



**HM Revenue
& Customs**

Sale of Lessor Companies etc-- Reforms

Draft Legislation and Explanatory Note
22 April 2009

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Foreword

In July 2008, HMRC published a discussion document inviting comments on proposals for changes to the Sale of Lessors legislation. The government has considered the responses and today publishes draft legislation for comment.

Comments should be sent to:

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Introduction

1. The Sale of Lessors legislation was enacted in Schedule 10 Finance Act 2006. The legislation applies where a business of leasing plant or machinery is carried on by a company alone or by a company in partnership and prevents a potential loss of tax when a lessor company is sold.
2. A company carrying on a business of leasing plant or machinery may derive a timing advantage from a claim to capital allowances. This is because the rate at which expenditure is written off for capital allowances purposes exceeds the rate at which the capital expenditure is written off for commercial accounting purposes. As a consequence of a claim to capital allowances the company is able to defer profits for tax purposes. Groups sought to turn this temporary deferral into a permanent deferral by selling the lessor company to a loss making group that was able to offset its own losses against the deferred profits of the newly acquired lessor company.
3. The legislation recoups the timing advantage by bringing into charge an amount of income which captures the difference between the tax written down value of the assets and the accounting value. The timing advantage is returned to the company in the form of an expense in the following accounting period. The effect of the legislation is triggered whenever there is a change in the ownership of the lessor company or a change in the profit-sharing arrangements of a partnership carrying on a leasing business and is designed so that the charge affects the selling group and the expense benefits the buying group. Where the buying group is profitable it benefits from any loss relief derived from the expense and is therefore willing to pay more for the company. The additional payment compensates the selling group for the effect of the charge. Where the buying group is loss-making the expense brings no benefit and the price the buyer is willing to pay does not compensate the selling group for the effect of the charge. This mechanism ensures that a sale to a loss making group is no longer attractive.
4. The legislation was introduced in response to a widespread pattern of avoidance and has operated successfully, providing valuable Exchequer protection, since it was brought into effect on 5 December 2005. However, recent changes in the financial climate have tested the legislation so that, in some circumstances, it may no longer deliver the intended policy objectives. In particular, concern was expressed that the inability of groups to utilise the relief within the permitted period was causing otherwise commercially motivated sales to founder.
5. In response, the Government published a document setting out a number of technical changes designed to ensure that the legislation operates appropriately in more complex situations, and described three ways in which changes could be made which would allow commercially motivated transactions to proceed even when the purchaser was unable to utilise the relief immediately.
6. The proposals were welcomed by respondents and the Government has considered the responses carefully.
7. Draft legislation dealing with technical changes to ensure that the legislation operates appropriately in more complex situations and to preserve the value of

the relief when the buying group has insufficient profits is published today for comment.

8. The Government has considered carefully the case for more radical action. Of the other options the option to ring fence the trade going forward as an alternative to Schedule 10 was the most popular. However, respondents considered the proposals too restrictive and asked that the ring fenced trade be permitted to expand through the purchase of new plant or machinery for the purpose of leasing. Ensuring that this does not undermine the Exchequer protection afforded by Schedule 10 would add considerable complexity to the legislation and it is not clear that such radical action is necessary in the current economic climate, particularly when the tax effect of a charge is likely to be mitigated by loss relief. The Government therefore proposes to keep this option under review.
9. Interested parties are invited to contribute evidence of situations where Schedule 10 is impeding normal commercial transactions and these difficulties have not been addressed by the proposed changes announced today.
10. Comments on draft legislation are invited and should be sent as soon as possible to:

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1 Sale of lessor companies etc: reforms

- (1) The Schedule contains provision amending Schedule 10 to FA 2006 (sale of lessor companies etc).

SCHEDULE

Section 1

SALE OF LESSOR COMPANIES ETC: REFORMS

Introduction

- 1 Schedule 10 to FA 2006 (sale etc of lessor companies etc) is amended as follows.

Paragraph 7

- 2 (1) Paragraph 7 (provision for purposes of condition A in paragraph 6) is amended as follows.
- (2) In sub-paragraph (8)(b), for “acquires any plant or machinery directly or indirectly from a person who is connected with the company” substitute “acquired any plant or machinery in circumstances in which this paragraph applies”.
- (3) For sub-paragraph (9) substitute –
- “(9) Paragraph (b) of sub-paragraph (8) above applies if –
- (a) the relevant day falls on or after 22 March 2006,
 - (b) the plant or machinery was acquired directly or indirectly from a person who was connected with the company when the acquisition took place, and
 - (c) either the acquisition took place on or after 5 December 2005 or the person from whom the plant or machinery was so acquired was also connected with the company on that date.”

Paragraph 13A

- 3 After paragraph 13 insert –

“No qualifying change of ownership where principal company’s interest in consortium company unchanged

- 13A (1) This paragraph applies if –
- (a) a company (“company A”) is owned by a consortium, and
 - (b) a relevant change in the relationship between company A and a principal company of company A occurs on any day, but the principal company’s interest in company A remains unchanged.
- (2) For the purposes of this Schedule, there is no qualifying change of ownership in relation to company A on that day as a result of that change in that relationship.

- (3) For the purposes of this paragraph the principal company’s interest in company A remains unchanged if the percentage of the ordinary share capital of company A that is beneficially owned directly or indirectly by the principal company is the same at the beginning and end of that day.
- (4) Section 838(2) and (4) to (10) of ICTA apply for construing sub-paragraph (3).”

Paragraph 17

- 4 (1) Paragraph 17 (meaning of “PM” in paragraph 16) is amended as follows.
- (2) In sub-paragraph (7)(b), for “acquires any plant or machinery directly or indirectly from a person who is connected with the company” substitute “acquired any plant or machinery in circumstances in which this paragraph applies”.
- (3) For sub-paragraph (8) substitute –
 - “(8) Paragraph (b) of sub-paragraph (7) above applies if –
 - (a) the relevant day falls on or after 22 March 2006,
 - (b) the plant or machinery was acquired directly or indirectly from a person who was connected with the company when the acquisition took place, and
 - (c) either the acquisition took place on or after 5 December 2005 or the person from whom the plant or machinery was so acquired was also connected with the company on that date.”

Paragraph 23

- 5 In paragraph 23 (leasing business carried on by company in partnership: change in company’s interest in business), for sub-paragraph (6) substitute –
 - “(6) This paragraph is subject to paragraph 23A and is supplemented by paragraph 24.”

Paragraph 23A

- 6 After that paragraph insert –
 - “23A(1) Paragraph 23 does not apply where conditions A, B and C are met.
 - (2) Condition A is that at the end of the relevant day none of the companies by which the business was carried on any longer have any share in the profits or loss of the business.
 - (3) Condition B is that, in consequence of what happens on the relevant day, the disposal value of all of the plant and machinery which was used for the purposes of the business and in respect of which capital allowances have been claimed is to be brought into account under section 61 of CAA 2001.
 - (4) Condition C is that the disposal value to be brought into account in relation to all of the plant or machinery is the price which the plant or machinery would fetch in the open market on that day.”

Paragraph 32

- 7 (1) Paragraph 32 (leasing business carried on by a company in partnership: amount of expense) is amended as follows.
- (2) In sub-paragraph (1) –
- (a) in sub-paragraph (c), for “increases at any time on” substitute “is greater at the end of that day than at the start of”, and
 - (b) in sub-paragraph (d), omit “at that time” (in both places).
- (3) For sub-paragraph (3) substitute –
- “(3) The appropriate percentage is –
- $$\frac{\text{OCI}}{\text{PCD}}$$
- where –
- OCI is the increase in the other company’s percentage share in the profits or losses of the business which is wholly attributable to the change in the partner company’s interest in the business, and
- PCD is the decrease in the partner company’s percentage share in the profits or losses of the business.”

Paragraph 39

- 8 (1) Paragraph 39 (relief for expense otherwise giving rise to carried forward loss) is amended as follows.
- (2) In sub-paragraph (1) –
- (a) in paragraph (c), insert at the end “or a later accounting period,”,
 - (b) in paragraph (d), after “company” insert “after the accounting period in which the loss is made”, and
 - (c) in paragraph (e), for “12 months beginning with” substitute “5 years beginning immediately after”.
- (3) In subsection (1A) –
- (a) in paragraph (b), for “, and” substitute “or a later accounting period,”,
 - (b) in paragraph (c), after “company” insert “after the accounting period in which the loss is made”, and
 - (c) after that paragraph insert “and
 - (d) the subsequent accounting period starts within the period of 5 years beginning with the day that is the relevant day within the meaning of paragraph 23(1) and does not start as a result of paragraph 3 or 33.”
- (4) In sub-paragraph (2) –
- (a) after “33” insert “or this sub-paragraph”, and
 - (b) for “an expense” substitute “giving rise to an expense of the relevant amount”.

(5) After that sub-paragraph insert –

“(2A) The relevant amount is the amount of the loss treated as an expense increased by –

$$\frac{D}{365} \times R$$

where –

D is the number of days in the accounting period in which the loss is made, and

R is the percentage rate applicable to section 826 of ICTA under section 178 of FA 1989.”

(6) In sub-paragraph (3), after “The” insert “amount of the”.

(7) In sub-paragraph (4) –

(a) after “33” insert “or this paragraph”, and

(b) for “the expense under that paragraph” substitute “that expense”.

Commencement

- 9 (1) The amendments made by paragraph 8 have effect in relation to losses incurred in accounting periods ending on or after 22 April 2009.
- (2) The other amendments made by this Schedule have effect where the relevant day is on or after that date.

EXPLANATORY NOTE

SCHEDULE: SALE OF LESSOR COMPANIES ETC - REFORMS

SUMMARY

1. This Schedule makes changes to Schedule 10 to Finance Act 2006 to ensure that the Schedule operates fairly.

DETAILS OF THE CLAUSE

2. Paragraph 2 makes changes to paragraph 7 of Schedule 10 by introducing in sub-paragraph (9) conditions to be satisfied before sub-paragraph (8)(b) applies. The conditions ensure that sub-paragraph (8)(b) only applies to plant or machinery acquired on or after 5 December 2005 or acquired at any time from a person connected to the company on 5 December.
3. Paragraph 3 inserts new paragraph 13A which sets out the circumstances where there is deemed to be no qualifying change in ownership. There is no qualifying change in ownership if the interest remains the same or the percentage of share capital held by the principal company remains unchanged.
4. Paragraph 4 amends Paragraph 17 of Schedule 10 to FA2006 by introducing in subparagraph (8) conditions to be satisfied before subparagraph (7)(b) of paragraph 17 applies. The conditions ensure that where a company acquires plant or machinery from a connected person, this condition only applies to plant or machinery acquired on or after 5 December 2005 or acquired at any time from a person connected to the company on 5 December.
5. Paragraph 6 inserts new paragraph 23A so that in circumstances where all of the companies that carried on the business in partnership cease to have a share in the profits or losses of the business and as a consequence the plant or machinery is treated as disposed of for a value equal to its open market value then no amount of income will be treated as received for the purposes of Paragraph 23.
6. Paragraph 7 changes the application of paragraph 32 so that it applies only when there is a percentage increase over the whole day and sets the calculation for determining the amount of the expense allocated to the other company as a consequence of a percentage increase.
7. Paragraph 8 makes changes to paragraph 39 of Schedule 10. The changes extend the period over which a loss derived from the expense can be utilised and provide for an increase in the amount of any loss not utilised.
8. Paragraph 9 sets out when the legislation will have effect. Changes made by paragraph 8 allowing extended access to

losses derived from the expense will have effect for accounting periods ending on or after 22 April 2009. The other amendments will have effect where the relevant day is on or after 22 April 2009.

BACKGROUND NOTE

9. This Schedule makes changes to Schedule 10 to Finance Act 2006 to ensure that it operates appropriately, particularly in the context of a leasing business carried on by a company owned by a consortium or carried on by companies in partnership. In addition it extends the period over which the buying group can access losses derived from the expense and maintains the value of any unutilised loss over a similar period.
10. Schedule 10 was introduced in response to a well established pattern of avoidance involving the sale of a lessor company with deferred tax profits. Groups sought to turn the temporary tax timing advantage gleaned from a claim to capital allowances into a permanent deferral by selling lessor companies with deferred tax profits to structural lossmakers who were then able to utilise losses to reduce the taxable profits of the lessor company.
11. The legislation is triggered when a lessor company changes hands. A charge and matching relief are calculated to reflect the tax timing advantage gained by a claim to capital allowances. The charge affects the selling group and the relief benefits the buying group.
12. The legislation has operated successfully but it has become clear that where there have been more complex transactions involving businesses carried on by companies in partnership and businesses carried on by companies owned by consortia it has had unexpected results.
13. The changes introduced here ensure that no Schedule 10 charge arises when a partnership is dissolved or a consortium company is transferred intra-group and that a company carrying on a leasing business in partnership that increases its interest in the business is allocated an appropriate amount of relief.
14. Changes to extend the period over which a loss derived from the expense is available to set against profits of the purchaser's wider group along with measures to ensure it retains its value over this period have been introduced in response to discussions with the leasing industry. These changes will benefit buying groups that are temporarily loss-making in the current economic downturn.