
GROUP RELIEF: PREFERENCE SHARES

Who is likely to be affected?

1. Groups of companies where some subsidiaries are funded in part by preference shares issued to external investors. The most commonly affected groups will be those including regulated financial institutions issuing preference shares that qualify as Tier 1 regulatory capital.

General description of the measure

2. Legislation will be introduced in Finance Bill 2009 to change paragraph 1 of Schedule 18 to the Income and Corporation Taxes Act 1988 (ICTA) to ensure that companies issuing particular types of new preference share capital to external investors do not lose the ability to enter into arrangements to claim and surrender group relief with other members of their group.
3. The same rules in Schedule 18 to ICTA are also used to define group relationships for other purposes, for example a chargeable gains group, or in some anti-avoidance rules. The changes will make it more difficult to inadvertently break a group structure or trigger an anti-avoidance provision through issuing a common commercial financing instrument to external investors.

Operative date

4. The changes apply to all accounting periods that commenced on or after 1 January 2008, unless an election is made to retain the existing treatment of shares issued before 18 December 2008 (or shortly after where a commitment to issue the shares was entered into before that date).

Current law and proposed revisions

5. Schedule 18 to ICTA identifies the equity holders in a company, and the amount of their entitlement to the profits or assets available for distribution. These rules are used to determine whether related companies are able to claim or surrender group relief, as well as, for example, whether they form a group for chargeable gains purposes. 'Equity holders' includes the holders of the company's ordinary shares, which are all the company's

shares except for fixed-rate preference shares. Thus the rights of fixed-rate preference share holders are ignored when determining whether companies can enter into group relief arrangements.

6. These changes remove the references to 'fixed-rate preference shares', and instead exclude the holders of a wider range of preference shares from being treated as equity holders in the company. These are the newly defined 'relevant preference shares'. In addition, to shares that carry rights to fixed rate dividends, relevant preference share dividends can be at a rate linked to a variable published market interest rate, or a rate linked to an index of consumer prices.
7. Preference shares where the dividend may not be paid, either at all or only in part, may in certain circumstances also be 'relevant preference shares'. Those circumstances cover companies in severe financial difficulties and companies for whom dividend payments are restricted by regulatory capital considerations.

Further advice

8. The changes introduced by this measure were announced by the Financial Secretary to the Treasury in a Written Ministerial Statement on 18 December 2008.
9. If you have any questions about this change, please contact Philip Donlan, on 020 7147 2633 (email: philip.donlan@hmrc.gsi.gov.uk) or Aidan Reilly on 020 7147 2575 (email: aidan.reilly@hmrc.gsi.gov.uk). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk