Finance Bill 2009 Groups of Companies – Amendment to paragraph 1(3) Schedule 18 ICTA 1988

On 18 December 2008, the Financial Secretary to the Treasury, Stephen Timms, announced in a Ministerial Statement to Parliament Government proposals to introduce legislation in the Finance Bill 2009 on two different tax issues to address problems that have come to light as a result of the recent turbulence in the financial markets. The Statement indicated that draft clauses on those measures would be published before the Chancellor's Spring Budget.

HMRC is today publishing draft legislation which makes changes to the treatment of companies that have issued certain preference shares (the newly defined 'relevant preference shares'), which include shares that can give variable returns, rather than just 'fixed-rate' preference shares. The changes are intended to ensure that such companies do not lose the ability to enter into arrangements to claim and surrender corporation tax group relief with other members of their group.

The draft legislation and draft Explanatory Note are attached.

Draft legislation for the foreign denominated losses measure also announced on the 18 December 2008 will be published shortly.

A copy of the Financial Secretary's Statement can be found on the HMRC website at:

http://www.hmrc.gov.uk/news/changes-bill-09.htm

SCHEDULE

Section 1

GROUP RELIEF: PREFERENCE SHARES

Amendments of Schedule 18 to ICTA

1 Schedule 18 to ICTA (definitions relating to group relief) is amended as follows.

2 (1) Paragraph 1 is amended as follows.

(2) In sub-paragraph (2), for "fixed-rate" substitute "relevant".

(3) In sub-paragraph (3)—

(a) for "fixed-rate" substitute "relevant",

(b) for paragraph (c) substitute—

"(c) either—

(i) do not carry a right to dividends, or

(ii) carry a right to dividends to which paragraph 1A applies; and", and

(c) in paragraph (d), for "that new consideration" substitute "the new consideration received by the company in respect of the issue of the shares".

3 After paragraph 1 insert—

"1A (1) This paragraph applies to a right to dividends carried by shares in a company if—

(a) the dividends represent no more than a reasonable commercial return on the new consideration received by the company in respect of the issue of the shares, and

(b) condition A, B or C is met.

(2) Condition A is that—

(a) the dividends are of a fixed amount or at a fixed rate per cent of the nominal value of the shares, and

(b) the company is not entitled in any circumstances to reduce the amount of, or not to pay, any of the dividends.

(3) Condition B is that—

(a) the dividends are of a rate per cent of the nominal value of the shares and the rate fluctuates in accordance with—

(i) a standard published rate of interest, or

(ii) the retail prices index, or any similar general index of prices which is published by the government, or by an agent of the government, of the country or territory in whose currency the shares are denominated, and

(b) the company is not entitled in any circumstances to reduce the amount of, or not to pay, any of the dividends.

(4) Condition C is that condition A or B would be met but for sub-paragraph (2)(b) or (3)(b), and—
   (a) the company is only entitled to reduce the amount of, or not to pay, any of the dividends in relevant circumstances, or
   (b) having regard to all the circumstances, it is reasonable to assume that the company is only likely to reduce the amount of, or not to pay, any of the dividends in relevant circumstances.

(5) For the purposes of sub-paragraph (4) a company reduces the amount of, or does not pay, dividends "in relevant circumstances" if—
   (a) at the time the dividend is or would be payable, the company is in severe financial difficulties, or
   (b) it does so for the purpose of—
      (i) complying with a requirement of the law of any country or territory, or
      (ii) following a recommendation of a relevant regulatory body.

(6) The Treasury may by order specify circumstances in which a company is to be treated as in severe financial difficulties for the purposes of sub-paragraph (5)(a).

(7) In sub-paragraph (5)(b) "relevant regulatory body" means—
   (a) in relation to a dividend paid by a company that is authorised for the purposes of the Financial Services and Markets Act 2000, the Financial Services Authority, and
   (b) in relation to a dividend paid by any other company, a body discharging functions in relation to the company under the law of a country or territory outside the United Kingdom that correspond to functions discharged by the Financial Services Authority in relation to a company authorised as mentioned in paragraph (a).

(8) In this paragraph "new consideration" has the same meaning as in section 254."

4 In paragraph 5B(4)(b), for "fixed-rate" substitute "relevant".

Commencement

5 The amendments made by this Schedule have effect for accounting periods beginning on or after 1 January 2008.

Election to opt out of changes in relation to pre-existing etc shares

6 If a company so elects, the amendments made by this Schedule do not have effect in relation to shares issued by the company—
   (a) before 18 December 2008, or
   (b) on or after that date under an agreement entered into before that date.

7 An election under paragraph 6—

(a) must be made by the company by being included in its company tax return for the relevant period (and may be included in the return originally made or by amendment), and

(b) is irrevocable.

8 In paragraph 7—

"company tax return" has the same meaning as in Schedule 18 to FA 1998 (see paragraph 3(1) of that Schedule);

"the relevant period" means the first accounting period of the company beginning on or after 1 January 2008.

9 In paragraph 10 of Schedule 18 to FA 1998 (other claims and elections to be included in company tax return), insert at the end—

"(6) An election under paragraph 6 of Schedule to the Finance Act 2009 (election to modify the effect of amendments affecting the treatment of certain preference shares for the purposes of group relief) can only be made by being included in a company tax return (see paragraph 7(a) of that Schedule)."

Paragraph 1(7) of Schedule 25 to ICTA

10 The amendments made by this Schedule do not have effect for the purposes of paragraph 1(7) of Schedule 25 to ICTA (controlled foreign companies: definition of non-voting fixed-rate preference shares).

EXPLANATORY NOTE

CLAUSE [A] SCHEDULE [X]: PREFERENCE SHARES - GROUP RELIEF

SUMMARY

1. Clause [A] and Schedule [X] provide that holders of certain preference shares, including those commonly issued by financial institutions as part of their regulatory Tier 1 capital base, are not treated as equity holders of a company. Previously only the holders of fixed-rate preference shares qualified for this exclusion. It is necessary to distinguish between equity holders and non-equity holders in order to identify companies that are sufficiently under common ownership so as to be regarded as belonging to the same group for tax purposes.

DETAILS OF THE CLAUSE

2. Clause [A] introduces Schedule [X] of the Finance Bill.

DETAILS OF THE SCHEDULE

3. Paragraph 1 of Schedule [X] introduces the amendments which follow. These amend Schedule 18 to the Income and Corporation Taxes Act 1988 (ICTA).

4. The rules in Schedule 18 to ICTA establish who are to be regarded as the equity holders in a company and to what extent, by reference to their shareholdings or entitlement to share in the company's distributable profits or assets. The rules are used primarily to determine a company's entitlement to surrender or claim group relief from related companies for trading losses and other amounts. A number of other tax provisions rely upon the rules in Schedule 18. Those provisions include chargeable gains, real estate investment trust, venture capital relief and leasing rules.

5. Paragraph 2 of Schedule [X] details the amendments to paragraph 1 of Schedule 18 to ICTA. The previous exclusion from treatment as an equity holder for holders of 'fixed-rate preference shares' is replaced by a new exclusion for holders of 'relevant preference shares'. Relevant preference shares must be issued for new consideration, so cannot, for example, be a bonus issue. They may carry either no rights to dividends, or rights which fulfil the conditions set out in new paragraph 1A of Schedule 18 to ICTA.

Shares which carry no rights to dividends are explicitly included as relevant rate preference shares.

6. Paragraph 3 of Schedule [X] inserts new paragraph 1A in Schedule 18 to ICTA.

7. New sub-paragraph 1A(1) of Schedule 18 to ICTA determines that where preference shares carry a right to a dividend, they will be relevant preference shares if they fulfil the 'reasonable commercial return' condition and one of conditions A, B or C set out in the following sub-paragraphs. The reasonable commercial return condition is carried over from the definition of a fixed-rate preference share, so is unchanged.

8. New sub-paragraph 1A(2) of Schedule 18 to ICTA sets out condition A. This is met by shares that carry rights to a dividend and would previously have been regarded as fixed-rate preference shares.

9. New sub-paragraph 1A(3) of Schedule 18 to ICTA sets out condition B. This is met where the dividend payable on the shares is not fixed absolutely, but is fixed by reference to a published variable rate, either a market rate of interest such as a central bank base rate, or to an appropriate retail prices index.

10. Both of conditions A and B are further qualified to ensure that the terms under which the shares are issued do not grant the issuer a right to pay dividends of less than the nominal rate. Where shares are issued under such terms, then condition C is relevant.

11. New sub-paragraph 1A(4) of Schedule 18 to ICTA sets out condition C. This is met in cases where condition A or B would have been met, but for the fact that the company has a right to reduce the dividends paid on the preference shares below the nominal rate in circumstances that are covered by the 'relevant circumstances' set out in the following sub-paragraph.

12. If the terms under which the shares have been issued would clearly only permit the company to reduce or not to pay the dividends in these relevant circumstances, and no other, then condition C will be met by virtue of subparagraph (4)(a).

13. However, there will be some circumstances in which the terms on which shares are issued are not in fact explicit. For example, the terms of issue may grant the directors of the company a degree of discretion as to whether to pay a dividend, or to pay a reduced dividend. In such cases, sub-paragraph (4)(b) allows wider factors to be taken into account so that condition C will be met where having regard to all the circumstances it is reasonable to assume that the

company is likely to reduce or not to pay the dividends in the relevant circumstances, and no other.

14. New sub-paragraph 1A(5) of Schedule 18 to ICTA sets out the relevant circumstances for the purposes of the preceding sub-paragraph. The first circumstance is when the company is in severe financial difficulties at the time the dividend is or would be payable. The second circumstance covers the situation where the dividend is reduced or not paid in order to comply with a legal requirement or to follow a recommendation of a relevant regulatory body.

15. New sub-paragraph 1A(6) of Schedule 18 to ICTA provides a power for the Treasury to make an order specifying what will be regarded as constituting 'severe financial difficulties' for these purposes.

16. New sub-paragraph 1A(7) of Schedule 18 to ICTA defines a "relevant regulatory body" in terms which cover the Financial Services Authority in the UK or an equivalent regulator in another State.

17. Paragraph 5 of Schedule [X] is the commencement rule. Shares can be relevant preference shares in relation to any accounting period that commences on or after 1 January 2008, irrespective of when the shares were issued.

18. Paragraph 6 of Schedule [X] permits a company to make an election to disregard the new rules for 'relevant preference shares' in respect of any shares that it had already issued, or was about to issue, when the changes were first announced by Ministerial Statement on 18 December 2008. Apart from shares that were in the process of being issued, an election will not have any effect for shares issued after 18 December 2008, where the revised rules will apply.

19. Paragraphs 7 to 9 of Schedule [X] set out the form of the election, how it is to be made, and specify that once made, it cannot be withdrawn.

20. Paragraph 10 of Schedule [X] ensures that the changes to Schedule 18 do not change the meaning of a 'fixed-rate preference share' for the purposes of the controlled foreign company rules in paragraph 1(7) of Schedule 25 to ICTA.

BACKGROUND NOTE

21. The policy underlying these changes is that the holders of preference shares that provide the holder with no more than an interest like return should not be regarded as equity holders in the issuing company.

22. The central change introduced by this clause and Schedule was announced by a Written Ministerial Statement on 18 December 2008. A copy of that statement is available on the HMRC website at:

http://www.hmrc.gov.uk/news/changes-bill-09.htm