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Mr Stephen Timms (Labour-East Ham)

Amendment 68: Schedule 5, page 109, line 10, at end insert-

‘Loan relationships: amounts not fully recognised for accounting purposes

10A (1) Section 85C of FA 1996 (amounts not fully recognised for accounting purposes) is amended as follows.

(2) In subsection (1)-

(a) in paragraph (c), for the words from “has at any time” to “liability” substitute “an amount (a “relevant capital contribution”) has at any time been contributed to the company which forms part of its capital (whether share or other capital)”, and

(b) in paragraphs (d) and (e), for “relevant accounting liability” substitute “relevant capital contribution”.

(3) In subsection (2)-

(a) for “or relevant accounting liability of the company” substitute “of the company or any relevant capital contribution made to the company”,
and

(b) for “or liability” (in both places) substitute “or contribution”.

(4) The amendments made by this paragraph have effect in relation to periods of account ending on or after 9 May 2007.

(5) But, in relation to periods of account beginning before that date, amounts are to be brought into account for the purposes of Chapter 2

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of Part 4 of FA 1996 as a result of those amendments only if the amounts relate to any time on or after that date.’.

EXPLANATORY NOTE

SUMMARY

1. This amendment inserts new paragraph 10A into Schedule 5 to the Finance Bill amending section 85C of Finance Act (FA) 1996.
2. Section 85C deals with certain cases where the accounting treatment causes profits on loan relationships not to be recognised, and so fall out of account for tax purposes.

DETAILS

3. Amendment 68 inserts new paragraph 10A into Schedule 5 to the Finance Bill.
4. Sub-paragraph (1) provides for the amendment of section 85C of FA1996.
5. Sub-paragraph (2) removes the requirement in section 85C(1) that loan relationship profits must be derecognised for accounts purposes as a result of the company having issued share capital. Instead, it will apply in any case where a contribution has been made to the company which forms part of its capital whether or not as share capital. This is termed a “relevant capital contribution”.

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6. Sub-paragraph (3) makes a consequential amendment to section 85C(2) replacing references to “relevant accounting liability” with references to “relevant capital contribution”.
7. Sub-paragraphs (4) and (5) provide that the amendment will have effect in relation to periods of account ending on or after 9 May but only in relation to amounts that arise on or after that date.

BACKGROUND NOTE

8. Section 85C deals with certain cases where the accounting treatment causes profits on loan relationships not to be recognised and in consequence fall out of account for tax purposes. It was introduced in FA2006 as a result of notifications under the avoidance disclosure rules.
9. In the original scheme, the avoiding company (Plc) subscribes for Preference Shares in a special purpose vehicle (SPV). SPV invests the subscription proceeds in a Loan Note. The terms of the Preference Shares are such that all of the total dividends and redemption amounts are contingent on the cash flows of the Note.
10. Under accounting rules, SPV is not required to recognise its investment in the Note or any of the income in its accounts, which should be respected for tax. Plc holds preference shares, distributions on which are not subject to tax.
11. The remedy introduced in FA2006 is that where a company has issued share capital that results in amounts in respect of any of its loan relationships not being fully recognised in its accounts, the full amounts must nonetheless be recognised for tax purposes.

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- 12.** HMRC has recently received a new disclosure revealing an attempt to get around this rule by using a company limited by guarantee. Such companies do not have issued share capital so the anti-avoidance rule cannot apply.
- 13.** The amendment extends the existing avoidance rule so that it also applies where amounts in respect of a company's loans are not fully recognised as a result of any contribution to the company's capital whether or not in respect of the issue of shares.