These notes refer to the Finance Act 2009 (c.10) which received Royal Assent on 21 July 2009

FINANCE ACT 2009

EXPLANATORY NOTES

INTRODUCTION

***Section 61* and *Schedule 30*: Financial Arrangements Avoidance**

Details of the Schedule

***Paragraph 1*: Interest payments: arrangements appearing very likely to produce post-tax advantage**

2. Paragraph 1 of the Schedule inserts new section 384A into the Income Tax Act 2007 (ITA). This is headed "Restriction on relief where arrangements minimise risk to borrower"

3. New subsection (1) of section 384A provides that relief will not be available for interest paid by a person on a loan if the loan is made as part of arrangements which appear very likely to produce a "post tax advantage" and the arrangements seem to have been designed to reduce any income tax or capital gains tax to which the borrower (or someone like the borrower) would be liable apart from the arrangements.

4. Subsection (2) provides that arrangements appear very likely to produce a post-tax advantage if one might reasonably assume there is no more than an insignificant risk of a 'post-tax advantage' not being produced.

5. This is a two-part test. It is firstly necessary to ascertain whether, within the meaning of the legislation, it is very likely that the incomings from the arrangements will exceed the outgoings on an after-tax basis. If that is the case then it is also necessary to ascertain whether the arrangements seem to have been designed to reduce income tax or capital gains tax liability that would have arisen independently of the arrangements. Subsection (10) explains in what circumstances arrangements are to be treated as designed to do this.

6. Subsection (3) defines what is meant by 'produce a post-tax advantage'. It means that the arrangements will produce an amount payable to the borrower or a connected person (or to someone else for the benefit of the borrower or person connected with the borrower) of an amount (or aggregate amount) that after making the appropriate tax adjustments is at least equal to the aggregate of the amount needed to meet the borrower's obligations (in respect of interest and principal) under the loan and any capital that the borrower has invested from his own resources. Where the loan is a limited recourse one the obligations may vary according to the results of the business in which it is invested.

7. "Appropriate tax adjustment" is defined in subsections (8) and (9). The adjustment ensures that the value of the tax relief for the interest (due apart from the new rule) is taken into account in determining the amount payable to the person (and that additional tax payable by the person as a result of the arrangements is also taken into account).

8. This is intended to ensure that relief for interest is not available in any case where there is no more than an insignificant risk that the payments to which the wider scheme

arrangements give rise will not produce a profit. The new measure will thus deny relief for interest if the loan is made as part of arrangements that are certain (ignoring insignificant risk) to produce a post-tax surplus for the investor by virtue of the interest being eligible for relief, provided that the arrangement seems designed to reduce tax to which the borrower would been liable apart from the arrangements. The legislation will not catch genuine commercial investments in business where there is significant uncertainty as to whether the level of return will secure a post-tax surplus for the investor.

9. Subsections (5) and (6) are anti-falsifying provisions. They ensure that the legislation will still apply if the arrangements include provision to secure that in the event of a post-tax advantage not being produced an amount not significantly less will still arise. Thus, the legislation would still apply if the arrangements gave rise to a say 30 per cent (more than insignificant) chance of a post tax advantage not being produced if in that event the investor is still certain to receive an amount not significantly less. This reflects the fact that an avoider may be willing to live with significant risk of a trivial loss if the alternative outcome is a significant post-tax profit.

10. Subsection (7) ensures that a sum is treated as payable to a person if that person directly or indirectly receives the benefit of any asset. In any such case, the sum treated as payable to the person is equal to the value of the asset.

11. Subsection (8) explains how to make the “appropriate tax adjustments” for the purpose of subsection (3) or (6). If “A” exceeds “B” the excess is to be deducted from the amount produced. If B exceeds A the excess is to be added to the amount produced.

12. Subsection (9) defines “A” and “B”. “A” is the amount of any income tax, capital gains tax or tax under the law of a territory outside the UK to which the borrower becomes liable as a result of the arrangements. “B” is the aggregate amount by which the borrower’s liability to income tax and capital gains tax would be reduced in consequence of the arrangements. This includes but is not limited to reduction in tax resulting from a claim under the interest relief provisions. For this purpose A and B are each to be computed independently of the other and it is to be assumed that relief for the interest is not blocked by subsection (1).

13. Subsection (10) explains that arrangements seem very likely to have been designed to reduce any tax liability that would arisen independently of the arrangements if and only if it would be reasonable to assume from all or any relevant circumstances that the arrangements or any part of then were so designed. This would, for instance, apply if the scheme is a marketed one and the marketing literature indicates that the arrangements are intended to reduce tax liability that would arise independently of the scheme.

14. Subsection (12) defines “related transaction” as a transaction that it would be reasonable to assume would not have been entered into or effected independently of the arrangements. Thus, a hedging agreement would be a related transaction in relation to a borrowing or investment if it would be reasonable to assume that the hedge would not have been taken out apart from the loan or investment. Similarly, anything that produces sums payable to or for the benefit of the borrower will be taken into account in determining whether a “post–tax advantage” arises provided that this is linked to the arrangements.

15. Much of the wording in the new section is taken from the “guaranteed return provisions” in sections 559 to 566 of the Income Tax (Trading and Other Income) Act 2005 (previously Schedule 5AA to the Income and Corporation Taxes Act 1988 (ICTA)).

16. Paragraph 1(2) provides that the amendment has effect in relation to interest paid on or after 19 March 2009.