

**HM REVENUE AND CUSTOMS
RESOLUTIONS 11 and 14-20**

**FINANCE BILL 2005
COMMITTEE
CLAUSE 39 &
SCHEDULE 7**

Amendment	Page	Line
*SC 78	97	32
*SC 79	97	39

Dawn Primarolo

(Bristol South - Lab)

Amendment 78

Schedule 7, page 97, line 32, leave out ‘are not income producing but’.

Amendment 79

Schedule 7, page 97, line 39, at end insert—

‘(1A) But Condition 1 is not satisfied if the whole or substantially the whole by fair value of the assets of the issuing company are income producing.’.

EXPLANATORY NOTE

SUMMARY

1. These two amendments amend and clarify the requirements for a share to be caught by Condition 1 of one of the rules inserted by paragraph 10 of Schedule 7 to the Bill. This rule, in new section 91B Finance Act (“FA”) 1996 treats certain shares as loan relationships (debt assets) for tax purposes.
2. The amendments clarify the “income producing” assets test in the Condition set out in section 91C FA 1996 so that it now applies by reference to the “whole or substantially the whole” of the company’s assets rather than all the assets. This means that the shares of a company are not caught by the rules if a small part of the company’s assets are not income producing.
3. The amendments also specify the measurement of assets rule so that it works by reference to fair value. This prevents manipulation where an asset which produces most of the return on the share has an artificially low book value so enabling the company to pass the income producing assets test.

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DETAILS

4. Amendment 78 simply removes from section 91C(1) FA 1996 the requirement that the assets of the issuing company are not income producing.
5. Amendment 79 reinstates the income producing assets test by inserting a new subsection (1A) into section 91C FA 1996. This provides that the Condition 1 is not satisfied if the whole or substantially the whole by fair value of the company's assets are income producing.
6. After the amendments are made, section 91C will read as follows—

“91C Condition 1 for section 91B(6)(b)

(1) Condition 1 is that the assets of the issuing company [.....] are of such a nature that the fair value of the share—

- (a) is likely to increase at a rate which represents a return on an investment of money at a commercial rate of interest, and
- (b) is unlikely to deviate to a substantial extent from that rate of increase.

Fluctuations in value resulting from changes in exchange rates are to be left out of account for the purposes of paragraph (b) above.

(1A) But Condition 1 is not satisfied if the whole or substantially the whole of the fair value of the assets of the issuing company are income producing.

(2) The assets which, for the purposes of this section, are “income producing” are—

- (a) any share as respects which the conditions in section 91A(1) above are satisfied;
 - (aa) any share as respects which Condition 1 above is satisfied or would, apart from subsection (1A), be satisfied;**

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- (b) any share as respects which Condition 2 in section 91D below is satisfied **or would, apart from subsection (1)(c) of that section (excepted shares) be satisfied;**
- (c) any share as respects which Condition 3 in section 91E below is satisfied;
- (d) any asset of a description specified in any paragraph of paragraph 8(2) of Schedule 10 to this Act (qualifying investments in relation to a unit trust scheme or an offshore fund).
- (e) rights under a repo in relation to which section 730A of the Taxes Act 1988 applies;**
- (f) any share in a company the whole or substantially the whole by fair value of whose assets are assets within paragraphs (a) to (e) above.**
- (3) The Treasury may by regulations amend this section for the purpose of adding to the assets which are income producing.
- (4) The provision that may be made by regulations under this section includes provision for the regulations to have effect in relation to accounting periods (whenever beginning) which end on or after the day on which the regulations come into force.
- (5) For the purposes of subsection (1) above, it shall be assumed that no transaction (or series of transactions) intended to cause the condition in paragraph (a) or (b) of that subsection not to be satisfied will be entered into by the investing company.
- (6) This section shall be construed as one with section 91B above.”

BACKGROUND NOTE

7. Schedule 7 to the Finance Bill 2005 introduces anti-avoidance rules (at paragraph 10) which treat certain shares as creditor loan relationships (debt assets) where they give an interest-like return. The purpose of the rules is to prevent companies converting what

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would otherwise be interest income into a capital gain, exempt dividends or tax nothings.

8. Section 91B treats certain shares as creditor loan relationships (debt assets) where one of three Conditions are met. Condition 1, set out in section 91C, applies where the assets of a company are not income producing but are such that the fair value of its shares is likely to increase at a rate which represents a return on an investment of money at a commercial rate of interest.