

CORPORATION TAX ACT 2009

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 6: Relationships treated as loan relationships etc

Overview

Chapter 6: Alternative finance arrangements

Overview

1388. This Chapter treats arrangements that comply with Shari'a law as falling within the loan relationships regime. Shari'a law prohibits transactions that involve interest, and arrangements for the borrowing or lending of money will usually involve some form of risk sharing instead. The rules are not limited to Shari'a compliant products but also apply to any finance arrangement that falls within their terms. In this Chapter these arrangements are known as "alternative finance arrangements".
1389. The rules covering alternative finance arrangements do not change the nature of the finance arrangements, nor do they in any way impute interest, or deem interest to arise where there is none. What they do is bring certain types of finance arrangements and the returns from those arrangements, into the same tax rules as those that apply to interest, providing a level playing field for tax between certain types of economically equivalent, but differently structured, finance arrangements.
1390. The Chapter sets out the nature of the five types of alternative finance arrangements in sections 503 to 507. Sections 509 to 513 explain which elements of the arrangements are treated as if they were loan relationships.
1391. Sections 48(1), 48B(4), 51, 51A and 56(3) of FA 2005 are not relevant for corporation tax purposes and therefore have not been rewritten in this Act. They remain in FA 2005 for non-corporation tax purposes.

Section 501: Introduction to Chapter

1392. This section provides an introduction to the Chapter by explaining what it does and provides definitions for the Chapter. It is based on paragraph 8(71) of Schedule 10 to FA 1996 and section 46(1) of FA 2005 and is new in part.

Section 502: Meaning of "financial institution"

1393. This section gives the meaning of "financial institution". It is based on section 46(2) and (3) of FA 2005.

Section 503: Purchase and resale arrangements

1394. This section deals with the first type of alternative finance arrangement, whereby an asset is purchased by a financial institution and then sold to another person with

the payment by that second person left on credit. It is based on section 47(1) to (3) of FA 2005. The price paid by that second person exceeds the price paid by the financial institution. The difference between the two prices equates to the return from an investment at interest and is treated as an alternative finance return (see section 511).

Section 504: Diminishing shared ownership arrangements

1395. This section deals with a second type of alternative finance arrangement. It is based on section 47A(1) to (4) of FA 2005. Two persons, at least one of them a financial institution, acquire an interest in an asset. The financial institution receives payments from the other party for that party's use of the financial institution's share as well as (usually leasing) payments, with the ownership of the asset passing by degrees to the other party. The other party in the arrangement has full use of the asset being acquired and may grant rights in the asset. Payments made by the other party in excess of the payments for the beneficial interest being acquired are treated as an alternative finance return.

Section 505: Deposit arrangements

1396. This section deals with a third type of alternative finance arrangement whereby deposits are made with a financial institution and payments are made to the depositor out of profits earned by the use of the money. It is based on section 49(1) of FA 2005. The payments must equate to a return from an investment at interest. The return is treated as an alternative finance return.

Section 506: Profit share agency arrangements

1397. This section deals with a fourth type of alternative finance arrangement. It is based on section 49A(1) of FA 2005. Here the investor appoints an agent to whom a sum of money is given to be invested at a specified return. Any additional sum above that specified return is retained by the agent as an incentive fee.

Section 507: Investment bond arrangements

1398. This section deals with a fifth type of alternative finance arrangement and sets out the conditions that must be present for arrangements to be treated as an investment bond arrangement. It is based on section 48A(1) and (2) of FA 2005. Investment bond arrangements are a new variety of alternative finance arrangement that share some characteristics of a bond.

1399. An investment bond arrangement exists where the "bond-issuer" uses the subscription proceeds to acquire assets, which are specified in the arrangement, and are held for the benefit of the "bond-holder". Income generated from the assets is distributed to the bond-holder and, on maturity of the bond, the assets are sold under pre-existing arrangements and the proceeds returned to the bond-holder.

Section 508: Provision not at arm's length: exclusion of arrangements from sections 503 to 507

1400. This section excludes arrangements from sections 503 to 507 where the parties are connected persons within the transfer pricing legislation in Schedule 28AA of ICTA, the arrangements are not at arm's length and the recipient of the alternative finance return is not subject to income or corporation tax or a similar non-United Kingdom tax. It is based on section 52(1) to (3) of FA 2005.

1401. In *subsection (2)(c)(ii)* "an amount representing relevant return" covers back to back arrangements where there is an intermediary between the two parties to the arrangements.

Section 509: Application of Part 5: general

1402. This section applies Part 5 to the five kinds of alternative finance arrangements. It is based on section 50(1) to (3) of FA 2005.

Section 510: Application of Part 5 to particular alternative finance arrangements

1403. This section provides, for each of the five alternative finance arrangements, the rules for what is to be treated as interest under that deemed loan relationship. It also provides some definitions for terms used in this section. It is based on section 50(1) to (2A) and (4) of FA 2005 and paragraph 7 of Schedule 2 to that Act.

Section 511: Purchase and resale arrangements

1404. This section explains the meaning of “alternative finance return” in relation to the purchase and resale arrangements in section 503. It is based on section 47(4), (6), (7) and (8) of FA 2005. It provides for where the second purchase price is paid either immediately or in instalments.

Section 512: Diminishing shared ownership arrangements

1405. This section explains the meaning of “alternative finance return” in relation to the diminishing shared ownership arrangements in section 504. It is based on section 47A(5) of FA 2005.

1406. “Costs and expenses” in section 47A(5) has been reduced to “expenses” in *subsection (3)* to avoid tautology.

Section 513: Other arrangements

1407. This section explains the meaning of “alternative finance return” in relation to deposit arrangements, profit share agency arrangements and investment bond arrangements. It is based on sections 48B(1), 49(2) and 49A(2) of FA 2005.

1408. In FA 2005 the return on some alternative investment arrangements is called “alternative finance return”, but the return on deposit arrangements and profit share agency arrangements is called “profit share return”. However, there is no material difference in the returns on these arrangements to justify different terminology. So “profit share return” has been replaced with “alternative finance return” in relation to deposit arrangements (section 505) and profit share agency arrangements (section 506). These are then consistent with purchase and resale arrangements, diminishing shared ownership arrangements and investment bond arrangements.

1409. Chapter 5 of Part 2 of FA 2005 is being amended to remove the term “profit share return” for income tax purposes.

Section 514: Exclusion of alternative finance return from consideration for sale of assets

1410. This section excludes the profits dealt with as interest under a loan relationship in relation to the arrangements under sections 503, 504 and 507 from determining the sale or purchase price for other tax purposes (eg trading or capital gains). It is based on section 53(1) to (3) of FA 2005. It does not prevent other tax provisions applying which substitute a different sum for a sale or purchase amount.

Section 515: Diminishing shared ownership arrangements not partnerships

1411. This section provides that diminishing shared ownership arrangements are not treated as a partnership for the purposes of the Corporation Tax Acts. It is based on section 47A(6) of FA 2005.

Section 516: Treatment of principal under profit sharing agency arrangements

1412. This section ensures that in the case of profit sharing arrangements the deposit-taker is taxable in respect of all of the profit resulting from the use of the money – both the depositor’s share of profit made under the arrangements and also the amount that the deposit-taker can retain. It is based on section 49A(3) of FA 2005. The deposit-taker is entitled to relief for the depositor’s share of profit.

Section 517: Treatment of bond-holder under investment bond arrangements

1413. This section provides that whatever the documentation accompanying investment bond arrangements may say, for tax purposes the bond-holder is not treated as having a legal or beneficial interest in the assets, and so is not entitled to capital allowances, nor is the bond-issuer treated as a trustee, or as making payments in a fiduciary or representative capacity. It is based on section 48B(2) of FA 2005.

Section 518: Investment bond arrangements: treatment as securities

1414. This section provides that alternative finance investment bonds are securities for the purposes of the Corporation Tax Acts. It is based on section 48B(3) of FA 2005.

Section 519: Investment bond arrangements: other provisions

1415. This section provides the rules about how investment bond arrangements impact on the regimes for securitisation companies, close companies and group relief. It is based on section 48B(6) to (8) of FA 2005.

Section 520: Provision not at arm’s length: non-deductibility of relevant return

1416. This section prevents any deduction in calculating profits for corporation tax purposes as a result of alternative finance arrangements where the arm’s length rule in section 508 applies. It is based on section 52(4) and (5) of FA 2005.

Section 521: Power to extend this Chapter to other arrangements

1417. This section provides the Treasury with powers to introduce further arrangements into this Chapter and make consequential amendments to the Tax Acts as necessary. It is based on section 98 of FA 2006.