

*These notes refer to the Taxation (International and Other Provisions)
Act 2010 (c.8) which received Royal Assent on 18 March 2010*

TAXATION (INTERNATIONAL AND OTHER PROVISIONS) ACT 2010

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Schedule 3: Leasing arrangements: finance leases and loans

Part 1: New Part 11A of ITA 2007

Chapter 2: Finance leases with return in capital form

Overview

819. This Chapter is concerned with finance leases intended to turn part of the associated rental income into capital receipts.

Section 614B: Arrangements to which this Chapter applies

820. This section describes the leasing arrangements that fall within Chapter 2. It is based on paragraphs 1(1) and 2(1) of Schedule 12 to FA 1997.

821. The arrangements fall within the Chapter if they involve the lease of any property or rights (see *subsection (1)* and the definition of “asset” in section 614DG).

822. The Chapter is only capable of applying if two conditions are met. First, the arrangements must fall to be treated under GAAP as a finance lease or loan (see *subsection (2)*). Second, it is necessary that some or all of the lessor’s return on investment in respect of the finance lease or loan is not in the form of rent and would not, apart from Part 11A of ITA or Part 21 of CTA 2010, be brought into account for tax purposes as rent (see *subsection (3)*).

823. References to Part 21 of CTA 2010 and to tax purposes (rather than only income tax purposes) have been included in subsection (3) to ensure that the division between that Part and Part 11A of ITA works as intended.

824. The Chapter is capable of applying to arrangements entered into before the commencement date of Schedule 12 to FA 1997 (see *subsection (4)(a)* and the commentary on section 614BX).

Section 614BA: Purposes of this Chapter

825. This section sets out the main purposes of Chapter 2. It is based on paragraph 1(2) of Schedule 12 to FA 1997.

826. The first purpose (in *subsections (2) to (4)*) is to substitute for the ordinary tax measure of income from the lease the amount recognised in accordance with GAAP where this is larger than the normal measure (see section 614BF).

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827. Under GAAP, part of the sum mentioned in section 614B(3) is recognised as annual income over the course of the lease and thus taken into account in computing commercial profits. Income is recognised in this way because in substance the lease is tantamount to a loan, the interest on which needs to be matched with the lessor's own borrowing costs in order properly to reflect the lessor's profit.
828. The income recognised in accordance with GAAP may be that shown in consolidated accounts of the lessor's group or in those of a company which is a "connected person" of the lessor. The reason for looking wider than the lessor (see subsection (4)) is that the full earnings from the lease may only be shown in, say, the accounts of the parent or in the consolidated group results.
829. The second purpose of Chapter 2 (in *subsections (5) and (6)*) is to recover appropriately any tax reliefs for capital expenditure already given.

Section 614BB: Application of this Chapter

830. This section, together with section 614BC, determines whether Chapter 2 applies to a particular lease. It is based on paragraph 2 of Schedule 12 to FA 1997.
831. For the Chapter to apply, the conditions in section 614BC must have been met in relation to the lease at some time in a period of account of the current lessor (see *subsection (1) (b)*). But once they have been met in relation to the lessor at the time, they are treated as continuing to be met as regards any subsequent lessor unless and until the lease is assigned to a wholly unrelated person (see *subsections (3) to (5)*).
832. *Subsection (2)* provides that the Chapter does not apply to long funding leases of plant or machinery in relation to which Part 2 of CAA gives capital allowances to the lessee instead of the lessor. Chapter 10A of Part 2 of ITTOIA sets out the basis of taxation of rental earnings under such leases.
833. *Subsection (6)* is a necessary consequence of the split into separate provisions for corporation tax purposes and income tax purposes.

Section 614BC: The conditions referred to in section 614BB(1)

834. This section sets out the five conditions, A to E, all of which must be met if Chapter 2 is to apply to a specific lease. It is based on paragraph 3(1) to (5) of Schedule 12 to FA 1997.
835. Condition A in *subsections (2) to (4)* requires the lease to fall to be treated under GAAP as a finance lease or loan.
836. Condition B in *subsection (5)* requires a "major lump sum" which is not rent to be payable and for part of that sum to be treated under GAAP as return on investment in respect of the finance lease or loan.
837. Condition C in *subsection (6)* is that not all of that part of the major lump sum would apart from Chapter 2 be brought into account for income tax purposes as the "normal rent" (see sections 614AA and 614BD(3) and (4)) from the lease for tax years ending with "the relevant tax year" (see section 614BD(1)).
838. Condition D in *subsection (7)* is that for the period of account of the lessor in which "the relevant time" (see section 614BD(1)) falls or for an earlier period of account of the lessor, the "accountancy rental earnings" (see section 614AB) in respect of the lease exceed the normal rent for the period. The point of this condition is that, if a lessor is consistently being taxed on at least as much income as the commercial accounts show, then the terms of the lease are not ones which are designed to turn rental income into a capital receipt.
839. Condition E in *subsection (8)* is that at the relevant time there exist such arrangements or circumstances as are mentioned in section 614BE.

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840. The arrangements and circumstances are set out in detail in section 614BE, but essentially there must be some likelihood that the lessee or a person connected with the lessee will buy out the lessor's interest in the leased asset for a major lump sum.
841. Condition E is intended to ensure that a lease does not come within Chapter 2 solely because there is a possibility that the lessor may obtain a major capital sum otherwise than from the lessee or a connected person. This might happen for example on the unplanned sale of the leased asset to a third party or on a claim under an insurance policy on the destruction of the asset.

Section 614BD: Provisions supplementing section 614BC

842. This section provides the meanings of "the relevant tax year" and "the relevant time" and sets out how the normal rent is to be determined, for the purposes of section 614BC. It is based on paragraph 3(7) and (8) of Schedule 12 to FA 1997.

Section 614BE: The arrangements and circumstances referred to in section 614BC(8)

843. This section sets out the arrangements and circumstances which constitute Condition E in section 614BC(8). It is based on paragraph 4 of Schedule 12 to FA 1997.
844. See the commentary on section 614BC.

Section 614BF: Current lessor taxed by reference to accountancy rental earnings

845. This section provides for the lessor to bring into account for income tax purposes the accountancy rental earnings in respect of the lease for a period of account if they exceed the normal rent for the period. It is based on paragraph 5 of Schedule 12 to FA 1997.

Sections 614BG to 614BK: Reduction of taxable rent by cumulative rental excesses

Overview

846. These sections ensure that the rule in section 614BF that the higher of the accountancy rental earnings and the normal rents (ordinary taxable rents) are taxed does not overall cause more rent to be taxed as income than is actually due to the lessor. They are based on paragraph 6 of Schedule 12 to FA 1997.
847. These sections achieve their purpose by requiring running totals to be kept of aggregate differences between accountancy rental earnings and the normal rents. Any aggregate excess of accountancy rental earnings over normal rents arising in past periods can then be set against any current excess of normal rents over accountancy rental earnings. Conversely, any aggregate excess of normal rents over accountancy rental earnings arising in past periods can be set against any current excess of accountancy rental earnings over normal rents.
848. The provisions of paragraph 6 of Schedule 12 to FA 1997 have been unpacked into five sections to provide greater clarity.

Section 614BG: Reduction of taxable rent by cumulative rental excesses: introduction

849. This section introduces sections 614BG to 614BK. It is based on paragraph 6(5) to (9) of Schedule 12 to FA 1997.

Section 614BH: Meaning of “accountancy rental excess” and “cumulative accountancy rental excess”

850. This section defines the terms “accountancy rental excess” and “cumulative accountancy rental excess”. It is based on paragraph 6(3), (4) and (8) of Schedule 12 to FA 1997.

Section 614BI: Reduction of taxable rent by the cumulative accountancy rental excess

851. This section applies if in relation to a lease for a period of account the normal rent exceeds the accountancy rental earnings (so it is the normal rent that is taxed) and there is a cumulative accountancy rental excess. It is based on paragraph 6(5) and (6) of Schedule 12 to FA 1997.

852. The rent that is brought into account for income tax purposes is found by reducing normal rent by the cumulative accountancy rental excess but not so as to bring into account an amount less than the accountancy rental earnings for the period.

Section 614BJ: Meaning of “normal rental excess” and “cumulative normal rental excess”

853. This section defines the terms “normal rental excess” and “cumulative normal rental excess”. It is based on paragraph 6(1), (2) and (6) of Schedule 12 to FA 1997.

Section 614BK: Reduction of taxable rent by the cumulative normal rental excess

854. This section applies if in relation to a lease for a period of account the taxable rent under section 614BF would be the amount of the accountancy rental earnings and there is a cumulative normal rental excess. It is based on paragraph 6(7) and (8) of Schedule 12 to FA 1997.

855. Section 614BF only applies if the accountancy rental earnings exceed the normal rent. To avoid more rent being taxed as income for the period than is actually due to the lessor where there is a cumulative normal rental excess for the period, the rent that is brought into account for income tax purposes is found by reducing the accountancy rental earnings by the cumulative normal rental excess, but not so as to bring into account an amount less than the normal rent for the period.

Sections 614BL to 614BO: Relief for bad debts by reduction of cumulative rental excesses

Overview

856. These sections are concerned with bad debts. Broadly, the aim is to ensure that any bad debts are sensibly taken into account in calculating taxable profits and accountancy rental excesses and normal rental excesses. If the lease runs its course, the net rents taxed should equal the net rents payable after allowing for any bad debts.

Section 614BL: Relief for bad debts: reduction of cumulative accountancy rental excess

857. This section deals with a bad debt deduction in respect of rent under a lease for a period of account if there is a cumulative accountancy rental excess for the period. It is based on paragraph 9(1) to (4) and (7) of Schedule 12 to FA 1997 and paragraph 5(1) of Schedule 2 to ITTOIA.

858. *Subsection (2)* reduces the cumulative accountancy rental excess for a period where the accountancy rental earnings exceed normal rent by an amount equal to the excess of the bad debt deduction over the accountancy rental earnings.

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859. *Subsection (3)* deals with the converse situation if, for a period of account, normal rent is at least equal to accountancy rental earnings (so that it is the normal rent which is taxed). In those circumstances there are two restrictions.
860. *Subsection (4)* provides that relief otherwise available under section 614BI(2) in a period for any cumulative accountancy rental excess brought forward from previous periods is restricted to any excess of the normal rent over any bad debt deduction given in respect of rents from the lease. That is because only the normal rent net of bad debt relief is in effect being brought into account for tax.
861. *Subsection (5)* applies if the bad debt deduction exceeds the normal rent for a period of account. In such a case any cumulative accountancy rental excess brought forward from previous periods is reduced by the amount by which the bad debt deduction exceeds the normal rent. That is because the excess of the bad debt deduction over the normal rent for the period of account already represents relief for rents taxed in previous periods.
862. The definition of “bad debt deduction” in *subsection (6)* corrects a missed consequential in ITTOIA by substituting for the cross-reference to “sub-paragraph (i), (ii) or (iii) of section 74(1)(j) of the Taxes Act 1988” a cross-reference to “section 35(1)(a), (b) or (c) of ITTOIA 2005”.

Section 614BM: Recovery of bad debts following reduction under section 614BL

863. This section reinstates any relief for cumulative accountancy rental excess reduced under section 614BL if the bad debt deduction is subsequently reversed (because the debt is recovered or prospects for its recovery improve). It is based on paragraph 9(5) to (7) of Schedule 12 to FA 1997.

Section 614BN: Relief for bad debts: reduction of cumulative normal rental excess

864. This section deals with the interaction of bad debt deductions and relief for cumulative normal rental excess under section 614BK. It is based on paragraph 10(1) to (4) and (7) of Schedule 12 to FA 1997.
865. As with section 614BL, the rationale is that the relief should only represent an excess of normal rent over accountancy rental earnings which have effectively been brought into account for tax and that the relief should only be given against rents similarly brought into account.
866. The structure of the detailed rules is identical with that in section 614BL.

Section 614BO: Recovery of bad debts following reduction under section 614BN

867. This section reinstates any relief for cumulative normal rental excess reduced under section 614BN if the bad debt deduction is subsequently reversed (because the debt is recovered or prospects for its recovery improve). It is based on paragraph 10(5) to (7) of Schedule 12 to FA 1997.

Section 614BP: Effect of disposals of leases: general

868. This section treats a period of account of the lessor as coming to an end for the purposes of Part 11A immediately before any disposal of the lessor’s interest under the lease, the leased asset or an asset representing the leased asset. It is based on paragraph 12(5) to (7) of Schedule 12 to FA 1997.
869. This enables the cumulative accountancy rental excess or the cumulative normal rental excess for the period of account of the lessor that then begins, and in which the disposal takes place, to be calculated.

870. The remaining sub-paragraphs of paragraph 12 of Schedule 12 to FA 1997 are rewritten as section 37A of TCGA by Part 2 of this Schedule. See the commentary on that section. *Subsection (5)* provides a signpost to that section.

Section 614BQ: Assignments on which neither a gain nor a loss accrues

871. This section deals with the assignment of a lease in circumstances which are regarded for the purposes of capital gains tax as giving rise to neither a gain nor a loss. It is based on paragraph 7 of Schedule 12 to FA 1997.
872. Paragraph 7(2) of Schedule 12 to FA 1997, on which *subsection (2)* is based, provides for a period of account of the assignor to end and a period of account of the assignee to begin with the assignment.
873. Paragraph 7(3) of Schedule 12 to FA 1997 provides that the assignee takes over the assignor's "unused cumulative accountancy rental excess" or "unused cumulative normal rental excess".
874. These "unused" cumulative excesses are the aggregate of the cumulative rental excess for the period of the assignor which ends with the assignment and any rental excess for that period.
875. But the combined effect of section 614BP(2) (based on paragraph 12(5) of Schedule 12 to FA 1997) and subsection (2) is that the period of account of the assignor which ends with the assignment is infinitesimally short. There can, therefore, in practice be no accountancy rental excess or normal rental excess for that period.
876. Accordingly, in rewriting paragraph 7(3) of Schedule 12 to FA 1997 in *subsections (3)* and *(4)*, the provision has been simplified by referring only to the cumulative accountancy rental excess or the cumulative normal rental excess for that period.
877. *Subsection (5)* ensures that the division of the income tax provisions in Part 11A of ITA and the corporation tax provisions in Part 21 of CTA 2010 works as intended.

Sections 614BR to 614BW: Capital allowances: claw-back of major lump sum
Overview

878. These sections unpack paragraph 11 of Schedule 12 to FA 1997 to improve its accessibility.

Section 614BR: Effect of capital allowances: introduction

879. This section introduces sections 614BS to 614BW and provides that they apply if a major lump sum (see section 614BC(5)) falls to be paid in relation to a lease. It is based on paragraph 11(1) and (2) of Schedule 12 to FA 1997.

Section 614BS: Cases where expenditure taken into account under Part 2, 5 or 8 of CAA 2001

880. This section deals with capital allowances in respect of plant or machinery, mineral extraction and patent rights. It is based on paragraph 11(3) to (7) of Schedule 12 to FA 1997.
881. *Subsection (2)* brings into account as disposal value for the purposes of CAA an amount equal to the amount or value of the major lump sum. This is subject to adjustment under *subsections (3)* to *(6)* if the disposal value is limited in accordance with CAA.

Section 614BT: Cases where expenditure taken into account under other provisions of CAA 2001

882. This section deals with capital allowances given under any provision of CAA other than those mentioned in section 614BS. It is based on paragraph 11(8) and (14) of Schedule 12 to FA 1997.
883. In these cases, an amount equal to the allowances given or, if less, the amount or value of the major lump sum is treated as a balancing charge.
884. Following the repeal of section 532 of ICTA by CTA 2009, the extended definition of the Capital Allowances Act in paragraph 11(14) of Schedule 12 to FA 1997 is otiose and has not been rewritten.

Section 614BU: Capital allowances deductions: waste disposal and cemeteries

885. This section deals with deductions for capital expenditure allowed under section 165, 168 or 170 of ITTOIA. It is based on paragraph 11(11) and (12) of Schedule 12 to FA 1997.
886. In these cases, an amount equal to the deductions allowed or, if less, the amount or value of the major lump sum is treated as a trading receipt.

Section 614BV: Capital allowances deductions: films and sound recordings

887. This section deals with deductions in respect of films and sound recordings allowed under section 135, 138, 138A, 139 or 140 of ITTOIA. It is based on paragraph 11(9) and (10) of Schedule 12 to FA 1997.
888. In these cases, if the amount or value of the major lump sum exceeds so much of that sum as was treated as a receipt of a revenue nature under section 134(2) of ITTOIA, the excess is also treated as a receipt of a revenue nature.

Section 614BW: Contributors to capital expenditure

889. This section deals with the case where capital allowances have been made to a person making contributions to capital expenditure on the provision of a leased asset under sections 537 to 542 of CAA. It is based on paragraph 11(13) of Schedule 12 to FA 1997.
890. *Subsection (2)* provides that sections 614BS and 614BT have the same effect in relation to the contributor and those allowances as they do in relation to the lessor and allowances given to the lessor for such expenditure by the lessor.

Section 614BX: Pre-26 November 1996 schemes where this Chapter does not at first apply

891. This section makes provision for recognising income from some finance leases which form part of a “pre-26 November 1996 scheme” as defined in section 614D(1)(a). It is based on paragraph 13 of Schedule 12 to FA 1997.
892. A lease which forms part of a pre-26 November 1996 scheme only falls within Part 11A if it meets all the conditions in section 614BC. It does not fall within Chapter 3 as that Chapter only applies to leases which do not form part of a pre-26 November 1996 scheme (see section 614CB(1)(b) and the definition of a post-25 November 1996 scheme in section 614D(1)(b)).
893. If a lease forming part of a pre-26 November 1996 scheme met all the conditions in section 614BC on 26 November 1996, it falls within Chapter 2 for all periods of account beginning, or treated under section 614DB as beginning, on or after that date, subject to section 614BB(3).

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894. But such a lease may not meet all those conditions until after 26 November 1996. In that case, this section effects a catching up exercise by taxing under section 614BF in the period when the lease is first subject to the rules in Chapter 2 the accumulated excess (if any) of the accountancy measure of income from the lease over the income actually taxed in earlier periods. No such excess relating to periods prior to 26 November 1996 can be taxed in this way nor are the assessments for earlier periods of account actually re-opened. The catching up is done in the period in which the conditions are met.
895. *Subsection (3)(b)* provides that for the purposes of Part 11A the time when the conditions are satisfied forms its own brief period of account. This ensures that the computational provisions in this section work correctly.
896. *Subsection (10)* provides for the case where for example there has been an assignment within section 614BQ and the lessor at an earlier time was within the charge to corporation tax.

Section 614BY: Post-25 November 1996 schemes to which Chapter 3 applied first

897. This section provides continuity of reliefs when a lease changes status. It is based on paragraph 14 of Schedule 12 to FA 1997.
898. It applies if a lease which is initially subject to the rules of Chapter 3 subsequently comes within those of Chapter 2. Any cumulative accountancy rental excess or any cumulative normal rental excess for the purposes of Chapter 3 counts for the purposes of Chapter 2.
899. *Subsection (4)* provides for the case where for example there has been an assignment within section 614BQ and the lessor at an earlier time was within the charge to corporation tax.