
CORPORATION TAX: LOAN RELATIONSHIPS: CONNECTED COMPANIES

Who is likely to be affected?

1. Companies that are subject to the corporation tax legislation on corporate debt (the 'loan relationships' rules).

General description of the measure

2. Legislation will be introduced in Finance Bill 2009 to amend the loan relationships rules affecting connected companies.
3. The first change amends the rules on the release of trade debts between connected companies.
4. The second change amends the rules on the late payment of interest between connected companies.

Operative date

5. The first change will apply to releases of trade debts that take place on or after 22 April 2009. The second change will have effect for company accounting periods beginning on or after 1 April 2009.

Current law and proposed revisions

6. Two companies are 'connected' under the loan relationships rules if one controls the other, or they are both under common control – so companies in the same group are connected. A creditor that formally releases a connected debtor from a trade debt (or a debt incurred in a UK or overseas property business) is denied a deduction for the loss on the debt, but currently the debtor may be taxed on its 'profit'.

7. Legislation will be introduced so that, where a trade or property business debt is released, the loan relationships rules apply to the debtor as well as to the creditor. This means that if the debtor company is connected with the creditor, no tax charge arises on the debt release. If the creditor and debtor companies are not connected, the debtor is taxed (unless the release is part of a statutory insolvency arrangement) and the creditor gets relief – just as at present.
8. The second change concerns the rule that allows a debtor company a deduction for interest payable to a connected creditor that is outside the loan relationships rules only on a 'paid basis', rather than on the 'accruals basis' that normally applies. This 'late interest rule' will be amended in cases where the connected creditor is a 'connected company' (as defined in the loan relationships rules), or a company that is a close company participator in the debtor company, or where either debtor or creditor have a 'major interest' in the other party. In such cases, the late interest rule will only apply if the creditor company is resident in a 'non-qualifying territory' (broadly, a tax haven). If this relaxation of the rule is abused, an anti-avoidance provision will be introduced in a future Finance Bill.
9. Rules similar to the late interest rule apply where connected and close companies issue deeply discounted securities. Equivalent changes will be made so that those rules also only apply to a creditor company that is resident in a non-qualifying territory.
10. A company will be able to elect for the 'paid basis' to continue for the first accounting period which begins on or after 1 April 2009.

Further advice

11. If you have any questions about these changes, please contact Sue Davies on 020 7147 2565 (email: sue.davies2@hmrc.gsi.gov.uk) or Tony Sadler on 020 7147 2608 (email: tony.sadler@hmrc.gsi.gov.uk.) Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk