



HM Revenue  
& Customs

# Corporate Interest Restriction: Tax response to accounting changes for leasing

## **Consultation document**

Publication date: 1 December 2017

Closing date for comments: 28 February 2018

<b>Subject of this consultation:</b>	Options for legislative changes required to ensure the Corporate Interest Restriction rules in Part 10 Taxation (International and Other Provisions) Act ('TIOPA') 2010 work as intended following the proposed repeal of section 53 Finance Act 2011 and the introduction of the new lease accounting standard IFRS16 with a mandatory implementation date of 1 January 2019.
<b>Scope of this consultation:</b>	We are asking for comments on the options for amendments to the Corporate Interest Restriction rules.
<b>Who should read this:</b>	Standalone companies and groups with net financing costs of more than £2 million per annum, who also lease assets for use in their business; lessors; agents and representative bodies.
<b>Duration:</b>	From 1 December 2017 to 28 February 2018
<b>Lead official:</b>	Adeline Chan, HM Revenue & Customs
<b>How to respond or enquire about this consultation:</b>	By email: <a href="mailto:interest-restriction.mailbox@hmrc.gsi.gov.uk">interest-restriction.mailbox@hmrc.gsi.gov.uk</a>  By post to: Adeline Chan, Room 3C/06, 100 Parliament Street, London SW1A 2BQ  If you have any queries, please contact Adeline Chan using the email address shown above or by telephone on 03000 586039.
<b>Additional ways to be involved:</b>	As this is largely a technical issue, the consultation responses are expected to be in written form. If, however, you would like to arrange a meeting, please submit a request via email to: <a href="mailto:interest-restriction.mailbox@hmrc.gsi.gov.uk">interest-restriction.mailbox@hmrc.gsi.gov.uk</a>  Please also contact this mailbox if you would like to have this document in Welsh or alternate formats including large print or Braille.
<b>After the consultation:</b>	A summary of the responses will be published later this year along with draft legislation. Legislation is expected to be included in Finance Bill 2018-19 with effect from 1 January 2019.
<b>Getting to this stage:</b>	The Corporate Interest Restriction legislation was enacted on 16 November 2017.
<b>Previous engagement:</b>	There have been previous consultations on the tax deductibility of corporate interest expense. In addition, in 2016, there was a discussion document titled <i>Lease Accounting Changes: Tax Response</i> . A further document, <i>Leasing: Tax response to accounting changes</i> , is being published on 1 December 2017.

# Contents

1	Executive Summary	4
2	Introduction	5
3	Options for Changes to CIR Rules	10
4	Summary of Consultation Questions	17
5	The Consultation Process: How to Respond	18
Annex A	Summary of CIR Treatment	20
Annex B	Relevant Current Legislation	23

**On request this document can be produced in Welsh and alternate formats including large print, audio and Braille formats**

# 1. Executive Summary

A lease is an agreement whereby one party (the lessor) hires an asset to another (the lessee) for a series of rental payments over an agreed period of time. The terms and conditions of some leases mean that commercially, those leases are a method of providing finance. Where a lease is essentially a form of financing, the Government's intention is to recognise that. Therefore, within the Corporate Interest Restriction ('CIR') rules, the finance cost or finance income element of the rental payments under such a lease should be recognised as tax-interest.

The current CIR rules uses as its starting point the accounting classification of leases into operating leases and finance leases. But the new international accounting standard, IFRS 16 *Leases*, will not classify leases in that way for lessees. This consultation invites comments on three options for amending the CIR rules to accommodate IFRS 16. Any changes to the CIR rules are expected to apply to all companies and not just those adopting IFRS 16. A summary of responses together with draft legislation taking account of them will be published in 2018.

## 2. Introduction

### An overview of the Corporate Interest Restriction rules

- 2.1. From 1 April 2017, the Corporate Interest Restriction ('CIR') rules limit tax deductions for interest expense and similar financing costs, aligning such deductions with the economic activities undertaken and taxed in the UK. These rules reflect the recommendations of the OECD Base Erosion and Profit Shifting Project and the requirements of the EU Anti-Tax Avoidance Directive.
- 2.2. The CIR rules combat attempts by multinational enterprises and other companies to obtain excessive tax relief for interest and similar financing costs. They align tax relief to the extent to which business activities are subject to UK Corporation Tax. Specifically, they address three risks identified by the OECD:
  - (a) groups placing higher levels of third party debt in high tax countries;
  - (b) groups using intragroup loans to generate interest deductions in excess of the group's actual third party interest expense; and
  - (c) groups using third party or intragroup financing to fund the generation of tax exempt income.
- 2.3. The CIR rules operate at the level of a worldwide group, defined in accordance with International Financial Reporting Standards ('IFRS') consolidation rules, for each period of account of the group's ultimate parent.
- 2.4. The default fixed ratio method imposes two main limits on the group's net tax-interest deductions. 'Tax-interest' includes interest-like amounts including finance charges from finance leases. The first limit is by reference to a fixed proportion (30%) of the aggregate taxable earnings before tax-interest, depreciation and amortisation (referred to as 'tax-EBITDA') of group companies. Tax-EBITDA and tax-interest are measured by reference to amounts taken into account in computing Corporation Tax. The second is a debt cap, which limits the net tax-interest deduction to a measure of the worldwide group's net external interest and economically similar expense.
- 2.5. As an alternative to the fixed ratio method, the group ratio method may be applied, under which the net tax-interest deduction is limited by applying the group ratio to tax-EBITDA. The group ratio is the ratio of group-interest to group-EBITDA, with both measures based on the group's consolidated accounts. Like the fixed ratio method, the group ratio method also incorporates a debt cap, based on the measure of the group's net interest expense that is used as the denominator in the group ratio.
- 2.6. Groups which provide public infrastructure, including rental property, can elect to use a different approach for some or all of their companies.
- 2.7. Interest above the limit is restricted and can be carried forward by a company indefinitely. It can be reactivated if there is sufficient interest allowance in a subsequent period. Unused interest allowance can be carried forward by a group for use in a subsequent period for up to five years. Any excess debt cap can be carried forward by a group indefinitely.

## Summary of the issue

- 2.8. The CIR rules need to be amended to accommodate IFRS 16 *Leases*, a new International Financial Reporting Standard. A brief explanation of why this is the case is set out below.
- 2.9. The term ‘tax-interest expense amount’ is defined in the CIR rules by reference to three main conditions, only one of which needs to be met to satisfy the definition. One of those conditions is the amount in respect of a financing cost implicit in amounts payable under a relevant arrangement, which includes a finance lease<sup>1</sup>.
- 2.10. A lease is classified as a ‘finance lease’ for accounting purposes if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset is classified as an ‘operating lease’. Under a finance lease, the lessee typically makes periodic payments over the term of the lease agreement to the lessor. These payments reflect both the fair value of the leased asset and a finance charge<sup>2</sup>. The finance charge is generally the amount of payments payable over the term of the lease agreement less the fair value of the leased asset or, if lower, the present value of the minimum lease payments, determined at the inception of the lease.
- 2.11. The finance amount of a finance lease is included within the scope of net tax-interest for CIR purposes. For the lessor, this is included in tax-interest income and for the lessee, this is included in tax-interest expense. Adjustments to tax-EBITDA are made as appropriate. Thus if the lessor and lessee both account for the lease as a finance lease, there is symmetry of treatment for CIR purposes. Annex A sets out the current CIR treatment. For the purpose of this consultation, the two treatments under the CIR rules are designated ‘Type A’ and ‘Type B’, with Type A treatment applied to finance leases and Type B treatment applied to operating leases.
- 2.12. The CIR rules assume that the accounting standard/accounting framework that a company applies will require it to classify leases as either operating leases or finance leases. This, however, will not be the case for a lessee company if it adopts IFRS 16.
- 2.13. Section 53 Finance Act 2011 currently applies to negate any change in a leasing accounting standard for tax purposes, so would act to negate the impact of IFRS 16 for the CIR rules. This section was, however, only intended to be a temporary measure. In the longer term, taxing companies based on notional accounts drawn up according to obsolete accounting standards is unnecessarily onerous and does not provide sufficient certainty. Therefore, section 53 is expected to be repealed at Finance Bill 2018-19 with effect from 1 January 2019 – this is

---

<sup>1</sup> Section 382(5)(a) TIOPA 2010

<sup>2</sup> The finance charge is referred to as ‘interest’ in certain accounting standards/accounting frameworks. For tax purposes, ‘interest’ has a particular meaning that comes from case law. Therefore, the interest charge in relation to a lease is referred to as a ‘finance charge’ and interest income is referred to as ‘finance income’.

dealt with in the consultation document titled *Leasing: Tax response to accounting changes*.

- 2.14. In light of this, the CIR rules must be amended to accommodate IFRS 16. There are a number of different options for how the CIR rules could be amended. These are set out in Chapter 2.

## IFRS 16 Leases

- 2.15. The new IFRS 16 standard, which replaces IAS 17, will be effective from 1 January 2019, with early adoption permitted.

### Lessees

- 2.16. IFRS 16 adopts a single 'on balance sheet' lease model for lessees, with no distinction between operating and finance leases. Thus all lessees applying IFRS or the equivalent UK accounting standard, FRS 101 (effectively EU adopted IFRS with disclosure exemptions that certain qualifying entities can adopt) will change the way they account for leases.

- 2.17. There are optional exemptions for lessees from the new lease model for short-term leases (a term of one year or less) and leases of low-value assets (such as laptops or office furniture costing less than US\$5,000). Where the exemption is taken, lessees will charge the rents payable to their income statement, usually on a straight line basis.

- 2.18. In addition, certain items are scoped out of IFRS 16. These items include biological assets, leases to explore for minerals or oil, and service concession arrangements within the scope of IFRIC 12 *Service Concession Arrangements*. Licences of intellectual property that fall within the scope of IFRS 15 *Revenue Recognition* are also scoped out, as are certain rights held by lessees under licencing agreements within the scope of IAS 38 *Intangible Assets* for items such as films, recordings, patents and copyrights. For other intangible assets, the lessee has a choice whether or not to apply IFRS 16.

- 2.19. Under the 'on balance sheet' lease model for lessees, all leases within scope will be on the balance sheet. This represents a significant shift from the current treatment of operating leases, which are currently all off balance sheet. When a contract is or contains a lease, the lessee will:

- (a) recognise lease assets and liabilities on the balance sheet;
- (b) recognise depreciation related to the right-to-use asset (unless it applies a fair value or revaluation model) and a finance charge on lease liabilities over the lease term in the income statement; and
- (c) separate the total amount paid into a principal portion (presented within financing activities) and a finance charge (presented within either operating or financing activities) in the statement of cash flows.

- 2.20. The finance charge on the lease liability in each period of account during the lease term is the amount that produces a constant periodic rate of interest on the

remaining balance of the lease liability. The 'periodic rate of interest' is the interest rate implicit in the lease, if that rate can be readily determined. Otherwise the incremental borrowing rate should generally be used.

### Lessors

2.21. Under IFRS 16, there are no significant changes for lessors, who will continue to classify leases as operating leases or finance leases, and to account for those two types of leases differently, consistent with current requirements in IAS 17. However, the lessor will be required to disclose additional information about its leasing activities and its exposure to residual value risk.

2.22. As for lessees, certain items are scoped out of IFRS 16. These items include biological assets, leases to explore for minerals or oil, and service concession arrangements within the scope of IFRIC 12. Licences of intellectual property that fall within the scope of IFRS 15 are also scoped out.

### Generally Accepted Accounting Practice in the UK ('UK GAAP')

2.23. UK GAAP includes FRS 101, FRS 102 and FRS 105.

2.24. FRS 101 uses the recognition and measurements requirements of EU adopted IFRS. It can be adopted by certain qualifying entities in the UK, including members of a group where the parent produces publicly available consolidated financial statements. FRS 101 users will therefore be within the scope of the requirements of IFRS 16.

2.25. FRS 102 and FRS 105 (which has replaced the FRSSE) will continue to apply the current leasing model, which is in line with IAS 17. In due course, these accounting frameworks may align with IFRS 16.

### **Aim and scope of the consultation**

2.26. The aim of this consultation is to explore the different options for amending the CIR rules to accommodate IFRS 16, bearing in mind the overall policy rationale for the CIR rules.

2.27. To help focus comments, this consultation identifies three main options, which are detailed in Chapter 2. Briefly, these are:

Option 1: Follow the accounting;

Option 2: Keep a distinction between operating leases and finance leases for CIR purposes;

Option 3: Introduce a distinction between 'funding leases' and 'non-funding leases', to be defined in tax legislation for CIR purposes.



2.28. Option 1 would be the least administratively burdensome, but it could increase interest restrictions for certain groups, whereas options 2 and 3 are expected to have similar outcomes to the current rules<sup>3</sup>.

2.29. In addition, Chapter 2 sets out the proposed treatment in an intra-group situation for dealing with short-term leases and leases of low-value assets, which may be exempted from the new 'on balance sheet' lease model under IFRS 16.

2.30. While this consultation will focus on the above-mentioned options, stakeholders are invited to provide details of any other option that they would prefer. Note, however, that an option that would introduce additional legislative complexity or would be significantly more administratively burdensome is unlikely to be taken forward.

---

<sup>3</sup> An assessment of impacts has not been included in this document since this consultation is calling for evidence that will be used to inform such an assessment, which the government expects to publish in 2018.

## 3. Options for Changes to CIR Rules

3.1. This chapter sets out different options for amending the CIR rules to accommodate IFRS 16.

### Option 1: Follow the accounting

3.2. Under this option, where the accounting standard/framework adopted by the lessee or lessor recognises a finance amount in respect of a lease, that amount would also be recognised as tax-interest within the CIR rules. Where no finance amount is recognised for accounting purposes, there would be no tax-interest pick up for CIR purposes.

3.3. This treatment would apply regardless of whether IAS or one of the UK GAAP frameworks is adopted. If the treatment of leases in the accounts is not in accordance with GAAP, an appropriate GAAP-compliant<sup>4</sup> treatment would be assumed to apply for CIR purposes.

3.4. This option would result in a different treatment for lessees depending on whether IFRS 16 or FRS 102 is adopted. An operating lease lessee under FRS 102 will not recognise a finance charge in its accounts and so will have nothing to bring in as tax-interest expense for CIR purposes. A lessee accounting for the same lease under IFRS 16 will recognise a finance charge in its accounts which would be brought in as tax-interest expense for CIR purposes.

3.5. In some circumstances, the lessee would have tax-interest expense but the corresponding lessor would not have tax-interest income. This mismatch could apply in a group situation upon adoption of IFRS 16 in respect of a lease that would be classified as an operating lease by the lessor.

3.6. Annex A sets out the CIR consequences for 'Type A' and 'Type B' leases. Under this option:

- 'Type A' leases are those where a finance amount is recognised in the accounts, that is, (a) all IFRS 16 leases<sup>5</sup> for the lessee; IFRS 16 finance leases for the lessor; and (c) FRS 102 finance leases for the lessee and lessor.
- 'Type B' leases are those where no finance amount is recognised in the accounts, that is, (a) IFRS 16 operating leases for the lessor; (b) FRS 102 operating leases for the lessee and lessor; and (c) IFRS 16 leases exempted from the 'on balance sheet' leasing model.

3.7. As a result of following Option 1, certain provisions in Part 10 TIOPA 2010 would need to be modified to align with the new definition of tax-interest.

---

<sup>4</sup> See section 309(4) CTA 2009; GAAP is defined by section 1127 CTA 2010.

<sup>5</sup> Except leases exempted from the 'on balance sheet' leasing model or scoped out of IFRS 16.

- 3.8. Adjustments would need to be made to the definition of group-interest and group-EBITDA. It is envisaged that the definition of group-interest would be amended to align with tax-interest. So amounts would be included within group-interest when the accounts recognise a finance amount in respect of a lease. And the definition of capital expenditure excluded from group-EBITDA, would include depreciation in respect of these leases.
- 3.9. It should be noted that this could give rise to differences between the calculation of tax-interest and group-interest where different accounting standards/frameworks are used at group level. For example, a FRS 102 lessee with an operating lease from a third party lessor would have no finance charge in its entity accounts but if the consolidated accounts follow IFRS 16, there would be a finance charge with respect to that lease to be included in group-interest and the depreciation charge would be added back in calculating group-EBITDA. A provision would be required to address this issue.
- 3.10. Question 1 – What are the advantages and disadvantages of option 1?**
- 3.11. Question 2 – Please provide specific examples of intra-group mismatches between the lessee and lessor that would arise under option 1 that would make a significant difference to the overall CIR position of the group.**
- 3.12. Question 3 – Would option 1 result in some lessees deciding not to adopt an accounting framework incorporating IFRS 16 for its individual entity accounts?**

### **Option 2: Keep a distinction between operating leases and finance leases for CIR purposes**

- 3.13. Under this option, and similar to option 1, tax interest would include amounts where a lessee recognises a finance charge in relation to a leased asset. However, that finance charge would not need to be included in tax-interest under the CIR rules where the lessor prepares GAAP-compliant accounts<sup>6</sup> which do not recognise the equivalent finance income in relation to that leased asset. In particular, this exclusion would apply where the lessor is accounting for the lease as an operating lease and using either FRS 102 or IFRS 16.
- 3.14. This would put IFRS 16 lessees in the same position as FRS 102 lessees where the lease is classified as an operating lease by the lessor under IFRS 16/FRS 102.
- 3.15. As with option 1, this option would apply regardless of which accounting standards/frameworks the lessee and lessor are adopting so long as the treatment of leases in the accounts is in accordance with GAAP.
- 3.16. Where the lessee recognises a finance charge in its accounts but can ascertain that (i) the lessor prepares IAS or UK GAAP accounts and (ii) the lessor does not

---

<sup>6</sup> That is, uses UK GAAP or IAS and accounts correctly for the lease in question.

include any finance income in respect of the lease, the lessee need not include its finance charge within tax-interest.

- 3.17. Where the lessee cannot (or opts not to) ascertain how the lessor is classifying the lease in its accounts, the lessee would need to include the finance charge that is recognised in its accounts in tax-interest for CIR purposes.
- 3.18. Where a finance charge is not recognised in the lessee's accounts, the lessee would not have a finance charge to include within tax-interest. This would apply, for example, where the lease is exempted from the 'on balance sheet' leasing model under IFRS 16.
- 3.19. This could mean that a FRS 102 finance lease lessee need not include the finance charge in tax-interest for CIR purposes if the corresponding lessor is accounting for the lease as an operating lease. This would remove the mismatches that can arise under the existing rules where the lessee is accounting for the lease as a finance lease while the lessor is accounting for the same lease as an operating lease<sup>7</sup>.
- 3.20. See Annex A for the CIR treatment, which is dependent on whether the lease is classified as a 'Type A' lease or a 'Type B' lease. Under this option:
- 'Type A' leases would be those where a finance amount is recognised as tax-interest for CIR purposes. In the case of an IFRS 16 lessee this is where the lessee recognises a finance charge and cannot ascertain that the lessor prepares accounts in which the lease is recognised as an operating lease in accordance with GAAP.
  - Conversely, 'Type B' leases would be those where a finance amount is not so recognised. In the case of an IFRS 16 lessee this would include leases where the lessor prepares GAAP-compliant accounts in which the lease is recognised as an operating lease.
- 3.21. In terms of the group position, the calculation of group-interest and group-EBITDA would be largely unchanged compared to the current rules.
- 3.22. Under this option, the CIR classification will generally be aligned at entity and group level, in which case no adjustments at group level should be required.
- 3.23. Question 4 – What are the advantages and disadvantages of option 2?**
- 3.24. Question 5 – Are there circumstances in which mismatches can arise under option 2, and would this be problematic?**

---

<sup>7</sup> However, there would still be a mismatch where a FRS 102 lessee accounts for the lease as an operating lease and so has no tax-interest expense but the corresponding lessor accounts for the lease as a finance lease and therefore has tax-interest income.

### **Option 3: Introduce a distinction between funding leases and non-funding leases, to be defined in tax legislation for CIR purposes**

- 3.25. Under this option, the accounting classification of a lease would be ignored, but the tax-interest amount for CIR purposes would still be based on the accounting measurement of the finance charge amount in accordance with GAAP.
- 3.26. Instead of applying accounting classification rules, a company would apply tax rules in order to classify a lease. It is proposed that the tax rules would differentiate between a 'funding lease' and a 'non-funding lease'.
- 3.27. The definition of a 'funding lease' and 'non-funding lease' would follow the definition at section 70J CAA 2001 but it would apply to all leases, not just to plant and machinery leases. Hire purchase contracts are carved out of the funding lease provisions at section 70J because they are dealt with in section 67 CAA 2001 (for capital allowances purposes) but they would not be carved out of the funding lease definition applying for CIR. Under the CIR rules, hire purchase contracts would be treated in the same way as leasing contracts.
- 3.28. The 'funding lease' definition would contain three tests to be applied to all leases:
- (a) finance lease test;
  - (b) lease payment test; and
  - (c) useful economic life test.

Only one of the tests needs to be met. Where none of the tests are met, the lease would be a 'non-funding lease'. These tests are broadly intended to identify leases that perform a financing function.

- 3.29. The finance lease test in section 70N CAA 2001 would be modified so that it can be applied by lessees using IFRS 16 whose accounts have not classified their leases as either finance or operating leases. The new finance lease test is likely to capture as a finance lease (for CIR purposes and capital allowances purposes) an agreement that 'transfers substantially all the risks and rewards incidental to ownership' of an asset. It is likely to use the criteria currently set out in IAS 17/FRS 102 to determine whether or not a lease achieves this result<sup>8</sup>.
- 3.30. The lease payment test, in existing section 70O CAA 2001, would be met when the present value of the minimum lease payments is equal to or more than 80 percent of the fair value of the asset. 'Minimum lease payments' are defined at section 70YE CAA 2001 and that definition would be kept.
- 3.31. The 'present value' of the minimum lease payments is calculated by using the interest rate implicit in the lease, which is the interest rate that would apply in accordance with normal commercial criteria, and is generally required under GAAP. Where the interest rate cannot be determined, as may be the case for some operating leases, LIBOR + 1% would be used, which would be in line with section 437C(6) CTA 2010.

---

<sup>8</sup> The exact formulation of this new finance lease test may depend on responses to question 3 of the consultation document *Leasing: Tax response to accounting changes*.

- 3.32. The useful economic life test, in existing section 70P CAA 2001, would be met if the term of the lease is more than 65 percent of the remaining useful economic life of the asset. The 'remaining useful economic life' is defined in section 70YI CAA 2001 as the period (a) beginning with the commencement of the term of the lease, and (b) ending when the asset is no longer used, and no longer likely to be used, by any person for any purpose as a fixed asset of a business.
- 3.33. Where a lease is classified as a 'funding lease', the lessor would include finance income relating to the lease recognised in its accounts in tax-interest for CIR purposes. The lessee would similarly include the finance charge relating to the lease recognised in its accounts in tax-interest for CIR purposes.
- 3.34. Although the classification for CIR purposes would not depend on whether a funding lease is 'long'<sup>9</sup> or not, plant and machinery leases that are considered to be 'long funding leases' for capital allowances purposes would all be considered to be 'funding leases' for CIR purposes<sup>10</sup>.
- 3.35. For funding leases, the finance amounts that are brought into tax-interest for CIR purposes would be the same amount of finance charge or income calculated under the accounting standard/framework adopted by the company. If the accounting treatment actually used is not GAAP-compliant, the company would be assumed to use GAAP-compliant accounting.
- 3.36. Even where a finance charge is not recognised in the lessee's accounts, the CIR rules would still require a finance charge to be included within tax-interest for CIR purposes on the basis that there is a financing transaction. This would apply, for example, where the lessee applies IFRS 16 and the lease is exempted from the 'on balance sheet' leasing model. It would also apply where the lessee applies FRS 102 and the lease is accounted for as an operating lease, even though it is a funding lease. In such cases, the amount of tax-interest expense for CIR purposes would be the finance charge that would be recognised in GAAP-compliant accounts if they were to recognise such a finance amount (for instance, as they would have done if the lease had been classified as a finance lease under FRS 102).
- 3.37. Likewise, where finance income is not recognised in the lessor's accounts, the lessor would still be required to include an amount of finance income within tax-interest for CIR purposes. This would apply, for example, where the lessor accounts for the lease as an operating lease. In such cases, the amount of tax-interest income for CIR purposes would be the finance income that would be recognised in GAAP-compliant accounts if they were to recognise such a finance amount (for instance, as they would have done if the lease had been classified as a finance lease).

---

<sup>9</sup> Therefore section 70G CAA 2001 would not apply.

<sup>10</sup> The government recognises that the economic substance of certain plant or machinery leasing arrangements is similar to a borrowing to buy a capital asset, thus allowing the lessee to claim capital allowances although strictly speaking, the legal ownership of the asset remains with the lessor.

- 3.38. Where a lease is classified for CIR purpose as a 'non-funding lease', no finance income or charge would be included as tax-interest for CIR purposes for the lessor or lessee, respectively.
- 3.39. See Annex A for the CIR treatment of 'Type A' and 'Type B' leases. Under this option:
- 'Type A' leases would be funding leases;
  - 'Type B' leases would be non-funding leases.
- 3.40. Certain adjustments would need to be made to the definition of group-interest and group-EBITDA. It is envisaged that the definition of group-interest would need to be amended to align with tax-interest. So amounts would be included within group-interest when the lease is a funding lease.
- 3.41. The definition of capital expenditure excluded from group-EBITDA, would need to be amended so as to include depreciation in respect of funding leases.
- 3.42. This option would require groups to determine whether or not leases fall within the definition of a funding lease, even where the leases are entered into by an overseas entity in the group.
- 3.43. Since the accounting classification is ignored under this option, it would not matter if the accounting standard/framework used at group level differed to that used at entity level. This means no further adjustments at group level should be required.

**3.44. Question 6 – What are the advantages and disadvantages of option 3?**

**3.45. Question 7 – Comparing options 1, 2 and 3, what is your preferred option and why?**

**Proposed treatment for intra-group leases that are short-term or of low-value assets**

- 3.46. As mentioned above, lessees of short-term and of low-value assets may elect not to use the new 'on balance sheet' lease model under IFRS 16. This would mean that there is no finance charge in the accounts for the lessee in respect of these assets. However, if the lessor classified such leases as finance leases (under IFRS 16 or FRS 102), the lessor would recognise finance income within tax-interest under the current CIR rules.
- 3.47. On a case-by-case basis, this mismatch may be insignificant, but when taken together across the whole population, this mismatch could make a significant difference to the overall amount of interest restricted. We are therefore proposing to introduce a rule to ensure symmetry of treatment within groups.
- 3.48. The proposal is that where the lessee does not recognise a finance charge in its accounts in respect of a particular lease, if the corresponding lessor is in the same CIR group as the lessee, it cannot include finance income from that lease

within tax-interest for CIR purposes. This rule would not be needed under option 3.

**3.49. Question 8: Would this proposal cause any significant difficulties?**



## 4. Summary of Consultation Questions

### **Option 1: Follow the accounting**

Q1 - What are the advantages and disadvantages of option 1?

Q2 – Please provide specific examples of intra-group mismatches between the lessee and lessor that would arise under option 1 that would make a significant difference to the overall CIR position of the group.

Q3 – Would option 1 result in some lessees deciding not to adopt an accounting framework incorporating IFRS 16 for its individual entity accounts?

### **Option 2: Keep a distinction between operating leases and finance leases**

Q4 – What are the advantages and disadvantages of option 2?

Q5 – Are there circumstances in which mismatches can arise under option 2, and would this be problematic?

### **Option 3: introduce a distinction between funding leases and non-funding leases**

Q6 – What are the advantages and disadvantages of option 3?

Q7 – Comparing options 1, 2 and 3, what is your preferred option and why?

### **Proposed treatment for short-term leases and leases of low-value assets for intra-group leases**

Q8 – Would this proposal cause any significant difficulties?

### **General**

Q9 – Please provide details of any other options you would prefer, bearing in mind legislative complexity and administrative burdens.

## 5. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal.

### How to respond

A summary of the questions in this consultation is included at chapter 3.

Responses should be sent by 28 February 2018, by e-mail to: [interest-restriction.mailbox@hmrc.gsi.gov.uk](mailto:interest-restriction.mailbox@hmrc.gsi.gov.uk) or by post to: Adeline Chan, Business, Assets & International, HM Revenue & Customs, 3C/06, 100 Parliament Street, London SW1A 2BQ

Telephone enquiries: 03000 586039

### **Please do not send consultation responses to the Consultation Coordinator.**

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC's GOV.UK pages](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

### Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

### Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: [hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk](mailto:hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk)

**Please do not send responses to the consultation to this address.**

## Annex A: Summary of CIR Treatment

This annex sets out the two ways leases are treated under the CIR rules. All the options put forward in this consultation retain these two treatments, though they differ in the rules that would be used to determine which treatment applies to any particular lease. For the purposes of this consultation, the two treatments are referred to as Type A and Type B.

Briefly, Type A leases are leases where a finance amount is brought in as tax-interest under the CIR rules whereas Type B leases are those where no finance amount is brought in under the CIR rules.

### Classification of leases

**Table 1: Type A leases - classification**

	<b>Lessee</b>	<b>Lessor</b>
<b>Current CIR Rules</b>	Finance leases	Finance leases
<b>Option 1</b>	IFRS 16: All leases except those exempted from 'on balance sheet' leasing model  FRS 102: Finance leases	Finance leases
<b>Option 2</b>	IFRS 16: All leases except – a) Leases exempted from 'on balance sheet' leasing model; or b) Operating leases where lessor does not recognise finance income.  FRS 102: Finance leases	Finance leases
<b>Option 3</b>	Funding leases	Funding leases

**Table 2: Type B leases - classification**

	<b>Lessee</b>	<b>Lessor</b>
<b>Current CIR Rules</b>	Operating leases	Operating leases
<b>Option 1</b>	IFRS 16: Leases which are exempted from 'on balance sheet' leasing model  FRS 102: Operating leases	Operating leases
<b>Option 2</b>	IFRS 16: a) Leases exempted from 'on balance sheet' leasing model; b) Operating leases where lessor does not recognise finance income.  FRS 102: Operating leases	Operating leases
<b>Option 3</b>	Non-funding leases	Non-funding leases

### Treatment under the CIR rules

The CIR treatment depends on whether or not the lessee or lessor is claiming capital allowances on the leased asset. This in turn depends on whether or not the lease is a long-funding lease for capital allowances purposes.

**Table 3: Type A leases – CIR treatment**

	<b>Lessee</b>	<b>Lessor</b>
<b>Long-funding leases</b> (lessee claims capital allowances)	<ul style="list-style-type: none"> <li>• Finance charge relating to the lease in the accounts included in tax-interest and therefore excluded from tax-EBITDA.</li> <li>• Capital allowances added back in calculating tax-EBITDA.</li> </ul>	<ul style="list-style-type: none"> <li>• Finance income relating to the lease in the accounts included in tax-interest and therefore excluded from tax-EBITDA.</li> </ul>
<b>Non-long funding leases</b>	<ul style="list-style-type: none"> <li>• Finance charge relating to the lease in the accounts included in tax-interest and</li> </ul>	<ul style="list-style-type: none"> <li>• Finance income relating to the lease in the accounts included in tax-interest and</li> </ul>

(lessor claims capital allowances)	<p>therefore excluded from tax-EBITDA.</p> <ul style="list-style-type: none"> <li>• Depreciation added back to tax-EBITDA.</li> </ul>	<p>therefore excluded from tax-EBITDA.</p> <ul style="list-style-type: none"> <li>• Capital allowances are added back in calculating tax-EBITDA.</li> <li>• Capital repayment amounts deducted from tax-EBITDA.</li> </ul>
------------------------------------	---	--

For Type A leases, the finance amount should be recognised in group-interest and depreciation in respect of the leased assets should be included in the capital expenditure adjustment and so added back to 'profit before tax' in calculating group-EBITDA.

**Table 4: Type B leases – CIR treatment**

	<b>Lessee</b>	<b>Lessor</b>
<b>Long-funding leases</b> (lessee claims capital allowances)	<ul style="list-style-type: none"> <li>• Capital allowances added back in calculating tax-EBITDA.</li> <li>• Full amount of rental payments<sup>11</sup> included in tax-EBITDA (effectively reversing out the capital allowances added back).</li> </ul>	<ul style="list-style-type: none"> <li>• Full amount of rental income<sup>12</sup> included in tax-EBITDA (effectively adjusting for capital allowances claimed by the lessee).</li> </ul>
<b>Non-long funding leases</b> (lessor claims capital allowances)	<ul style="list-style-type: none"> <li>• Rental payments already within tax-EBITDA; no adjustment is required.</li> </ul>	<ul style="list-style-type: none"> <li>• Rental income already within tax-EBITDA.</li> <li>• Capital allowances added back in calculating tax-EBITDA.</li> </ul>

For Type B leases, the finance amount should be recognised in group-EBITDA rather than group-interest and depreciation in respect of the leased assets should not be included in the capital expenditure adjustment (and so should not be added back to 'profit before tax' in calculating group-EBITDA).

<sup>11</sup> The tax deductions available for the lessee are reduced by s379 (2) CTA 2010 by a proportion of the expected reduction in the value of the asset. This is compensated for by the fact that the lessee can claim capital allowances. For example, the lessee pays £100 under the lease but only gets relief for £20 with £80 restricted under s379. The deduction in calculating tax-EBITDA should be the full £100.

<sup>12</sup> To reflect the absence of capital allowances, the lessor's income for tax purposes will be reduced in accordance with s363 (2) CTA 2010. For example, the rental income is £100 where £20 is taxable and £80 subject to the s363 adjustment. The full £100 should be included in tax-EBITDA.

# Annex B: Relevant Current Legislation

Part 10 TIOPA 2010 - Corporate Interest Restriction

Chapter 2 Part 9 Corporation Tax Act 2010 - Long funding leases of plant and machinery

Chapter 6A Part 2 Capital Allowances 2001 – Interpretation of provisions about long funding leases