

CORPORATION TAX ACT 2009

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 5: Loan Relationships

Overview

Chapter 6: Connected companies relationships: impairment losses and releases of debts

Overview

1137. This Chapter provides rules for impairment losses and release of debt where there is a connection between the debtor and creditor companies.
1138. Paragraph 5ZA of Schedule 9 to FA 1996 requires paragraphs 6, 6A and 6C of that Schedule to apply in relation to a debit in respect of the release of a liability as they apply in relation to an impairment loss. In rewriting these paragraphs references to a debt on the release of a liability (referred to here as a “release debit”) have been inserted into the relevant sections.

Section 353: Introduction to Chapter

1139. This section explains the subject and layout of the Chapter and provides some definitions. It is based on section 87(3) of, and paragraphs 4A(8), 5ZA and 6C(1) of Schedule 9 to, FA 1996.

Section 354: Exclusion of debts for impaired or released connected companies debts

1140. This section provides the basic rule that neither impairment losses nor debts arising as a result of the release of liability under a creditor relationship (“release debits”) are brought into account if the debtor and creditor company are connected. It is based on paragraph 6(1) to (3) and (8) of Schedule 9 to FA 1996.

Section 355: Cessation of connection

1141. This section provides that debits for impairment losses or release debits which are not brought into account under the preceding section are not to be brought into account in subsequent accounting periods after connection ceases. It is based on paragraph 6C(1) and (3) of Schedule 9 to FA 1996.
1142. Paragraph 6C(3) of Schedule 9 refers to a “debit in respect of an amount” although there is now no preceding reference in the paragraph to an amount. This reference was not repealed following an amendment by FA 2002. Sub-paragraph (1) previously read:
- (1) Where, in the case of a creditor relationship of a company,-

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- (a) a departure that would otherwise have been allowed under paragraph 5(1) above in respect of an amount is or was, by virtue of paragraph 6 above, not allowed in the case of an accounting period; and
- (b) there is a subsequent accounting period for which there is, within the meaning of section 87 of this Act, no connection between the company and any person standing in the position of a debtor as respects the debt, sub-paragraphs (2) and (3) below shall apply.

1143. The paragraph has been rewritten to reflect the fact that “the amount” refers to the impairment loss (or release debit by virtue of paragraph 5ZA of Schedule 9).

Section 356: Exception to section 354: swapping debt for equity

1144. This section provides the first of two exceptions to the basic rule in section 354. It is based on paragraph 6(4) and (5) of Schedule 9 to FA 1996. The exception in this section applies when the liability is released in consideration for shares in the debtor company which give rise to the connection.

Section 357: Exception to section 354: insolvent creditors

1145. This section provides the second exception to the basic rule in section 354. It is based on paragraph 6A(1) and (2) of Schedule 9 to FA 1996. The exception in this section applies where the creditor is in insolvent liquidation, etc and the impairment loss or release debit accrues during the winding up, etc.

Section 358: Exclusion of credits on release of connected companies debts: general

1146. This section precludes a debtor company from bringing a credit into account under this Part on the release of a debt where the debtor and creditor companies are connected. It is based on paragraph 5(3) and (5) of Schedule 9 to FA 1996. This section excludes the credits on the release since the debits have been disallowed (see section 354).

1147. *Subsection (1)(b)* brings out the fact that the section applies in respect of the accounting period in which the release occurs.

Section 359: Exclusion of credits on release of connected companies debts during creditor’s insolvency

1148. This section precludes a debtor company from bringing a credit into account on the release of a debt where the creditor company meets the insolvency, etc conditions in section 357 if the insolvency, etc breaks the connected company relationship. It is based on paragraph 5(3) and (6) of Schedule 9 to FA 1996.

1149. *Subsection (1)(d)* and *(e)* reflect the rule in section 12(7) and (7ZA) of ICTA that an accounting period ends with insolvency or administration.

Section 360: Exclusion of credits on reversal of impairments of connected companies debts

1150. This section provides that the credit on a reversed impairment loss is not brought into account under this Part where that loss is not brought into account under section 354. It is based on paragraph 6(3A) and (8) of Schedule 9 to FA 1996.

Section 361: Acquisition of creditor rights by connected company at undervalue

1151. This section applies where a company acquires a debt from a third party as a result of which it becomes connected to the debtor. The section is based on paragraph 4A of Schedule 9 to FA 1996. If the pre-acquisition value of the debt exceeds the

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consideration, the difference is treated as a release by the acquiring company and hence a charge on the debtor company.

1152. Under paragraph 4A(2)(d) the provisions of that paragraph do not apply where the new creditor acquires the debt from a connected person. "Person" has been rewritten in *subsection (1)(d)* to apply to a company only. See *Change 56* in Annex 1.

Section 362: Parties becoming connected where creditor's rights subject to impairment adjustment

1153. Under this section where a debtor company and a creditor company become connected, any reduction in the value of the debt as a result of an impairment loss which was not yet reflected in the book value of the debt at the time of acquisition is treated as a release by the creditor. It is based on paragraph 4A(1), (4), (5), (7) and (10) of Schedule 9 to FA 1996.

Section 363: Companies connected for sections 361 and 362

1154. This section explains what is meant by connected companies for the purposes of the two preceding sections. It is based on paragraph 4A(8) and (9) of Schedule 9 to FA 1996.
1155. This definition differs from the definition for connectedness in section 466 by its application to periods of account rather than accounting periods.