UK companies by a connected company in a non-qualifying territory. Following the repeal, deferred interest and discounts will be subject to the normal loan relationship rules, and will generally be brought into account as they accrue in a company's accounts. The repeal has effect from 3 December 2014 in respect of loans entered into on or after that date. For loans and securities entered into before that date, the current rules will continue to apply in respect of interest and discounts accrued up to 31 December 2015.

DETAILS OF THE CLAUSE

2. Subsection (1) provides for Part 5 of CTA 2009 to be amended.
3. Subsection (2) omits sections 374, 377, 407 and 408 which bring certain cases within the particular rules setting out when deferred interest payable on loans and discounts on deeply discounted securities are to be brought into account for tax. Those cases are situations where companies are connected and where one party to the debt has a major interest in the other.
4. Subsections (3) and (4) make consequential amendments to sections 372 and 373.
5. Subsection (5) makes consequential amendments to section 406.
6. Subsection (6) provides that the repeal of sections 374 and 377 becomes effective from 3 December 2014 for loans entered into on or after that date. For loans which were entered into before 3 December 2014, the current treatment will continue in respect of interest accruing up to 31 December 2015.
7. Subsection (7) sets out, in similar terms, when the repeal of sections 407 and 408 becomes effective for debts entered into on or after 3 December 2014 and for those entered into before that date.
8. Subsections (8) to (14) give further detail of the arrangements for loans and securities entered into before 3 December 2014.

9. Subsection (9) provides that where a company has an accounting period straddling 1 January 2016, it is to be split for the purposes of this provision.

10. Subsections (10) and (12) provide that, if a loan or deeply discounted security entered into before 3 December 2014 is modified between 3 December 2014 and 31 December 2015, the old rules will cease to apply in respect of that loan or security from the date of the modification. Subsection (14) provides that, for this purpose, a new accounting period is deemed to commence when the modification takes effect.

11. Subsections (11) and (13) define a modification of a loan or deeply discounted security as a material change to the terms of the debt or a change in the creditor.

BACKGROUND NOTE

12. At Budget 2013, the Government announced a review of the corporation tax rules governing corporate debt (or ‘loan relationships’) and derivative contracts. There was consultation on a wide-ranging package of measures to update and simplify these regimes and to reduce their susceptibility to tax avoidance. This clause is being introduced in the context of these wider changes, also to be included in Finance Bill 2015.

13. The ‘late-paid interest’ rules were originally introduced as anti-avoidance provisions to prevent mismatches between the timing of relief for interest in debtor companies and its taxation in the creditor. Interest may be accrued in the accounts of the debtor, and relieved, even though it may not be actually paid and taxed on the creditor until much later, or not at all. A similar effect could be achieved through mismatches in the timing of relief for, and taxation of, discounts on deeply discounted securities.

14. Rules in respect of interest on loans are in Chapter 8, Part 5 of CTA 2009, and Chapter 12 contains rules for deeply discounted securities. Under the late-paid interest rules, relief for interest unpaid 12 months after the period in which it accrued is deferred until it is actually paid. In the case of discounts on deeply discounted securities, no 12 month period is involved, but relief is not available until the security is redeemed.

15. The Chapter 8 rules apply in four cases: where the parties are connected; where the creditor is a participator in a close company; where one of the parties has a major interest in the other; and where the loan is made by trustees of an occupational pension scheme. The Chapter 12 rules for deeply discounted securities effectively mirror the first, second and third of these cases. This clause is concerned with the rules in so far as they apply to connected parties and where one party has a major interest in the other.

16. In 2009 the scope of the rules was greatly restricted, so that, in the case of connected parties or where one party has a major interest in the other, they now only apply where the creditor is resident in a ‘non-qualifying’ territory (broadly, a ‘tax haven’). The anti-avoidance effect of the rules is therefore now very limited in those cases.

17. In addition, the rules have regularly been used by some groups to manage and manipulate the emergence of profits and losses. Under the group relief rules in Part 5 of CTA 2010, excess amounts, including trading losses and non-trading loan relationship deficits, can be surrendered to other group companies, permitting immediate relief. If these amounts cannot be used in the period in which they arise, either in the company itself or by surrender as group relief, they can only be carried forward in the company until such time as profits arise in that company against which they can be relieved. Carried forward amounts cannot be surrendered as group relief.

18. For this reason, some groups use structures involving companies in non-qualifying territories and deliberately defer payment of interest so that losses can be timed to arise in accordance with the availability of profits elsewhere in the group which can absorb them. This effectively sidesteps the intention behind the group relief rules that relief should be available for in-year losses only. Nor does it accord with the anti-avoidance purpose of the late paid interest rules, described above.

19. The wider changes being made to the loan relationships rules will include introduction of a new regime-wide anti-avoidance rule, whose scope will include counteraction of timing mismatches of the kind originally targeted by the late paid interest rules.

20. If you have any questions about this change, or comments on the legislation, please contact Andy Stewardson on 03000 586085 (email: andy.stewardson@hmrc.gsi.gov.uk).