

Ministerial Statement

Corporate Taxation

The Financial Secretary to the Treasury (Stephen Timms MP): I am today announcing the Government's intention to introduce in the next Finance Bill a further change to the rules on how groups of companies are taxed when they buy back their issued debt at a discount to the amount borrowed. The further change is in addition to the changes I previously announced in my Statement on 14 October.

In my Statement on 14 October, I announced that the Government proposed to deal with the circumstances in which companies could buyback their debt at a discount to the amount borrowed without being taxed. I announced changes that would tighten the rules dealing with debt buybacks to ensure that only those debt buybacks that are undertaken as part of genuine corporate rescues will benefit from discount not being subject to tax.

The Statement made clear that even if a company benefited from the discount not being taxed under the new proposals any subsequent cancellation of the debt by the new creditor will result in the debtor being taxed on the previously untaxed discount.

HM Revenue and Customs (HMRC) published more detail on these proposals on 22 October, available at www.hmrc.gov.uk/drafts/debt-buyback.htm, which clarified the circumstances in which the discount on the debt buyback would not be taxed and the mechanism by which a subsequent release of such a debt would result in the debtor being taxed on the discount.

It has since come to light that groups of companies may be able to avoid the discount, that was not taxed at the time of the buyback, being taxed on the subsequent release of the debt. Groups may be able to achieve this by means of the new creditor accepting ordinary shares in the debtor in order to release the debtor from its liability.

The Government is therefore proposing to introduce additional legislation to prevent this. The new legislation will ensure that where the discount on a buyback is not taxed, any subsequent release of the debt where the consideration for the release is ordinary shares in the debtor or the entitlement to any such shares then the debtor will be taxed on the previously untaxed discount arising on the debt buyback.

The further legislation announced today will have effect in relation to releases of debt that occur on or after today in relation to any debt that was subject of a debt buyback occurring on or after 14 October and to which the proposed legislation announced on 14 October will apply.

Draft legislation will today be published on HMRC's website covering both the 14 October announcement and today's announcement.

Taxation of Foreign Profits

I am also today announcing the Government's intention to present to Parliament in the next Finance Bill amendments to the "debt cap" provisions set out in Schedule 15 of Finance Act 2009.

The debt cap forms part of the important reforms to the taxation of the foreign profits of UK companies, which the Government introduced in Finance Bill 2009. The cornerstone of the foreign profits package was the wide-ranging dividend exemption, effective from July this year, which was strongly welcomed by business. This allows UK companies to bring profits back to the UK free of UK tax. To make the dividend exemption affordable, the Government worked closely with business to introduce a debt cap guarding against excessive debt funding of UK companies, which will be effective from 1 January 2010.

The amendments announced today will ensure that the debt cap functions as intended providing Exchequer revenue protection while at the same time keeping the compliance burden as small as possible. Specifically, there will be the following amendments made:

- Legislation will be introduced to remove accountancy mismatches in the application of the gateway test to ensure that a consistent way of measuring liabilities is used in arriving both at the worldwide group's gross debt and the net debt of UK companies.
- Legislation will be introduced to put beyond doubt that preference shares are excluded from the relevant liabilities both of the worldwide group and of UK companies when applying the gateway test.
- Legislation will be introduced to extend the definition of "financial instrument" to include all derivatives, such as options, swaps, futures, forwards and contracts for differences. This is because the current definition, which relies on the FSA Handbook, may exclude certain derivatives which are routinely traded by many banks and other financial institutions. The change will ensure that groups are not disqualified from the "qualifying financial services groups" exemption because they undertake such dealings.
- Legislation will be introduced allowing companies to elect that no debt cap disallowance is allocated to them. This will benefit companies, such as those involved in whole business securitisations, that need certainty of tax treatment in order to protect their credit ratings. This legislation will also mandatorily restrict the allocation of disallowances to dual resident investment companies.
- Legislation will be introduced to extend the definition of "financing income", so that guarantee fees are included as financing income. This provides consistency of treatment where guarantee fees are paid within a group, or are deemed to be paid under transfer pricing legislation, since a guarantee fee is already treated as a financing expense of the payer.

- Legislation will be introduced to refine the definition of a group treasury company for the purposes of the debt cap rules so as to exclude trading companies performing a peripheral group treasury company function.
- Legislation will allow interest paid by UK subsidiaries of tax-exempt non-departmental public bodies to disregard interest they pay to that body for debt cap purposes.
- Legislation will be introduced to clarify what is meant by “ancillary costs” relating to amounts borrowed, for the purpose of computing the available amount.
- Legislation will be introduced to deal with the case where external borrowing is undertaken by a partnership in which a UK company is a partner. This will ensure that the available amount reflects the economic cost to the group of borrowing by partnerships in which it has an interest, and is computed in a way consistent with the UK tax treatment of partnership debts.
- Legislation will be introduced to ensure that certain partnerships, formed under the laws of an overseas territory, qualify for the collective investment scheme exclusion for the purposes of identifying an ultimate parent company under the debt cap rules. Where an overseas corporate fund vehicle has a majority stake in a number of commercially unrelated groups of companies, this will minimise the possibility of all of its controlled holdings being treated as a single group for debt cap purposes.
- Legislation will be introduced to ensure that securitisation companies, which come within the special tax regimes we introduced in 2005, are excluded from the debt cap rules. This will ensure that the “tax-neutral” status of these companies is not jeopardised and will avoid any adverse effect on their credit ratings.
- A new power will be introduced to allow the definitions of the available amount and the tested expense amount to be changed or added to through secondary legislation. Regulations made under this power will be capable of having effect from 1 January of the calendar year in which they are made. This will ensure that difficulties arising where the accounting treatment for external borrowing in the consolidated accounts differs from that in a UK company’s individual accounts can be addressed through regulations.

A technical paper providing further details of all of these changes is being issued on HMRC’s website today. Draft legislative amendments will be published alongside the 2009 Pre-Budget Report for comment.