

# FINANCE ACT 2010

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## EXPLANATORY NOTES

### INTRODUCTION

#### *Section 38 Schedule 12: Transactions in Securities*

#### Summary

1. **Section 38** and Schedule 12 introduce legislation to replace existing legislation that counters tax advantages arising from certain transactions in securities. The scope has been widened to include all close companies where there has not been a fundamental change in ownership but is targeted more effectively at arrangements involving tax avoidance.

#### Details of the Schedule

##### Income tax

2. Paragraphs 1 and 2 amend Chapter 1 of Part 13 of the Income Tax Act 2007 (ITA), by replacing sections 682 to 694 with new sections 682 to 687 inclusive. The scope of the legislation is changed to focus more effectively on those instances where there is a tax advantage that needs to be countered, although there is no change in the effect of the legislation.
3. New section 684 requires that the main, or one of the main purposes, of the transaction is to obtain an income tax advantage, and that an income tax advantage is actually obtained as a result of the transaction. This replaces the previous exception for transactions in securities made for genuine commercial reasons or in the ordinary course of making or managing investments, and where obtaining an income tax advantage was not the main, or one of the main objects of the transaction.
  - a. New subsection (1) sets out the four positive conditions for a person to be liable to a counteraction of their income tax advantage.
  - b. New subsection (1)(a) sets out the first condition. This provision is designed to be deliberately wide such that any person who enters into or is involved in any transaction in securities would meet this condition. The meaning of a transaction in securities is defined in subsection (2).
  - c. New subsection (2) defines “transaction in securities” for the purposes of Chapter 1 of Part 13 of ITA (Chapter 1). This definition is the same as that in the legislation it replaces.
  - d. New subsection (4) makes it clear that this provision is subject to sections 696(3) and 697(5) of Chapter 1 which are unchanged. Section 696(3) involves a person making a statutory declaration that section 684 does not apply, and section 697(5) involves a decision by a tribunal on an opposed notification that section 684 does not apply.
4. New section 685 merges the two provisions previously contained in section 689 and 690 of ITA. If either of two conditions are met the section will apply. The only substantive

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change is that the reference to a “relevant company” that was previously defined in section 691 of ITA is replaced with the term “close company”.

- a. New subsection (2) sets out the first condition (A). It covers three situations where a person receives “relevant consideration” as a result of the transactions in securities or any one or more such transactions and does not pay or bear income tax on that consideration other than under Chapter 1. “Relevant consideration” for these purposes is defined in new subsections (4) and (5).
  - b. New subsection (3) provides the rules relating to Condition B. It requires all of the positive conditions in new subsections (3)(a), (3)(b) and (3)(c) to be met. These replicate the previous legislation except that they apply to “close companies” rather than the “relevant company”.
  - c. New subsection (4) provides the meaning of “relevant consideration” for the purposes of new subsections (2)(a) and (2)(b). Relevant consideration is consideration that falls within the meaning of either new subsection (4)(a) or (4)(b) or (4)(c) which replicate the legislation at section 689(3) of ITA that is substituted by this new legislation.
  - d. New subsection (5) provides the meaning of “relevant consideration” for the purposes of new subsections (2)(c) and (3). It defines “relevant consideration” as consideration which consists of any share capital or any security issued by a close company and which is or represents the value of assets that fall within the meaning of either new subsection (5)(a) or (5)(b) or (5)(c). This subsection replicates the provisions previously contained within sections 690(3) and 690(4) of ITA but in relation to close companies.
  - e. New subsections (6) and (7) replicate the position previously set out in section 689(5) of ITA.
  - f. New subsection (8) replicates the position previously set out in section 690(8) of ITA and defines consideration as including any money or money’s worth.
  - g. New subsection (9) replicates the position as to the meaning of “security” and “share” that were previously set out in section 713 of ITA.
5. New section 686 excludes from the ambit of the transactions in securities legislation transactions that are immediately preceded by a fundamental change of ownership in the close company.
- a. New subsection (1) introduces a new exclusion from Chapter 1 covering circumstances involving a fundamental change of ownership as set out in new subsections (1)(a) and (1)(b).
  - b. New subsection (2) explains that there is a fundamental change of ownership for the purpose of this Chapter if both of the conditions in new subsections (2)(a) and (2)(b) are met.
  - c. New subsection (2)(a) requires that, as a result of the transaction or transactions in securities, conditions A, B and C in new subsections (3), (4), and (5) respectively are met.
  - d. New subsection (2)(b) provides that for a fundamental change of ownership to exist for the purpose of Chapter 1, all of the conditions set out in new subsection (2)(a) must be met for a continuous period of two years following the fundamental change of ownership.
  - e. New subsection (3) sets out condition A which is that at least 75 per cent of the ordinary share capital of the close company must be held beneficially by a person as set out in new subsections (3)(a) or 3(b).

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6. Subsection (1) of new section 687 introduces a new definition of income tax advantage for the purposes of Chapter 1. A person obtains an income tax advantage if there is an amount falling due under either new subsection (1)(a) or (1)(b).
  - a. New subsection (2) introduces a limit on the amount of relevant consideration that may be included in determining whether an income tax advantage has been obtained by a person. Any amount of relevant consideration in excess of the amount of qualifying distributions that could in any circumstances be paid to the person is not to be taken into account for the purposes of calculating an income tax advantage under new subsections (1)(a) or (1)(b).
7. Paragraph 3 of the Schedule makes consequential amendments to section 698 of ITA.
8. Paragraph 4 repeals section 699 of ITA.
9. Paragraphs 5 and 6 make consequential amendments to sections 700 and 701 of ITA.
10. Paragraph 7(2) adds to section 713 of ITA a definition of “close company” that includes a company that would be a close company if it were resident in the UK. This amended definition is intended to bring non resident companies that would be close companies if they were resident in the UK within the scope of Chapter 1.
11. Paragraph 7(3) removes the definition of a transaction in securities from section 713 of ITA because it is now defined in new section 684(2).

#### Corporation Tax

12. Paragraph 9 makes a consequential amendment to section 733(2) of the Corporation Tax Act 2010 (CTA).
13. Paragraph 10 repeals section 735 of CTA. This section covers abnormal dividends used for exemptions or reliefs. Section 735 contained circumstance A of section 704 of the Income and Corporation Taxes Act 1988. This part of section 704 has been deleted from both the income tax and corporation tax codes. Amendments to ensure that the shadow advance corporation tax (ACT) regime continues to work appropriately for abnormal dividends paid in these circumstances will be made to [SI 1999/358](#).

#### Consequential amendments

14. Paragraphs 11 and 12 make consequential amendments to ITA.
15. Paragraph 13 makes a consequential amendment to the Finance Act (FA) 2007
16. Paragraph 14 amends Schedule 1 to CTA, by omitting paragraphs 545 and 546. That paragraph amended section 690(8) of ITA which is substituted by this new legislation. The amendment is therefore no longer necessary.

#### Commencement

17. Paragraph 15 sets out the commencement provisions for income tax and corporation tax. The amendments made by paragraphs 2 to 5, 7 and 11 to 13 (and paragraph 1 in relation to them) have effect in relation to income tax advantages obtained on or after 24 March 2010. The amendment made by paragraph 6 (and paragraph 1 as far as it relates to it) are treated as having come into force on 1 April 2009. And the amendments to CTA will have effect in relation to corporation tax advantages obtained on or after 1 April 2010.

#### Background Note

18. An Anti-Avoidance Simplification Review was launched at the 2007 Pre-Budget Report. The aim was to simplify anti-avoidance legislation whilst protecting tax revenues.
19. In July 2008, the transactions in securities legislation was identified as a candidate for simplification. This culminated in a set of proposals, including draft legislation to

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amend ITA, that were subject to public consultation in July 2009. This Schedule is the outcome of those consultations.

20. This Schedule provides for amendments to be made to the transactions in securities legislation. The existing legislation in ITA is replaced with simplified legislation that will ensure that all relevant transactions that involve tax avoidance are within its scope.
21. This is achieved by using a new narrower definition of an income tax advantage; by replacing the current definition of a “relevant company” with that of a “close company”; and by including a new exemption covering fundamental changes in ownership of shares in a close company.
22. This Schedule also amends CTA in relation to certain circumstances where the cancellation of a corporation tax advantage may arise in connection with a transaction in securities.