These notes refer to the Finance Act 2010 (c.13) which received Royal Assent on 8 April 2010

FINANCE ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Section 61Schedule 18: Sale of Lessors: Election Out of Charge on Qualifying Change

Summary

1. Section 61 and Schedule 18 make changes to Chapter 3 of Part 9 of the Corporation Tax Act (CTA) 2010 to offer an option to elect for an alternative treatment.

Details of the Schedule

2. Paragraph 1 introduces the changes to Chapter 3 of Part 9 of CTA 2010 (formerly Schedule 10 to the Finance Act (FA) 2006).

3. Paragraph 2 makes consequential changes to section 382 of CTA 2010.

4. Paragraph 3 inserts new subsection (1A) into section 383 which signposts those sections defining “qualifying change of ownership”.

5. Paragraph 4 substitutes a new section 392 which defines “relevant change in relationship” by reference to the circumstances set out in section 393 or 394.

6. Paragraph 5 inserts new section 394A which defines when there is a “qualifying change of ownership” for the purposes of the sale of lessors Chapters by reference to a “relevant change in the relationship” between A and a principal company of A and lists those sections that set out circumstances when this is not the case.

7. Paragraph 6 inserts new sections 398A, 398B, 398C, 398D, 398E, 398F and 398G after section 398.

8. New section 398A provides for an election for an alternative treatment to that provided for by the current sales of lessors legislation. It is available where a company (A) is carrying on a business of leasing plant or machinery alone, there is a relevant change in the relationship between A and a principal company and A elects for the section to apply.

9. New section 398A(2) sets out the effect of the election:

   - there is no qualifying change of ownership in relation to the company, but subsections (2)(b) and (4)(b) of section 383 apply bringing the accounting period of the company to a close and commencing a new accounting period on the day after the relevant day;
   - new section 398D applies during the relevant period; and
   - new sections 398E to 398G apply during the relevant period and on the relevant day.

10. New section 398A(3) defines “the relevant period” as beginning with the day after the relevant day and ending when there is next a relevant change in the relationship between

A and a principal company of A as set out in subsection (4). Where there is not such an event the relevant period continues.

11. New section 398A(4) sets out the requirements to be satisfied before the relevant period is brought to an end. There must be a relevant change in the relationship between A and a principal company of A that results in the unadjusted basic amount being treated as a receipt of the business of leasing plant or machinery. This is extended to include a case where the unadjusted basic amount of income would have been treated as a receipt of the business, but for a further election.

12. New section 398A(5) explains the consequences when there is a relevant change in the relationship but the relevant period is not brought to an end. In these circumstances there is no qualifying change of ownership and the effects of the election continue.

13. New section 398B provides how the election must be made. The election must be made by notice to an officer of HM Revenue & Customs (HMRC) and within two years beginning with the relevant day. The election is irrevocable.

14. New section 398B(4) ensures that the effect of the election can be reflected by making any assessments and adjusting any assessments.

15. New section 398C introduces new sections 398D and 398E which make special provision about the trade or property business consisting of or including the business of leasing plant or machinery. For the purposes of new sections 398D and 398E, the trade or the property business is the "relevant activity".

16. New sections 398D sets out the restrictions on the use of losses etc against profits of the relevant activity:

- no loss may be deducted under chapter 2 of Part 4 (trade losses), section 62 (losses made in UK property business) or section 189 (charitable donations);
- no group relief under Part 5 is available;
- no deficit may be set off under section 461 of CTA 2009 (non-trading deficit from loan relationship);
- no loss may be set off under section 753 of CTA 2009 (non-trading loss on intangible fixed assets);
- no deduction under section 1219 of CTA 2009 (expenses of management of investment business) is allowed;
- no sum may be set off under paragraph 1 of Schedule 26 to the Income and Corporation Taxes Act 1988 (ICTA) if A is a controlled foreign company subject to an apportionment; and
- if the company would otherwise be a tonnage tax company it is to be treated as not being a tonnage tax company.

17. New section 398E takes expenditure that has an unallowable purpose out of account when computing the profits or losses of the relevant activity. Expenditure has an unallowable purpose if the main purpose, or one of the main purposes, of the lessor company in incurring it, is to obtain a relevant tax advantage. New paragraph 398E(4) defines "relevant tax advantage" as:

- a reduction in the corporation tax profits attributable to the carrying on of the relevant activity;
- the creation of a corporation tax loss attributable to the carrying on of the relevant activity; or

- an increase in corporation tax losses attributable to the carrying on of the relevant activity.

18. New section 398F limits the availability of capital allowances on expenditure incurred by the lessor company by preventing expenditure incurred on the acquisition or creation of an "independent asset" from qualifying for capital allowances.

19. An "independent asset" is defined as being an asset that, in the normal course of business, could be used individually, whether or not it could also be used as a constituent part of a single combined asset, or, an asset that could be used "at different times" as a constituent part of different combined assets. A "combined asset" is a single asset consisting of more than one asset.

20. New section 398G deals with transfers of assets into and out of the lessor company. Where the transfer falls within section 948, or where the lessor company is the predecessor and section 265 of the Capital Allowances Act 2001 applies, then the transfer value is treated as equal to its market value as defined in section 437(9) i.e. the value of the asset unencumbered by any leases or other encumbrances.

21. Paragraph 7 amends section 437 of CTA 2010 (interpretation of the sale of lessors Chapters), by inserting new subsection (8A) which defines "property business" as meaning a UK or overseas property business.

22. Paragraph 8 makes consequential changes to Schedule 4 to insert references to the definition of "property business", "relevant changing relationship" and "qualifying change of ownership in relation to a company".

23. Paragraph 9 provides that the amendments made by the Schedule have effect where the relevant day is on or after 9 December 2009.

24. Paragraph 10 makes corresponding amendments to Schedule 10 to FA 2006, (the legislation re-written as Chapter 3 of Part 9 of CTA 2010 and which is in force in relation to the period between 9 December 2009 and the enactment of CTA 2010).

25. Paragraph 11 disapplies section 398F where expenditure is incurred as a consequence of a contract entered into by the company and finalised before 9 December 2009.

26. Paragraph 12 prevents the relevant period from being brought to a close where sections 398A(4) and (5) apply and the relevant day is before 24 March 2010.

27. Paragraph 13 disapplies section 398D(6) in relation to accounting periods beginning before 24 March 2010, and disapplies section 398D(7) until 24 March 2010.

Background Note

28. The sale of lessor companies legislation prevents a potential loss of tax when a lessor company changes hands. Tax could be lost if a lessor company with deferred tax profits is sold to a loss-making concern that is able to utilise its own losses against the deferred tax profits of the lessor company. A sale to a loss-making concern is deterred by the legislation through the imposition of a charge that is matched by a relief; the charge affecting the selling group and the relief benefiting the buying group. Where the lessor company is sold to a profit-making concern the relief is valuable and the buyer will pay enough for the shares in the lessor company to compensate the seller for the imposition of the charge. Where the lessor company is sold to a loss-making concern the relief brings no benefit and the buyer is not willing to pay enough to compensate the seller.

29. It has become clear that in some limited circumstances the legislation can act as a deterrent in cases where there is no tax avoidance motive. Typically, this is because the buyer is not a loss-making concern but, as a consequence of a temporary dip in profitability or as a consequence of the particular nature of the buying entity, it is not able to utilise the relief efficiently.

30. This Schedule introduces an option to elect for an alternative treatment which replaces the charge and relief with a ring fence that preserves the profits of the leasing business by restricting the set off of losses, preventing the fragmentation of the business without tax effect and the reduction of the profits of the business through additional claims to capital allowances and the creation of artificial deductions. As a consequence of these restrictions tax is collected on the deferred profits over time.

31. The election offers an alternative where Schedule 10 acts as a barrier to a commercially motivated sale while ensuring that the incentive to sell a lessor company to a loss-making concern is not reinstated.