

1 Restrictions on relief for interest payments

- (1) Section 384 of ITA 2007 (general restrictions on relief for interest payments), is amended as follows.
- (2) In subsection (2), for “interest is paid at a rate in excess of a reasonable commercial rate” substitute “the interest paid on a loan in a tax year exceeds a reasonable commercial amount of interest on the loan for the relevant period”.
- (3) After subsection (2) insert—
 - “(3) The relevant period is the tax year or, if the loan exists for part only of the tax year, the part of the tax year for which the loan exists.
 - (4) A reasonable commercial amount of interest on the loan for the relevant period is an amount which, together with any interest paid before that period (other than unrelieved interest), represents a reasonable commercial rate of interest on the loan from the date it was made to the end of that period.
 - (5) “Unrelieved interest” means interest which because of subsection (2) is not eligible for relief under this Chapter.”
- (4) The amendments made by this section have effect in respect of interest paid on or after 9 October 2007; but in respect of interest paid in the period from 8 October 2007 to the end of the tax year 2007-08, they have effect as if the references in section 384(2) and (3) to a tax year were to that period.

2 Distributions from shares treated as loan relationships

- (1) In FA 1996, in—
 - (a) section 91A(2)(b) (distributions in respect of shares subject to outstanding third party obligations), and
 - (b) section 91B(2)(b) (distributions in respect of non-qualifying shares), omit “falling within section 209(2)(a) or (b) of the Taxes Act 1988”.
- (2) The repeals made by subsection (1) have effect in relation to distributions on or after 9 October 2007.

EXPLANATORY STATEMENT

THESE NOTES SUPPLEMENT AND EXPLAIN THE DETAILS OF THE DRAFT CLAUSES.

The Government has announced at the Pre-Budget Report that it plans to introduce legislation Finance Bill 2008 to tackle avoidance of income and corporation tax. The legislation will in each case take effect from 9th October 2007.

This note provides an explanatory commentary on the draft clauses and sets out the background to them.

We will be consulting with interested parties, and welcome comments from anyone with an interest in this area on whether the draft legislation properly captures and explains the purpose and principles set out in this statement, but not on the principles themselves. Representations should be directed to:

Richard Rogers
HMRC (CT & VAT)
3rd Floor, 100 Parliament St.
London SW1A 2BQ

Or by e-mail to Richard.rogers@hmrc.gsi.gov.uk

RESTRICTION ON RELIEF FOR INTEREST PAYMENTS

DETAIL

1. Subsection (1) amends section 384 of the Income Tax Act (ITA) 2007, which restricts relief for interest payments made by individuals which would otherwise be eligible for relief under section 383 of ITA 2007 against their income or gains.
2. Subsection (2) substitutes a new section 384(2), which denies relief for interest paid where the interest exceeds a reasonable commercial amount of interest for a relevant period.
3. Subsection (3) inserts new subsections (3) to (5) into section 384:
4. New subsection 384(3) defines the relevant period as the tax year in which the interest is paid. Where the loan is entered into or repaid during the tax year the relevant period is that part of the tax year during which the loan exists.
5. New subsection 384(4) defines what is a reasonable commercial amount of interest for the relevant period. It is the amount of interest which together with any interest paid before that period (apart from unrelieved interest) equates to a reasonable commercial rate of interest from the date the loan was made to the end of the relevant period.
6. New subsection 384(5) defines unrelieved interest as interest that has not been allowed in previous tax years because of new section 384(2). As this has not been allowed for tax purposes there is no need for it to be used to restrict relief for later interest payments.
7. Subsection (4) provides the commencement rule, which is that it applies to interest that is paid on or after the date of the PBR announcement.

BACKGROUND

8. Section 383 of ITA 2007 provides that a person who pays interest on loans that are used for certain qualifying purposes is entitled to relieve the interest against other income or gains. The relief is given in an amount equal to the amount of interest paid in the tax year. Section 384 of ITA 2007 limits this relief to so much of the interest as does not exceed a reasonable commercial rate of interest.
9. A scheme has been notified to HMRC involving arrangements whereby individuals claim to pay all interest on the loan in advance. This is intended to accelerate relief compared with what would be possible if the interest were spread over the life of the loan. The individual may then immediately repay the loan - however, because the loan is no longer interest-bearing, the amount to be repaid is reduced. HMRC does not believe that this scheme achieves its object, and any claims to relief on the basis of it will be resisted.
10. The amendments made by this clause ensure that relief cannot be claimed for any element of “interest” paid in advance where this would result in the overall rate of

interest for the period from the date the loan was entered into to the end of the period being excessive. Any excess amounts for which relief is denied in the tax year are not eligible for relief in any later tax year.

DISTRIBUTIONS FROM SHARES TREATED AS LOAN RELATIONSHIPS

DETAIL

11. Subsection (1) extends section 91A(2)(b) and section 91B(2)(b) of the Finance Act (FA) 1996 so that they apply to any type of distribution, not just distributions falling within section 209(2)(a) and (b) of the Income and Corporation Tax Act (ICTA) 1988.
12. Subsection (2) provides that the amendments have effect in relation to distributions paid on or after the date of PBR.

BACKGROUND

13. The “shares-as-debt” rules in sections 91A and 91B FA 1996 were introduced in 2005 to charge to corporation tax as income profits on certain types of shares that produce returns equivalent to interest. Where the relevant conditions are met the shares are deemed, for the holder, to be rights under a creditor loan relationship. Any distribution paid in respect of the shares is not treated as a distribution falling within section 209(2)(a) or (b) of ICTA 1988 and so is taxable notwithstanding the rule in section 208 of ICTA 1988 that distributions paid by one UK company to another are generally exempt.
14. A scheme has been notified to HMRC indicating that attempts have been made to get around the “shares-as-debt” rules by structuring the shares so that they pay other types of distribution exempt under section 208 of ICTA 1988. The amendments made by this clause ensure that where the relevant conditions are met any type of distribution in respect of the shares is taxable under sections 91A and 91B of FA 1996.