These notes refer to the Corporation Tax Act 2009 (c.4) which received Royal Assent on 26 March 2009

CORPORATION TAX ACT 2009

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 5: Loan Relationships

Overview

Chapter 15: Tax avoidance

Overview

This Chapter brings together provisions which counter avoidance, including avoidance which arises because transactions are not at arm's length.

Section 440: Overview of Chapter

1274. This section explains what the Chapter is about and the provisions it contains. It is new.

Section 441: Loan relationships for unallowable purposes

1275. This section prevents a company from bringing into account debits in respect of a loan relationship with an "unallowable purpose" (defined in the following section) or exchange gains on such a loan relationship. It is based on paragraph 13(1) and (1A) of Schedule 9 to FA 1996. Once such debits or credits are disallowed they are not brought into account for any other tax purposes.

Section 442: Meaning of "unallowable purpose"

1276. This section gives the meaning of "unallowable purpose" for section 441. It is based on paragraph 13(2) to (5) of Schedule 9 to FA 1996.

Section 443: Restriction of relief for interest where tax relief schemes involved

1277. This section prevents a company from bringing into account debits for interest paid as part of a scheme or arrangements, the sole or main benefit of which is the obtaining of the debit for that interest. It is based on section 787 of ICTA.

1278. Section 787 differs from paragraph 13 of Schedule 9 to FA 1996, rewritten in sections 441 and 442, in the following ways:

- paragraph 13 covers all debits and not just interest;
- paragraph 13 looks at the purposes of a loan relationship and section 787 at the benefit that might be expected to accrue from a scheme or arrangements;
- where section 787 is in point the whole of the interest is disallowed whereas paragraph 13 restricts only so much of the debit on the loan relationship as on a just and reasonable apportionment is attributable to the unallowable purpose.

1279. For these reasons both paragraph 13 of Schedule 9 to FA 1996 and section 787 of ICTA are rewritten in full.

1280. Section 787(1A) of ICTA requires the reference in section 787(1) to giving relief in respect of a payment of interest to be read "as including" a debit for interest under Chapter 2 of Part 4 of FA 1996 (loan relationships). This must be interpreted as applying that subsection to loan relationships alone as debits for interest are only allowed under Chapter 2 of Part 4 of FA 1996 (section 337A(2)(a) of ICTA). *Subsection (1)* is worded accordingly.

Section 444: Transactions not at arm's length: general

1281. This and the following seven sections provide rules for where transactions in respect of a loan relationship are not on arm's length terms. It is based on section 103(1) of, and paragraph 11(1) to (3A) of Schedule 9 to, FA 1996. The section requires debits and credits to be determined as if the related transaction in respect of which they arise were on arm's length terms. Exchange gains and losses are not affected. Schedule 28AA to ICTA (provision not at arm's length) has priority where it also applies (see section 445).

1282. Paragraph 11(2) refers to debits arising from the acquisition of rights under a loan relationship. The 1996 notes on sections read "…[paragraph 11] specifically does not affect the buyer when it has paid less than the market price – we are quite happy when it comes to sell the loan relationship, in computing the profit, it only gets the amount it actually paid taken into account at cost rather than market value". When the company comes to sell the loan relationship the transaction may not be at arm's length, but the arm's length value is clearly still intended to apply.

1283. It was therefore intended that the debits refer to the entries in the asset account on the acquisition of a loan relationship acquired at below market value.

1284. Paragraph 6204 of the Corporate Finance Manual reads:

FA96/SCH9/PARA11(2) provides that the Para 11(1) adjustment does not apply to *debits* arising from the purchase of a loan relationship at less than market value.

Although this rule is primarily aimed at cases where the vendor is not within the charge to corporation tax, it does apply in other cases too. So, when a company buys a debt at undervalue (not at arm's length), there is *no* adjustment in its accounts; it brings in the lower value and is taxed on the full amount of any resulting profit. Para 11(1) does apply to the vendor, however – where it sells a debt at undervalue (not at arm's length) it is taxed as if it had sold the loan relationship at the market value.

1285. Ghosh and Johnson's "Taxation of Loan Relationships and Derivatives", in referring to paragraph 11(2), agrees with this interpretation. Paragraph 6.351 reads:

However, there is no market value uplift for the purpose of computing any debits arising from the acquisition of rights under a loan relationship at less than market value (para 11(2)). "Debit" here means an "expense", ie acquisition cost.

1286. In most instances transactions other than at arm's length are between group companies and Schedule 28AA to ICTA will apply. Schedule 28AA has precedence as a result of paragraph 11(1A) of Schedule 9 to FA 1996 and paragraph 11(1) of Schedule 9 will not then apply.

1287. A rewrite change has not been introduced to reflect this meaning of paragraph 11(2) because some non-HMRC specialists on loan relationship disagree with this interpretation.

Section 445: Disapplication of section 444 where Schedule 28AA to ICTA applies

1288. This section provides an exception to section 444. Where Schedule 28AA to ICTA also applies in respect of the related transaction, section 444 does not apply. It is based on paragraph 11(1A) and (1B) of Schedule 9 to FA 1996. The section also excludes an adjustment to exchange gains and losses from any Schedule 28AA adjustments.

Section 446: Bringing into account adjustments made under Schedule 28AA to ICTA

1289. This section requires credits and debits under this Part to reflect adjustments made under Schedule 28AA of ICTA. It is based on paragraph 16(1) and (2) of Schedule 9 to FA 1996.

Section 447: Exchange gains and losses on debtor relationships: loans disregarded under Schedule 28AA to ICTA

1290. This and the following four sections provide rules for exchange gains and losses on loan relationships which are not on arm's length terms. It is based on paragraph 11A(1) to (3) of Schedule 9 to FA 1996 and paragraph 8(1) and (3) of Schedule 28AA to ICTA.

1291. The section leaves exchange gains and losses, or a proportion of them, out of account where, under Schedule 28AA to ICTA, the whole or part of a loan representing a debtor relationship is ignored.

Section 448: Exchange gains and losses on debtor relationships: equity notes where holder associated with issuer

1292. This section applies where interest is to be treated as a distribution under section 209(2)(e)(vii) of ICTA. It is based on paragraph 11A(1) of Schedule 9 to FA 1996. Exchange gains and losses on the security giving rise to that interest are left out of account in computing gains under this Part in respect of the debtor company.

Section 449: Exchange gains and losses on creditor relationships: no corresponding debtor relationship

1293. This section applies where a company is in a creditor relationship and the transaction giving rise to the loan would not have been made on arm's length terms. It is based on paragraph 11A(4) and (5) of Schedule 9 to FA 1996. The section leaves exchange gains and losses out of account where there is no corresponding debtor relationship (explained in section 450).

Section 450: Meaning of "corresponding debtor relationship"

1294. This section provides the meaning of "corresponding debtor relationship" for the purposes of section 449. It is based on paragraph 11A(4) of Schedule 9 to FA 1996.

1295. Part 2(6) of Schedule 11 to F(No 2)A 2005 repeals the words "or would apart from section 84A(2) to (10) of this Act" in paragraph 11A(4)(c) of Schedule 9 to FA 1996 (rewritten in *subsection (6)*) with effect from a day to be appointed. This subsection will therefore cease to have effect from an appointed day (see Part 8 (loan relationships) of Schedule 2 to this Act).

Section 451: Exception to section 449 where loan exceeds arm's length amount

1296. Where a loan would, on arm's length terms, have been of an amount more than nil but less than the full amount this section takes into account a suitable proportion of the exchange gains and losses for the purposes of this Part. It is based on paragraph 11A(5) and (6) of Schedule 9 to FA 1996.

Section 452: Exchange gains and losses where loan not on arm's length terms

1297. This section provides that, where a guarantor company is connected to the creditor company, a claim under paragraph 6D of Schedule 28AA to ICTA is assumed to apply to exchange gains and losses as well as interest. It is based on paragraph 11A(7) to (10) of Schedule 9 to FA 1996.

1298. Paragraph 6D of Schedule 28AA to ICTA applies where a company has an interest payment reduced by the transfer pricing rules of that Schedule and the loan on which that interest is paid is guaranteed by another company. The guarantor company may make a claim to be treated as if it had itself paid the interest. The guarantor company then obtains the deduction that was disallowed to the paying company. This is called a "compensating adjustment". The interest is allowed to the extent that an independent lender would take the guarantee into account in determining the borrower's debt capacity.

Section 453: Connected parties deriving benefit from creditor relationships

1299. This section provides that if a company receives less than a commercial return under a loan relationship and, in consequence, a connected company derives benefit as a result of that relationship, credits representing that benefit are brought into account in computing the creditor company's gains. It is based on section 93C of FA 1996. This counters an avoidance device whereby a company arranges for the equivalent value of interest that would otherwise be received to be passed by the borrower to a connected company which is not a party to the relationship.

Section 454: Application of fair value accounting: reset bonds etc

1300. This section provides rules for debits and credits on loan relationships represented by bonds on which the terms change after issue, to be determined on the basis of fair value accounting. It is based on section 88A of FA 1996.

1301. Principally, this section counters avoidance where companies subscribe for reset bonds which increase in value after issue and are transferred to another group company at cost under section 340 onwards. That company is then sold outside the group at market value with the profit on the bond reflected in the capital gain on the sale of the subsidiary and not as a credit under this Part.

Section 455: Disposals for consideration not fully recognised by accounting practice

1302. This section provides that rights disposed of under a creditor relationship are to be brought into account where the disposal is not wholly recognised in the accounts and there is an intention to avoid tax. It is based on paragraph 11B of Schedule 9 to FA 1996.