

LOAN RELATIONSHIPS: DRAFT LEGISLATION ON RELEASE OF TRADE ETC. DEBTS

DRAFT CONSULTATION CLAUSE

Release of trade etc debts

(1) CTA 2009 is amended as follows.

(2) In section 353 (introduction to Chapter 6 of Part 5)—

(a) omit subsection (3), and

(b) in subsection (6), after “loss” insert “and “release debit””.

(3) In section 476(1) (definitions for purposes of Parts 5 and 6), after the definition of “profit sharing arrangements” insert—

““release debit” means a debit in respect of a release of a liability,”.

(4) Section 479 (relevant non-lending relationships not involving discounts) is amended as follows.

(5) In subsection (2)—

(a) omit the “and” at the end of paragraph (b),

(b) in paragraph (c), after “loss)” insert “or release debit”, and

(c) insert at the end “, and

(d) a debt in relation to which a relevant deduction has been allowed to the company and which is released.”

(6) In subsection (3), for “(2)” substitute “(2)(c)”.

(7) After that subsection insert—

“(3A) In subsection (2)(d) “relevant deduction” means a deduction allowed in calculating the profits of a trade, UK property business or overseas property business.”

(8) Section 481 (application of Part 5 to relevant non-lending relationships) is amended as follows

(9) In subsection (3)—

(a) in paragraph (d), after “loss” insert “or release debit” and for “impairment, and” substitute “impairment or release,”, and

(b) insert at the end “and

(f) in the case of a debt in relation to which a relevant deduction has been allowed to the company and which is released, the release.”

(10) In subsection (4), for “(3)” substitute “(3)(d) and (e)”.

(11) After that subsection insert—

“(4A) In subsection (3)(f) “relevant deduction” has the meaning given in section 479(3A).”

(12) The amendments made by this section have effect for accounting periods beginning on or after 1 April 2009.

EXPLANATORY NOTE FOR DRAFT CONSULTATION CLAUSE

Background

1. Section 74(1)(j) ICTA 1988, which previously gave relief where trade debts had become bad or doubtful, was repealed by Finance Act 2005. Where a company writes off a money debt that has arisen in the course of a trade, or a UK or overseas property business, section 100(1)(c)(iii) FA 1996 now brings the debit in the company's accounts into the ambit of the loan relationships rules (Chapter 4 Part 2 FA 1996).
2. The result is that where the creditor company is unconnected with the debtor, the creditor will get relief for the impairment, either as a trading expense or as part of a non-trading loan relationships deficit. HMRC would also regard relief as being available if the debit arises from the creditor having formally released the debt. If, however, the creditor is connected with the debtor company (for example, they are companies within the same group) paragraph 6 Schedule 9 FA 1996 means that no relief for impairment losses is available. Paragraph 5ZA Schedule 9 applies this to debt releases as well.
3. But, where a trade or property business debt is released, nothing in section 100 FA 1996 bears on the debtor's position. Even if the debtor is paying interest on the debt, or exchange differences arise, section 100 only applies the loan relationships rules to the interest or the exchange differences. The normal principles for taxing trade or property income apply to the credit that will appear in the debtor's accounts. This means that, under section 94 ICTA 1988, the debtor's "profit" will be taxable, unless the release occurs as part of a statutory insolvency arrangement. It does not matter whether or not the debtor company is connected with the creditor.
4. Thus, where a creditor releases a trade or property business debt owed by a connected debtor company, the creditor will get no tax relief but the debtor will be taxed. This mismatch can inhibit debt releases that might otherwise occur in group reconstructions, for example as a result of mergers or acquisitions. The purpose of the draft clause is to remove this asymmetry.
5. It does so by bringing the debtor within the loan relationships rules. This has no practical effect where creditor and debtor are unconnected. The credit in the debtor company's accounts will remain taxable in the first instance, although paragraph 5(4) Schedule 9 FA 1996 ensures that exemption continues to be given where the release forms part of a statutory insolvency arrangement. Where the parties are connected, however, paragraph 5(5) Schedule 9 will apply, so that the debtor does not need to bring in a taxable credit.
6. Since section 80(5) FA 1996 gives loan relationships priority over any other taxing provisions, section 94 ICTA 1988 cannot apply. It is not intended to repeal section 94. Just as section 88D ICTA 1988 continues to give "bad debt relief" for the very restricted class of debts that fall outside of section 100 FA 1996, section 94 will ensure that releases of such debts are taxable. This principally applies to debts arising from barter arrangements, which are not "money debts".

Detail of the draft clause

7. Although the more familiar ICTA 1988 and FA 1996 section numbers have been used in the explanation above, the clause will amend the Corporation Tax Act 2009. This Bill is now before Parliament, and will be available on the Parliament website (<http://services.parliament.uk/bills>) and on the HMRC website.
8. Paragraphs (2) and (3) effect some preliminary amendment of definitions. The definition of “release debit” is moved from section 353 (introduction to Chapter 6 Part 5 – this chapter contains the rules on impairment losses and connected companies) to section 476 (definitions for the purposes of Parts 5 and 6). This ensures that the definition applies to “relevant non-lending relationships”, which are dealt with in Part 6, as well as to loan relationships within Part 5.
9. Paragraphs (4) to (11) amend sections of CTA 2009 that were formerly part of section 100 FA 1996.
10. Section 479(2)(c) deals with the creditor’s position: it treats a debt as a “relevant non-lending relationship” (i.e. a money debt to which the loan relationship rules are applied) if an impairment loss arises because of an unpaid “business payment”. A “business payment” is one that, if paid, would be brought into account as a receipt of a trade or a property business (section 479(3)). Paragraph (5)(b) of the clause puts it beyond doubt that this also applies if the debt is released.
11. Paragraph (5)(c) makes the corresponding debtor relationship a “relevant non-lending relationship” by adding a new paragraph (d) to section 479(2). This covers the case where a “relevant deduction” has been allowed to the company, and the debt is released. “Relevant deduction” is defined in a new subsection (3A). It is a deduction that has been allowed in calculating the profits of a trade or a UK or overseas property business.
12. Paragraph (9) makes corresponding changes to section 481, which sets out the effect of a debt being a “relevant non-lending relationship”. For the creditor, paragraph (9)(a) ensures that the release debit comes within the loan relationships rules; while, for the debtor, paragraph (9)(b) brings about the same result for the credit arising from the debt release.
13. Paragraph (12) gives the commencement date. The amendments apply for accounting periods beginning on or after 1 April 2009 (which is the date by which CTA 2009 will come into force).

Comments

If you have any comments on this draft clause, please send them by 16 January 2009 to:

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