Explanatory Note

Clause 23: Loan relationships: non-market loans

Summary

1. This measure restricts the corporation tax deductions for the notional finance costs that can arise on interest-free loans and other loans on non-market terms where they would otherwise give rise to asymmetrical tax treatment between the borrower and lender. The measure has effect from 1 April 2016.

Details of the clause

2. Subsection 1 introduces new section 446A to Corporation Tax Act (CTA) 2009, concerning the treatment of interest-free loans and other loans on non-market terms.

3. New section 446A applies where a loan liability is initially recognised in the borrowing company's accounts at an amount less than the amount borrowed, and the accounting discount arising on inception is not brought into account. It will apply where the lender is an individual (or other non-corporate) or where there is a corporate lender which is resident in a non-qualifying territory

4. Where this section applies, the debits resulting from the unwind of the discount over the term of the loan are restricted for tax purposes. Where the discount on inception is partly brought into account, the restriction applies to the part of the discount which is not brought into account (referred to as the 'relevant discount amount').

5. Subsection 2 explains that the section has effect for accounting periods beginning on or after 1 April 2016.

6. Subsection 3 provides that where an accounting period straddles 1 April 2016, it is treated, for this purpose only, as two separate accounting periods. In this case section 446A has effect for the accounting period that is treated as beginning on 1 April 2016.

Background note

7. At Budget 2013, the government announced consultation on a package of proposals to modernise the Corporation Tax rules governing the taxation of corporate debt and derivative contracts. The main changes made as a result of the consultation are contained in Schedule 7 to Finance (No.2) Act 2015.

8. As a result of recent changes to UK accounting standards, companies can now be required to recognise interest-free loans and other non-market loans in their accounts at a value lower than the actual amount of the loan. This discount unwinds progressively in later periods'

accounts. This can create a notional interest cost in the accounts of the borrower which does not reflect any real interest paid. Normally there would also be an accounting credit entry arising for the borrower on inception of the loan. Following the wider changes made in Finance (No.2) Act 2015, these accounting credit entries may not be taxable.

9. In some cases this could result in a tax deduction in the borrower, but no matching UK tax liability for the lender. In particular, the accounting treatment can create an asymmetry where the lender is an individual or where interest is paid cross-border.

10. This measure therefore restores the borrower, in appropriate cases, to the position that would have arisen before the accounting changes. In particular, it restricts tax relief for the borrower's notional interest expense where the borrower's corresponding accounting credit entry on inception of the loan is not taxed.

11. If you have any questions about this change, or comments on the legislation, please contact Richard Daniel on 03000 569 408 (email: richard.daniel@hmrc.gsi.gov.uk).