

## **CFMxxxxx - Loan relationships: connected parties: late interest: accounting periods beginning on or after 1 April 2009**

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### **Changes to the late interest rule after 1 April 2009**

Schedule 20 Finance Act 2009 amended the late interest rule for accounting periods beginning on or after 1 April 2009. It inserted new conditions at CTA09/S374(1A), CTA09/S375(4A), and CTA09/S377(2), applying respectively to cases where the creditor is a 'connected company' (CFMxxxx), a close company participator (CFMxxxx) or a 'major interest' company (CFMxxxx).

In each case the new condition is that the late interest rule will only apply where the creditor is a company that is 'resident' in a 'non-qualifying territory'.

'Non-qualifying territory' takes its meaning from ICTA88/SCH28AA/PARA5E, and is explained at INTM432112. It means any territory that is not a 'qualifying territory', which in turn means a territory with which the UK has a double taxation treaty that contains a non-discrimination article. The list of such territories at INTM432112 includes all EU countries and the majority of other normal tax jurisdictions. It excludes tax havens and similar jurisdictions. If a territory is not on this list, HM Revenue & Customs' (HMRC's) view is that a creditor company is located in a 'non-qualifying' territory for the purposes of the late interest rule.

Resident is defined as 'liable to tax by reason of domicile, residence, or place of management, or effectively managed in a non-qualifying territory other than one in which companies are liable to tax by reason of domicile, residence or place of management'.

Some territories do not levy tax by reason of domicile, residence or place of management, and a company effectively managed in such a territory would not be 'resident for tax purposes' in such a territory. The words 'effectively managed' are broadly equivalent to the concept of 'place of effective management' used in Double Taxation Treaties. A company will therefore be caught by the late interest rule even if its creditor is managed in a jurisdiction that does not levy an Income Tax or Corporation Tax on profits, or one that only taxes local-source income, and would not otherwise be 'resident' there for tax purposes.

The changes made by FA09 mean that in the majority of cases where the creditor is a company, unless that company is located in a tax haven, normal loan relationships principles will apply, and interest will be deductible as it accrues in the accounts, not when it is paid. The changes have no effect where the creditor is an individual or a pension scheme.

Equivalent changes were made to similar rule that applies to deeply discounted securities (CFMxxxxx).

The Budget 2009 announcement on the amendment to the rule stated that if the changes to these provisions were abused, anti-avoidance measures would be introduced in a future Finance Bill. HMRC staff should report examples of avoidance to CT&VAT (Financial Products Team).

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## **CFMxxxxx - Loan relationships: connected parties: late interest: accounting periods beginning on or after 1 April 2009: transition to the new rules**

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### **Transition to the new rules**

A company may elect under FA09/SCH20/PARA(9)(2) for the 'paid basis' to apply for the first accounting period beginning on or after 1 April 2009. This provides time for groups to rearrange their inter-company loans if they so wish. The election must be made in the Corporation Tax return for the accounting period in question. No such election can be made for an accounting period ending after 31 March 2011. The election may be revoked by amending the return within normal time limits.

Beyond this no special rules are prescribed for interest accruing but unpaid in accounting periods beginning before 1 April 2009. Debits disallowed under the rule as it stood for accounting periods beginning before 1 April 2009 (or if an election is made for the first AP for which the changes would otherwise have an effect, the next following AP) will be deductible in accordance with the rules before the amendments took effect; that is, when the interest is paid.

In some cases, interest should have been disallowed in earlier periods but may not have been, either because returns were accepted without challenge, or because of the decision set out in Revenue & Customs Brief 33/08 not to pursue points relating to paragraph 2 for currently open periods (see below). The amount allowable in periods beginning on or after 1 April 2009 is the amount not previously allowed.

Where brought forward unpaid interest relating to periods beginning before 1 April 2009 is paid in periods beginning on or after that date (including cases where some interest for the earlier periods has been deducted and some has not), any reasonable apportionment of the interest paid between current and earlier periods will be accepted.

### **Revenue & Customs Brief 33/08**

RCB33/08 issued in July 2008 announced that HMRC would not seek to apply paragraph 2(1A) Schedule 9 FA 1996 as it then stood, in corporation tax returns for accounting periods submitted on or after the date of RCB33/08, or open at that date. RCB 33/08 was a temporary measure to enable returns to be settled pending consultation over a permanent legislative change, and applies only for accounting periods beginning before 1 April 2009 when the amendments to the late interest rule came into force.

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## **CFMxxxxx - Loan relationships: connected parties: late interest: accounting periods beginning on or after 1 April 2009: multi-investor partnerships**

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### **Multi-investor partnerships**

Where a UK company obtains funding from a multi-investor fund, which may typically be structured as a limited partnership with both corporate and non-corporate investors, from a number of different countries, and which may on-lend to the UK company via a non-UK intermediary company, it may be difficult for the UK company to decide whether the late interest rule applies to it.

### **Company partner is a connected company or a major interest company**

The UK debtor company may be connected (within the meaning of CTA09/S374) with a company partner in the partnership, in which case the late interest rule will apply if that corporate investor is located in a non-qualifying territory. 'Look through' rules (CTA09/S467) ensure that company partner remains connected where the lending is undertaken via a partnership. The same principle applies for the 'major interest' test (CTA09/S377) (CFMxxxxx) by virtue of CTA09/S474.

### **Company partner is a participator**

The late interest rule will apply where the creditor is a corporate partner that is a close company participator or otherwise within CTA09/S375, and is located in a non-qualifying territory. The same 'look through' principle applies where the partnership is a 'transparent entity' to ensure that the participator is the person standing in the position of creditor.

CTA09/S379 ensures that the company partner will be caught by S375 where the lending is made indirectly, via a series of loan relationships. This will apply in 'back to back' or conduit arrangements (see CFMxxxxx), where the lending is done via a non-UK intermediary company.

However, the non-UK company may on-lend the funds from the partnership on different terms to the UK company. The debt from the fund to the non-UK company will be different (legally and economically) to the debt from the non-UK company to the UK company. There will be no indirect loan relationship and CTA09/S375 will not apply (outside of 'Ramsay' type issues, or where under IAS32 HMRC might challenge whether the asset and

liability in the non-UK company are so closely linked that derecognition (CFMxxxxx) would be appropriate).

### **Practical approach**

There may be cases where it is impractical for the UK company to establish whether interest should be deductible on the 'paid' or 'accruals' basis, and in what proportion, for example where the investor group is very large, or the profit share agreement very complex. In such cases, HMRC will accept the partnership rather than the partners as 'standing in the position of loan creditor' for the purposes of CTA09/S375(4A), with the result that the late interest rule will not be disapplied. A 'paid basis' will then apply to interest paid by the debtor. It remains open to the company to apply the accruals basis to the extent that it is able to establish that its creditor companies are not resident in non-qualifying territories.

This treatment of the partnership as standing in the position of creditor is a pragmatic approach which applies only for the purposes of enabling the debtor company to decide if the late interest rule in CTA09/S375 applies to it, where for example large and complex investor structures give rise to practical difficulties. It has no bearing on the determination of the loan relationships credits and debits of company partners under CTA09/PT5/CH9 (CFMxxxxx).

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### **CFMxxxxx - Loan relationships: special types of security: deeply discounted securities: connected and close companies: accounting periods beginning on or after 1 April 2009**

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#### **Changes to the rules on deeply discounted securities after 1 April 2009**

Schedule 20 Finance Act 2009 amended the rules on the postponement of debits for discounts on securities issued by connected and close companies, for accounting periods beginning on or after 1 April 2009. It inserted new conditions at CTA09/S407(1A) and CTA09/S409(1), applying respectively to cases where the securities are issued by a 'connected company' (CFMxxxxx), and by a close company to a participator (CFMxxxxx).

In each case the new condition is that the postponement of debit for discounted accruing will only apply where the creditor is a company that is 'resident' in a 'non-qualifying territory'.

For further details on the definitions of 'non-qualifying territory' and 'resident', and on the transitional arrangements, see the explanation of the FA09 changes at [CFMxxxxx](#) to CFMxxxxx.

As with the changes to the late interest rule (CFMxxxxx), the amendment to the rules on the postponement of discount debits mean that in the majority of cases where the creditor is a company, unless that company is located in a tax haven, normal loan relationships principles will apply, and discount will be deductible as it accrues in the accounts, not on redemption of the security. The changes have no effect where the creditor is an individual.

Note also that the 'practical approach' described in [CFMxxxxx](#) which applies where a UK company obtains funding from a multi-investor fund is equally relevant to cases where the debtor company holds a deeply discounted security.

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