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Mr Chancellor of the Exchequer

Amendment 99

Page **181**, line **2** [*Schedule 6*], at end insert—

“Repeal of rent factoring provisions

A1 (1) Sections 43A to 43G of ICTA (rent factoring) shall cease to have effect.

(2) The amendment made by this paragraph has effect in relation to transactions entered into on or after 6th June 2006.”.

Amendment 100

Page **185**, line **8** [*Schedule 6*], at end insert—

‘Structured finance agreements: factoring of income receipts etc

3B (1) After section 774 of ICTA (transactions between dealing company and associated company) insert—

“Factoring of income receipts etc

774A Meaning of “structured finance arrangement” for purposes of s.774B

(1) For the purposes of section 774B an arrangement is a structured finance arrangement in relation to a person (“the borrower”) if the following condition is met in relation to the borrower.

(2) The condition is that—

(a) under the arrangement the borrower receives from another person (“the lender”) any money or other asset (“the advance”) in any period,

(b) in accordance with generally accepted accounting practice the accounts of the borrower for that period record a financial liability in respect of the advance,

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- (c) the borrower, or a person connected with the borrower, makes a disposal of an asset (“the security”) under the arrangement to or for the benefit of the lender or a person connected with the lender,
 - (d) the lender, or a person connected with the lender, is entitled under the arrangement to payments in respect of the security, and
 - (e) in accordance with generally accepted accounting practice those payments reduce the amount of the financial liability in respect of the advance recorded in the accounts of the borrower.
- (3) For the purposes of this section, in any case where the borrower is a partnership, references to the accounts of the borrower include the accounts of any member of the partnership.
- (4) For the purposes of this section and section 774B–
- (a) references to a person connected with the borrower do not include the lender, and
 - (b) references to a person connected with the lender do not include the borrower.

774B Disregard of intended effects of arrangement involving disposals of assets

- (1) If–
 - (a) an arrangement is a structured finance arrangement in relation to a person (“the borrower”), and
 - (b) the arrangement would (disregarding this section) have had the relevant effect (see subsections (2) and (3)),the arrangement is not to have that effect.
- (2) If the borrower is a person other than a partnership, the relevant effect is that–
 - (a) an amount of income on which the borrower, or a person connected with the borrower, would otherwise have been charged to tax is not so charged,

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- (b) an amount which would otherwise have been brought into account in calculating for tax purposes any income of the borrower, or of a person connected with the borrower, is not so brought into account, or
- (c) the borrower, or a person connected with the borrower, becomes entitled to an income deduction.
- (3) If the borrower is a partnership, the relevant effect is that—
- (a) an amount of income on which a member of the partnership would otherwise have been charged to tax is not so charged,
- (b) an amount which would otherwise have been brought into account in calculating for tax purposes any income of a member of the partnership is not so brought into account, or
- (c) a member of the partnership becomes entitled to an income deduction.
- (4) If—
- (a) a person in relation to whom the structured finance arrangement would otherwise have had the relevant effect is a person within the charge to income tax, and
- (b) in accordance with generally accepted accounting practice the accounts of the person record an amount as a finance charge in respect of the advance,
- that person may treat the amount for income tax purposes as interest payable on a loan.
- (5) If a person in relation to whom the structured finance arrangement would otherwise have had the relevant effect is a company within the charge to corporation tax—
- (a) the advance is to be treated, in relation to the company, for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 as a money debt owed by the company,
- (b) the arrangement is to be treated, in relation to the company, for the purposes of that Chapter as a loan

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relationship of the company (as a debtor relationship),
and

(c) any amount which, in accordance with generally accepted accounting practice, is recorded in the accounts of the company as a finance charge in respect of the advance is to be treated as interest payable under that relationship.

(6) For the purposes of this section, in any case where the borrower is a partnership,—

(a) references to accounts include the accounts of the partnership, and

(b) any deemed interest is treated as payable by the partnership (whether or not the finance charge is recorded in the accounts of the partnership).

(7) For the purpose of determining when any deemed interest in respect of the advance is paid—

(a) the payments mentioned in section 774A(2)(d) are treated as consisting of amounts for repaying the advance and amounts (“the interest elements”) in respect of interest on the advance, and

(b) the interest elements of those payments are treated as paid when those payments are paid,

and the deemed interest in respect of the advance is treated as paid at the times when the interest elements are treated as paid.

(8) In this section “deemed interest” means any amount which is treated as interest as a result of subsection (4) or (5).

(9) This section is subject to the exceptions contained in section 774E.

774C Meaning of “structured finance arrangement” for purposes of s.774D

(1) For the purposes of section 774D an arrangement is a structured finance arrangement in relation to a partnership

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(“the borrower partnership”) if condition A or B is met in relation to the borrower partnership.

(2) Condition A is that—

(a) a person (“the transferor partner”) disposes of an asset (“the security”) under the arrangement to the borrower partnership,

(b) the transferor partner is a member of the borrower partnership immediately after the disposal (whether or not a member immediately before the disposal),

(c) under the arrangement the borrower partnership receives from another person (“the lender”) any money or other asset (“the advance”) in any period,

(d) in accordance with generally accepted accounting practice the accounts of the borrower partnership for that period record a financial liability in respect of the advance,

(e) there is a relevant change in relation to the membership of the borrower partnership involving the lender or a person connected with the lender (see subsection (6)),

(f) under the arrangement the share of the lender or person connected with the lender in the profits of the borrower partnership is determined by reference (wholly or partly) to payments in respect of the security, and

(g) in accordance with generally accepted accounting practice those payments reduce the amount of the financial liability in respect of the advance recorded in the accounts of the borrower partnership.

(3) For the purposes of condition A, references to the accounts of the borrower partnership include the accounts of the transferor partner.

(4) Condition B is that—

(a) the borrower partnership holds an asset (“the security”) as a partnership asset at any time before the arrangement is made,

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- (b) under the arrangement the borrower partnership receives from another person (“the lender”) any money or other asset (“the advance”) in any period,
 - (c) in accordance with generally accepted accounting practice the accounts of the borrower partnership for that period record a financial liability in respect of the advance,
 - (d) there is a relevant change in relation to the membership of the borrower partnership involving the lender or a person connected with the lender,
 - (e) under the arrangement the share of the lender or person connected with the lender in the profits of the borrower partnership is determined by reference (wholly or partly) to payments in respect of the security, and
 - (f) in accordance with generally accepted accounting practice those payments reduce the amount of the financial liability in respect of the advance recorded in the accounts of the borrower partnership.
- (5) For the purposes of condition B, references to the accounts of the borrower partnership include the accounts of any person who is a member of the partnership immediately before the arrangement is made.
- (6) For the purposes of this section and section 774D there is a relevant change in relation to the membership of the borrower partnership involving the lender or a person connected with the lender if directly or indirectly in consequence of, or otherwise in connection with, the arrangement—
- (a) the lender, or a person connected with the lender, becomes a member of the borrower partnership at any time, or
 - (b) there is at any time a change in the share of a member of the borrower partnership in the profits of the borrower partnership in a case where that member is the lender or a person connected with the lender.

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(7) For the purposes of subsection (6)(b) the reference to a person connected with the lender includes a person who at any time becomes connected with the lender directly or indirectly in consequence of, or otherwise in connection with, the arrangement.

774D Disregard of intended effects of arrangement involving change in relation to a partnership

(1) This section applies if—

- (a) an arrangement is a structured finance arrangement in relation to a partnership (“the borrower partnership”), and
- (b) any relevant change in relation to the membership of the borrower partnership involving the lender or a person connected with the lender would (disregarding this section) have had the following effect.

(2) The effect is that—

- (a) an amount of income on which a relevant member of the borrower partnership would otherwise have been charged to tax is not so charged,
- (b) an amount which would otherwise have been brought into account in calculating for tax purposes any income of a relevant member of the borrower partnership is not so brought into account, or
- (c) a relevant member of the borrower partnership becomes entitled to an income deduction.

(3) In this section “relevant member of the borrower partnership” means—

- (a) in any case where condition A in section 774C is met in relation to the arrangement, the transferor partner, and
- (b) in any case where condition B in that section is met in relation to the arrangement, any person other than the lender who is a member of the borrower partnership immediately before the time at which the relevant

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change in relation to the membership of the borrower partnership involving the lender or a person connected with the lender occurs.

(4) Part 9 of ITTOIA 2005 and section 114 above are to have effect in relation to any relevant member of the borrower partnership as if the relevant change in relation to the membership of the borrower partnership involving the lender or a person connected with the lender had not occurred.

Accordingly, the structured finance arrangement is not to have the effect mentioned in subsection (2).

(5) The following provisions of this section confer relief from tax the availability of which depends on which of the conditions in section 774C is met in relation to the arrangement.

(6) In any case where condition A in section 774C is met, if—

- (a) the transferor partner is a person within the charge to income tax, and
- (b) in accordance with generally accepted accounting practice the accounts of the borrower partnership record an amount as a finance charge in respect of the advance,

the transferor partner may treat the amount for income tax purposes as interest payable by the transferor partner on a loan.

(7) In any case where condition A in that section is met, if the transferor partner is a company within the charge to corporation tax—

- (a) the advance is to be treated, in relation to the company, for the purposes of paragraph 19 of Schedule 9 to the Finance Act 1996 (and the other provisions of Chapter 2 of Part 4 of that Act) as a money debt owed by the borrower partnership,

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(b) the arrangement is to be treated, in relation to the company, as a transaction for the lending of money from which that debt is treated as arising for those purposes, and

(c) any amount which, in accordance with generally accepted accounting practice, is recorded in the accounts of the borrower partnership as a finance charge in respect of the advance is to be treated as interest payable by the company under that transaction.

(8) For the purposes of subsections (6) and (7), references to the accounts of the borrower partnership include the accounts of the transferor partner.

(9) In any case where condition B in section 774C is met, if—

(a) a relevant member of the borrower partnership is a person within the charge to income tax, and

(b) in accordance with generally accepted accounting practice the accounts of the borrower partnership record an amount as a finance charge in respect of the advance,

the relevant partner may treat the amount for income tax purposes as interest payable by the borrower partnership on a loan.

(10) In any case where condition B in that section is met, if a relevant member of the borrower partnership is a company within the charge to corporation tax—

(a) the advance is to be treated, in relation to the company, for the purposes of paragraph 19 of Schedule 9 to the Finance Act 1996 (and the other provisions of Chapter 2 of Part 4 of that Act) as a money debt owed by that partnership,

(b) the arrangement is to be treated, in relation to the company, as a transaction for the lending of money from which that debt is treated as arising for those purposes, and

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(c) any amount which, in accordance with generally accepted accounting practice, is recorded in the accounts of the borrower partnership as a finance charge in respect of the advance is to be treated as interest payable by the borrower partnership under that transaction.

(11) For the purposes of subsections (9) and (10), references to the accounts of the borrower partnership include the accounts of any relevant member of the borrower partnership.

(12) For the purpose of determining when any deemed interest in respect of the advance is paid—

(a) the payments mentioned in section 774C(2)(f) or (4)(e) are treated as consisting of amounts for repaying the advance and amounts (“the interest elements”) in respect of interest on the advance, and

(b) the interest elements of those payments are treated as paid when those payments are paid,

and the deemed interest in respect of the advance is treated as paid at the times when the interest elements are treated as paid.

(13) In this section “deemed interest” means any amount which is treated as interest as a result of any of subsections (6) to (10).

(14) This section is subject to the exceptions contained in section 774E.

774E Sections 774B and 774D: exceptions

(1) Section 774B or 774D does not apply if the whole of the advance under the structured finance arrangement—

(a) is charged to tax on a relevant person (see subsection (7)) as an amount of income,

(b) is brought into account in calculating for tax purposes any income of a relevant person, or

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(c) is brought into account for the purposes of any provision of the Capital Allowances Act as a disposal receipt, or proceeds from a balancing event or disposal event, of a relevant person.

For the purposes of this subsection the effect of section 785A (rent factoring of leases of plant or machinery) is to be disregarded.

(2) Subsection (1)(c) is not to be taken as met in any case where—

(a) the receipt or proceeds gives rise to a balancing charge, and

(b) the amount of the balancing charge is limited by any provision of the Capital Allowances Act.

(3) Section 774B or 774D does not apply if, at all times, the whole of the advance under the structured finance arrangement—

(a) is a debtor relationship of a relevant person for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 (loan relationships), or

(b) would be a debtor relationship of a relevant person for those purposes if that person were a company within the charge to corporation tax.

For the purposes of this subsection references to a debtor relationship do not include a relationship to which section 100 of the Finance Act 1996 (money debts etc not arising from the lending of money) applies.

(4) Section 774B or 774D does not apply in so far as the structured finance arrangement is an arrangement in relation to which—

(a) section 263A of the 1992 Act (agreements for sale and repurchase of securities) applies,

(b) paragraph 15 of Schedule 9 to the Finance Act 1996 (repo transactions and stock-lending) applies, or

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- (c) Chapter 5 of Part 2 of the Finance Act 2005 (alternative finance arrangements) has effect.
- (5) Section 774B or 774D does not apply in so far as.
- (a) the security under the structured finance arrangement is plant or machinery which is the subject of a sale and finance leaseback, or
- (b) the structured finance arrangement is an arrangement in relation to which sections 228B to 228D of the Capital Allowances Act apply with the modifications contained in section 228F of that Act (lease and finance leaseback).

(6) For the purposes of subsection (5)(a), whether plant or machinery is the subject of a sale and finance leaseback is determined in accordance with section 221 of the Capital Allowances Act.

But, in applying that section, it is to be assumed that the words “and which are not a long funding lease in the case of the lessor” were omitted from section 219(1)(b) of that Act (meaning of “finance lease”).

(7) For the purposes of this section a “relevant person” means—

- (a) if section 774B applies, a person in relation to whom the structured finance arrangement would (but for that section) otherwise have had the relevant effect (within the meaning of that section), and
- (b) if section 774D applies, a relevant member of the borrower partnership (within the meaning of that section).

774F Sections 774B and 774D: power to provide further exceptions

(1) The Treasury may make regulations prescribing other circumstances in which section 774B or 774D is not to apply in relation to a structured finance arrangement.

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- (2) Any regulations under subsection (1) may make provision amending section 774E.
- (3) The power to make regulations under subsection (1) includes—
- (a) power to make provision having effect in relation to times before the making of the regulations (but not times earlier than 6 June 2006),
 - (b) power to make different provision for different cases or different purposes, and
 - (c) power to make incidental, supplemental, consequential or transitional provision and savings.

774G Sections 774A to 774D: minor definitions etc

- (1) For the purposes of sections 774A to 774D “arrangement” includes any agreement or understanding (whether or not legally enforceable).
- (2) For the purposes of sections 774A to 774D “income deduction” means—
- (a) a deduction in calculating any income for tax purposes, or
 - (b) a deduction against total income or total profits.
- (3) For the purposes of sections 774A to 774D—
- (a) references to a person’s receiving any asset include the person’s obtaining directly or indirectly the value of any asset or otherwise deriving directly or indirectly any benefit from it,
 - (b) references to a disposal of an asset include anything which constitutes a disposal of the asset for the purposes of the 1992 Act,
 - (c) references to payments in respect of any asset include obtaining directly or indirectly the value of any asset or otherwise deriving directly or indirectly any benefit from it.

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(4) For the purposes of sections 774A to 774D, section 839 (connected persons) applies.

(5) For the purposes of sections 774A to 774D references to the accounts of any person who is a company include the consolidated group accounts of a group of companies of which it is a member.

(6) If any person does not draw up accounts in accordance with generally accepted accounting practice, sections 774A to 774D apply as if the accounts had been drawn up by the person in accordance with that practice.

(7) Sections 277 to 281 of ITTOIA 2005 and section 34 above (lease premiums) are not to apply in relation to a premium paid in respect of a grant of a lease where the grant constitutes a disposal of an asset for the purposes of section 774A(2)(c) or 774C(2)(a).”.

(2) The amendment made by this paragraph has effect in relation to any arrangements whenever made (but see subparagraphs (3) and (4)).

(3) In relation to arrangements made before 6th June 2006, amounts are, as a result of the amendment made by this paragraph,—

(a) to be charged to tax, or

(b) to be brought into account in calculating any income for tax purposes or deducted from any income for tax purposes,

only if the amounts arise on or after that date.

(4) The amendment made by this paragraph has no effect in relation to any arrangement made before that date in so far as section 43B or 43D of ICTA (rent factoring) applies to it.

(5) In any case where, in relation to arrangements made before that date, a person is treated, as a result of the amendment made by this paragraph, as being a party to any loan relationship—

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- (a) a period of account is to be treated for the purposes of Chapter 2 of Part 4 of FA 1996 as beginning on that date, and
- (b) the loan relationship is to be treated for those purposes as being entered into by the person for a consideration equal to the notional carrying value of the liability representing the relationship.
- (6) For this purpose, the notional carrying value is the amount that would have been the carrying value of the liability in the accounts of the person if a period of account had ended immediately before that date.
- (7) “Carrying value” has the same meaning here as it has for the purposes of paragraph 19A of Schedule 9 to FA 1996.

Rent factoring of leases of plant or machinery

3C (1) Section 785A of ICTA (rent factoring of leases of plant or machinery) is amended as follows –

(2) After subsection (5) (provision about partnerships with legal personality) insert –

“(5A) This section does not apply in so far as section 774B or 774D (structured finance arrangements) applies in relation to the arrangements mentioned in paragraph (c) of subsection (1) above as a result of the transfer mentioned in that paragraph”.

Transactions associated with loans or credit

3D (1) Section 786 of ICTA (transactions associated with loans or credit) is amended as follows –

(2) After subsection (5) (transaction under which a person assigns, surrenders etc income arising from property) insert –

“(5ZA) But subsection (5) above does not apply if the person mentioned in that subsection is, as a result of section 774B or 774D (structured finance arrangements), chargeable to tax on the amount of income assigned, surrendered, waived or forgone”.

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Structured finance arrangements: chargeable gains treatment of acquisitions and disposals

3E (1) After section 263D of TCGA 1992 (gains accruing to persons paying manufactured dividends) insert—

“263E Structured finance arrangements

(1) This section applies if—

(a) section 774B of the Taxes Act (disregard of intended effects of arrangement involving disposals of assets) applies in relation to a structured finance arrangement,

(b) the borrower or a person connected with the borrower makes a disposal of any security at any time under the arrangement to or for the benefit of the lender or a person connected with the lender, and

(c) condition A or B is met.

(2) Condition A is that the person making the disposal subsequently acquires under the arrangement the asset disposed of by that disposal.

(3) Condition B is that—

(a) the asset disposed of by that disposal subsequently ceases to exist at any time, and

(b) that asset was held by the lender, or a person connected with the lender, from the time of the disposal until that time.

(4) The disposal of the security by the borrower or a person connected with the borrower is to be disregarded for the purposes of this Act.

(5) Any subsequent acquisition by the person making the disposal of the asset disposed of by that disposal is to be disregarded for the purposes of this Act.

(6) In this section—

“the borrower”, in relation to a structured finance arrangement, means the person who is the borrower under

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the arrangement for the purposes of section 774A of the Taxes Act,

“the lender”, in relation to a structured finance arrangement, means the person who is the lender under the arrangement for the purposes of that section,

“security” means any such asset as is mentioned in subsection (2)(c) and (d) of that section.

(7) For the purposes of this section.

(a) references to a person connected with the borrower do not include the lender, and

(b) references to a person connected with the lender do not include the borrower”.

(2) The amendment made by this paragraph has effect in relation to disposals made on or after 6th June 2006.

(3) The amendment made by this paragraph also has effect in relation to any disposal made by a person before that date if the person makes a claim to that effect under this sub-paragraph”.

Amendment 101

Page 349, line 19 [*Schedule 16*], leave out from “into” to end of line 20 and insert—

“structured finance arrangements to which section 774B or 774D of ICTA applies (factoring of rent and other income receipts)”.

SUMMARY

2. Amendment 100 insert sections 774A to 774G into the Income & Corporation taxes Act 1988 (“ICTA”). Those sections will apply where a person enters into a “structured finance agreement”. A structured finance arrangement (or “SFA”) is an arrangement where in accordance with generally accepted accounting practice (GAAP) a person (“the borrower”) records in its account a

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financial liability in respect of a sum (“advance”) paid by “the lender”, and that sum is paid to acquire assets (including an income stream), which will be used to repay the advance. The reference to accounts of the borrower includes a reference to the consolidated group accounts of a group of companies of which the borrower is a member.

3. Where there is a SFA and that arrangement would have had the effect that either:
 - income or receipts that would have been brought into account on the borrower for tax purposes are not brought into account or
 - the borrower would have become entitled to a deduction in computing its income or profits for tax purposes,then
 - the arrangement will not have that effect, so that the income from the transferred asset will continue to be taxed on the borrower, and
 - any disposal or reacquisition of the asset will be disregarded for the purposes of the Taxation of Chargeable Gains Act 1992 (“TCGA”).
4. Tax relief will be allowed for the amount of any interest or ‘finance charge’ in respect of the finance agreement shown in the borrower’s accounts. For a company, this amount will be treated as interest payable on a debtor loan relationship to which it is party, and for any other person as interest payable.
5. Amendment 99 repeals the rent factoring legislation introduced in the Finance Act (“FA”) 2000. It is now subsumed into the new rules introduced by amendment 100. Amendment 101 amends the Real Estate Investment Trusts (UK-REITs) legislation in Schedule 16 to the Bill to reflect that repeal. Amendment 100 also makes consequential amendments to other legislation to ensure there is no overlap.
6. The changes have effect from 6 June 2006. Where an arrangement was entered into before that day, only income arising on or after that day is affected.

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DETAILS

7. Amendment 100 inserts a new paragraph 3A into Schedule 6, which in turn inserts a series of new sections after section 774 in Part 18 of ICTA which deals with tax avoidance. The bundle of sections is headed “Factoring of income receipts etc” and provides a particular tax treatment for what the legislation calls “structured finance arrangements”.
8. New sections 774A and 774B deal with the definition of structured finance arrangements and their tax treatment where they involve the transfer of an asset including an income stream from a “borrower” to a “lender”. New sections 774C and 774D deal with a more complex type of arrangement involving partnerships and changes in profit sharing arrangements.
9. New section 774E sets out the exceptions from the charge, new section 774F provides a regulation making power and new section 774G provides some definitions that are common to the first four sections.

The simple case – sections 774A and 774B

10. Section 774A(1) provides that, in the simple case, a “structured finance arrangement” (“SFA”) is one where the conditions in section 774A(2) are met in relation to a person, who the legislation calls “the borrower”.
11. The conditions, as set out in section 774A(2), are that
 - in any period the “borrower” receives money (or some other asset) from another person, who is called the “lender”,
 - that the borrower records in its accounts for that period, and in accordance with GAAP, a financial liability in respect of the advance. This provision is taken directly from the rent factoring legislation and in particular section 43A(1) ICTA (subject to renaming “obligation” as “liability” to better accord with accounting terminology),
 - the borrower, or a person connected with him, disposes of an asset, which is labelled the “security”, to the lender, or to a

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person connected him (collectively referred to from here as “the lender etc”, or the lender etc obtains the benefit of the asset (cf. section 43B(1) ICTA),

- as a result of that transfer the lender etc is entitled to receive payments in respect of the security,
- in accordance with GAAP the payments reduce the amount of the financial liability recorded in the borrower’s accounts.

12. It is, of course, highly likely that if the arrangement is accounted for as a financial liability secured on certain assets, that there will be an advance, a transfer of the security and payments to the lender under the security, but the additional conditions make it clear that even though the transaction may be accounted for as a financial liability it must also have these standard structural characteristics of a secured loan. Merely being accounted for as a financial liability is not enough.
13. Section 774A(3) makes it clear that where the borrower is a partnership then the accounts to which resort may be had to determine whether the accounts record a financial liability in accordance with GAAP include the accounts of any member of the partnership as well as of the partnership itself.
14. And see also section 774G(5) in connection with consolidated group accounts.
15. Section 774A(4) ensures that references to a person connected with the lender or borrower do not include the borrower or lender respectively. This means that the section and section 774B cannot be triggered accidentally just because lender and borrower are connected.
16. If a case is one to which section 774A applies because the subsection (2) conditions are met, then the tax treatment of the transaction is set out in new section 774B.
17. It is first necessary to determine (section 774B(1)) if the SFA would, as far as the borrower is concerned, have had what the legislation calls “the relevant effect”. If the SFA would, but for

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section 774B have had that relevant effect, then the arrangement is treated as not having that effect for tax purposes.

18. What the relevant effect is depends on whether the borrower is a partnership or not. In either case the test is whether one of three conditions is met.
19. The first, in section 774B(2)(a) and (3)(a) is that an amount of income which would otherwise have been charged to tax, in a non-partnership case, on the borrower, or a person connected with him, (called from here “the borrower etc”), and in a partnership case on a member of the partnership, is not so charged. This would cover cases where the income is “pure income profit”.
20. The second, in section 774B(2)(b) and (3)(b) is that an amount which would otherwise have been brought into account in calculating, in a non-partnership case, the borrower etc’s income and in a partnership case, a member of the partnership’s income, is not so brought into account.
21. This covers receipts which form part of the calculation of a profit whether of a trade, a property business or some other business.
22. The third, in section 774B(2)(c) and (3)(c) is that, in a non-partnership case, the borrower etc, and in a partnership case, a member, would have become entitled to an income deduction. This term is defined in section 774G(2) to mean any deduction in calculating income (e.g. an expense in a Case I or trading computation, or a Schedule A or property business computation) or a deduction against total income (for income tax cases) or total profits (for corporation tax cases).
23. This provision is to cover a case which the rent-factoring legislation currently caters for in section 43D. If the asset transferred is not one which generates income, but the lender etc grants out of it some form of subordinate right to income (e.g. a lease) to the borrower etc, and the conditions in section 774A(2)(a) to (c) are met, it will be the case that section 774A(2)(d) is met, as the payments under the subordinate right will be payments under

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the arrangement by virtue of section 774G(3)(c) as the lender will be at least indirectly obtaining a benefit from the security.

24. Section 774B(3) which deals with the partnership borrower case looks through to the members of the partnership to see whether the income is charged to tax, brought into account in computing income or there is an entitlement to a deduction. This is because under UK tax law it is the members of a partnership who are charged to tax on their share of the profits of the partnership and the partnership itself is not treated as a taxable entity.
25. The consequence of the application of section 774B(1) is that the borrower etc (including the members of a partnership) continues to be charged to tax as if the transaction was in form as well as in substance a loan, so that the transfer of the asset is treated as merely by way of security and the income from the security continues to be taxed on the borrower or, where the borrower is a partnership, the members.
26. Note that this rule has no consequence for and no effect on the lender etc. Both rent-factoring transactions and cases where section 774A etc is expected to apply involve lenders which are banks within the charge to corporation tax or, though investment companies, likely to be taxed on the basis of a discounting transaction or are non-resident entities or otherwise exempt from UK tax.
27. In the “deduction” case, the remedy is to deny relief for the deduction: this is a similar approach to that in paragraph 1(5) to (8) Schedule 7 Finance (No. 2) Act 2005 (commencement rules for changes to rent factoring legislation in interposed lease cases).
28. Section 774B(4) to (6) deal with the granting of relief to the borrower etc for the interest element in the arrangement. Since the arrangement will involve the borrower paying more to the lender than it receives from the lender and this excess is in substance interest on the loan, the borrower should be entitled to relief for those amounts as if they were real interest. In the income deduction case this rule has the same effect as the limitation in

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paragraph 1(7) Schedule 7 Finance (No. 2) Act 2005 concerning the “principal in rent”.

29. Section 774B(4) deals with borrowers etc who are persons within the charge to income tax and treats any amount recorded in the accounts as a finance charge as being an amount of interest payable on a loan. Where the receipts that are temporarily alienated under the SFA are trading receipts, the interest will be part of the deductions allowed under Chapter 3 Part 2 of the Income Tax (Trading and Other Income) Act 2005 (“ITTOIA”).
30. Section 774B(5) deals with the company borrower case and in that case the advance under the arrangement is treated as a money debt owed by the company for the purposes of Chapter 2 Part 4 Finance Act (“FA”) 1996 (loan relationships) and is treated in relation to the company borrower as a debtor relationship. Any amount shown in the accounts as a finance charge is treated as interest payable under that relationship. Section 774B(8) refers to this amount as “deemed interest”.
31. The relevance of the last provision is that the amount will become subject, where appropriate, to those rules in Chapter 2 which apply to interest such as paragraph 2 of Schedule 9 FA 1996. In order to give a rule as to the time of payment of the interest (relevant for that paragraph) section 774B(7) treats the payments under the SFA as divided into principal and interest with the interest element of each payment treated as paid when the payment is made.
32. Section 774B(6) provides that where relief is available for the finance charge in the case of a partnership, references to the accounts include the accounts of the partnership and amounts treated as interest are treated as interest payable by the partnership, even if reflected in the accounts of the individual partner. In the corporate case this will mean that the provisions of paragraph 19 Schedule 9 FA 1996 apply to attribute the interest to the company partners in accordance with their shares and each partner will be subject to the provisions of Chapter 2 in relation to that part of the interest.

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33. Section 774B(9) signposts the exceptions to the charge in section 774E.

The complex partnership case – sections 774C and 774D

34. New section 774C deals with the definitional aspects of the complex partnership case and provides that an arrangement is a structured finance arrangement in such a case, if either condition A or condition B is met.
35. Condition A is set out in section 774C(2) and requires that
- a person who the legislation calls the “transferor partner” disposes of an asset under the arrangement to a partnership which the legislation calls “the borrower partnership”.
 - the borrower partnership is one of which the transferor partner is a member immediately after that disposal – it does not matter whether it was a partner before the disposal.
 - then the borrower partnership has to receive in any period money or another asset which is called the advance, as in section 774A, from another person called the lender.
 - the accounts of the borrower partnership have to record in accordance with GAAP for that period a financial liability in respect of the advance.
 - there is a relevant change in relation to the membership of the partnership involving the lender etc (i.e. including a person connected with the lender). “Relevant change” is defined by section 774C(6).
 - the share of the lender etc in the profits of the borrower partnership falls to be determined (wholly or partly) by reference to payments in respect of the security.
 - in accordance with GAAP the payments reduce the amount of the financial liability.
36. Thus, in these types of arrangements, the lender’s advance is made in the form of a contribution to the partnership and its profit share is such that payments are made to it which repay that contribution together with interest. Once the repayment with interest has been made it is likely that there are arrangements under which the lender

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ceases to be a member of the partnership or to share in the profits of it.

37. Section 774C(3) makes it clear that any reference to the accounts of a borrower partnership, (to see if the accounts record a financial liability) includes a reference to the accounts of any transferor partner.
38. See also section 774G(5) in connection with consolidated group accounts.
39. Section 774C(4) sets out condition B. This deals with a case where an existing partnership, rather than one established for the purposes of the arrangement, enters into an arrangement under which the lender becomes a partner and shares in the profits to an extent sufficient to repay its contribution with interest. It differs from Condition A in that there is no reference to a transfer of an asset or a transferor partner.
40. Section 774C(5), which is the equivalent of section 774A(3), allows resort to the accounts of any person who was a member of the partnership before the arrangement to see if there is an accounting for the arrangement as a financial liability.
41. Section 774C(6) provides that there is a “relevant change” in relation to the partnership membership for the purposes of section 774C and section 774D where, in connection with the arrangement, the lender etc is either admitted to the partnership or receives a revised share of its profits.
42. Section 774C(7) provides that where in connection with the arrangements a person becomes connected with the lender, then that person is treated as connected with the lender for the purposes of section 774C(6).
43. New section 774D sets out the tax effects of a section 774C arrangement.
44. The primary requirement in section 774D(1) is that the section applies if the SFA is in relation to a partnership and there is a

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relevant change in relation to the membership of the partnership that would, apart from section 774D, have the “relevant effect” (set out in section 774D(2)).

45. What the relevant effect is depends on whether one of three conditions is met in relation to a “relevant member of the borrower partnership”. “Relevant member of the borrower partnership” is defined in section 774D(3) as being
- in a Condition A (section 774C(2)) case, the transferor partner
 - in a Condition B (section 774C(4) case, any member of the partnership immediately before the time at which a “relevant change” occurs (but does not include the lender).
46. The first condition, in section 774D(2)(a) is that an amount of income which would otherwise have been charged to tax on a relevant member is not so charged. This would cover cases where the income is “pure income profit”.
47. The second, in section 774D(2)(b), is that an amount which would otherwise been brought into account in calculating a relevant member’s income is not so brought into account.
48. This covers receipts which form part of the calculation of a profit whether of a trade, a property business or some other business.
49. The third, in section 774D(2)(c) is that a relevant member would have become entitled to an income deduction.
50. Section 774D(4) provides that both Part 9 of ITTOIA (income tax) and section 114 ICTA (corporation tax) are to have effect in relation to a relevant member of the borrower partnership as if the relevant change had not occurred so that, as section 774D(4) second sentence puts it, the SFA does not have the effect mentioned in subsection (2) of excluding the income from charge on, or allowing a deduction to, relevant members of the borrower partnership.
51. Section 774D(5) to (7) deal with the relief for the finance charge in a Condition A case in a similar manner to section 774B(4) to (6)

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—but in the income tax case the finance charge is treated as interest payable by the transferor partner and in the corporation tax case the advance is treated for the purposes of paragraph 19 of Schedule 9 FA 1996 as a money debt owed by the borrower partnership and as a transaction for the lending of money and as interest payable by the transferor partner.

52. Section 774D(8) again provides that references to the accounts of the borrower partnership are to include the accounts of any transferor partner.
53. Section 774D(9) and (10) deal with the finance charge in a condition B case in a similar manner, but attribute the relief to any relevant member of the borrower partnership and not just the transferor partner. Section 774D(11) provides that references to the accounts of the borrower partnership include those of any relevant member.
54. Section 774D(12) replicates the rule in section 774B(7) for determining when the deemed interest is paid. Again, the payments made in respect of the security are treated as split between interest and repayment of principal, with the interest paid on the date that the payment is made.
55. Section 774D(13) defines the terms “deemed interest” in similar manner to section 774B(8).
56. Section 774D(14), as with section 774B(9), provides that the charging provision and the relieving provisions are subject to the exceptions in section 774E.

The exceptions

57. Section 774E then sets out those exceptions.
58. The first in section 774E(1) disapplies sections 774B or 774D if the whole of the advance is
 - charged to tax as an amount of income,
 - brought into account in computing income or

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- brought into account under any provision of the Capital Allowances Act 2001 (“CAA”) as a disposal receipt or the proceeds from a balancing event or disposal event.

Section 774E(1) also requires that the effect of section 785A(1) ICTA be ignored in determining if the whole of an amount is charged to tax as income. Section 785A applies to any assignment of the rights to receive plant & machinery rentals and treats the whole amount of the consideration as income to the extent it is not already so treated. This subsection is necessary so that section 774A etc can apply to a SFA involving the transfer of such rentals. See also section 785A(5A) and paragraph 78 below

But it is not sufficient that the amount falls within the provisions of TCGA.

59. Section 774E(2) makes it clear that in the case of a capital allowances balancing charge, an advance is not to be treated as wholly brought into account if there is a restriction on the amount of that charge (for instance, the advance is greater than the expenditure which qualified for allowances so that, for example, section 62 CAA had effect).
60. Section 774E(3) excludes any arrangements which are at all times loan relationships for the purposes of Chapter 2 Part 4 FA 1996 apart from section 100 FA 1996 (money debts which are not lending transactions) or would be such loan relationships if owed by a company. This is because the tax treatment of that type of transaction is already provided for in a similar fashion.
61. Section 774E(4) excludes any arrangements which are repos or stock-lending arrangements because the tax treatment of that type of transaction is already provided for in a similar fashion and any arrangements which are alternative finance arrangements within the meaning of Chapter 5 Part 2 FA 2005.
62. It should be noted that that Chapter might possibly apply to certain types of alternative finance arrangements known as sukuks. But consideration is being given to making, in due course, regulations under Chapter 5 (see clause 98 of the Finance (No. 2) Bill 2006) to

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bring those arrangements within that Chapter and to give them the same tax treatment as is afforded by these sections.

63. Section 774E(5) excludes cases where the security (the asset transferred) is the subject of a sale and finance lease back, or where the SFA is one in relation to which sections 228B to 228D CAA apply.
64. Section 774E(6) provides that section 221 CAA is used to find the meaning of “sale and finance lease back”, but the exclusion made by paragraph 14 of Schedule 9 to the Bill for long funding leases is disregarded. This means that it does not matter whether the lease back is a long funding lease or not: it is still excluded.
65. Section 774E(7) identifies the person on whom the charge to income must arise before there is an exception and it is the person who would not be charged to tax or would be allowed a deduction but for section 774B or section 774D.

Regulation-making powers

66. Section 774F gives the Treasury a regulation-making power to exclude any other cases by amending section 774E and those excluding regulations are capable of having retrospective effect. Thus, if it were to be established once the legislation has been tabled that there is an exclusion which ought to be made, it could be made to have effect from the date from which 774A etc have effect, even though the regulations themselves cannot be made until Royal Assent.

Minor definitions etc.

67. New section 774G provides a number of minor definitions for the other sections.
68. Section 774G(1) defines, in a boilerplate provision, that “arrangement” is to include any agreement or understanding, whether it is legally enforceable or not.

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69. Section 774G(2) defines “income deduction” – see paragraph 22 above.
70. Section 774G(3) provides that receiving an asset or payments in respect of an asset, includes the obtaining the value of, or a benefit from, an asset, whether directly or indirectly (see paragraph 23 above), and it also provides that any reference to a disposal of an asset includes anything which is a disposal for the purposes of the TCGA. Thus it includes a part disposal (see section 21(2) TCGA) and the grant of a lease.
71. Section 774G(4) provides that the section 839 meaning of connected persons applies.
72. Section 774G(5) and (6) deal with accounting practice and accounts. References to accounts include the consolidated group accounts of a group of companies of which the relevant person is a member and in addition subsection (5) provides that if accounts are not drawn up in accordance with GAAP the sections apply as if they were. GAAP, in this case, includes both UK GAAP or International Accounting Standards – see section 50 FA 2004. In the case of UK GAAP it will often be FRS5 (accounting for the substance) which provides that a structured financing arrangement is accounted for as a financial liability.
73. Section 774G(7) ensures that the lease premium rules in section 34 ICTA (including as applied to overseas leases by section 70A ICTA) (corporation tax) and sections 277 to 281 ITTOIA (income tax) do not apply in a case where a disposal of a security consists of the grant of a lease at a premium. Cf. section 43E(5) ICTA.
74. Sub-paragraphs (2) to (7) of new paragraph 3A deal with commencement. The primary rule in sub-paragraph (2) is that the provisions of sections 774A to 774G inserted by sub-paragraph (1) have effect whenever any arrangement has been made.
75. They differ from, for example, the rent factoring rules which applied to a transfer taking place on or after the relevant date. For the purpose of this paragraph it is irrelevant that any transfer of the security took place before the announcement, but sub-paragraph

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(3) goes on to provide that the effect of section 774B and 774D is only to charge to tax or bring income into account so far as it arises on or after 6th June.

76. Sub-paragraph (4) deals with the repeal of the rent factoring legislation. New paragraph A1 of Schedule 6 repeals that legislation in relation to transactions entered into on or after 6th June 2006 and sub-paragraph (4) preserves the rent-factoring legislation in its application to transactions entered into before that date and provides that nothing in section 774A to 774D has effect on a rent factoring arrangement within sections 43A to 43G ICTA.
77. Sub-paragraphs (5) to (7) deal with the loan relationships consequences where an arrangement is treated as a loan relationship by the new sections. A period of account for the purposes of Chapter 2 Part 4 FA 1996 is treated as beginning on 6th June 2006. The loan relationship itself is treated as having been entered into for a consideration equal to its notional carrying value and that is defined as the amount which would have been the carrying value in the accounts (carrying value with the meaning it has for paragraph 19A Schedule 9 FA 1996) if a period of account had ended immediately before the 6th June.
78. The inserted paragraph 3C of Schedule 6 makes a consequential amendment to section 785A ICTA which deals with factoring of plant and machinery rentals. Section 785A is capable of having effect in relation to some types of SFA but a new section 785A(5A) ensures that section 774B or 774D has priority.
79. The inserted paragraph 3D of Schedule 6 makes a consequential amendment to section 786 ICTA which deals with transactions associated with loans or credit. Section 786(5) is capable of having effect in relation to some types of structured finance arrangements but a new section 786(5ZA) ensures that section 774B or 774D has priority.
80. The inserted paragraph 3E of Schedule 6 inserts a new section 263E into the TCGA to deal with the consequences of structured financing arrangements for the purposes of that Act.

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81. Consistently with section 26 of that Act and with sections 263A to 263D, dealing with repos and stock-lending, section 263E(1) provides that the disposal of a security by the borrower etc is disregarded for the purposes of TCGA. This disregard will apply in accordance with subsection (1), if section 774B applies to a SFA and there is a disposal of the security within the meaning of those sections to the lender etc and conditions A or B are met.
82. Condition A is set out in section 263E(2) and is that under the arrangement the person making the disposal reacquires exactly the same asset.
83. Condition B is in section 263E(3) and is that the asset ceases to exist because, for example, it is a stream of income which expires once the “loan” has been repaid with interest, and the asset was held by the lender etc until that time.
84. Section 263E(4) provides that the initial disposal is disregarded, and section 263E(5) that any subsequent reacquisition is also disregarded as long as it is made by the person who made the disposal.
85. Section 263E(6) provides some definitions of terms used in it and gives them the same meaning as they have in section 774A onwards.
86. Section 263E(7) ensures that for the purposes of section 263E references to a person connected with the lender or borrower do not include the borrower or lender respectively. This aligns the rule with section 774A, see paragraph 15 above.
87. Sub-paragraphs (2) and (3) gives the commencement. If the disposal is on or after the date of announcement, section 263E has effect automatically. If the disposal was made before the date of announcement then the section applies if a claim is made to that effect. If no claim is made in such a case, then the subsequent reacquisition is not disregarded.

Amendment 99

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88. Amendment 99 inserts a new paragraph A1 into Schedule 6. Paragraph A1(1) provides for the repeal of the rent-factoring legislation in sections 43A to 43G ICTA.
89. Paragraph A1(2) gives the commencement rule for that repeal: in relation to transactions entered into on or after 6 June 2006. Thus the rent factoring legislation will only apply from that date to restrict deductions where paragraph 1(5) to (8) Schedule 7 Finance (No. 2) Act 2005 applies (commencement rules for changes to rent factoring legislation in interposed lease cases).

Amendment 101

90. Amendment 101 substitutes, in paragraph 4 of Schedule 16 to the Bill, a reference to the provisions of section 774B or 774D ICTA for one to sections 43A to 43G ICTA. Clause 104 of the Bill defines “property rental business” for the purpose of the regime that applies to Real Estate Investment Trusts (UK-REITs). The basis of the definition in clause 104 is UK property rental business dealt with under Schedule A.
91. The regime exempts tax from such a business from corporation tax. Schedule 16 provides details of various types of property business and classes of income, normally taxable or deemed to be taxable under Schedule A, which are excluded from the remit of a “property rental business” for the purposes of the regime.

BACKGROUND NOTE

92. Where a person obtains finance by way of a loan, the finance provider (say a bank) is repaid both interest and the loan principal. The borrower normally gets tax relief for the interest shown in its accounts but not for the principal: correspondingly it is not taxed on the receipt of the finance. The finance provider is taxed on the interest as its profit from the lending transaction.
93. In the basic version of the avoidance scheme, a person, call him “Borrower”, makes a disposal of an asset (“underlying asset”) on

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which there is a predictable income stream, or simply transfers the right to that income stream, in return for a lump sum from another person, call him “Lender”. The income stream acquired by Lender will be sufficient to repay both the lump sum and interest. In a case where an underlying asset is acquired, there are likely to be arrangements such as options under which it will revert to Borrower. Borrower will account for the arrangement as a loan, so that only the finance cost will be charged to the profit and loss account or income statement.

94. It is claimed that the income or receipts arising during the period of the arrangement is not taxable on Borrower, and that the lump sum is either a capital receipt giving rise to a gain subject only to the provisions of TCGA or is not taxable at all.
95. The aim of the arrangement is to give effective tax relief to Borrower not only for the finance charge but also for the principal of the ‘loan’. Compare the following examples, where a company wishes to obtain finance of £100 million over 5 years.

Example 1: the company could get a loan at interest from a finance provider. Over the five-year period, it might pay, say, £2.5m interest p.a. giving total repayments of £112.5m. For tax purposes, relief would be available for each annual amount of the £2.5m interest, but not for repayment of the £100m principal.

Example 2: the company holds an asset on which income of £22.5m a year will arise. It transfers this asset to the finance provider for a lump sum of £100m for a period of 5 years, at the end of which it can reacquire that asset for nothing. During the five years, income of total £112.5m is paid to the bank, effectively repaying the lump sum with interest.

The company claims the £100m sum it receives for transfer of the asset either gives rise to a capital gain (normally of a very much smaller amount because of base costs and reliefs), or is not taxable at all. It also claims that it is not taxable on the income of £112.5m, which flows to the finance provider.

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The effect is that the company has got effective tax relief for the repayment of the £100m lump sum (equivalent to loan principal) as well as for the £12.5m interest.

96. The deduction generation scheme is similar in effect, but instead of foregoing a taxable income stream the avoider uses the asset to generate tax-deductible expenditure.

Example 3: Borrower has a freehold interest in land that it occupies for the purpose of its business. It grants a 51-year lease over the land to the finance provider for a premium of, say, £100 m.

The finance provider immediately grants a 5-year sublease to Borrower for payment of rent of £22.5m a year. The rent paid by Borrower will be sufficient to repay the £100m advance from the bank together with interest over the 5-year period. There will be an arrangement in place to ensure that all of the benefits of ownership will revert to Borrower at the end of 5 years. .

In substance Borrower has borrowed £100m from the finance provider, which it repays plus interest. But again the effect would be that the company would get effective tax relief (for example in a trading profit computation or a Schedule A business computation) for the repayment of £100m (equivalent to loan principal) as well as for £12.5m interest.

97. This particular scheme involving income from real property is countered by the current rent factoring legislation in section 43A to 43G ICTA, but this legislation is now to be repealed. Under those rules, the £100m premium received by A would have been be taxed as income in the period of receipt. The new legislation will instead ensure that A will be taxed as it had borrowed £100m with relief given only for the £12.5m finance change. It will operate in the same way as applies to those rent-factoring schemes described here which fall within paragraph 1(5) to (8) of Schedule 7 Finance (No. 2) Act 2005 (abolition of 15 year limit).
98. More complex arrangements can be entered into.

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Example 4: an asset held by Borrower may be transferred to a partnership of which it is a member. Lender then joins the partnership for a capital contribution of say £100m, in return for the right to receive partnership profits amounting to £112.5m over the next 5 years. Thereafter, all of the rights to receive partnership profits will revert to the borrower (who may be able to buy out Lender's interest for a nominal consideration or expel Lender). In substance, Lender has made a loan of £100m for the benefit of Borrower.

99. Again, it is claimed that Borrower is not taxable on the income of £112.5m, which flows to the partnership and allocated to Lender.
100. In all of these cases, Borrower will account for the lump sum paid by Lender as a financial liability, with payments made to the lender in respect of the asset reducing the principal amount of that liability over the term of the loan.