

Principles based approach to financial products avoidance

November 2008



HM TREASURY



HM Revenue
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Subject of this consultation:	Principles-based legislation as a means of tackling tax avoidance involving disguised interest (corporation tax) and transfers of income streams (corporation tax and income tax).
Scope of this consultation:	This consultation invites comments on whether the draft legislation, based on principles, will successfully tackle the arrangements targeted and not affect any transactions to which it is not intended to apply.
Impact Assessment:	We have carried out an initial screening in line with Better Regulation principles and our expectation is that the measures would not impact on compliant business, charities or the public sector. Should anyone think that the measures would impact on compliant business, charities or the public sector we would be glad to understand what these impacts are, and the likely costs or benefits attached to them.
Who should read this:	Large businesses and their advisors.
Duration:	PBR date - 11 February 2009
Enquiries and How to respond:	Richard Rogers 020 7147 2625 3 rd Floor 100 Parliament Street London SW1A 2BQ Richard.Rogers@hmrc.gsi.gov.uk
Additional ways to become involved:	In order to assess the effectiveness of the approaches outlined in the draft legislation, two open days will be held (one on disguised interest and one on transfers of income streams) early in the New Year. Requests to attend can be made to Richard Rogers. As this is a technical issue with specialist interests, we also seek written responses to the questions raised.
After the consultation:	A decision will be made on whether legislation should be included in Finance Bill 2009. A summary of responses to the consultation will be published.
Getting to this stage:	Following earlier consultation in 2007/2008, the Government decided that legislation would be deferred to allow further consultation to take place.
Previous engagement	Two open days were held in early 2008 at which an earlier version of the disguised interest legislation was discussed. Over summer 2008, four workshops were held with stakeholders to discuss the key issues that need to be addressed. The draft legislation in this document reflects the matters that were raised in the initial consultation and during the workshops.

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1

Introduction

1.1 A consultation document ‘Principles-based approach to financial products avoidance’ was issued by HM Treasury (HMT) and HM Revenue and Customs (HMRC) in December 2007. This document was seeking to establish whether a principles-based approach – rather than the continual introduction of detailed rules – may be a more appropriate way of countering avoidance in the area of financial products.

1.2 Following the responses to that document, at Budget 2008 the Chancellor announced that consultation on the possible introduction of principles-based legislation to counter financial products avoidance would continue, with the introduction of any legislation deferred to Finance Bill 2009.

1.3 During the summer of 2008 HMRC and HMT held workshops with interested external stakeholders, based on technical papers that HMRC had prepared for discussion at those workshops. The papers contained possible proposals including revised drafts of legislation, and took into account comments made by stakeholders in response to the consultation document. HMRC also held bilateral meetings on the proposals.

1.4 HMRC and HMT are very grateful for the very detailed responses to the first consultation document and the very constructive participation of stakeholders in the summer workshops.

1.5 This second consultation document seeks to take the work forward for the possible introduction of legislation at Finance Bill 2009. The document summarises the responses received to the first consultation document. It also contains revised draft legislation and Explanatory Notes which explain the intended operation of the clauses. This draft legislation takes into account many of the points made in response to the first consultation document and in the workshops.

1.6 Chapter 2 considers disguised interest, and Chapter 3 considers transfers of income streams.

1.7 HMRC and HMT are keen to receive the views of business and other stakeholders on this draft legislation, and in particular would like to know if it deals appropriately with the issues raised in response to the first consultation document and in the workshops.

1.8 Details of the consultation process and of questions on which stakeholders’ views are sought are contained in Chapter 4.

2

Disguised interest

2.1 This section of the document is divided into the following parts:

- Discussion of scope of proposals;
- Discussion of issues arising from consultation and how these have been addressed in revised draft legislation;
- Draft legislation;
- Explanatory Note; and
- Appendix – summary of responses to consultation document.

Part 1: Scope of proposals

Quasi-loans and disguised interest in non-loan transactions

2.2 UK tax law has two general approaches to transactions which produce a return which is economically similar to interest (a time value and certain return). Where, as part of a standard, non-fiscally-driven transaction, there is in substance an advance of money and its subsequent repayment together with a reward based on the time value of money, the general approach is to treat the entire transaction as if it were a loan at interest, and for the most part¹, to include the entire transaction within the loan relationships legislation in Chapter 2 Part 4 Finance Act (FA) 1996. This kind of standard **quasi-loan transaction** includes repos within Schedule 13 FA 2007 (which are in substance lending secured on shares and debt instruments), finance leasing, hire purchase contracts, alternative finance arrangements (Islamic Finance) within sections 47 to 54 FA 2005, structured finance arrangements within sections 774A to 774G Income and Corporation Taxes Act 1988 (ICTA) and some transactions involving derivatives².

2.3 Quasi-loan transactions are likely to be accounted for (for example in accordance with FRS 5) as if they were real loan transactions, with assets and liabilities recognised according to the substance. In general, quasi-loan transactions are treated symmetrically for tax purposes recognising that these transactions are entered into by “debtors” as much as “creditors” for good commercial reasons.

2.4 The disguised interest rules set out in the December 2007 consultative document, and revised in February 2008, were primarily aimed at transactions which are **not** quasi-loans, but which nevertheless produce a time value of money return. The tax treatment of the transaction is fundamental to the form that it takes. In general these transactions will have been created with or by a “debtor” which is either indifferent to any tax relief (because it is tax exhausted or not within the scope of UK taxation) or is a financial trader or obtains by some other means relief for the amount that corresponds to the creditor’s “return”.

¹ An obvious exception is the rules on finance leasing in s. 502A ff. ICTA 1988: but they have the same effect.

² see for example *Griffin v Citibank* 2000 STC 1010.

2.5 In these cases not involving quasi-loans, the approach to date has been to enact legislation on a piecemeal basis to pick off particular schemes, including those notified under Part 7 FA 2004, and has led to legislation such as section 91A to 91I FA1996. This type of legislation tries to simply identify an interest-like return embedded within an instrument or arrangement which does not have loan-like characteristics, for example in an increase in the value of shares and the effect of arrangements affecting those shares such as a contribution to the capital of the company, or the underlying transactions carried out by the company in which the shares are held.

2.6 The object of the disguised interest legislation is to replace these piecemeal responses with a comprehensive rule ensuring that a time value of money return is charged to corporation tax in all circumstances where an arrangement is structured with the intention that (apart from the legislation) the return would arise in a form that is not charged to tax as income.

Preference shares accounted for as liabilities

2.7 Non-participating or fixed rate redeemable preference shares treated as a financial liability rather than equity for accounting purposes give rise to specific issues. Such preference shares are quasi-loans as the accounting treatment shows. Such shares raise tax issues which are of a different order to those raised by non loan transactions producing disguised interest.

2.8 The draft legislation below therefore proposes that such shares are dealt with by what is in effect a revised version of section 91D of FA 1996, applying in much the same circumstances that section 91D currently applies (including the “unallowable purpose” rule), but with the following key differences:

- Replacement of the “redeemability” condition with a requirement that under GAAP the share would be accounted for as a liability.
- Exclusion for shares held by a person connected with the issuer. This is analogous to the similar excluded share rule that has been inserted into the draft disguised interest legislation. It allows the prescriptive “mirroring shares” rules in section 91D to be removed.
- Application of normal loan relationship rules to the deemed creditor relationship (no stipulation of accounting method to be followed for tax).

Part 2: Revised draft legislation and issues arising from consultation

2.9 This part of the document identifies a number of issues raised during the initial consultation and subsequent workshops and explains how they have been addressed in the revised draft legislation that follows.

Purpose of Schedule

2.10 Some who commented noted that while paragraph 1 (purpose of Schedule) of the draft legislation published in February refers to a return economically equivalent to interest, the operative rule in that draft refers to a return which equates in substance to interest. If these are meant to refer to the same thing, then it was asked why the wording differs.

2.11 HMT/HMRC Response: This has been dealt with in the draft legislation in this document by omitting the purpose clause. See also the comments at paragraph 3.10 to 3.13 on the section on transfers of income streams.

What is meant by a return that equates in substance to interest?

2.12 Some thought that the legislation should contain criteria for determining whether a return is one that equates in substance to a return at interest. Possible requirements for such a return were that it should be predictable from the outset, should relate to some form of investment made by the company, and should be a return that is payment by time for the use of the investment.

2.13 HMT/HMRC Response: This has been dealt with by defining what is meant by “a return economically equivalent to interest” – see draft section 485B(2) of the Corporation Tax Act 2009 (CTA).

How are contingent returns/forex differences treated?

2.14 Some commentators felt that it was not clear whether the legislation would tax only the interest element or the full return from the arrangements. For instance, where the interest return is augmented or decreased by exchange gains and losses, is the tax charge to be calculated by reference to the gross or net amount?

2.15 HMT/HMRC Response: Draft section 485B(1) of CTA makes clear that the amount charged to tax is the amount that is economically equivalent to interest. Section 485B(6) is intended to make clear that a return computed by reference to an overseas rate of interest may be such a return; and that if such a return has been obtained exchange gains and losses arising by reference to the return are also to be brought into account. A specific rule for these amounts is needed because they are likely to be contingent and thus outside the definition of a return economically equivalent to interest.

2.16 Some asked whether the RPI element on an index-linked gilt would be within the scope of the legislation.

2.17 HMT/HMRC Response: The return on an RPI-linked gilt currently within section 94 FA 1996 will continue to be taxed under the loan relationship rules, which take priority over the disguised interest provision – see section 485C(b). For index-linked gilts within section 94 the amount charged to tax under the loan relationship rules is the time value return that is economically equivalent to interest leaving no amount to be brought into account under the disguised interest rules.

Split returns

2.18 The draft legislation in the 2007 consultation document provided that where two or more persons are party to an arrangement designed to produce a tax-privileged investment return, then each will be taxed on so much of the return as is reasonable. Some felt it was unclear on what basis the allocation would be made.

2.19 HMT/HMRC Response: The draft legislation in section 485B(5) of CTA provides for allocation of the overall return on a just and reasonable basis. In practice, it is likely to be clear how much of the overall return is to be attributed to each company. No allocation will be made to the extent that part of the return is brought into account as income apart from the disguised interest rules – section 485C. HMRC would be happy to consider examples of situations where the legislation might give rise to unclear or unreasonable outcomes.

Exclusions

2.20 Some felt that having specific exceptions was inconsistent with a principled approach.

2.21 There was strong objection that the tax-motivated utilisation of stranded losses of a subsidiary company by means of a contribution to its capital that subsequently earned interest should give rise to a disguised interest return.

2.22 Some said that it would be helpful if the legislation were to make clear that the exceptions were illustrative and that failing to fall within them would not bring a company within the scope of the legislation.

2.23 HMT/HMRC Response: Having specific exemptions is not viewed by Government as inconsistent with a principled approach, but is a recognition that a principle needs to sit alongside other policies. The carve-out for excluded shares in section 485E of CTA (and the equivalent preference share provision in section 520C(1)(c)) offers a safe harbour for all straightforward intra-group share investments so that it becomes unnecessary to consider whether an arrangement produces a return economically equivalent to interest, or whether the arrangement might be viewed as tax-driven.

2.24 We consider that it is clear that not falling within one of the exclusions does not automatically trigger the application of the legislation. All the conditions for the legislation to apply would still have to be met – in particular, those at section 485B(2) of CTA (meaning of return economically equivalent to interest) and 485D (tax avoidance test).

Single return taxed on more than one company.

2.25 Shares in a company that holds assets which produce interest or an interest-like return may increase in value so as to produce a return for a person holding shares in the company that is economically equivalent to interest. Moreover, that increase in value may be transmitted through a chain of shareholdings to persons at each tier above the company.

2.26 HMT/HMRC Response: The exclusion for intra-group shareholdings is intended to put beyond doubt that straightforward share investments in group companies cannot give rise to a charge at any tier. This is because the only return that arises at each tier is an increase in the value of the relevant shareholding in a group company.

2.27 So if company A holds all shares in company B which holds all shares in company C, then company B's holding is excluded if the return company B obtains is an increase in value of the company C shares and company A's holding is excluded if its return is an increase in value of the company B shares.

2.28 Where a share pays a dividend, we consider (see HMRC's Corporate Finance Manual at paragraph 6334) that this will not affect the amount of the return obtained, since the profits out of which the dividend is paid will directly contribute to the fair value of the share immediately prior to its payment. So the fact that such dividends are paid does not affect the amount of the return that is produced or prevent that return reflecting only an increase in fair value of the share. Similarly, if the shares are sold for their fair value, the return has already been produced so the disposal itself does not prevent the return reflecting only the increase in fair value of the share.

2.29 Where the shares are in a non-group company, then the legislation cannot apply unless the main purpose, or one of the main purposes, of the arrangement is to secure that the return (which must of course meet the definition of a return that is economically equivalent to interest) is not brought into account for CT purposes as income – section 485D of CTA. This obviously will not apply in relation to straightforward share investments.

Interaction with Controlled Foreign Companies (CFC) regime

2.30 Many commenting asked how the rules on disguised interest interact with the CFC legislation.

2.31 HMT/HMRC Response: section 485E of CTA provides that the draft legislation on disguised interest will not apply where an interest-like return arises to a company purely as a result of an increase in value of any share that it holds in a group company.

2.32 As for non-group companies the legislation proceeds on the basis that the only automatic exclusion should be for shares in a controlled foreign company whose profits are apportioned or would have been apportioned but for section 748(1) or (3) of ICTA. But as already noted, straightforward share investments in non-group companies will not be caught because of the definition of a return economically equivalent to interest and the tax avoidance test.

Interaction with capital gains regime

2.33 Some were concerned about the interaction of the draft Schedule with the rules for charging corporation tax on capital gains.

2.34 HMT/HMRC Response: We think that section 37 of Taxation of Chargeable Gains Act (TCGA) 1992 should prevent any double charge, but welcome views.

Part 3: Draft legislation

2.35 Many of the statutory references in the draft legislation below are to the Corporation Tax Act 2009. This is currently in Bill form and the version of the Bill referred to in the draft is not yet in public circulation. The explanatory note that follows the draft legislation therefore generally refers to the pre-CTA equivalent provisions that are currently in force.

2.36 The draft Corporation Tax Bill is divided into Parts, some of which are mentioned in the draft below. The Parts (so far as relevant) are as follows:

- Part 3: Rules for trading income;
- Part 4: Rules for property income;
- Part 5: Rules for loan relationships;
- Part 6: Assimilation into Part 5 of certain relationships treated as loan relationships (e.g. repos);
- Part 7: Rules for derivative contracts; and
- Part 8: Rules for intangible fixed assets.

1 Disguised interest

The Schedule contains provision about the corporation tax treatment of disguised interest.

SCHEDULE DISGUISED INTEREST

Amendments of Part 6 of CTA 2009

1 Part 6 of CTA 2009 (relationships treated as loan relationships etc) is amended as follows.

2 (1) Section 476(2) (overview of Part 6) is amended as follows.

(2) After paragraph (a) insert –

“(aa) Chapter 2A (disguised interest),”.

(3) For paragraph (f) substitute –

“(f) Chapter 6A (shares accounted for as liabilities),”.

3 After Chapter 2 insert –

“CHAPTER 2A DISGUISED INTEREST

485A Introduction to Chapter

(1) This Chapter provides for Part 5 to apply in relation to returns which are economically equivalent to interest (see section 485B).

(2) For exclusions from this Chapter, see –

- (a) section 485C (return otherwise taxable),
- (b) section 485D (arrangement with no tax avoidance purpose), and
- (c) section 485E (excluded shares).

485B Disguised interest to be regarded as profit from loan relationship

(1) Where a company is party to an arrangement which produces for the company a return in relation to any amount which is economically equivalent to interest on that amount, Part 5 applies as if the return were a profit arising to the company from a loan relationship.

(2) For the purposes of this section a return produced for a company by an arrangement in relation to any amount is “economically equivalent to interest” if (and only if) –

- (a) it is reasonable to assume that it is a return by reference to the time value of that amount of money,
- (b) it is at a rate reasonably comparable to a commercial rate of interest, and
- (c) at the time the arrangement is entered into by the company there is no practical likelihood that it will cease to be produced in accordance with the arrangement.

(3) The credits and debits to be brought into account for the purposes of Part 5 in respect of the return must be determined on an amortised cost basis of accounting.

(4) But if any of the return is not recognised in determining the company’s profit or loss for any period it is to be treated as recognised using an amortised cost basis of accounting.

(5) Where 2 or more persons are party to an arrangement which produces a return such as is mentioned in subsection (1) –

- (a) for the persons (when taken together), but
- (b) not for either (or any) of them individually,

this section applies as if there were a profit arising to such (if any) of them as are companies from a loan relationship of so much of the return as is just and reasonable.

(6) In subsection (3) “credits” and “debits” include exchange gains and losses arising as a result of translating the carrying value of the return at different times.

(7) In this Chapter “arrangement” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).

485C Exclusion where return otherwise taxable

This Chapter does not apply to an arrangement which produces a return for a company if and to the extent that the return –

- (a) is brought into account under Part 3 (trading income), Part 7 (derivative contracts) or Part 8 (intangible fixed assets), or
- (b) is brought into account under Part 5 apart from this Chapter.

485D Exclusion where arrangement has no tax avoidance purpose

This Chapter does not apply in relation to an arrangement which produces a return unless the main purpose, or one of the main purposes, of the arrangement is to secure that the return is not brought into account as income for corporation tax purposes.

485E Excluded shares

(1) This Chapter does not apply in relation to an accounting period (“the relevant accounting period”) of a company (“the holding company”) for which an arrangement produces a return for the company if the arrangement involves only relevant shares held by the company.

(2) For the purposes of this section an arrangement “involves only” relevant shares if (and only if) the return produced reflects only an increase in the fair value of the shares.

(3) In subsection (2) “fair value”, in relation to relevant shares held by the holding company, means an amount which the company would obtain from a knowledgeable and willing purchaser of the shares dealing at arm’s length.

- (4) In this section “relevant shares” means shares which, throughout the relevant period, are fully paid-up shares of a relevant company.
- (5) In subsection (4) “the relevant period” means the period –
- (a) beginning when the holding company becomes a party to the arrangement, and
 - (b) ending with the end of the relevant accounting period.
- (6) For the purposes of subsection (4) shares are fully paid-up if there are no actual or contingent obligations –
- (a) to meet unpaid calls on the shares, or
 - (b) to make a contribution to the capital of the issuing company that could affect the value of the shares.
- (7) In subsection (4) “a relevant company” means –
- (a) a relevant group company, or
 - (b) a non-group CFC.
- (8) A relevant group company is a company which –
- (a) is a member of the same group of companies as the holding company, and
 - (b) either is not a controlled foreign company (within the meaning of Chapter 4 of Part 17 of ICTA) or is within subsection (11).
- (9) A non-group CFC is a company which –
- (a) is not a member of the same group of companies as the holding company, and
 - (b) is within subsection (11).
- (10) For the purposes of subsections (8)(a) and (9)(a) section 170 of TCGA 1992 applies for reading references to a group of companies as it applies for the purposes of sections 171 to 181 of that Act.
- (11) For the purposes of subsections (8)(b) and (9)(b) a company is within this subsection if any of its chargeable profits (within the meaning of Chapter 4 of Part 17 of ICTA) –
- (a) are apportioned to the holding company for the relevant accounting period in accordance with section 752 of that Act by virtue of section 747(3) of that Act, or
 - (b) are not so apportioned because of section 748(1) or (3) of that Act.”

4 After Chapter 6 insert –

“CHAPTER 6A

SHARES ACCOUNTED FOR AS LIABILITIES

520A Introduction to Chapter

- (1) This Chapter contains rules for Part 5 to apply in some cases as if at some times in the accounting period of a company (“A”) which holds shares of a certain kind in another company (“B”) the shares were rights under a creditor relationship of A.
- (2) See, in particular –
- (a) section 520B (application of Part 5 to some shares as rights under creditor relationship), and
 - (b) section 520C (which describes the shares to which the rules apply).

(3) In this Chapter references to the investing company are to A and references to the issuing company are to B.

(4) For the purposes of this Chapter, the definition of “share” in section 474(1) only applies so far as it provides that “share” does not include a share in a building society.

(5) See section 116B of TCGA 1992 for the effect for chargeable gains purposes of shares beginning or ceasing to be shares to which section 520C applies.

520B Application of Part 5 to certain shares as rights under creditor relationship

(1) This section applies in relation to the times in a company’s accounting period when—

- (a) the company holds a share in another company, and
- (b) section 520C (shares accounted for as liabilities) applies to the share.

(2) Part 5 applies as if at those times—

- (a) the share were rights under a creditor relationship of the investing company, and
- (b) any distribution in respect of the share were not a distribution (and accordingly is within Part 5).

(3) Where Part 5 applies in relation to the investing company in accordance with subsection (2) it so applies as if the issuing company stood in the position of debtor as respects the debt in question.

(4) In this Chapter references to “the share” are to the share mentioned in subsection (1).

520C Shares accounted for as liabilities

(1) This section applies to the share if—

- (a) the share would be accounted for as a liability in accordance with generally accepted accounting practice,
- (b) the share is designed to produce a return which equates, in substance, to the return on an investment of money at a commercial rate of interest,
- (c) the issuing company and the investing company are not connected companies,
- (d) corporation tax would not be chargeable on distributions in respect of the share (apart from this Chapter),
- (e) the condition in subsection (2) is met, and
- (f) the investing company’s purpose in acquiring the share is an unallowable purpose (see section 520D).

(2) The condition mentioned in subsection (1)(e) is that the share does not fall to be treated for the accounting period in question as if it were rights under a creditor relationship of the company because of section 489 (holdings in OEICs, unit trusts and offshore funds treated as creditor relationship rights).

(3) Section 465 (companies connected for an accounting period) applies for the purposes of this section.

520D Unallowable purpose

(1) For the purposes of section 520C, a share is acquired by the investing company for an unallowable purpose if—

- (a) the purpose for which the company holds the share or one of the main purposes is to circumvent section 130 (traders receiving distributions etc), or
- (b) the purpose for which it does so or one of the main purposes is any other purpose which is a tax avoidance purpose (see subsection (3)).

- (2) But subsection (1)(a) does not apply if the investing company shows that –
- (a) immediately before it acquired the share, some or all of its business consisted of making and holding investments, and
 - (b) it acquired the share in the ordinary course of that business.
- (3) In this section “tax avoidance purpose”, in relation to a company, means any purpose which consists of securing a tax advantage (whether for the company or another person).
- (4) For the meaning of “tax advantage”, see section 475(1).

520E Shares becoming or ceasing to be shares to which section 520B applies

- (1) This section applies if at any time section 520B (application of Part 5 to certain shares as rights under creditor relationship) begins or ceases to apply in the case of a share held by the investing company.
- (2) The investing company is treated for the purposes of Part 5 –
- (a) as having disposed of the share immediately before that time for consideration of an amount equal to the notional carrying value of the share at that time, and
 - (b) as having immediately reacquired it for consideration of the same amount.
- (3) In subsection (2) “notional carrying value”, in relation to the share, means the amount which would have been its carrying value in the accounts of the investing company if a period of account had ended immediately before section 520B began to apply in the case of the share and the investing company.
- (4) For the purposes of subsection (3) “carrying value” has the same meaning as it has for the purposes of section 315 (see section 316).”

Amendments and repeals

5 (1) Section 116B of TCGA 1992 (shares beginning or ceasing to be shares to which section 522 of CTA 2009 applies) is amended as follows.

- (2) In subsection (1) and the heading, for “522” substitute “520B”.
- (3) In subsection (1)(b), for “its fair value” substitute “the notional carrying value of the share”.
- (4) In subsection (2), for the definition of “fair value” substitute –
- ““notional carrying value” has the same meaning as in section 520E(2) of CTA 2009 (see subsection (3) of that section),”.
- (5) In that subsection, in the definition of “investing company” –
- (a) for “7” substitute “6A”, and
 - (b) for “with guaranteed returns) (see section 521(3)” substitute “accounted for as liabilities) (see section 520A(3))”.

6 In section 26 of F(No.2)A 2005 (tax arbitrage), for subsection (10) substitute –

“(10) This subsection applies to an amount that is brought into account by virtue of Chapter 2A or 6A of Part 6 of CTA 2009 (shares treated as loan relationships).”

7 In consequence of the amendments made by this Schedule, omit –

- (a) section 736C (deemed interest: cash collateral under stock lending arrangement of ICTA,
- (b) section 736D (quasi-stock lending arrangements and quasi-cash collateral) of ICTA,
- (c) sections 131 to 133 of FA 2004 (companies in partnership),

- (d) paragraph 12 of Schedule 13 to FA 2007 (repo under arrangement designed to produce quasi-interest: anti-avoidance), and
- (e) Chapter 7 (shares with guaranteed returns etc) and Chapter 8 (returns from partnerships) of Part 6 of CTA 2009.

8 Omit the following provisions (which relate to the provisions repealed by paragraph 7) –

- (a) sections 736B(4) and 807A(2B) of ICTA,
- (b) section 171(3A) of TCGA 1992,
- (c) paragraphs 5 and 9 of Schedule 7 to F(No.2)A 2005,
- (d) paragraphs 3 and 4 of Schedule 6 to FA 2006,
- (e) paragraphs 172 and 373 of Schedule 1 to ITA 2007, and
- (f) paragraphs 168, 198(2), 295 and 459 of Schedule 1 to CTA 2009.

Commencement

9 The amendments made by paragraphs 2(2) and 3 have effect in relation to any arrangement which produces for a company a return which is economically equivalent to interest if the company becomes a party to the arrangement on or after 1 April 2009.

10 The amendments (and repeals) made by paragraphs 2(3) and 4 to 8 come into force on that date.

11 (1) This paragraph applies where –

- (a) any of the provisions repealed by paragraph 7, or
- (b) section 91A or 91B,

applies in relation to anything done by a company before 1 April 2009 which amounts to becoming party to an arrangement (within the meaning of section 485B(7) of CTA 2009).

(2) The company is to be treated for the purposes of Chapter 2A of CTA 2009 as having become a party to the arrangement on that date.

(3) But this paragraph does not apply in circumstances in which paragraph 13 does.

12 (1) This paragraph applies where –

- (a) section 91A or 91B of FA 1996, or
- (b) Chapter 7 of Part 6 of CTA 2009,

applies in relation to a share held by a company on 31 March 2009.

(2) Section 91G(2) of FA 1996, or section 116B(1) of TCGA 1992, is to be treated as applying as if the condition in section 91A(1) or 91B(1) of FA 1996 ceased to be satisfied in the case of the share, or section 522 of CTA 2009 ceased to apply in relation to the share, on that date.

(3) But this paragraph does not apply if paragraph 13 applies in relation to the share and the company

13 (1) This paragraph applies where –

- (a) section 91B of FA 1996 applies in relation to a share held by a company on 31 March 2009 by reason of the Condition in section 91D being satisfied, or
- (b) Chapter 7 of Part 6 of CTA 2009 applies in relation to a share held by a company on that date by reason of the redemption return condition being met (see section 528 of that Act),

and section 520B of CTA 2009 applies in relation to the share and the company on 1 April 2009.

(2) Part 5 of CTA 2009 applies as if the company had acquired the share on 1 April 2009 for an amount equal to the notional carrying value of the share on that date.

(3) In sub-paragraph (2) “notional carrying value” has the same meaning as in section 520E(2) of CTA 2009 (see subsection (3) of that section).

(4) Section 520E of CTA 2009 does not apply by virtue of the coming into force of section 520B of that Act.

Part 4: Explanatory Note

2.37 Paragraph 1 amends Part 6 of Corporation Tax Act 2009 (CTA), which deals with certain matters that are treated as loan relationships, although they are not actually loan relationships.

2.38 Paragraph 2 inserts into CTA a reference to the new Chapter 2A which contains the draft legislation on disguised interest.

2.39 Paragraph 3 inserts the new Chapter 2A into CTA. The statutory references that follow are to the section numbers in CTA.

2.40 Section 485A is introductory. It provides for Part 5 of CTA (loan relationships) to apply in relation to returns which are economically equivalent to interest. It also refers to exceptions in section 485C to 485E (see notes on the exceptions below).

2.41 Section 485B(1) contains the legislative principle. Where a company is party to an arrangement that produces for it a return on an amount which is “economically equivalent to interest on that amount” then the return is to be taxed as if it were a profit from a loan relationship.

2.42 Section 485B(2) then defines what is meant by a return on an amount that is “economically equivalent to interest”.

2.43 Section 485B(2)(a) reproduces a number of indicia commonly cited in cases on the meaning of interest:

- The return must be calculated by reference to an amount. In *Euro Hotel (Belgravia) Ltd* 51TC293 Megarry J said: “there must be a sum of money by reference to which the payment which is said to be interest is to be ascertained”; and
- It must be reasonable to assume that it is a return by reference to the time value of that amount. In *Bennett v. Ogston* 15 TC 374 Rowlatt J described interest as ‘payment by time for the use of money’.

2.44 Section 485B(2)(b) provides that the return must be reasonably comparable to a commercial rate of interest.

2.45 Section 485B(2)(c) then ensures that, viewed at the outset, there must be no “practical likelihood” that the arrangement will cease to produce the return. This is famously the term used by Lord Oliver in *Craven v White* 62 TC 1 commenting on Lord Brightman’s speech in *Furniss v Dawson* 55 TC 324 describing the cases when the *Ramsay* principle, as understood at the time, would apply. It has now to be understood in the light of the judgment of the House of Lords in *Scottish Provident Institution* 76 TC 538 as precluding attempts to manufacture a “falsifying” arrangement.

2.46 It must be clear at the outset that the return will be produced. Thus, although there is no longer an express requirement for the arrangement to be “designed” to produce the return, the return must be initially predictable so that such design is likely to be present.

2.47 Subsections (3) and (4) are similar to paragraphs 2(2) and 2(3) of the draft legislation on disguised interest published in February (“February draft”), ensuring that the credits and debits in respect of the loan relationship are taxed on an amortised cost basis, and regardless of whether they are recognised in the accounts of the company that obtains the return.

2.48 Section 485B(5) deals with cases where two or more persons are party to an arrangement which in aggregate produces a return to which the legislation would apply if it were produced for just one of them. The taxable return is apportioned between them on a just and reasonable basis. This replicates paragraph 1(6) of the February draft.

2.49 Section 485B(6) ensures that the credits and debits to be brought into account include exchange gains and losses that arise as a result of translating the accounts carrying value of the return.

2.50 Subsection (7) defines arrangement as including any agreement, understanding, scheme, transaction or series of transactions.

2.51 Section 485C is a scope or boundary rule: it provides that any part of the return that is brought into account in computing for tax purposes trading income, or derivative contract or intangible fixed asset profits is not charged under the Chapter. It also provides that any amount brought into account under the loan relationship rules, apart from amounts brought into account under this new Chapter 2A, are excluded.

2.52 Section 485D provides an important exclusion for any case where it is not the main purpose or one of the main purposes (if there is more than one) of the arrangement producing the return to secure that the return is not brought into account as income for corporation tax purposes.

2.53 Section 485E introduces the other main exclusion and the notion of “excluded shares”. Section 485E(1) states that the Chapter will not apply for an accounting period (the “relevant accounting period”) for which an arrangement produces a return if the arrangement involves only a “relevant share” held by the company (“holding company”) for which the return is produced, provided that throughout the “relevant period” the share is “fully paid-up”.

2.54 Section 485E(2) to (11) contain definitions relevant for construing section 485E(1).

2.55 Section 485E(2) explains what is meant by “involves only” a share. An arrangement involves only a share if (and only if) the return that is produced for the company consists purely of an increase in the fair value of the share. This thus excludes from Chapter 2A all straightforward share investments in “relevant shares” where the only economic exposure that the holding company has to the shares that it holds is to the value of the shares.

2.56 It follows that the legislation is not prevented from applying where the return is derived from a combination of holding the share and some other arrangement such as a forward sale or other derivative. But in any such case it would still be necessary for a tax avoidance purpose (within section 485D) to be present before the legislation could apply.

2.57 There is a question for consideration here. Are both the “unallowable purpose” and the “excluded shares” exclusions necessary? If not which should remain?

2.58 Section 485E(3) defines “fair value” in the same way that it is currently defined for loan relationship purposes (see section 103 of FA 1996).

2.59 Section 485E(4) defines “relevant shares” as meaning shares which throughout the “relevant period” are “fully paid up shares” of a “relevant company”.

2.60 Section 485E(5) defines “relevant period” as the period starting with the date on which the company becomes party to the arrangement and ending with the end of the accounting period for which it is necessary to ascertain whether the share is a relevant share.

2.61 Subsection (6) defines “fully paid-up share” for the purposes of subsection (1), in terms similar to section 91A(6) FA 1996. This requirement is meant to ensure that arrangements such as those within section 91A FA 1996 will continue to be caught.

2.62 Subsection (7) defines “relevant company”. A relevant company is a “relevant group company” or a “non-group CFC”.

2.63 Subsection (8) defines “relevant group company”. In essence it means a company which is a member of the same group of companies as the holding company. That would naturally include a controlled foreign company within the meaning of Chapter 4 of Part 17 of ICTA (“CFC”), but the subsection puts it beyond doubt that it includes a CFC which is a member of the group.

2.64 Subsection (9) defines a “non-group CFC” as a company which is not a member of the same group as the holding company and is a CFC within subsection (11).

2.65 Subsection (10) provides that in subsections (8) and (9) “group” is to have its section 170 TCGA 1992 meaning.

2.66 Subsection (11) completes the definitions. A company is within the subsection (for the purpose of subsections (8) and (9)) if it is a CFC, whether its chargeable profits are apportioned to the holding company for the relevant accounting period or are not so apportioned because of section 748(1) or (3) ICTA.

2.67 The effects of section 485E can be simply stated:

- Investments in shares in group companies are automatically excluded; and
- Investments in shares in non-group companies are not automatically excluded except where they are shares in a CFC in relation to which an apportionment is made, or is not made because of section 748(1) or (3) ICTA.

2.68 A question which arises from these rules is whether they cater appropriately for all international joint venture arrangements.

2.69 None of the exclusions affects the computation of the CFC’s own chargeable profits. For this purpose, the effects of Chapter 2A will still need to be taken into account in the same way as any other UK rule relating to CT on income, and so may increase the amount of apportionable profits.

Shares accounted for as liabilities

2.70 Paragraph 4 inserts a new Chapter 6A into the CTA (“Shares accounted for as liabilities”). It provides a limited replacement for sections 91B to 91E FA 1996, particularly for that part dealing with “preference share lending” (mostly section 91D) as it is considered better to deal separately with disguised interest in what are clearly not loans in substance or form on the one hand, and quasi-loans on the other (which the preference shares within new Chapter 6A are).

2.71 The Chapter as a whole is headed “Shares accounted for as liabilities”. This will cover many shares which are redeemable in accordance with their terms.

2.72 Section 520A(1) introduces the Chapter and provides for it to treat certain shares held by one company in another company as if they were rights under a creditor loan relationship. Subsection (1) (taken with subsection (3)) provides for the main loan relationships rules in Part 5 (currently Chapter 2 Part 4 FA 1996) to apply to the holder of certain shares. Section 520A(2) and (5) signpost later sections of CTA and also section 116B TCGA dealing with the TCGA implications of changes in the status of certain shares. Section 520A(4) ensures that shares already treated as loan relationships – those in a building society – are not included in the meaning of shares.

2.73 Subsection (3) states that references in the Chapter to the “investing company” and “issuing company” are respectively to A and B.

2.74 Subsection (4) ensures that for the purposes of the Chapter a “share” does not include a share in a building society. This replicates section 91B(8) FA 1996.

2.75 Subsection (5) highlights that section 116B of TCGA 1992 (section 91G(2) of FA 1996) applies to determine the effect for the purposes of corporation tax on chargeable gains when a share begins or ceases to be one to which section 520C applies. See also the note on paragraph 5 of the draft Schedule below.

2.76 Section 520B is the operative rule. Subsection (2) applies Part 5 (loan relationships) to the holder of the share in relation to the times in that company’s accounting period when it holds a share in another company and section 520C applies to the share. It also disapplies (subsection (2)(b)) the rule in section 464 of CTA (currently paragraph 1 Schedule 9 FA 1996) which ensures that no distribution (within the meaning in section 209 etc ICTA) falls within the loan relationships rules except in certain avoidance cases.

2.77 Subsection (3) ensures that where relevant to the treatment of the holder, the issuing company is treated as a debtor under the loan relationship deemed by subsection (2). Identification of the debtor may be needed in some cases so that other tax rules, such as transfer pricing, can operate correctly. But as noted below the legislation cannot apply where the share issuer and holder are connected so section 87 FA 1996 (connected companies required to use amortised cost accounting) will not be in point in relation to this provision.

2.78 Subsection (4) ensures that when the Chapter refers to the share it is to the share referred to in subsection (1).

2.79 Section 520C contains the conditions a share must meet to be a “share” to which section 520B(2) applies. By virtue of subsection (1) a share is to be treated as a creditor relationship if:

- The share would be accounted for as a liability in accordance with generally accepted accounting practice – subsection (1)(a). This means generally accepted accounting practice as defined by section 50 FA 2004, which for this purpose means either IAS 32 or the UK equivalent FRS 25. This accounting rule replaces the “redeemability” condition in section 91D(1)(a) FA 1996. The use of the word “would” means that it is unnecessary for the holder to know how the issuer actually has accounted for it. The question is how would any issuer adopting IAS 32 or FRS 25 account for it;
- The share is designed to produce a return which equates in substance to a return on an investment of money at a commercial rate of interest (whether through dividends, redemption amount or a combination) – subsection (1)(b). This is the same as the wording in section 91D(1)(b) FA 1996;
- The issuing company and the investing company are not connected companies – subsection (1)(c). This does not replicate any provision in section 91D, and provides certainty that a share cannot be treated as a creditor relationship where the issuer and holder are connected companies. It does however mean that it is not necessary to replicate the mirroring shares provisions in section 91D(6) to (8) FA 1996. Similarly Chapter 2A cannot apply in relation to that share provided that section 485E (excluded shares) applies in relation to it. If section 520C does apply then since the return from the share will be taken into account under Part 5 of the CTA then Chapter 2A cannot apply – section 485C;
- Corporation tax is not chargeable on distributions in respect of the share – subsection (1)(d). This might be under section 130 CTA (currently section 95 ICTA) or section 83 FA 1989 (life assurance business). This replicates the condition introduced into section 91D via section 91B(6)(a) FA 1996;
- The share is within subsection (2) – subsection (1)(e); and
- The investing company’s purpose in acquiring the share is an unallowable purpose as defined by section 520D. This replicates the condition in section 91D(1)(c) FA 1996.

2.80 Subsection (2) provides that a share is within subsection (2) for the purposes of subsection (1)(e) if the share is not already treated as a creditor relationship because of (what is currently) paragraph 4 of Schedule 10 FA 1996 (unit trusts and offshore funds treated as creditor relationships). This replicates what is currently in section 91D (see section 91B(1)(b) FA 1996).

2.81 Subsection (3) gives “connected” the same meaning as in (what is currently) section 87 FA 1996.

2.82 Section 520D defines in what circumstances a share is to be treated as acquired for an unallowable purpose.

2.83 Under subsection (1) a share is acquired by the investing company for an unallowable purpose if the purpose (or one of the main purposes) for which the company holds the share is to circumvent (what is currently) section 95 of ICTA or the purpose (or one of the main purposes) for which it holds the share is any other purpose which is a tax avoidance purpose. This replicates the wording of section 91D(9) FA 1996.

2.84 Subsection (2) ensures that subsection (1)(a) (circumventing section 130 CTA) does not apply if the investing company shows that immediately before it acquired the share some or all of its business consisted of the making and holding of investments and it acquired the share in the ordinary course of that business. This replicates the effect of section 91D(10) FA 1996.

2.85 Subsection (3) defines “tax avoidance purpose” in the same way as section 91D(11).

2.86 In subsection (4) “tax advantage” is defined as in section 840ZA ICTA.

2.87 The legislation does not contain the exclusions for publicly issued shares in section 91D as that exclusion is in any case overridden if there is an unallowable purpose (see section 91D(5) FA 1996).

2.88 Section 520E deals with the consequences for loan relationships and CT on chargeable gains purposes when a share begins or ceases to meet the conditions in section 520C. This may be because the share begins or ceases to be accounted for as a liability, begins or ceases to be held for an unallowable purpose or the parties become or cease to be connected.

2.89 Under subsection (2) the investing company is treated for the purposes of the loan relationship rules in Part 5 of CTA 2009 as having acquired and disposed of the share for an amount equal to its “notional carrying value”.

2.90 Subsection (3) defines notional carrying value as meaning the amount which would have been the carrying value of the share in the investing company’s accounts if a period of account had ended immediately before section 520B began or ceased to apply.

2.91 Section 520E(4) defines “carrying value” by reference to what is currently paragraph 19A(4) of Schedule 9 to FA 1996.

2.92 The overall effect of section 520E is that the acquisition value for the deemed loan relationship should generally be the accounts carrying value of the shares and the deemed disposal should generally be for an amount equal to the accounts carrying value. It will be rare for the accounts carrying value to differ from the tax carrying value because of the exclusion for connected party shares.

2.93 Paragraph 5 amends section 116B TCGA 1992. Section 116B is the rewritten version of section 91G(2) FA 1996 (so far as it applies for the purposes of CT on chargeable gains) and is reproduced below as it will appear following the amendments:

Shares beginning or ceasing to be shares to which section 520B of CTA 2009 applies

(1) If at any time section 520B of CTA 2009 begins or ceases to apply in the case of a share held by the investing company it is treated for the purposes of this Act [chargeable gains] —

- (a) as having disposed of the share immediately before that time for consideration of an amount equal to the notional carrying value of the share at that time, and
- (b) as having immediately reacquired it for consideration of the same amount.

(2) In this section —

“notional carrying value” has the same meaning as in section 520E(2) of CTA 2009 (see subsection (3) of that section),

and

“investing company” has the same meaning as it has for the purposes of Chapter 6A of Part 6 of that Act (shares accounted for as liabilities) (see section 520A(3) of that Act).”

2.94 The effect of this is that (on a share ceasing to meet the conditions in section 520C) the acquisition value for the shares for the purposes of CT on chargeable gains should generally be the accounts carrying value of the shares and (on a share beginning to meet those conditions) the deemed disposal value should generally be the accounts carrying value. As with section 91G FA 1996, there is no provision for any hold over of gain or loss.

Repeals and amendments

2.95 Paragraph 6 makes a consequential amendment to the rules on arbitrage in section 26 of F(No 2)A 2005 so that references in subsection (10) to section 91A and 91B FA 1996 are replaced by equivalent references to Chapter 2A or 6A of Part 6 of CTA 2009.

2.96 Paragraph 7 signposts the repeals. The most important repeals here are those of sections 91A to 91G FA 1996 – the rules that treat shares as loan relationships in certain circumstances. It also repeals sections 91H and 91I FA 1996 and sections 131 to 133 FA 2004, which cover partnerships. This points up that the rules here go wider than dealing with shares and deal with any arrangements including partnerships and contributions to partnerships as well as shares. The rules on quasi-stocklending at sections 736C and 736D of ICTA, and quasi-interest arising from repos in paragraph 12 of Schedule 13 to FA 2007, are also repealed.

2.97 Paragraph 8 contains consequential repeals.

Commencement

2.98 Paragraph 9 gives a possible commencement rule. The disguised interest rules would have effect in relation to any arrangement to which the company became party on or after 1 April 2009. This is subject to paragraph 11 in relation to existing “caught” arrangements.

2.99 Paragraph 10 states that the amendments and repeals made by paragraphs 2(3), 4 (shares accounted for as liabilities), 5 (amendments and repeals relating to section 116B TCGA 1992), 6 (arbitrage), 7 (repeals) and 8 (consequential repeals) come into force on 1 April 2009.

2.100 Paragraph 11(1) gives the transitional rule in respect of caught arrangements and provides that the paragraph applies where section 91A or 91B FA 1996, or any of the other provisions being repealed applies in relation to anything done by a company before 1 April 2009 which amounts to an arrangement within the meaning of section 485B(7).

2.101 Subparagraph 2 then provides that the company is to be treated for the purposes of Chapter 2A as having become party to an arrangement on that date. This will not automatically trigger the application of Chapter 2A, but merely make it capable of applying if all the other conditions are met in relation to that deemed arrangement.

2.102 Subparagraph 3 provides that paragraph 11 does not apply if paragraph 13 (section 91D shares which become Chapter 6A shares) applies instead.

2.103 Paragraph 12(1) gives the rule for determining the treatment for the purposes of corporation tax on chargeable gains in a case where section 91A or 91B applies in relation to a share held by a company on 31 March 2009.

2.104 Subparagraph (2) provides that (what is currently) section 91G(2) of FA1996 is to be treated as applying as if, on 31 March 2009, the share ceased to be one to which section 91A or 91B applied.

2.105 This deemed disposal (triggered by the version of section 91G in force at 31 March 2009) has the effect that any gain or loss originally deferred under section 91G when the shares as debt rules began to apply (only applicable if they began to apply on 16 March 2005) is crystallised. Thereafter, any return can be brought into account only under Chapter 2A. It also gives rise to a deemed disposal of the (deemed) creditor loan relationship at fair value and a deemed acquisition cost for the purpose of CT on chargeable gains at that value.

2.106 Subparagraph 3 provides that paragraph 12 does not apply if paragraph 13 (section 91D shares which become Chapter 6A shares) applies instead.

2.107 Paragraph 13 sets out a separate rule where the share is one to which section 91D applied on 31 March 2009 and section 520B CTA 2009 applies to the share on 1 April 2009.

2.108 Subparagraph (2) provides in this case that Part 5 of CTA applies as if the company has acquired the share on 1 April 2009 for its notional carrying value on that date. There might be a difference between this amount and the closing value of the creditor relationship as at 31 March 2009.

2.109 Subparagraph (3) defines notional carrying value as having its section 520E(2) meaning.

2.110 Subparagraph (4) ensures that section 520E does not come into force by the coming into force of section 520B.

Chapter 2 Appendix

Disguised Interest: Summary of responses to consultation document

30 responses were received, from a range of respondents including the major legal and accounting practices. The table below summarises responses. A detailed discussion of the responses is included in part 2 above.

Themes of concerns	Number of respondents
Paras 1 & 2 of the draft legislation	
Confusion between phrase “economically equivalent to interest” in 1 and “equates in substance to a return at interest” in 2(4)(a)	4
Meaning of designed – in 2(5) is this situation exhaustive, does this definition apply to Para 1?	7
Inconsistency between the principle and operative paragraphs. A clear policy distinction should be made between credit risk returns and equity risk returns	8
Use the accounting – substance over form approach to make the debt/equity distinction.	3
Use of phrase ‘reasonable to assume’ is objective not subjective	7
Need an avoidance motive test or get-out for genuine commercial transactions	12
Should not be asymmetry between the taxation of the recipient and providing relief to the payer. Effect on prefs. market.	15
How 4(b) provisions fit with self-assessment – could be taxed a long time after return deadline.	4
How the disaggregation rules work, on what legislative basis?	7
Paras 3 – 5	
Objection to the rules applying in cases of b/f non-trade deficits specifically, but also interaction with other specific reliefs – e.g. s.94, s.96 gilts	12
Concerns about interaction with CFC/CC rules – disguised interest rules should not be a back-stop	21
Other specific carve-outs:	
Forex	2
Regulatory capital	1
Publicly issued prefs	1
AIFs and OSFs	1
Para 6	
Better to use income-producing asset exemption as in s.91C	3
How the credit rules will work – interaction with SA	9
If no overall UK group advantage –not sure paras 3 and 6 are sufficient in all chains of company arrangements	9
Interaction with CG –not sure s.37 TCGA will work in all circs	5
Other Issues	
Legislation should be clear – no legislating (relieving) by guidance/administrative discretion	20
Availability of pre-transaction clearance facilities – resource implications	9
Transitional provisions: either grandfather existing structures or make specific provision for move from fair value to amortised cost in relevant circumstances	4
Whether proposals EU compliant	3

3

Transfers of income streams

3.1 This section of the document is divided into the following parts:

- Discussion of scope of proposals;
- Discussion of issues arising from consultation and how these have been addressed in revised draft legislation;
- Draft legislation;
- Explanatory Note; and
- Appendix – summary of responses to consultation document.

Part 1: Scope of proposals

3.2 The text on transfers of income streams included in the consultation document issued in December 2007 explains that the draft legislation included in that document aimed to introduce into UK tax law the principle established in the Australian case of *Henry Jones (IXL) Limited v. Federal Commissioner of Taxation* (22 ATR 328):

An assignment of income from property without an assignment of the underlying property will, no matter what its form, bring about the result that the consideration for that assignment will be on revenue account as being merely a substitution for the future income that is to be derived.

3.3 As noted in that consultation document, this is not a completely established principle of UK tax law, which is why a range of legislative provisions have been introduced to treat sales of income as income in particular cases. Some of the legislative responses have been included as part of a particular code, but others are specifically targeted at particular schemes involving particular types of income. The legislative solutions are often different from each other in minor ways that do not reflect differences if any in the nature of the income.

3.4 These provisions are set out in the proposed repeals at paragraph 5 of the draft legislation below.

3.5 The aim of the transfers of income streams legislation is to generalise the type of tax treatment that these provisions prescribe, allowing the specific provisions to be repealed and the gaps between them to be filled. This would apply both to companies and individuals, reflecting existing law.

3.6 Unlike the original draft legislation published in December 2007, the revised legislation in this document also aims to limit the tax charge on the transferee where the transaction is accounted for by the transferee as a financial asset.

3.7 As indicated in the explanatory notes, the draft legislation below is intended to apply only to transfers of income already earned by the transferor which that person would have received by reference to circumstances that were largely in place at the time of the transfer. It is not intended to apply as a result of the grant or transfer of any right that by being exploited by the transferee gives rise to income to which the transferor was not entitled. Thus, an assignment of rights which has no existing income attached is outside the legislation, whilst an assignment of a pre-existing income stream is intended to be caught to the extent of the market value of that income.

Part 2: Revised draft legislation and issues arising from consultation

3.8 This part of the document identifies a number of issues raised during the initial consultation and subsequent workshops and explains how they have been addressed in the revised draft legislation that follows.

3.9 Many comments were directed to the general approach set out in the consultation document and these are considered in relation to the Chapter on disguised interest. There were nevertheless a few responses specifically on the transfers of income streams legislation.

Purpose of legislation

3.10 Those who commented on “income streams” were almost unanimously of the opinion that the “purpose” test in Clause 1(1) of the CT provisions and the draft section 809A ITA 2007 of the income tax provisions were neither necessary nor helpful and indeed commentators pointed out that there were differences between the content of the purpose subsection, the principle as set out in paragraph 3.5 of the consultation document and the operative charging rule in Clause 1(2).

3.11 HMT/HMRC Response: An earlier (unpublished) draft version of the legislation contained the following opening purpose statement:

“The purpose of this clause is to secure that (unless taxable as income) receipts derived from a right to receive income (which, as such, are an economic substitute for income) are treated as income for the purposes of corporation tax.”

3.12 That statement was drafted by Parliamentary Counsel in response to the initial comments about the purpose clause: it is of course absent from the current draft but is set out here to illustrate how the comments on the wording of, rather than the principle of having, the purpose clause would have been taken into account. It moves away from the formulation set out in the first consultation document and from the reference to receipts “which equate in substance to income” and proposes instead to demonstrate that the purpose is only to tax those amounts which are an economic substitute for income.

3.13 Despite the comments made by many of the commentators about the role of purpose statements in legislation, the Government would still be interested in views on this revised statement and whether it would be at least not unhelpful to have it embodied in the legislation; whether it would be better to include it in the Explanatory Notes to the Finance Bill where it might be referred to in the circumstances set out by Lord Steyn in *Westminster City Council v National Asylum Support Service* [2002] UKHL 38; or whether it should be included in HMRC guidance.

Symmetry

3.14 A number of respondents said there should be symmetry between the seller of an income stream and the purchaser.

3.15 HMT/HMRC response: paragraph 4 of the draft Schedule below gives the symmetry requested. Consideration is also being given to applying the paragraph 4 (transferee) approach to section 774A etc structured finance transactions, and comments on this would be welcome.

Application to property transactions

3.16 Bodies representing the property industry were concerned about the effect of the rules where there was a grant of an overriding lease rather than the sale of a freehold subject to a lease.

3.17 HMT/HMRC response: Under the draft legislation, if the transfer of the income stream also involves as a consequence the transfer of certain specified assets, then the rules do not apply.

3.18 One type of specified asset is a freehold interest in land. And in the light of the representations that in certain cases a person wishing to realise their entire investment in land is not able or willing to transfer the freehold subject to a lease giving rise to a rental stream, but instead will grant an overriding long lease for a premium substantially equal to the value of the freehold where the grantee becomes entitled to the remaining rental stream, a transfer of freehold land is also taken to include the grant of an overriding long lease (50 years or more).

3.19 Similar representations were made by the oil industry about certain transfers of rights. In this case it is considered that these should come within the scope of the legislation where an income stream is transferred without an underlying asset.

3.20 The Government would welcome comments on the “land” exclusion in paragraph 2(1) of the draft legislation. Is the exception for long leases sufficient to remove the problems foreseen by the property industry and its representatives? It should be stressed that where a lease is granted for less than 50 years, the lease premium legislation in Chapter 4 Part 4 CTA 2009 will apply to part of the premium on a sliding scale. Where any amount is treated as income under the lease premium rules, paragraph 1 will not apply to the extent of that amount.

3.21 Are there any remaining concerns about particular transactions in the oil industry?

Interaction with Taxation of Chargeable Gains Act (TCGA 1992)

3.22 Some representations sought clarification about the interaction with TCGA 1992. There was a request that there should be specific CGT exemption for consideration received for the transfer, and uncertainty about how the part-disposal rules work.

3.23 HMT/HMRC response: In relation to the first point, Section 37 TCGA 1992 is considered to apply. As to the second, the draft legislation does not yet deal with any consequential changes that might be needed to TCGA 1992. It is recognised that the rules in sections 37 and 39 and the part disposal rules in section 42 TCGA 1992 do not always deal adequately with “income stripping” transactions of the sort covered by paragraphs 1 and 3 of the draft Schedule. Further consideration is being given to what changes might be desirable.

Part 3: Draft legislation

3.24 This clause takes into account both the general comments about the purpose provision in the original draft clause, and detailed comments on the drafting of the remaining part of the original draft clause. An earlier version of this latest draft was discussed in the summer workshop and revised as a result of those discussions.

1 Transfer of income streams

Schedule 1 contains provision about transfers of income streams.

SCHEDULE 1

TRANSFERS OF INCOME STREAMS

Company transferors

1 (1) This paragraph applies where a company within the charge to corporation tax (“the transferor”) makes a transfer of a right to relevant receipts.

(2) “Relevant receipts” means any receipts which (but for the transfer) would be receipts of the transferor brought into account in calculating any income of the transferor for the purposes of corporation tax.

(3) An amount equal to the market value of the right to the relevant receipts which (as a result of the transfer) will not be received by the transferor is to be treated as income of the transferor chargeable to corporation tax in the same way as that in which the relevant receipts would have been chargeable but for the transfer.

(4) The income is to be treated as arising in the accounting period or periods for which, in accordance with generally accepted accounting practice, the consideration for the transfer would be recognised for accounting purposes in a profit and loss account or income statement of the transferor.

(5) But if the consideration for the transfer is (to any extent) not recognised for accounting purposes in a profit and loss account or income statement of the transferor, the income is to be treated as arising at the time when the transfer takes place; and so much of the income as represents any amount by which the market value of the right exceeds the consideration for the transfer is also to be treated as arising at that time.

(6) This paragraph is subject to paragraph 2 (exclusions).

(7) In this paragraph and paragraph 2 references to a transfer include sale, exchange, gift and assignment (or assignation) and any other arrangement which equates in substance to a transfer; and references to anything being transferred are to be read accordingly.

(8) In this paragraph references to a transfer taking place are, in the case of an arrangement other than a sale, exchange, gift or assignment (or assignation), to the making of the arrangement.

2 (1) Paragraph 1 does not apply if the transfer of the right to relevant receipts is a consequence of—

- (a) the transfer of shares in a company that confer on the person who holds them rights other than the right to the relevant receipts, or
- (b) the transfer of a freehold interest in land or the grant of a lease of land whose effective duration (determined as for the purposes of Chapter 4 of Part 4 of CTA 2009: see sections 242 to 244 of that Act) is more than 50 years.

(2) The Treasury may by order amend sub-paragraph (1).

(3) Paragraph 1 does not apply if and to the extent that the consideration for the transfer or (if greater) the amount mentioned in sub-paragraph (3) of that paragraph is –

- (a) charged to tax as income of the transferor,
- (b) brought into account in calculating the profits of the transferor, or
- (c) brought into account under CAA 2001.

(4) Paragraph 1 does not apply if the consideration for the transfer is the advance under an arrangement that is a structured finance arrangement for the purposes of section 774A or 774C of ICTA in relation to the transferor or a partnership of which the transferor is a member.

Individual transferors

3 In ITA 2007, after section 809 insert –

“CHAPTER 5A

TRANSFERS OF INCOME STREAMS

809AZA Application of Chapter

(1) This Chapter applies where a person within the charge to income tax (“the transferor”) makes a transfer of a right to relevant receipts.

(2) “Relevant receipts” means any receipts which (but for the transfer) would be receipts of the transferor brought into account in calculating any income of the transferor for the purposes of income tax.

(3) For exclusions from this Chapter, see –

- (a) section 809AZC (transfer of underlying asset),
- (b) section 809AZD (amount otherwise taxed), and
- (c) section 809AZE (transfer by way of security).

809AZB Value of transferred income stream treated as income

(1) An amount equal to the market value of the right to the relevant receipts which (as a result of the transfer) will not be received by the transferor is to be treated as income of the transferor chargeable to income tax in the same way as that in which the relevant receipts would have been chargeable but for the transfer.

(2) The income is to be treated as arising in the chargeable period of the transferor in which the transfer takes place.

(3) If (apart from the transfer) the relevant receipts –

- (a) would have been chargeable to tax in accordance with Part 2 or 3 of ITTOIA 2005 (trading income and property income), and
- (b) in accordance with generally accepted accounting practice, would be recognised otherwise than wholly in the chargeable period in which the transfer takes place,

so much of the relevant receipts as is recognised in each chargeable period of the transferor is to be treated as income arising in that chargeable period.

(4) For this purpose “recognised”, in relation to a chargeable period, means recognised for accounting purposes in the transferor’s profit and loss account or income statement for the period.

809AZC Exception: transfer of underlying asset

(1) This Chapter does not apply if the right to relevant receipts is a consequence of –

- (a) the transfer of shares in a company that confer on the person who holds them rights other than the right to the relevant receipts, or
- (b) the transfer of a freehold interest in land or the grant of a lease of land whose effective duration (determined as for the purposes of Chapter 4 of Part 3 of ITTOIA 2005: see sections 303 to 305 of that Act) is more than 50 years.

(2) The Treasury may by order amend subsection (1).

809AZD Exception: amount otherwise taxed

This Chapter does not apply if and to the extent that the consideration for the transfer or (if greater) the amount mentioned in subsection 809AZB(1) is –

- (a) charged to tax as income of the transferor
- (b) brought into account in calculating the profits of the transferor, or
- (c) brought into account under CAA 2001.

809AZE Exception: transfer by way of security

Paragraph 1 does not apply if the consideration for the transfer is the advance under an arrangement that is a structured finance arrangement for the purposes of section 774A or 774C of ICTA in relation to the transferor or a partnership of which the transferor is a member.

809AZF Interpretation

(1) In this Chapter references to a transfer include sale, exchange, gift and assignment (or assignment) and any other arrangement which equates in substance to a transfer; and references to anything being transferred are to be read accordingly.

(2) In this Chapter references to a transfer taking place are, in the case of an arrangement other than a sale, exchange, gift or assignment (or assignment), to the making of the arrangement.”

Company transferees

4 (1) Part 6 of CTA 2009 (relationships treated as loan relationships etc) is amended as follows.

(2) In section 476(2) (overview of Part 6), after paragraph (aa) insert –

“(ab) Chapter 2B (transferred income streams),”.

(3) After Chapter 2A insert –

“CHAPTER 2B

TRANSFERRED INCOME STREAMS

485F Introduction to Chapter

(1) This Chapter provides for Part 5 to apply in relation to a company to which an income stream transfer is made.

(2) An “income stream transfer” is a transfer to which either of the following provisions applies –

- (a) paragraph 1 of Schedule 1 to FA 2009 (transfers of income streams by companies), or
- (b) Chapter 5A of Part 13 of ITA 2007 (transfers of income streams by individuals).

485G Consideration to be treated as money debt

Where, in accordance with generally accepted accounting practice, the amount of the consideration for the transfer of the right to the relevant receipts is recorded in the

accounts of the company as a financial asset, that amount is to be treated for the purposes of Part 5 as if it were a money debt arising from a transaction for the lending of money.”

Consequential amendments and repeals

5 (1) In consequence of this Schedule, omit –

- (a) section 730 of ICTA (transfers of rights to receive distributions in respect of shares),
- (b) section 775A of ICTA (transfers of rights to receive annual payments),
- (c) section 785A of ICTA (rent factoring of leases of plant or machinery),
- (d) in section 786 of ICTA (transactions associated with loans or credit) –
 - (i) in subsection (5), “assigns,” “(without a sale or transfer of the property)” and “assigned,”
 - (ii) in subsection (5ZA), “assigned,” and
 - (iii) in subsection (5A), “assigned,”
- (e) in Chapter 11 of Part 4 of ITTOIA 2005 (transactions in deposits) –
 - (i) in section 551(2), the words after “of it”, and
 - (ii) in section 552(1), paragraph (e) and the word “and” before it, and
- (f) Chapter 13 of Part 4 of ITTOIA 2005 (sales of foreign dividend coupons).

(2) Omit the following provisions (which relate to the provisions repealed by sub-paragraph (1)) –

- (a) in section 98 of TMA 1970, in column 1 of the Table, the entry relating to section 730(8) of ICTA,
- (b) in section 774E(1) of ICTA, the second sentence,
- (c) paragraph 23 of Schedule 7 to FA 1996,
- (d) section 135 of FA 2004,
- (e) paragraph 300 of Schedule 1 to ITTOIA 2005,
- (f) paragraphs 2 and 4 of Schedule 7 to F(No.2)A 2005,
- (g) paragraph 7 of Schedule 6 to FA 2006,
- (h) in section 1016 of ITA 2007, in Part 3 of the table, the entry relating to section 730(4) of ICTA, and
- (i) paragraphs 183 and 545 of Schedule 1 to ITA 2007.

(3) In section 785ZB(3) of ICTA, for “has the same meaning as in section 785A” substitute “includes an underlease, sublease, tenancy or licence and an agreement for any of those things”.

(4) In section 2(13) of ITA 2007, omit the “and” at the end of paragraph (d) and insert at the end “or (f) transfers of income streams (Chapter 5A).”

(5) In Schedule 4 to that Act (index of defined expressions), after the entry relating to “transferor (in Part 12)” insert –

“transfer and taking place (in Chapter 5A of Part 13)	Section 809AZF”.
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Commencement

- 6 (1) Paragraphs 1 and 2 have effect in relation to transfers on or after 1 April 2009.
- (2) The amendment made by paragraph 3 has effect in relation to transfers taking place in the tax year 2009-10 or any subsequent tax year.
- (3) The amendment made by paragraph 4 has effect –
- (a) in relation to transfers by a company within the charge to corporation tax taking place on or after 1 April 2009, and
 - (b) in relation to transfers by a person within the charge to income tax taking place in the tax year 2009-10 or any subsequent tax year.
- (4) The amendments made by paragraph 5 have effect –
- (a) for the purposes of corporation tax, in relation to transfers taking place on or after 1 April 2009, and
 - (b) for the purposes of income tax, in relation to transfers taking place in the tax year 2009-10 or any subsequent tax year.

Part 4: Explanatory Note

Introduction

3.25 This note provides detailed comment on the clause, and concentrates in particular on changes proposed from the clause included in the December 2007 consultation document.

3.26 Comments are welcomed on any part of the draft legislation or the detailed Explanatory Notes below. The notes themselves raise questions in one or two places.

Detail

3.27 Subsection (1) of the clause sets out the case. It differs from draft clause 1(2) as set out in the first consultation document because instead of the reference to a right to receive income it refers to a transfer of a right to relevant receipts, and subsection (2) defines “relevant receipts” as receipts that, but for the transfer, would be taken into account as income of the transferor for CT purposes. The reason for moving away from just “income” to amounts to be taken into account as income is to ensure that the sale of a right to a receipt which is a component in the calculation of profits from a trade or other business is unambiguously included as well as an amount of “pure income”. The distinction between the two types of receipt is demonstrated elsewhere in the Tax Acts, for example in section 208 of ICTA 1988, and this formulation puts beyond doubt that the sale of a right to a trading receipt is included.

3.28 The requirement that relevant receipts must be those which would be receipts of the transferor but for the transfer is included to emphasise that the legislation is not concerned with the *creation* of income receipts for example by the grant of a lease or the entering into of the contract giving rise to the receipts. A useful distinction has been drawn by, in particular, courts in the United States of America, between a “right to earn income” and a “right to earned income”. See in this regard the discussion in *Lattera & Lattera v Commissioner* [437 F.3d 399 – 3rd Circuit Court of Appeals 2006 – <http://www.ca3.uscourts.gov/opinarch/044721p.pdf>]. This legislation, like many of the provisions it replaces such as section 730 ICTA, deals with the transfer of income the right to which has already arisen.

3.29 It is recognised that some would argue that the disposal proceeds from the sale of ordinary shares in a company could be regarded as an “economic substitute for income” in the shape of future distributions. *Lattera*, and the discussion of previous cases there, shows that a sale of such a share constitutes the sale of a “right to earn income” in the shape of dividends and other forms of return in the future. There are however some transactions which do not fit easily into this distinction eg between the sale of a bare right to a dividend as in section 730 and the sale of the share. This is also recognised in *Lattera*: the Court of Appeals there adopted a “family resemblance” test. To that end paragraph 2 of the legislation makes a distinction between cases where an underlying asset of a substantial economic value apart from the right to income is necessarily transferred and those where it is not – see paragraph 3.36 below.

3.30 Subsection (3) replaces the original Clause 1(3). Instead of “consideration” here the clause operates by reference to an amount equal to the market value of the right to the relevant receipts that would not be received by the transferor. This change was prompted by the same considerations as led to the amendment to section 785A of ICTA 1988 made by paragraph 1 of Schedule 22 to the Finance Act 2008. This amendment was designed to block schemes purporting to side-step section 785A by transferring rights to lease rentals in exchange for value which, it was argued, was not “consideration” under English law. It also ensures that non arm’s length transactions are dealt with by reference to the market value of the rights transferred, if

that is greater (or indeed less) than the consideration. In most cases at arm's length the consideration will be the same as the market value of the rights.

3.31 The subsection, which is the operative provision for the clause, has the same effect as the original subsection (3) and brings the market value of the rights transferred into account in the same way as that in which the income or other receipts would have been chargeable had there been no transfer of the rights to them. The December 2007 draft referred to "the same Schedule (in the case of Schedule A) or the same Case of the same Schedule (Cases I, III, V or VI of Schedule D)". The draft legislation now will apply only for accounting periods to which the Corporation Tax Act 2009 applies, and that Act will not refer to the Schedules and Cases.

3.32 Subsections (4) and (5) set out the timing rule, replacing the original clause 1(4). The general rule is that the timing of the inclusion of the market value of the rights follows their treatment under generally accepted accounting practice (GAAP). Corporation Tax on income is charged explicitly or implicitly by reference to the treatment of the amounts under GAAP. Subsection (5) deals with a case where, for any reason, either the whole or part of the actual consideration or the excess of the market value of the right over the consideration is not brought into account in a profit and loss account or an income statement (in the case of IFRS) of the transferor. Where this is the case, then the income is treated as arising at the time of the transfer.

3.33 Subsection (6) signposts the exclusions from the charge under the clause now set out in paragraph 2.

3.34 Subsection (7) glosses the word "transfer" as used in subsection (1) in particular. It follows the original Clause 1(8). There the consultation document said "Transfer is defined very widely in subsection (8) to include specific realisation events such as sale, exchange, gift, surrender or assignment and also any arrangements that equate in substance to a transfer. This might include transactions involving options, total return swaps, etc. It would not however cover transactions which amount in form to a transfer but in substance to, say, the giving of security such as in a repo." (The reference to "surrender" is no longer there, as it is recognised that a surrender is a different type of transaction – a bilateral arrangement between the recipient and payer of the income, not a transaction with a third party). This deals with comments made on the consultation document on this point.

3.35 Subsection (8) glosses the phrase "a transfer taking place" in the case of wider non-sale etc arrangements so that it also includes the making of that arrangement.

3.36 Paragraph 2, as mentioned above, sets out the exclusions. Paragraph 2(1) provides the "family resemblance" test (see paragraph 3.29 above). If the transfer of the receipts also involves as a consequence the transfer of certain specified assets, then paragraph 1 does not apply. These are assets where there is clearly a sale of a right to earn income.

3.37 The first type of specified asset is shares which confer rights other than the right to the receipts. This would include any shares where there is a right to assets in a winding up, or there is a right to redemption such as in the case of redeemable preference shares. In the light of the judgment of the House of Lords in *Scottish Provident Institution 76 TC 538* illusory or insignificant rights will not count.

3.38 The second type of specified asset is a freehold interest in land. But a transfer of freehold land is also taken to include the grant of an overriding long lease (50 years or more using the definitions in the lease premiums legislation in Part 4 of CTA 2009).

3.39 Paragraph 2(2) allows the Treasury to amend the list of specified assets.

3.40 Paragraph 2(3) replaces clause 1(6) in the consultation document. It provides an exclusion where and to the extent that the relevant receipts are

- already charged to tax as income
- brought into account in calculating any income or
- brought into account for the purposes of the Capital Allowances Act 2001.

3.41 This exclusion would, for example, apply where the loan relationships legislation in Part 5 CTA 2009 or the derivative contracts legislation in Part 7 of that Act applied, or where the amounts are treated as trading receipts under Part 3.

3.42 Paragraph 2(4) recognises that some transfers of the right to relevant receipts are in substance a transfer by way of security only. So the section does not apply if the transferor transfers the rights to the income streams as part of a structured finance arrangement and the consideration is an “advance” to the transferor or a partnership of which the transferor is a member for the purposes of the legislation in sections 774A to 774G ICTA. This deals with comments made on the consultation document on this point.

3.43 Paragraph 3 makes similar provision to paragraphs 1 and 2 for income tax. It does so by inserting a new Chapter 5A into Part 13 Income tax Act 2007 consisting of sections 809AZA to 809AZF.

3.44 These provisions match those in paragraphs 1 and 2 and differ only to the extent necessary to cater for the different structure of income tax.

3.45 Paragraph 4 amends CTA 2009. Sub-paragraph (3) inserts new sections 485F and 485G into that Act. (Sections 485A to 485E are part of the “disguised interest” legislation). The two new sections provide something that many commentators on the consultation document requested and that is an explicit statement of the treatment of the transferee of the right. In most cases, the amount paid for the right to acquire the income stream will equal the present value of the rights acquired and the acquisition cost will be treated by the purchaser as a financial asset for accounting purposes. The only amount then taken to the company’s profit and loss account or income statement will be the difference between the cost and later cash flows.

3.46 Section 485F gives the case: where there is an income stream transfer under paragraph 1 or under the income tax equivalent set out in paragraph 3. In such a case section 485G CTA 2009 provides that the financial asset will be treated as a loan relationship so that only the finance return recognised in the company’s profit and loss account will be chargeable to tax.

3.47 Paragraph 4(2) inserts a reference to this rule in the overview of Part 6 CTA in section 476.

3.48 There is no income tax equivalent of paragraph 4 (treatment of transferee). If a transferee liable to income tax acquired an income stream to which either Chapter 5A Part 13 ITA 2007 or paragraph 1 of the CT Schedule applies, it will either be a financial trader or will treat the transaction as a discounting transaction within section 381 ITTOIA.

Repeals and amendments

3.49 Paragraph 5 sets out the repeals made as a consequence of the legislation. The list is the same as the list in the December 2007 consultation document, with these changes;

- The repeals in sections 34 and 99 ICTA are omitted (and not replaced by a reference to any section in Part 4 CTA 2009);
- The repeal of sections 279 to 281 ITTOIA is omitted;

- Repeals consequential on those repeals are omitted;
- A repeal of a reference to section 730 ICTA in section 98 TMA is added;
- A consequential repeal in section 774E ICTA is added; and
- An amendment is made to section 785ZB ICTA (inserted into that Act by FA 2008) as a consequence of the repeal of section 785A.

Commencement

3.50 Paragraph 6 sets out the commencement rules.

3.51 The CT provisions in paragraphs 1 and 2 have effect for transfers taking place on or after 1 April 2009, and the IT provisions in paragraph 3 for transfers taking place in the tax year 2009/10 and after (i.e. from 6 April 2009).

3.52 The transferee rules in paragraph 4 have effect by reference to transfers on or after those dates, as do the repeals etc in paragraph 5.

Other points

3.53 As mentioned above the clauses do not yet deal with any consequential changes that might be needed to TCGA 1992. It is recognised that the rules in sections 37 and 39 and the part disposal rules in section 42 TCGA 1992 do not always deal adequately with “income stripping” transactions of the sort covered by paragraphs 1 and 3. Further consideration is being given to what changes might be desirable.

3.54 Consideration is also being given to applying the paragraph 4 (transferee) approach to section 774A etc structured finance transactions.

3.55 Any legislation drafted as a result of consideration given to these points will be published as soon as possible on the HMRC website, and will invite further comment.

Chapter 3 Appendix

Transfers of income streams: Summary of responses to consultation document

Themes of concerns	Number of respondents
Should be symmetry between the taxation of the recipient and providing relief to the payer.	10
Should be specific carve-out for transactions to which structured finance legislation applies (section 774A to 774G ICTA1988).	6
Confusion between purposive statement in subsection (1) and "traditional rules" in subsections (2) to (8).	5
Uncertainty as to treatment of transactions involving property rentals.	4
Should be specific CGT exemption for consideration received for transfer.	4
Uncertainty as to how legislation applies to part disposals.	4
Does clause 1(4) deal properly with transfers where rights under an oil licence are transferred in exchange for a royalty?	3
Repeal of section 34(4) and (5) without more could deny relief under section 87 for commutation payment made by tenant.	2
Suggestion that legislation should contain specific avoidance test.	2
Inclusion of "gift" within definition of "transfer" is inconsistent with requirement that transfer requires consideration.	2
Surrender is not a transfer so should not be included in scope of rule.	1
Uncertainty as to treatment of sub-participation agreements involving transactions that in substance amount to income transfers.	1
Definition of "transfer" should ensure that provision does not apply to a transfer by way of security (as stated in guidance).	1
How does legislation deal with sales of surplus oil line capacity?	1

4

Consultation process

4.1 Responses to this document are requested by 11 February 2009. Questions on which views are particularly sought are contained in the Appendix to this chapter.

4.2 The Government continues to recognise the importance to business that these changes should have no unintended consequences and that any transition to a new regime is handled smoothly. Representations on the proposals are sought from interested parties. HMRC and HMT also propose to hold a further 'open day' in respect of each of disguised interest and transfers of income streams early in the New Year, at which the proposals can be discussed and where stakeholders will be invited to provide their views.

4.3 Requests to attend either of the 'open days' and any representations on this document should be made to Richard Rogers (telephone 020 7147 2625), either by email to Richard.Rogers@HMRC.gsi.gov.uk, or by post to 3rd floor, 100 Parliament Street London SW1A 2BQ.

Confidentiality disclosure

4.4 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).

4.5 If you want the information 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, amongst other things, with 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 the Department.

4.6 The Department 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.

About the consultation process

4.7 This consultation is being conducted in accordance with the Government's Consultation Code of Practice. If you wish to access the full version of the Code, you can obtain it online at:

<http://www.berr.gov.uk/files/file47158.pdf>

The consultation criteria

- 1 When to consult** – Formal consultation should take place at a stage when there is scope to influence the policy outcome.

- 2 **Duration of consultation exercises** – Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- 3 **Clarity of scope and impact** – Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- 4 **Accessibility of consultation exercise** – Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- 5 **The burden of consultation** – Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees’ buy-in to the process is to be obtained.
- 6 **Responsiveness of consultation exercises** – Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- 7 **Capacity to consult** – Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

4.8 If you feel that this consultation does not satisfy these criteria, or if you have any complaints about the process, please contact:

Richard Bowyer, Better Regulation Unit
020 7147 0062 or richard.bowyer@hmrc.gsi.gov.uk

Chapter 4 Appendix

Questions on which Respondents views are sought

General:

- Will any part of these proposals give rise to any serious issues or problems? If so, what are they?
- Do respondents foresee any significant costs resulting from these changes, and if so, what? Will any subsequent savings and benefits outweigh any initial costs?
- Would the principles-based approach be likely to work more efficiently and effectively than other approaches?
- Do the principles or the approach require any changes?
- Does the draft legislation apply to transactions that should not be caught? If so, what are they?
- Would the proposals be effective in replacing the legislation that is to be repealed? If not, where would they be ineffective?
- Are the principles expressed by the draft clauses clear and unambiguous?
- The disguised interest legislation might take effect for companies entering into arrangements on or after 1 April 2009 (and also for arrangements to which the existing legislation in e.g. sections 91A and 91B FA 1996 applies on 31 March 2009). The transfer of income streams legislation might take effect in relation to transactions entered into on or after 1 April 2009 (for companies), and on or after 6 April 2009 (for individuals). Does this give rise to any practical difficulties (paragraphs 2.98 and 3.51)?
- Are there any provisions that the new rules would allow to be repealed, in addition to those shown in the draft clauses (paragraphs 2.96, 2.97 and 3.49)?
- Does the current draft legislation for each of disguised interest and transfers of income streams meet the aim 'that it would be clear, on a first reading, what was being addressed and with what outcome in mind' (first consultation document paragraph 1.8)?
- Does the current draft legislation for each of disguised interest and transfers of income streams increase certainty?

Disguised interest:

- Do the disguised interest rules deal adequately with cases where there are chains of companies so that increases in share value are reflected in more than one company (paragraph 2.26)? If not, please provide specific examples.
- Do the disguised interest rules cater appropriately for all international joint venture arrangements (paragraph 2.68)?
- Are the transitional provisions in the draft legislation likely to give rise to any practical difficulties?
- Does section 37 TCGA 1992 prevent any double charge under the disguised interest rules and the rules for charging CT on capital gains (paragraph 2.34)?

- Are both the 'unallowable purpose' and the 'excluded shares' exclusions necessary in the disguised interest rules, and if not, which should remain (paragraph 2.57)?

Transfers of income streams:

- Would it be helpful to have a purpose statement in the legislation; would it be better to include it in the Explanatory Notes to the Finance Bill or should it be included in HMRC guidance (paragraph 3.13)?
- How should the transferee rules in paragraph 4 of the draft schedule be applied to section 774A etc (structured finance arrangements) (paragraph 3.15)?
- Is the exception for long leases sufficient to remove the problems foreseen by the property industry (paragraph 3.20)?
- Are there any remaining concerns in respect of particular transactions in the oil industry (paragraph 3.21)?

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