

CORPORATION TAX ACT 2009

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 5: Loan Relationships

Overview

Chapter 12: Special rules for particular kinds of securities

Overview

1211. This Chapter brings together a number of loan relationship rules from within and outside Chapter 2 of Part 4 of FA 1996 on particular types of securities.
1212. Section 96 of FA 1996, which one might expect to be rewritten here, is not. That section prevents any rise in capital value of certain gilts from being brought into charge as credits on a loan relationship. The two gilts identified in the section are expressly protected from a capital gains charge and it was considered improper that a charge should arise on changes in capital value under the loan relationships legislation. Therefore the interest component only in any credit is taxed.
1213. 3½% Funding Stock 1999-2004 was redeemed in June 2003. Section 96 of FA 1996 is rewritten in Schedule 2 to this Act.

Section 398: Overview of Chapter

1214. This section explains how the Chapter is organised. It is new.

Section 399: Index-linked gilt-edged securities: basic rules

1215. This and the following section provide special rules for dealing with index-linked securities. It is based on section 94(1), (2) and (7) of FA 1996. The section contains the main rule that fair value accounting must be used and requires adjustments under the following section. It also defines terms used in this and the following section.

Section 400: Index-linked gilt-edged securities: adjustments for changes in index

1216. This section applies to remove a profit or loss arising on an index-linked gilt-edged security by adjusting the value of the security in the accounts by the change in the retail prices index. It is based on section 94(2) to (6) of FA 1996. The section also provides for Treasury powers to amend the adjustments required under this section.

Section 401: Gilt strips

1217. This section gives the rules that apply when a gilt-edged security is converted into strips and when strips are consolidated into a single security; in each case there is a deemed redemption and acquisition. It is based on section 95(1) to (3) of FA 1996.

1218. Section 95(1) of FA 1996, which *subsection (1)* rewrites, refer to “a gilt-edged security or a strip of a gilt-edged security”. Section 103(1) of FA 1996 (rewritten in section 476(1)) adopts the definition of “gilt-edged security” in Schedule 9 to TCGA. Paragraph 1A of that Schedule brings strips within the definition of a gilt and subsection (1)(b) of this section reflects this by referring to any *other* gilt-edged security.

Section 402: Market value of securities

1219. This section explains what is meant by the market value of a security in section 401 and gives the Treasury power to amend that meaning. It is based on section 95(4) to (6) of FA 1996.
1220. *Subsection (3)* allows orders to be made for “such incidental, supplemental, consequential and transitional provision and savings”. This is a standard formulation in this Act for the additional amendments that can be introduced under an order and regulation-making power. It is not considered a change in the law.

Section 403: Meaning of “strip”

1221. This section gives the meaning of “strip” for this Chapter, rewriting in full the definition from FA 1942 instead of relying on a cross-reference to that section as does section 95(7) of FA 1996. It is based on section 47 of FA 1942 and section 95(7) of FA 1996.

Section 404: Restriction on deductions etc relating to FOTRA securities

1222. This section prevents debits arising on FOTRA securities where the profits are exempt under section 1279. It is based on section 154(6) and (8) of FA 1996 and section 161(1), (4) and (7) of FA 1998.

Section 405: Certain non-UK residents with interest on 3½% War Loan 1952 Or After

1223. This section restricts a debit for borrowing costs where a non-UK resident company holds 3½% War Loan for use in a business of banking, insurance or dealing in securities. It is based on section 475 of ICTA. Interest on 3½% War Loan is paid without deduction of tax and is exempt in the hands of a non-UK resident company. Because a company may borrow to acquire these securities an allowable debit may arise on the cost of the borrowing but without giving rise to a taxable credit. Consequently the appropriate proportion of the costs of borrowing is disallowed as a loan relationships debit.
1224. Step 2 in *subsection (3)* makes reference only to “interest which is not brought into account ... under this Part” (although section 475(2) and (4) of ICTA might be read as comprising other interest for corporation tax purposes) since interest can only be brought into account under loan relationships rules as a result of section 337A(2)(a) of ICTA.
1225. *Subsections (1), (3) and (4)* rewrite “3½% War Loan 1952 or after” as “3½% War Loan 1952 Or After” to prevent the reader attaching the words “or after” to any following words, thereby adopting the solution used in section 154(8)(b) of FA 1996.

Section 406: Introduction

1226. This section introduces the following six sections which all deal with deeply discounted securities. It is based on paragraphs 17(3) and (4) and 18(2B) and (3) of Schedule 9 to FA 1996.

Section 407: Postponement until redemption of debits for connected companies' deeply discounted securities

1227. This section provides that debits on a deeply discounted security are, in certain circumstances, only brought into account under this Part on redemption where the debtor and creditor are connected. It is based on paragraph 17(1) to (3) and (5) of Schedule 9 to FA 1996.

Section 408: Companies connected for section 407

1228. This section explains what is meant by two companies being connected for the previous section. It is based on paragraph 17(5) and (9) of Schedule 9 to FA 1996.

Section 409: Postponement until redemption of debits for close companies' deeply discounted securities

1229. This section provides that debits on a deeply discounted security can only be brought into account under this Part on redemption if the creditor is a participator, etc in the debtor company. It is based on paragraph 18(1) to (2B) of Schedule 9 to FA 1996.

Section 410: Exceptions to section 409

1230. This section provides exceptions to the preceding section, where either credits equalling debits are brought into account under this Part or where the debtor company is a CIS-based close company or a CIS limited partnership. It is based on paragraph 18(1ZA) to (1C) and (4) of Schedule 9 to FA 1996.

1231. "The debtor company" in paragraph 18(1C)(c) of Schedule 9 has been rewritten for consistency in *subsection (4)* as "the issuing company", the term used elsewhere in that paragraph.

Section 411: Interpretation of section 409

1232. This section provides definitions and deals with other matters necessary to interpret section 409. It is based on paragraph 18(3B) to (5) of Schedule 9 to FA 1996.

Section 412: Persons indirectly standing in the position of creditor

1233. This section enables sections 407 and 409 to apply where there is a series of loan relationships or money debts between the company issuing the deeply discounted security and the person in the creditor relationship. It is based on paragraphs 17(8) and (8A) and 18(2C) and (2D) of Schedule 9 to FA 1996.

1234. Paragraph 18(2D) of Schedule 9 refers to the term "corresponding creditor relationship" in sub-paragraph (1A)(c). That sub-paragraph was repealed by FA 2002. The reference to paragraph (1A)(c) has been rewritten as if it referred to sub-paragraph (1A)(b), the sub-paragraph containing the reference to the person standing in the position of a creditor.

Section 413: Issue of funding bonds

1235. This section treats issues of funding bonds as interest payments. It is based on section 582(1) and (3) to (4) of ICTA. The corresponding rule for income tax is in section 380 of ITTOIA.

1236. *Subsection (2)* rewrites, for clarification, "value of the bonds at the time of their issue" in section 582(1)(a) as "market value of the bonds at their issue".

1237. For the rewrite of the Schedule D Case VI charge in section 582(2A) of ICTA see *Change 59* in Annex 1.

Section 414: Redemption of funding bonds

1238. This section prevents repayments of funding bonds from being a payment of interest if the issue was treated as such in the hands of an individual or company. It is based on section 582(1) and (4) of ICTA. The corresponding rule for income tax is in section 754 of ITTOIA.

Section 415: Loan relationships with embedded derivatives

1239. Where GAAP requires separate treatment of a loan relationship and its embedded derivative, this section enables the loan relationship to be treated separately for the purposes of this Part also. It is based on section 94A(1) and (2) of FA 1996.
1240. **Section 585** in Part 7 (derivative contracts) rewrites as much of section 94A of FA 1996 as deals with the treatment of embedded derivatives under Schedule 26 to FA 2002.

Section 416: Election for application of sections 415 and 585

1241. This section permits a company subject to old UK GAAP to make an election to apply the treatment allowed under section 415 even though separate treatment of loan relationship and derivative does not apply under that accounting policy. It is based on paragraph 7(1), (1A), (3), (4), (6) and (7) of Schedule 6 to F(No 2)A 2005.

Section 417: Further provisions about elections under section 416

1242. This paragraph makes further provisions about elections under section 416. It is based on paragraph 7(2), (3) and (5) of Schedule 6 to F(No 2)A 2005.

Section 418: Loan relationships treated differently by connected debtor and creditor

1243. This section applies where connected companies are debtor and creditor to a loan relationship which is treated as bifurcated by the debtor but not by the creditor. It is based on section 94B(1) to (6) of FA 1996. Where the debits brought into account by the debtor exceed the credits brought into account by the creditor additional credits must be brought into account by the creditor.

Section 419: Section 418: supplementary

1244. This section explains terms used in section 418. It is based on section 94B(7) to (10) of FA 1996.

Section 420: Assumptions where options etc apply

1245. This section deals with loan relationships accounted for under an amortised cost basis which are affected by options after the end of the accounting period. It is based on paragraph 3(1) and (2) of Schedule 9 to FA 1996. The debits and credits to be brought into account under this Part are those which would arise if the option were exercised in the way most favourable to the party to the loan relationship.