

**EXPLANATORY MEMORANDUM TO
THE CORPORATION TAX (EXCLUSION FROM SHORT-TERM LOAN
RELATIONSHIPS) REGULATIONS 2009**

2009 No.

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ('HMRC') and is laid before the House of Commons by Command of Her Majesty.
2. **Purpose of the instrument**
 - 2.1 The purpose of the regulations is to exclude a finance arrangement from being a short-term loan relationship in two circumstances. The first of these is where part or all of the arrangements are made for a long-term funding purpose. The second circumstance is where the finance arrangement is a long-term aggregated loan relationship.
3. **Matters of special interest to the Select Committee on Statutory Instruments**
 - 3.1 None.
4. **Legislative Context**
 - 4.1 The regulations will be made under powers included in paragraph 62(4) of Schedule 15, Finance Act 2009, introduced by section 35. This will be the first occasion on which those powers will be exercised.
 - 4.2 Section 35 of Finance Bill introduced rules in Schedule 15 dealing with the taxation of financing costs and income. The rules limit the amount of finance costs that a company brings into account in calculating its profits for corporation tax purposes. Where the net finance costs of the UK members of a group exceed the gross consolidated finance costs of the group the excess is disallowed.
 - 4.3 Debits and credits in respect of loan relationships are financing expense amounts and financing income amounts for the purpose of Schedule 15. Where financing expense amounts are payable by one member of a group to another member of the group in respect of a loan relationship that is treated as a short-term loan relationship, the two members can elect to treat the financing expense amount as not being subject to Schedule 15. Where the amount in question is payable to a UK member of the group, the financing income amount receivable by that member is also treated as not subject to Schedule 15.
 - 4.4 Schedule 15 contains rules that determine whether a single loan relationship is a short-term loan relationship or not. Paragraph 62(4) provides powers for the Treasury to make regulations excluding certain financing arrangements from being short-term loan relationships.

4.5 The purpose of the regulations is to exclude a finance arrangement from being a short-term loan relationship in two circumstances. The first of these is where part or all of the arrangements are made for a long-term funding purpose. There is a long-term funding purpose where it is reasonable to expect that the debt in question will not be settled within 12 months. Where a sequence of finance arrangements taken individually would be short-term loan relationships, but the sequence forms part of a scheme having as a main purpose the characterisation of long-term funding as short-term loan relationships, the sequence is treated as having a long-term funding purpose.

4.6 The second circumstance is where the finance arrangement is a long-term aggregated loan relationship. A long-term aggregated loan relationship is defined as an arrangement existing between the same two companies, comprising a number of separate finance arrangements, with no repayment terms relating specifically to each advance, accounts show the finance arrangement as a single net balance between companies at all times and the conditions in paragraph 62(1) of Schedule 15 to FA 2009 are not met where the finance arrangements are taken together. Such a structure is typical of many inter-company loan accounts within a group.

4.7 Regulations may not be made under this power unless a draft of the statutory instrument containing them has been laid before, and approved by a resolution of, the House of Commons.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury, Stephen Timms has made the following statement regarding Human Rights:

In my view the provisions of the Corporation Tax (Exclusion from Short-term Loan Relationships) Regulations 2009 are compatible with the Convention rights.

7. Policy background

- *What is being done and why*

7.1 The policy intention is that UK companies (and UK permanent establishments of non-UK companies carrying on a trade in the UK) that are members of a group should not be able to claim finance costs in calculating their profits for corporation tax where in total the net finance costs of those UK members of the group exceed the gross consolidated finance costs of the group as a whole. To the extent that other UK members of the group have net finance income and which in total does not exceed the finance costs disallowed, that net finance income will not be included in those member's calculation of profits for corporation tax.

- 7.2 The policy intention is not to include finance costs and (to the extent they are payable to other UK members of the group) finance income where those amounts are in respect of a short-term loan relationship. Short-term is a period of 12 months or less. Schedule 15 provides rules to identify single loan relationships that are short-term. These regulations ensure that debts which, in legal form, terminate within 12 months are nevertheless not included as short-term debt where they form part of the long-term financing structure of a company. This includes the case where a company enters into a scheme designed to characterise a long-term funding requirement as short-term debt, for example by continually rolling over 364-day loans.
- 7.3 The rules contained within Schedule 15, Finance Bill 2009 are being introduced as a measure to support the introduction of exemption of distributions.

8. Consultation outcome

- 8.1 A consultation document was published in December 2008 which provided draft clauses for Schedule 15. Those draft clauses contained no exclusion for finance costs and finance income in respect of short-term loan relationships. Various respondents to the consultation exercise commented that application of the draft clauses could be simplified if groups were allowed to exclude finance costs and finance income in respect of short-term borrowings. The government has accepted this suggestion and provisions to accomplish this were included in Schedule 15 as enacted .

9. Guidance

- 9.1 HMRC will publish guidance on the operation of the Schedule, including the regulations.

10. Impact

- 10.1 Schedule 15, Finance Bill 2009 is one of a package of measures being introduced as part of the Government's review of the taxation of the foreign profits of companies. A full and final impact assessment of the effect the package as a whole will have on the costs of business and the voluntary sector is available at <http://www.hmrc.gov.uk>.
- 10.2 The impact on business, charities or voluntary bodies is expected to be negligible. The provisions in Schedule 15 regarding short-term debt, taken together with the supporting regulations, are broadly positive since they allow the exclusion of such short-term debts from the loan relationships rules. These particular regulations will reduce the scope of that overall exclusion for a limited number of companies.
- 10.3 The impact on the public sector is expected to be negligible.

10.4 These regulations should have a negligible effect on that impact assessment.

11. Regulating small business

11.1 The legislation will not apply to small business.

12. Monitoring & review

12.1 HMRC intend to monitor how the regulations are applied in practice and will review the methods by which companies apply the apportionment method allowed in paragraph of the regulations.

13. Contact

Sue Davies at HM Revenue and Customs (Tel: 020 7147 2565 or email: sue.davies2@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.