EXPLANATORY MEMORANDUM TO

THE BUILDING SOCIETIES (CORE CAPITAL DEFERRED SHARES) REGULATIONS 2013

2013 No. 460

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs on behalf of Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations provide that where a building society issues deferred shares, or converts existing securities into deferred shares, ("CCDS") that will form part of its core tier one capital those shares will be taxed as shares.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 These Regulations are the first use of the power in section 221 Finance Act 2012 (c.14) which allows the Treasury to make provisions about the tax and stamp duty consequences in relation to securities issued in pursuance of any regulatory requirement imposed by the European Union or the UK.

4.2 Regulatory provisions made by the Financial Services Authority require building societies to maintain a certain level of core tier one capital. Building societies are mutual organisations run for the benefit of their members and as such are restricted in the type of capital raising instruments that they can issue. There are specific tax rules for building societies' existing tier one instruments, known as permanent interest bearing shares, which ensure that they are taxed as debt instruments. However, CCDSs will not qualify as permanent interest bearing shares. The closest equivalent instrument to a CCDS is a share in a company so these regulations provide that the tax treatment is equivalent.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, Greg Clarke has made the following statement regarding Human Rights:

In my view the provisions of the Building Societies (Core Capital Deferred Shares) Regulation 2013 are compatible with the Convention rights.

7. Policy background

7.1 CCDSs will replace a building society's existing tier one capital instruments which will not count towards tier one capital once the Capital Resource Directive IV (CRD IV) is in force. CRD IV, amongst other matters, aims to increase the loss absorbing capacity of regulatory capital instruments issued by financial institutions. The loss absorbing features of CRD IV compliant regulatory capital instruments leads to uncertainty in relation to the tax treatment of such instruments.

7.2 The current tax rules were designed in relation to building societies' existing tier one instruments which share features with debt type instruments. However, these rules are not appropriate for CCDSs which are equivalent to equity, so these Regulations make provision to ensure that CCDSs are taxed as shares.

8. Consultation outcome

8.1 In December 2012 draft regulations were published for comment, in accordance with HMRC's Tax Consultation Framework (http://www.hmrc.gov.uk/consultations/tax-consultation-framework.pdf), for a period of four weeks starting on 11 December 2012.

8.2 This process has enabled HMRC to develop these regulations in partnership with interested stakeholders, from whom assistance and input has been received. These contributions have resulted in regulations which stakeholders, including the industry representative body, supports.

9. Guidance

9.1 Her Majesty's Revenue and Customs Corporate Finance Manual will be updated to reflect the changes set out in this instrument as part of the normal guidance update process.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is nil.

10.3 A Tax Information and Impact Note covering this instrument will be published on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 The new rules may affect small firms (that is, with fewer than 20 employees). However, the impact is likely to be minimal and businesses of all sizes impacted by this change will benefit from a slightly reduced administrative burden in relation to these provisions.

11.3 The representative body for building societies has been fully engaged in the consultation process.

12. Monitoring & review

12.1 The outcome will be subject to regular internal review.

13. Contact

Fiona Hay at Her Majesty's Revenue and Customs Tel: 020 7147 2543 or email: fiona.hay@hmrc.gsi.gov.uk can answer any queries regarding the instrument.