

# 2006 Pre-Budget Report



**HM Revenue  
& Customs**

**PBRN 06**

**6 December 2006**

---

## **AVOIDANCE OF CORPORATION TAX**

---

### **Who is likely to be affected?**

1. Companies that enter into certain types of arrangement designed to avoid corporation tax.

### **General description of the measure**

2. These measures block six avoidance schemes that have been notified to HM Revenue and Customs under the disclosure rules introduced in Finance Act 2004.
3. Legislation will be introduced to block the following schemes:
  - a) Arrangements whereby certain companies create artificial tax losses by claiming exemption from tax on annual payments paid by individuals, but seek a deduction in computing their profits for the cost of acquiring the rights to the payments.
  - b) The use by banks and other financial traders of authorised investment funds (AIFs) to avoid restrictions on claiming double taxation relief.
  - c) Arrangements to avoid the manufactured payment unallowable purpose rule by characterising such a payment as a fee.
  - d) Arrangements involving guarantees and thinly capitalised companies to hedge currency exposure that result in tax relief where there is a loss on a loan relationship but no tax charge when there is a gain.
  - e) Arrangements involving lease and leaseback of plant and machinery whereby the company claims tax relief for paying rents that are in substance a loan but is not taxable on what is, in substance, the repayment.
  - f) Arrangements whereby companies seek to shift profits offshore and return them to the UK without incurring a tax charge.
4. Draft clauses and draft explanatory notes giving effect to items (a) and (c) to (f) above are published today. Regulations giving effect to item (b) are laid today.

### **Operative date**

5. The changes apply to scheme (a) where an annual payment is made on or after 6 December 2006.

6. The changes apply to scheme (b) where a distribution is made by the AIF on or after 6 December 2006.
7. The changes apply to scheme (c) where a manufactured payment is made on or after 6 December 2006, but only to the extent that the scheme has not already given rise to income or chargeable gains within the charge to corporation tax.
8. The changes apply to scheme (d) in relation to accounting periods that end on or after 6 December 2006, except where the company has already ceased to be party to the loan relationship.
9. The changes apply to scheme (e) in relation to arrangements entered into on or after 6 December 2006. The changes also apply to existing arrangements where rentals are receivable on or after 6 December 2006:
  - in respect of any period beginning on or after 6 December 2006; or
  - in respect of a period that straddles or ends on 6 December 2006, but only to the extent they refer to the part of the period that begins on 6 December 2006.
10. The changes in (f) apply to schemes where any relevant tax is paid, or any relevant income received, on or after 6 December 2006.

### **Current law and proposed revisions**

11. The proposed changes will block each scheme as follows:
  - (a) Section 347A of the Income and Corporation Taxes Act 1988 (ICTA) exempts from corporation tax certain annual payments received by a company that have been made, or treated as made, by individuals, where the individual is not entitled to a deduction for the payment. This exemption will be removed by Finance Bill 2007.
  - (b) Section 798A ICTA 1988 restricts relief for overseas tax on dividends received by financial traders to the UK tax on the amount of those dividends less the expenses of earning them. There is corresponding provision in section 804C for general insurance business. Where a banking or similar financial concern receives a distribution from an AIF, the distribution is currently treated by regulations as having had UK income tax deducted. This allows them to avoid the section 798A and 804C restrictions. The regulations will be changed so that the tax is treated as overseas tax to the extent the distribution represents overseas income. This treatment will apply only for the purposes of section 798A ICTA and section 804C ICTA. The rule will not apply unless the business holds rights to more than 50 per cent of the net assets of the AIF, nor will it apply to rights in an AIF held as assets of an insurance company's long-term insurance fund. The regulations making this change have been laid today and will be published on the HMRC website.

- (c) The manufactured payment unallowable purpose rule in paragraph 7A of Schedule 23A ICTA 1988 will be amended by Finance Bill 2007 so that it is also capable of applying to any manufactured payment that is treated by paragraph 7(1) of Schedule 23A as a fee.
- (d) Paragraph 11A of Schedule 9 of Finance Act 1996 will be amended by Finance Bill 2007 to ensure that exchange gains are taxed in circumstances where exchange losses would have been tax deductible.
- (e) The principal function of section 228D of The Capital Allowances Act 2001 is to restrict the taxable amount of rent receivable by the lessor where the amount which the lessee may deduct is restricted. In the case of a lease and leaseback the deduction for rents payable by the lessee is restricted to the finance charge element of the rents and accordingly only the finance charge element of rents received by the lessor is taxed. These rules were based on arrangements under which lessees under the head lease paid a premium for which no deduction would be available, and the rules worked symmetrically.

Schemes have been notified under the disclosure rules whereby the lessee under the head lease pays rentals, sometimes in advance, and seeks a deduction for the full amount of the lease rentals it pays while only being taxed on the finance charge element of income it receives under the leaseback and so the rules do not work symmetrically. Amendments will be made so that section 228D no longer applies to lease and leaseback transactions and so the full amount of the rentals receivable by the lessor under the leaseback will be taxable.

- (f) Section 804ZA reduces or eliminates claims to double taxation relief (DTR) where there is an avoidance scheme or arrangement. Amendments will be made in order to put beyond doubt that it applies to schemes involving underlying tax, where the relief relates to underlying UK tax.

### **Further advice**

12. If you have any comments or questions about these changes, please contact Richard Rogers on 020 7147 2625 or Richard Thomas on 020 7147 2558 (schemes (a) to (d)), Paul Lane on 020 7147 2637 (scheme (e)) or Martin Brooks on 020 7147 2651 (scheme (f)). Information about Pre-Budget Report measures is available on the HM Revenue & Customs website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk)