*These notes refer to the Corporation Tax Act 2010 (c.4) which received Royal Assent on 3 March 2010*

# CORPORATION TAX ACT 2010

## EXPLANATORY NOTES

### INTRODUCTION

### Part 5: Group relief

### *Chapter 6: Equity holders and profits or assets available for distribution*

### Overview

623. This Chapter sets out how the rights of equity holders are determined in this Part. These rights (to profits and assets of a company) are used as alternatives to simple shareholding for determining interests in a company:

- in determining the proportion of a company's loss etc that can be surrendered to a member of a consortium that owns the company (section 143(3));
- in determining the proportion of a company's profits that can used to absorb losses etc surrendered by a member of a consortium that owns the company (section 144(3)); and
- in the tests as to whether or not a company is a 75% subsidiary (or a 90% subsidiary) of another (section 151(4)).

### *Section 157: Introduction to Chapter*

624. This section sets out the structure of the Chapter. It is based on Schedule 18 to ICTA.

625. *Subsection (2)* gives two rules of interpretation for the Chapter.

### *Section 158: Meaning of "equity holder"*

626. This section defines "equity holder". It is based on paragraph 1 of Schedule 18 to ICTA.

627. *Subsection (1)* establishes that an equity holder may be:

- a shareholder (but only in relation to "ordinary shares" – see section 160); or
- a loan creditor (but only in relation to loans that are not "normal commercial loans" – see section 162).

628. *Subsection (2)* sets out the tests in section 417 of ICTA (also rewritten in section 453) to determine whether a person is a loan creditor of a company.

### *Section 159: Use of relevant company's assets*

629. This section extends the meaning of "equity holder". It is based on paragraph 1 of Schedule 18 to ICTA.

630. The section treats as an equity holder a person who provides money to a company so that it can acquire an asset which is used in a trade by the person who provided the money. The company claims capital allowances on the asset.

631. In this case the person who provides the money has an economic stake in the company, whose results depend on the profits of the trade in which the asset is used. And this is the case even if the money is provided by way of, say, restricted preference shares which would not otherwise count towards the investor's stake in the company (see section 160).

632. *Subsection (1)* sets the scene, specifying the conditions to be met for the section to apply.

633. *Subsection (2)* is the main rule: the person who provides the money is treated an equity holder.

634. *Subsection (3)* sets out the capital allowances to which the company must be entitled if the section is to apply.

635. *Subsection (4)* excludes from the application of the section a normal commercial loan made in the course of a banking business. The exclusion applies only to the extent that the amount of the commercial loan exceeds the cost of the assets.

### *Section 160: Meaning of "ordinary shares"*

636. This section defines "ordinary shares" by excluding restricted preference shares from the holdings that are to be considered for the purposes of this Chapter. It is based on paragraph 1 of Schedule 18 to ICTA.

637. *Subsection (2)* introduces the five conditions that have to be met if the shares are to be excluded as restricted preference shares.

638. *Subsection (3)* is the first condition. There must be new consideration. "New consideration" is defined in section 157(2) by reference to section 1115.

639. *Subsections (4)* to *(7)* set out the other conditions.

### *Section 161: Meaning of "restricted right to dividends"*

640. This section defines restricted right to dividends for use in condition D in section 160(6). It is based on paragraph 1A of Schedule 18 to ICTA.

641. *Subsection (1)* sets out the condition that dividends should not represent more than a reasonable commercial rate of return. This condition must be met whichever of the other conditions is relied on.

642. *Subsection (2)* rewrites condition A in paragraph 1A(2) of Schedule 18 to ICTA. It relates to fixed rate shares.

643. *Subsection (3)* rewrites condition B in paragraph 1A(3) of Schedule 18 to ICTA. It relates to shares that carry a dividend based on a published index (see subsection (5)).

644. *Subsection (4)* rewrites condition C in paragraph 1A(4) of Schedule 18 to ICTA. It relates to shares that carry a dividend that may be reduced or not paid in special circumstances (see subsection (6)).

645. *Subsections (5)* to *(8)* provide interpretative rules for the section, including a Treasury power in relation to "special circumstances" for the purpose of subsection (4).

### *Section 162: Meaning of "normal commercial loan"*

646. This section defines normal commercial loans so that they can be excluded from the loansthat are to be considered for the purposes of this Chapter. It is based on paragraph 1 of Schedule 18 to ICTA.

647. *Subsection (1)* requires that the loan includes new consideration. "New consideration" is defined in section 157(2) by reference to section 1115.

648. The subsection also introduces the four further conditions for a loan to be excluded. The details of the conditions are in *subsections (2)* to *(5)*.

### *Section 163: Normal commercial loans: company's results or value of assets*

649. This section explains some of the concepts used in section 162. It is based on paragraph 1 of Schedule 18 to ICTA.

650. *Subsection (1)* allows a "fixed" rate of interest to include a rate that depends inversely on the company's results. Interest at a rate that increases when the company's results improve is like a dividend. But there is no need to treat interest as a dividend if its rate reduces when the company's results improve.

651. *Subsection (2)* allows a "fixed" rate of interest to include a rate that depends inversely on the value of the company's assets. Interest at a rate that increases when the company's assets increase in value is like a dividend. But there is no need to treat interest as a dividend if its rate reduces when the company's assets increase in value.

652. *Subsections (3)* to *(6)* make clear that a loan is not treated as depending on the value of any of the company's assets (see section 162(4)(b)) simply because it is secured by a charge over land acquired with the loan.

### *Section 164: Sections 160 and 162: supplementary*

653. This section explains how the "quoted parent company" test is applied. It is based on paragraph 1 of Schedule 18 to ICTA.

654. In accordance with section 158 a holder of restricted preference shares does not count as an equity holder. Such shares may carry the right to conversion into shares or securities in the company's "quoted parent company" (see section 160(4)(c)). In order to establish whether the company (S) is a 75% subsidiary of the possible quoted parent company (P) it may be necessary to know whether P is an equity holder in S (see section 151(4)). So the process becomes circular.

655. A similar circularity can result from consideration of whether a loan is a normal commercial loan. The loan may carry the right to conversion into shares or securities in the company's "quoted parent company" (see section 162(2)(c)). Again, it is necessary to establish whether the company is a 75% subsidiary of the possible quoted parent company.

656. *Subsection (1)* deals with shares. It applies if all the conditions in section 160 are met, apart from the one (B) which may depend on conversion to shares or securities in a quoted parent company.

657. *Subsection (2)* deals with securities. It applies if all the conditions in section 162 are met, apart from the one (A) which may depend on conversion to shares or securities in a quoted parent company.

658. *Subsection (3)* sets out the main condition for a company having a quoted parent company: it must be a 75% subsidiary; and the parent's shares must be quoted on a stock exchange.

659. *Subsection (6)* sets the scope of the rule which breaks the circularity. It applies only for the purposes of sections 160 and 162 and this section.

660. *Subsection (7)* is the rulewhich breaks the circularity: the "candidate company" is assumed to be a quoted parent company.

### Section 165: *Proportion of profits available for distribution to which company is entitled*

661. This section sets out how to apply the tests in this Part that are based on an entitlement to a distribution of profits. It is based on paragraph 2 of Schedule 18 to ICTA.

662. The tests in this Part, based on an entitlement to a distribution of profits, are in sections 143(3)(b), 144(3)(b) and 151(4)(a). The tests are also applied, by cross-reference, in, for example, the rules about small profits relief (see section 33(7)).

663. *Subsection (1)* sets the scope of the section and introduces company A (the parent) and company B (the subsidiary).

664. *Subsection (2)* is the basic rule: the proportion of the profits to which company A is entitled is based on what it would get if all company B's profits of an accounting period were distributed to its equity holders. If there are no profits in that accounting period a notional profit of £100 is assumed.

665. *Subsection (3)* clarifies the position in the case where some of company B's profits are in fact distributed. The section is still concerned with the whole of its profits.

666. *Subsection (4)* requires that company B's profits are calculated in accordance with United Kingdom tax rules, wherever it is resident.

667. *Subsection (5)* makes clear that the section is not concerned with any payments that are repayments of capital.

668. *Subsection (6)* includes in company A's entitlement any payment which it gets as an equity holder even if the payment would not otherwise count as a distribution.

### Section 166: *Proportion of assets available for distribution to which company is entitled*

669. This section sets out how to apply the tests in this Part that are based on an entitlement to a distribution of assets in a winding up. It is based on paragraph 3 of Schedule 18 to ICTA.

670. The tests in this Part, based on an entitlement to a distribution of assets in a winding up, are in sections 143(3)(c), 144(3)(c) and 151(4)(b). The tests are also applied, by cross-reference, in the rules about small profits relief (see section 33(7)).

671. *Subsection (1)* sets the scope of the section and introduces company A (the parent) and company B (the subsidiary).

672. *Subsection (2)* is the basic rule: the proportion of the assets to which company A is entitled is based on what it would get if company B's net assets at the end of an accounting period were distributed to its equity holders in a winding up. If there are no net assets (or if there is no balance sheet) at the end of that accounting period net assets of a notional amount of £100 are assumed.

673. *Subsection (3)* identifies the gross assets of company B, from which its liabilities are deducted to arrive at its net assets.

674. *Subsection (4)* identifies the liabilities of company B, which are deducted from its gross assets to arrive at its net assets.

675. *Subsection (5)* includes in company A's entitlement any payment which it would get as an equity holder even if the payment would not otherwise count as a distribution of assets.

676. *Subsections (6)* and *(7)* make clear that the section is not concerned with any payments that are repayments of capital. This exclusion affects the calculations of both company B's gross assets and the amount to which the equity holder is entitled.

### ***Section 167: Profits or assets available for distribution and entitlement: supplementary***

677. This section includes three special rules for calculating an equity holder's entitlements for the purposes of sections 143(3), 144(3) and 151(4). It is based on paragraphs 1 and 6 of Schedule 18 to ICTA.

### ***Section 168: Meaning of "the relevant accounting period"***

678. This section defines some expressions. It is based on paragraph 7 of Schedule 18 to ICTA.

679. The "relevant accounting period" is used for the calculation of a company's entitlement to profits or assets. Such a calculation is used to determine whether or nota company:

- is a member of a group; or
- is owned by a consortium.

680. *Subsections (2)* and *(3)* explain how to make the calculations in the cases of non-UK resident companies.

### ***Section 169: Application and interpretation of sections 170 to 182***

681. This section introduces a group of sections that deal with shares and securities that have restricted or temporary rights. It is based on paragraphs 4, 5 and 5F of Schedule 18 to ICTA.

### ***Section 170: Shares or securities with limited rights***

682. This section requires an alternative calculation if an equity holder's rights (either to profits or to assets in a winding up) are restricted. It is based on paragraph 4 of Schedule 18 to ICTA.

683. *Subsection (1)* introduces the section. The calculation is made at the "relevant time" (see section 169(2)).

684. *Subsection (2)* requires a calculation of the "alternative proportion" on the assumption that all the restricted rights are waived. So, if those rights belong to the company in question, its proportion is reduced. But if the rights belong to other equity holders its proportion is increased.

685. *Subsection (3)* substitutes the alternative proportion for the proportion worked out using the basic rules, but only if the alternative proportion is smaller.

686. *Subsection (5)* makes clear that any sort of restriction of the rights of an equity holder is to be taken into account for the purposes of the section.

687. *Subsection (6)* draws attention to the fact that restrictions based on profits or assets referable to a trade carried on in the United Kingdom by a non-UK resident company are dealt with in sections 179 to 182 and not in this section.

### ***Section 171: Shares or securities with temporary rights***

688. This section and section 172 require an alternative calculation if an equity holder's rights (either to profits or to assets in a winding up) are capable of changing. Both sections are based on paragraph 5 of Schedule 18 to ICTA.

689. *Subsection (1)* sets the scope of the section. If it applies, the consequences are set out in section 172. The calculation is made at the "relevant time" (see section 169(2)).

### *Section 172: Company A's proportion if shares etc have temporary rights*

690. This section and section 171 require an alternative calculation if an equity holder's rights (either to profits or to assets in a winding up) are capable of changing. Both sections are based on paragraph 5 of Schedule 18 to ICTA.

691. *Subsection (1)* takes up the story from the previous section, which determines whether or not this section applies. To arrive at the "alternative proportion" one must assume that the rights of the equity holders are now what they will be at a "future time" when the rights become different (see section 171(2) and (3)).

692. *Subsection (2)* explains "relevant future time".

693. *Subsection (3)* is the rule that the alternative proportion is used if it is smaller than the proportion that would otherwise be used.

### *Section 173: Cases in which option arrangements are in place*

694. This section defines "option arrangement" for the purpose of section 174. It is based on paragraph 5B of Schedule 18 to ICTA.

695. *Subsection (1)* is a cross-reference to section 174, which sets out the consequences of option arrangements.

696. *Subsection (2)* introduces the two conditions that have to be satisfied if an arrangement is to be an option arrangement.

697. *Subsection (3)* is the condition that the arrangement changes the equity holder's entitlement. The subsection refers (twice) to beneficial entitlement but paragraph 5B(2) of Schedule 18 to ICTA refers only to entitlement. This is not a change in the law because the option arrangements are relevant only if they are used for a "determination" to be made under paragraph 5B(7) of the Schedule. The determination is made in accordance with paragraph 2(1) or 3(1) of the Schedule. Those sub-paragraphs make clear that the Schedule is concerned only with beneficial entitlements.

698. *Subsection (4)* is the condition that the option may lead to a person acquiring shares or securities. Shares must be ordinary shares (defined in section 160). The option may be a "call" option, which gives a person the right to acquire the shares or securities; or a "put" option, which gives a person the right to require another person to acquire shares or securities.

699. *Subsection (5)* excludes rights that arise from an SAYE option scheme or that are to acquire normal commercial loans.Rights to acquire restricted preference shares (see section 160) are excluded by the reference to "ordinary shares" in subsection (4).

700. *Subsections (6)* and *(7)*set out the excluded rights under an SAYE option scheme.

### *Section 174: Company A's proportion if option arrangements in place*

701. This section requires an alternative calculation if an equity holder's rights (either to profits or to assets in a winding up) are affected by option arrangements. It is based on paragraph 5B of Schedule 18 to ICTA.

702. There is a distinction between:

- an option which affects the rights carried by shares or securities; and
- an option which leads to the acquisition of shares or securities.

703. In the first case, such an option would fall within section 171. This section deals with the second case, which was considered in J Sainsbury plc v O'Connor (1991), 64 TC 208 CA[1].

704. *Subsection (1)* provides a method statement. It requires a calculation for every permutation of rights that may exist if options are exercised so that shares or securities in the company are acquired. The permutation that gives the lowest proportion is the "alternative proportion".

705. *Subsection (2)* is the rule that the alternative proportion is used if it is lower than the proportion that would otherwise be used.

## *Sections 175 to 178*

### Overview

706. The first step in a calculation of an equity holder's proportion of profits available for distribution is based on the equity holder's share holding (see section 165). The equivalent first step in the calculation of an equity holder's proportion of assets available for distribution in a winding up is in section 166.

707. The next step is to check whether there is a (lower) alternative proportion in accordance with the three special rules in:

- section 170 (limited rights);
- section 172 (temporary rights); or
- section 174 (options).

708. If only one of the special rules applies the lower alternative proportion is used. But sections 175 to 178 explain what happens if two or three of the special rules apply in the same case.

709. If two rules apply, there are four possible proportions:

- calculated under the basic rule in section 165 or 166;
- calculated under one of the special rules;
- calculated under the other of the special rules; or
- calculated under both rules together.

710. If all three rules apply, there are eight possible proportions.

711. In all cases, the lowest proportion is used.

## ***Section 175: Cases in which both sections 170 and 172 apply***

712. This section deals with the first and second special rules. It is based on paragraph 5A of Schedule 18 to ICTA.

## ***Section 176: Cases in which both sections 170 and 174 apply***

713. This section deals with the first and third special rules. It is based on paragraph 5C of Schedule 18 to ICTA.

## ***Section 177: Cases in which both sections 172 and 174 apply***

714. This section deals with the second and third special rules. It is based on paragraph 5D of Schedule 18 to ICTA.

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**1** [1991] STC 318

### *Section 178: Cases in which sections 170, 172 and 174 all apply*

715. This section deals with the first, second and third special rules. It is based on paragraph 5E of Schedule 18 to ICTA.

### *Section 179: Cases in which surrendering or claimant company is non-UK resident*

716. This section introduces special rules about equity holders in non-UK resident companies. It is based on paragraph 5F of Schedule 18 to ICTA.

717. *Subsection (1)* sets the scope of the section.

718. *Subsection (2)* applies the special rules in section 180 if the equity holder's rights are used to establish whether or not a non-UK resident company is owned by a consortium.

719. *Subsection (3)* applies the special rules in section 180 if the equity holder's rights are used to establish whether or not a non-UK resident company is a subsidiary of another company.

720. *Subsection (4)* applies the special rules if ("Case 1") the equity holder's rights are referable to the profits or assets of the non-resident company's "UK trade". It also operates in this way if ("Case 2") the equity holder has rights under an option arrangement which are referable to the profits or assets of the non-resident company's UK trade. The extent to which profits or assets are referable to the company's UK trade is determined in accordance with section 182.

### *Section 180: Company A's proportion if non-UK resident involved*

721. This section is the main special rule aboutequity holders in non-UK resident companies. It is based on paragraph 5F of Schedule 18 to ICTA.

722. *Subsection (1)* introduces the section: subsection (2) applies in cases where there are no limited rights, temporary rights or option arrangements; subsection (3) applies in other cases.

723. *Subsection (2)* deals with the straightforward case in which none of sections 170 (limited rights), 172 (temporary rights) or 174 (options) applies. The alternative proportion calculated on the assumptions in section 181 is used if it is lower than the proportion that would otherwise be used.

724. *Subsection (3)* is a method statement which deals with the more complicated cases involving sections 170 (limited rights), 172 (temporary rights) and 174 (options), either singly or in the various possible combinations (see sections 175 to 178). The rule is that any calculations under those sections is done again using the assumptions in section 181 and the result of that calculation is used if it is lower than the proportion would otherwise be.

### *Section 181: Assumptions to be applied if non-UK resident company involved*

725. This section sets out how to calculate the "alternative proportion" for section 180. It is based on paragraph 5F of Schedule 18 to ICTA.

726. All the calculations under section 180 are done by reference to amounts that are "referable to company B's UK trade" (defined in section 182).

727. Assumptions 2 and 3 do not include £100 as an alternative to the company's United Kingdom profits or assets (see paragraph 5F(7)(b) of Schedule 18 to ICTA, which applies if the profits are between £1 and £99). This is because the alternative has little or no practical effect. See *Change 26* in Annex 1. In a case where there are no profits, section 165(2) substitutes the amount of £100.

728. Assumption 4 refers (three times) to beneficial entitlement but paragraph 5F(7)(c) and (8) of Schedule 18 to ICTA refers only to entitlement. This is not a change in the law because the option arrangements are relevant only if they are used for a “determination” to be made under paragraph 5F(4) or (5) of the Schedule. The determination is made in accordance with paragraph 2(1) or 3(1) of the Schedule. Those sub-paragraphs make clear that the Schedule is concerned only with beneficial entitlements.

### *Section 182: Assets etc referable to UK trade*

729. This section determines the extent to which amounts are referable to a company’s “UK trade”. It is based on paragraph 5F of Schedule 18 to ICTA.

730. *Paragraph (b)* of the section excludes amounts attributable to activities that are “double taxation exempt”. That expression is defined in section 186.