These notes refer to the Finance Act 2012 (c.14) which received Royal Assent on 17 July 2012

FINANCE ACT 2012

EXPLANATORY NOTES

INTRODUCTION

Section 23: Loan Relationships: Debts Becoming Held by Connected Company

Summary

1. Section 23 modifies the corporation tax rules on loan relationships that apply when the parties to a loan relationship become connected. The section changes the circumstances in which companies that become connected with pre-existing debt bring in a deemed release in respect of that debt, and the calculation of the amount of that deemed release. It inserts a new anti-avoidance rule to ensure that the existing rules relating to deemed releases cannot be circumvented. It also inserts a retrospective provision in relation to particular arrangements circumventing the existing rules where a company becomes creditor to a loan relationship on or after 1 December 2011 and before 27 February 2012.

Details of the Section

2. Subsection (1) provides for the loan relationships rules in Chapter 6 of Part 5 of the Corporation Tax Act 2009 (CTA) to be amended. The amendments are to section 362 of CTA under which, a debtor company brings in a deemed release when the debtor and creditor companies become connected and the debt is impaired, and the insertion of a new section 363A.

3. Subsection (2)(a) amends section 362 of CTA so that it applies to all cases where previously unconnected parties to a loan relationship, as debtor (D) and creditor (C) respectively, become connected. Previously section 362 applied where the creditor's rights under the loan relationship were subject to an impairment adjustment.

4. Subsection (2)(b) substitutes new sections 362(3) and 362(4).

5. New section 362(3) changes the calculation of the amount treated as released to the amount by which the pre-connection carrying value (PCCV) of the debt in D's accounts exceeds the PCCV of the debt in C's accounts.

6. New subsection 362(4) defines the PCCV for D and C.

7. Subsection (2)(d) amends the title of section 362 of CTA as the new section no longer only applies to debts where the creditor's rights are subject to an impairment adjustment.

8. Subsection (3) inserts a new section 363A in CTA which will apply to nullify the effect of arrangements that are entered into where the main purpose, or one of the main purposes, of any party entering into the arrangements is to avoid or reduce an amount treated as released under section 361 or 362. 'Arrangements' are defined in new section 363A(3).

9. Subsections (4) to (7) set out the commencement provisions. The amendments made to section 362 of CTA have effect where companies become connected on or after 27 February 2012. However, where the companies become connected on or after 27

February 2012 and before 1 April 2012 different subsections (3) and (4) are substituted. Subsection (3) changes the calculation of the amount treated as released to the greater of two amounts. The first amount is similar to that which currently arises under section 362(1)(c) of CTA. The second is the amount by which the pre-connection carrying value (PCCV) of the debt in D's accounts exceeds the PCCV of the debt in C's accounts. Subsection (4) defines the PCCV for C and D. New section 363A of CTA will have effect where arrangements are entered into on or after 27 February 2012 or, where the arrangements are entered into before that date, in relation to deemed releases arising on or after that date.

10. Subsections (8) to (12) sets out provisions applying where arrangements are entered into which lead directly or indirectly to, or in consequence of which, company "C" becomes party to a loan relationship as creditor on or after 1 December and before 27 February 2012 and C becomes connected to the debtor before 27 February 2012. 'Arrangements' are defined in subsection (9). Where this rule applies the conditions at sections 361(1)(a) to (c) of CTA will be deemed to be met. Thus section 361 of CTA will apply to C at the point it becomes party to the loan relationship.

11. Subsection 10 ensures, in particular, that the normal loan relationship rules apply for partnerships involving companies.

12. Subsection 11 prevents anything done after 27 February 2012, for example a change or a decision to change partnership profit shares or accounting dates, affecting the application of section 361 in accordance with subsection (8) of this section.

13. Subsection 12 prevents double taxation. If section 361 of CTA applies to a case as a result of subsections (8) to (10) of this section, then section 362 of CTA will not also apply at the point that C becomes connected to D.

Background Note

14. The rules that apply to loan relationships work on the principle that amounts taxed and relieved as credits and debits under those rules are the profits and losses arising in accounts drawn up in accordance with generally accepted accounting practice. When a debt is impaired or written off by a creditor company its expense will normally be allowable as a loan relationship debit. When a debtor company is released from a debt it owes, its profit will be taxable as a loan relationship credit.

15. Where a debt exists between connected companies, such credits and debits are not normally brought into account for tax purposes. Specific rules prevent exploitation of this exception when debt is acquired by a new creditor connected to the debtor or when previously unconnected creditors and debtors become connected. This is achieved by imposing a deemed release on the debtor if the debt has been purchased at a discount by a connected creditor or the debt is impaired when the creditor and debtor become connected.

16. HM Revenue & Customs have become aware of arrangements that have been entered into to avoid the tax charge that would normally arise in these circumstances. The changes to the rules both prevent these and similar arrangements achieving this effect from 27 February 2012 and in relation to the particular arrangements retrospectively to 1 December 2011.

17. The calculation of the amount of a deemed release where unconnected parties to a loan relationship become connected was amended in response to comments on the draft legislation published on 27 February 2012. This change has effect from 1 April 2012.