

Technical Note

Leased Plant and Machinery

Anti-avoidance

9 October 2007

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1 INTRODUCTION

- 1.1 On 9 October 2007 the Government announced that it is taking action to prevent two types of arrangement that seek to avoid tax through the leasing of plant or machinery.
- 1.2 The first type of scheme relies on abuse of section 222 of the Capital Allowances Act 2001 ('CAA').
- 1.3 The second type of scheme attempts to abuse the long funding lease rules (introduced in Finance Act 2006) to generate tax losses where there is a commercial profit.
- 1.4 This note outlines the schemes and describes the counter-measures.
- 1.5 A draft of the clause and Schedule that will be incorporated into the 2008 Finance Bill is in the Annex. Draft Explanatory Notes are in part 4 of this note.
- 1.6 HMRC will welcome comments made by 8 January 2008.
- 1.7 Comments should be addressed to

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2 OUTLINE OF THE AVOIDANCE SCHEMES AND COUNTER-MEASURES: SCHEMES RELYING ON SECTION 222 CAA

- 2.1 All statutory references in part 2 of this Note are to CAA unless stated otherwise.

Background

- 2.2 Sections 222 and 224 apply to sale and finance leaseback transactions.
- 2.3 Section 222 restricts the capital allowances disposal value that is brought into account by the seller and section 224 restricts the amount on which the lessor is entitled to claim capital allowances to the seller's disposal value.
- 2.4 In a typical transaction the restricted disposal value (and so the amount on which capital allowances may be claimed by the purchaser) is the notional tax written down value¹ of the plant or machinery that is sold. For example, plant or machinery that originally cost £25m might have a market value of £10m and a notional written down value of £2m. On sale, only £2m is brought into account for tax purposes, and so £8m is received free of tax, but the purchaser (lessor) is only entitled to claim capital allowances on £2m.
- 2.5 These rules were originally introduced² to counter avoidance where a business that was unable to use capital allowances to reduce its immediate tax liability entered into a sale and finance leaseback with a lessor that could use the capital allowances in that way. Such arrangements allowed the seller/lessee to gain indirect benefits from the capital allowances through the reduction in lease rentals that was possible because of the lessor's ability to use capital allowances immediately.
- 2.6 These rules were exploited by profitable businesses selling valuable plant or machinery to businesses that were tax-indifferent. The seller gained the benefit of the restricted disposal value and could also claim a deduction for the lease rentals. The commercial effect of the transactions was that the business had borrowed money and obtained tax relief for all or part of the cost of repaying the amount borrowed.
- 2.7 Section 134 of Finance Act 2004 countered this abuse by introducing sections 228A to 228J CAA. These new sections were intended to remove the unintended tax benefits for lessees. The main operative section is section 228B which limits the relief for the lease rental payments and brings the tax treatment of these transactions more closely into line with their commercial substance.

The schemes

- 2.8 The schemes that have been disclosed to HMRC attempt to avoid the application of section 228B in a number of ways. For example:

¹ This is the tax written down value the plant or machinery would have assuming all possible capital allowances had been claimed.

² Section 222 onwards was originally introduced as section 76A Capital Allowances Act 1990 by section 46 Finance (No.2) Act 1997.

- a business enters into a sale and finance leaseback in which the leaseback is to a person connected with the seller but who is not resident in the UK. The seller enjoys the benefits of section 222 but the non-resident lessee is not affected by section 228B.
- a business enters into a sale and finance leaseback with the seller/lessee migrating from the UK shortly afterwards. Because the seller/lessee migrates section 228B cannot apply to restrict the deductions available for lease rentals. The result is that the lessee enjoys the benefits of section 222 without that benefit being recouped by section 228B.

2.9 HMRC has not yet seen the documentation surrounding these schemes and does not yet accept that they achieve their aims. It is, however, possible that they do, and this counter-measure will prevent further schemes being entered into.

The proposed counter-measures

- 2.10 The proposed legislation includes the repeal of section 222. As a consequence, sections 228D, 228E and 228F are no longer needed and are also repealed. The repeals only apply to sale and finance leaseback transactions entered into on or after 9 October 2007 and so these sections continue in effect where the sale and finance leaseback took place before that date.
- 2.11 As section 222 is being repealed, sections 228B and 228C will no longer apply to sale and leaseback transactions. However, these sections are modified by section 228F to apply to lease and leaseback transactions and so are still required. As they no longer apply to sale and finance leasebacks the modifications that were provided for by section 228F can now be incorporated directly into sections 228B and 228C (sub-paragraphs 2(3) and (4) of the Schedule).
- 2.12 As these sections are no longer modified by section 228F that section is also repealed and the definition of a lease and finance leaseback is moved to a new version of section 228A. New section 228A therefore defines what is meant by lease and finance leaseback for the purposes of sections 228B and 228C (sub-paragraph 2(2) of the Schedule).
- 2.13 Without further action the original avoidance described in paragraph 2.5 above could re-surface and so, as a general rule, all leases in sale and finance leaseback transactions will be treated as long funding leases.³ This is achieved by treating the lease in a sale and finance leaseback as a lease that is not a short lease (as defined in section 70I, see new subsection 70I(10)).
- 2.14 Treating the lease as a lease that is not a short lease means that, as the lease in a sale and finance leaseback is, by definition, a finance lease (and so it is a funding lease within the terms of section 70J), the lease is a long funding lease.
- 2.15 The definition of a sale and finance leaseback in section 221 continues to be needed as it is, for example, used in the new section 70I(10). However, prior to these amendments, long funding leases were excluded from the definition of a

³ The lessor in a long funding lease is not entitled to claim capital allowances and, instead, is taxed on its commercial profit. Thus no tax advantage is obtained by the lessor.

'finance lease' in section 219. That exclusion is removed by paragraph 1(5) of the Schedule.

- 2.16 There will be one exception to the general rule, and that is where new or nearly new plant or machinery is sold and finance leased back – see new subsections 70I(11) and (12). This exception broadly mirrors an existing exemption from the rules in sections 222 and 224, but will only apply where the lease would otherwise be a short lease.
- 2.17 The exception will allow the parties to a sale and finance leaseback to elect that the leaseback is not treated as a long funding lease. This will facilitate businesses financing or re-financing newly acquired assets, and allow the lessor to claim capital allowances, but only where the lease would not be a long funding lease had the lessor acquired the plant or machinery other than in a sale and finance leaseback.
- 2.18 Minor consequential amendments are made to sections 228G to 228J CAA and section 774E Income and Corporation Taxes Act 1988.
- 2.19 Section 217 prevents a person claiming first year allowances in some circumstances but it does not apply in the case of sale and finance leasebacks: section 223 applied instead (see section 217(3)) to prevent first year allowances in the case of all sale and finance leasebacks. As lessors of plant or machinery are rarely able to claim first year allowances,⁴ section 223 had little practical effect. The effect is even less marked now that most leasebacks will be treated as long funding leases. Therefore section 217 is amended so that it continues not to apply to sale and finance leasebacks but no longer refers to section 223, which is repealed.
- 2.20 Section 218, which limits the amount on which the lessor can claim capital allowances, did not apply in the case of a sale and finance leaseback (see section 218(4)). Instead section 224 or section 225 applied unless an election was made under section 227, in which case section 224 did not apply, but section 228 did. Section 218 is amended so that it continues not to apply to sale and finance leasebacks.
- 2.21 As a result of the amendments to sections 217 and 218, a lessor in a sale and finance leaseback continues to be able to claim first year allowances (in those few circumstances where they are available) where an election is made under section 70I or section 227.

⁴ See s.46(2) and (5) CAA.

3 OUTLINE OF THE AVOIDANCE SCHEMES AND COUNTER-MEASURES: SCHEMES GENERATING TAX LOSSES

3.1 All statutory references in part 3 of this note are to Income and Corporation Taxes Act 1988 ('ICTA') unless stated otherwise.

The schemes

- 3.2 In broad terms these schemes seek to create tax losses where there is a commercial profit.
- 3.3 HMRC believe the users of these schemes will argue that –
- a lessor acquires plant or machinery on trading account
 - the plant or machinery is leased out under a long funding lease
 - the lessor's taxable income under the lease is restricted under sections 502B to 502D
 - the lessor is entitled to claim a deduction for the cost of the plant or machinery on normal case I principles.
- 3.4 If these arguments were to succeed, the lessor would generate a tax loss broadly equivalent to the cost of the leased plant or machinery in circumstances where there was no commercial loss.
- 3.5 HMRC does not accept that these schemes achieve their aims. Nevertheless, it is prudent to put the matter beyond doubt.

The counter-measures

- 3.6 The legislation takes the approach of providing, in broad terms, that sections 502B to 502G do not apply where –
- the lessor is able to obtain a trading deduction for the cost of the leased asset, or
 - the arrangements are entered into with a view to exploiting the long funding lease rules to generate tax losses where there are no commercial losses.
- 3.7 The disclosed schemes use long funding finance leases but they could equally well have used long funding operating leases. Therefore the countermeasures cover both finance and operating leases.
- 3.8 Section 502GA counters schemes where the lessor is able to obtain a deduction for the cost of the leased plant or machinery in computing its profits or losses for the purposes of corporation tax.
- 3.9 The basic approach is to deny the benefit of sections 502B to 502G where any of the expenditure on the provision of plant and machinery is allowed as a deduction in computing profits or losses for the purposes of corporation tax. The meaning of "expenditure incurred on the provision of the plant or machinery" is the same as in the Capital Allowances Act. This therefore includes the cost of the asset and the cost of transporting the asset to where it will be used, but not indirect costs such as the cost of financing the asset.

- 3.10 Subsections 502GA(3) and (5) cater for the possibility that the leased plant or machinery is acquired otherwise than as trading stock. In these circumstances, if the asset is leased out under a long funding lease, sections 502B to 502G will apply initially. However, if the plant or machinery is later appropriated to trading stock it will no longer be appropriate for those sections to apply.
- 3.11 Where this occurs, subsection (5) provides for the lessor's taxable income to be adjusted on a just and reasonable basis. This section will be operated in a way that ensures that the lessor is taxed on an amount equal to its commercial profits.

Example

Assume that an asset costing £1000 is leased on full payout terms over 10 years for £135 a year and is appropriated to trading stock at the end of year 3. Simply put, the rentals might comprise:

	'Finance charge' element (£)	'Repayment' element (£)
Total for years 1 - 3	150	250
Total for years 4 - 10	200	750
Total for all years	350	1000

The effect of section 502B is that in years 1-3 only £150 of the rentals is taxed.

If the asset is appropriated to trading account when its value is £800 (and so £800 is available as a deduction in computing the profits of the trade) then simply taxing the full rentals in years 4 to would be insufficient because the deduction for £800 is not matched by taxing the 'repayment' element of the rentals of £750. However, assuming no other issues need to be taken into account, it might be just and reasonable to tax an additional £50 in year 3.

If, however, the asset is appropriated when its value is only £650 then taxing the full £750 'repayment' element of the rentals is unlikely to be just and reasonable. Instead, and again assuming no other issues need to be taken into account, it might be appropriate to tax £650 of the £750 'repayment' element on a pro-rated basis over the remainder of the lease term.

In both cases, the finance charge element of the lease rentals remains taxable in full.

- 3.12 Section 502GB counters arrangements involving a long funding lease and which are intended to create taxable profits or allowable losses that are substantially different from the profits from those arrangements as shown in the company's accounts. Unlike section 502GA, the section takes a purposive approach and applies where –
- (a) a company enters into an arrangement that includes a long funding lease in addition to one or more other transactions (condition A);
 - (b) the main purpose, or one of the main purposes, of the arrangement is to secure that there is a substantial difference between the profits attributable to those arrangements as shown in the accounts and as computed for tax purposes;

(c) that difference is wholly or partly attributable to the application of any of sections 502B to 502G.

3.13 This section is a carefully targeted anti-avoidance provision which uses the well-established concept of “the main purpose, or one of the main purposes” to counter avoidance intended to create a substantial mismatch between the tax and accounting profits and which it is claimed arises (at least partly) because of the application of one or more of sections 502B to 502G.

3.14 To ensure consistency of approach this section will only be applied to any case with the approval of the appropriate technical advisers in HMRC’s CT & VAT Product and Processes and Anti-Avoidance directorates.

4 EXPLANATORY NOTES

- 4.1 This section contains a draft of the Explanatory Notes based on the current draft of the legislation.

Plant or machinery subject to a sale and finance leaseback or lease and finance leaseback

- 4.2 Paragraph 1 deals with the repeal of sections 222, 223, 224 and 226 CAA and makes consequential amendments. The paragraph also adds subsections (10) to (12) to section 70I CAA. These new subsections treat the lease in a sale and finance leaseback as a long funding lease except in certain circumstances, where an election may be made to the contrary.
- 4.3 Sub-paragraph (1) provides that Part 2 of CAA is to be amended.
- 4.4 Sub-paragraph (2) inserts 3 new subsections into section 70I CAA.
- (a) New subsection (10) provides that the lease in a sale and finance leaseback (as defined following these amendments, see sub-paragraph (5)) is not to be treated as a short lease. The words in parentheses in subsection (10) ensure that this subsection only applies where the lease would otherwise be a short lease.
- (b) New subsection (11) allows the parties to the sale and finance leaseback to elect that subsection (10) does not apply where the conditions in section 227(2) are met. In broad terms, these conditions require the plant or machinery to be new or nearly new. If an election is made the amount on which the purchaser ('B') may claim capital allowances may not exceed the cost to the seller or a person connected to the seller (section 228(2) and (3)). However, section 225 may still apply to prevent the lessor claiming any capital allowances. This election can only be made where the lease would be treated as a short lease but for new subsection (10).
- (c) New subsection (12) provides that subsections (4) to (6) of section 227 apply to an election under section 70I, in the same way as to elections under section 227.
- 4.5 Sub-paragraph (3) replaces subsection (3) of section 217. Section 217 continues not to apply where the plant or machinery is subject to a sale and finance leaseback, but there is no longer any need to refer to section 223 as that section is repealed (see sub-paragraph (7)).
- 4.6 Sub-paragraph (4) replaces subsection (4) of section 218. Section 218 continues not to apply where the plant or machinery is subject to a sale and finance leaseback but there is no need to refer to section 224 as that section is repealed (see sub-paragraph (7) below). Sub-paragraph (4) also draws attention to section 225, which may apply to prevent a lessor being entitled to any capital allowances.
- 4.7 Sub-paragraph (5) removes words from section 219, so that the definition of "finance lease" now includes leases that are long funding leases.

- 4.8 Sub-paragraph (6) replaces the reference in section 221 to “sections 222 to 228” with “section 225”. This change reflects the facts that sections 222, 223, 224 and 226 have been repealed and that the definition of “sale and finance leaseback” in section 221 is no longer needed for sections 227 and 228.
- 4.9 Sub-paragraph (7) omits sections 222, 223, 224 and 226 because they have been repealed.
- 4.10 Sub-paragraph (8) removes sub-paragraph (ii) of subsection 227(1)(b) so that it no longer applies where to sale and finance leasebacks as defined in section 221. (Section 227 now only applies to sale and finance leasebacks where an election is made under section 70I(10).) The sub-paragraph also modifies section 227(2)(c) so that it no longer refers to sections 223 and 224, which are repealed.
- 4.11 Sub-paragraph (9) modifies section 228 so that it no longer refers to section 224, which is repealed. Subsection (4), which provided that section 228 did not prevent section 225 applying, is removed as the reference to the possibility that section 225 might apply where section 228 applies is now found in section 70I(11)(b).
- 4.12 Sub-paragraph (10) removes the second sentence of section 774E(6) ICTA. That sentence required an assumption that the words in section 219 that are omitted by sub-paragraph (5) above had been removed. As those words have now been removed, no such assumption is necessary.
- 4.13 Sub-paragraph (11) contains the commencement provisions for this paragraph. The provisions of the paragraph only apply where the sale and finance leaseback takes place on or after 9 October 2007. For this purpose the sale and finance leaseback is as defined in section 221 and the date of the transaction is a reference to the date as defined in section 221(2); that is the date of the sale, the making of the contract or the assignment referred to in section 213(1).
- 4.14 Paragraph 2 of the Schedule deals with lease and leaseback transactions. It makes no changes to the way in which lease and leaseback transactions are taxed; it merely re-organises the provisions that refer to lease and leaseback transactions to reflect the fact that they are now the only type of transaction to which sections 228B and 228C apply.
- 4.15 Sub-paragraph (1) provides that Chapter 17 of Part 2 of CAA is to be amended.
- 4.16 Sub-paragraph (2) replaces the existing section 228A with a new section 228A.
- 4.17 New section 228A explains that sections 228B and 228C apply to lease and finance leasebacks as defined by this new section.
- (a) New subsection (1) explains that sections 228B and 228C apply to lease and finance leasebacks.
- (b) New subsections (2) to (4) define a lease and finance leaseback as it was defined in subsections (5) to (7) of section 228F.

- 4.18 Sub-paragraphs (3) and (4) make the changes to sections 228B and 228C respectively that were previously made by section 228F and amend the headings accordingly.
- 4.19 Sub-paragraph (5) omits sections 228D, 228E and 228F because they have been repealed.
- 4.20 Sub-paragraphs (6) and (7) make consequential amendments to sections 228G and 228H respectively to reflect the changes made to sections 228B and 228C.
- 4.21 Sub-paragraph (8) makes a consequential amendment to section 228J to reflect the fact that the definition of lease and finance leaseback is now in section 228A.
- 4.22 Sub-paragraph (9) makes a consequential amendment to section 774E(5)(b) of ICTA.
- 4.23 Sub-paragraph (10) contains the commencement provisions for this paragraph. The amendments made by this paragraph only have effect where a lease and leaseback transaction is entered into on or after 9 October 2007.

Lessors under long funding leases of plant or machinery – avoidance

- 4.24 Paragraph 3 introduces new sections 502GA and 502GB into the Income and Corporation Taxes Act 1988 (ICTA). These new sections counter schemes that are intended to generate tax losses where there is a commercial profit or to generate tax losses that are substantially greater than the commercial loss.

Section 502GA – Cases where sections 502B to 502G do not apply: plant or machinery held as trading stock

- 4.25 Sub-paragraph (1) introduces new section 502GA into ICTA.
- (a) Subsections (1) and (2) of section 502GA provide that sections 502B to 502G do not apply where any part of the expenditure incurred on the provision of the leased plant or machinery is allowable as a deduction in calculating the profits or losses of the company for the purpose of corporation tax.
- The reference to “(apart from those sections)” ensures that the section is not triggered where, for example, section 502E allows a deduction by reference to the cost of the leased plant or machinery.
- (b) Subsection (3) caters for the possibility that a company acquires the plant or machinery otherwise than as trading stock (perhaps as a fixed capital asset) and then appropriates it to trading stock in circumstances which entitle the company to a deduction in computing its profits. In such circumstances the lessor may originally have fallen within the provisions of sections 502B to 502G, but once a deduction that represents the cost or value of the asset is available the provisions of sections 502B to 502G should no longer apply (but see also subsection (5)).
- (c) Subsection (4) provides that references to expenditure on the provision of plant or machinery for leasing have the same meaning as in Part 2 of the Capital Allowances Act.

- (d) Subsection (5) provides that where the leased plant or machinery is acquired in circumstances that mean its cost is not an allowable deduction in computing profits (so any of sections 502B to 502G have applied), and is later appropriated to trading stock whilst subject to a long funding lease, the amounts that are taken into account in computing the company's profits are to be adjusted on a just and reasonable basis. The amounts which may be adjusted include amounts taken into account both before and after the appropriation to trading stock.
- (e) Subsection (6) allows the necessary assessments and adjustments to assessments to be made to give effect to subsection (5).

Section 502GB – Cases where sections 502B to 502G do not apply: other avoidance

4.26 Sub-paragraph (2) of paragraph 3 introduces new section 502GB into ICTA.

- (a) Subsection (1) of section 502GB provides that sections 502B to 502G do not apply where a company is or has been the lessor of plant or machinery under a long funding lease where three conditions are met.
- (b) Subsection (2) describes the first condition, which is that the long funding lease forms part of any arrangement entered into by the company that includes at least one other transaction. The definition of an arrangement is given by section 70YI CAA and includes a transaction or series of transactions but this condition ensures entering a single transaction cannot trigger the section. There is no restriction on when the transactions that make up the arrangement may be entered into.
- (c) Subsection (3) describes the second condition, which is that the main purpose or one of the main purposes of the arrangement is to secure that over the relevant period (defined in subsection (4)) there is a substantial difference between two amounts. Those amounts are –
- the total of the amounts recognised in determining the company's profits or losses for accounting purposes, and
 - the total of the amounts brought into account in computing profits for tax purposes.

The reference to a "substantial difference" ensures that trivial differences between the amounts recognised for accounting and tax purposes cannot trigger the section.

The references to the "total of the amounts" ensure that differences on a period-by-period basis are ignored.

- (d) Subsection (4) defines the "relevant period" for the purposes of the second condition as the period between inception (which is defined in section 70YI CAA) and the end of the term of the lease (which is defined in section 70YF CAA).
- (e) Subsection (5) describes the third condition, which is that the difference in the second condition is at least partly attributable to the application of any of sections 502B to 502G ICTA.

- (f) Subsection (6) describes the circumstances in which an amount is recognised for accounting purposes.
- (g) Subsection (7) makes it clear that the arrangements targeted by this section can involve several parties.
- (h) Subsection (8) makes it clear that arrangements include (but are not limited to) two or more transactions where it would be reasonable to assume that at least one of the transactions
 - would not have been entered into independently, or
 - if it had been entered into independently, would have been entered into in a different form or on different terms.
- (i) Subsection (9) is similar in effect to section 502GA(5). It provides that where any of sections 502B to 502G have applied and arrangements that meet the conditions A to C are met at a later time the amounts that are taken into account in computing the company's profits are to be adjusted on a just and reasonable basis. The amounts which may be adjusted include amounts taken into account both before and after the arrangements were entered into.
- (j) Subsection (10) allows the necessary assessments and adjustments to assessments to be made to give effect to subsection (9).

4.27 Sub-paragraph (3) of paragraph 3 of the Schedule contains the commencement provisions for section 502GA.

4.28 Sub-paragraph (4) contains the commencement provisions for section 502GB.

Sections 148FA and 148FB ITTOIA

4.29 Paragraph 4 of the Schedule inserts new sections 148FA and 148FB into the Income Tax (Trading and Other Income) Act 2005. These sections are the income tax equivalent of sections 502GA and 502GB ICTA. No additional Explanatory Notes are necessary.

ANNEX: DRAFT CLAUSE AND SCHEDULE

1 Leasing of plant and machinery

The Schedule contains provision in relation to the leasing of plant and machinery.

SCHEDULE

Section 1

LEASING OF PLANT AND MACHINERY

Plant or machinery subject to a sale and finance leaseback or lease and finance leaseback

- 1 (1) Part 2 of CAA 2001 (plant and machinery allowances) is amended as follows.
- (2) In section 70I (meaning of “short lease”), insert at the end –
 - “(10) Where plant or machinery is the subject of a sale and finance leaseback, as defined in section 221, the finance lease mentioned in subsection (1)(c) of that section is not a short lease (if it would, apart from this subsection, be one).
 - (11) But, if the conditions set out in section 227(2) are met, B and S (within the meaning of section 221) may make an election the effect of which is that –
 - (a) subsection (10) above does not apply in relation to B and S,
 - (b) section 228(2) and (3) apply in relation to B (but this does not prevent section 225 from applying), and
 - (c) section 228(5) applies in relation to S.
 - (12) Subsections (4) to (6) of section 227 apply in relation to elections under this section as they apply in relation to elections under that section.”
- (3) In section 217 (no first-year allowance for B’s expenditure), for subsection (3) substitute –
 - “(3) This section does not apply if plant or machinery is the subject of a sale and finance leaseback (as defined in section 221).”
- (4) In section 218 (restriction on B’s qualifying expenditure), for subsection (4) substitute –
 - “(4) This section does not apply if plant or machinery is the subject of a sale and finance leaseback (as defined in section 221), but see section 225.”
- (5) In section 219(1) (meaning of “finance lease”), omit “and which are not a long funding lease in the case of the lessor”.
- (6) In section 221(1) (meaning of “sale and finance leaseback”), for “sections 222 to 228” substitute “section 225”.
- (7) Omit –
 - (a) section 222 (disposal value restricted),
 - (b) section 223 (no first-year allowance for B’s expenditure),
 - (c) section 224 (restriction on B’s qualifying expenditure), and
 - (d) section 226 (qualifying expenditure limited in subsequent transactions).

- (8) In section 227 (circumstances in which election may be made) –
- (a) in subsection (1)(b), omit sub-paragraph (ii) (together with the “or” before it), and
 - (b) in subsection (2)(c), for “217, 218, 223 or 224” substitute “217 or 218”, and the italic cross-heading before that section accordingly becomes “*Sale and leaseback: election for special treatment*”.
- (9) In section 228 (effect of election: relaxation of restriction on B’s qualifying expenditure, etc) –
- (a) in subsection (1), omit “or 224”, and
 - (b) omit subsection (4).
- (10) In section 774E(6) of ICTA (structured finance arrangements: exceptions), omit the second sentence.
- (11) The amendments made by this paragraph have effect in the case of plant or machinery which is the subject of a sale and finance leaseback (as defined in section 221 of CAA 2001) where the date of the transaction (within the meaning of that section) is on or after 9 October 2007.
- 2 (1) Chapter 17 of Part 2 of CAA 2001 (plant and machinery allowances: anti-avoidance) is amended as follows.
- (2) For section 228A substitute –
- “228A Application of sections 228B and 228C**
- (1) Sections 228B and 228C apply where plant or machinery is the subject of a lease and finance leaseback.
 - (2) Plant or machinery is the subject of a lease and finance leaseback if –
 - (a) a person (“S”) leases the plant or machinery to another (“B”),
 - (b) after the date of that transaction, the use of the plant or machinery falls within sub-paragraph (i), (ii) or (iii) of section 221(1)(b), and
 - (c) it is directly as a consequence of having been leased under a finance lease that the plant or machinery is available to be so used after that date.
 - (3) For the purposes of subsection (2), S leases the plant or machinery to B only if –
 - (a) S grants B rights over the plant or machinery,
 - (b) consideration is given for that grant, and
 - (c) S is not required to bring all of that consideration into account under this Part.
 - (4) Plant or machinery is not the subject of a lease and finance leaseback for the purposes of this section in any case where the condition in subsection (3)(c) is met only because of an election under section 199 made before 18th May 2004.”
- (3) In section 228B (lessee’s income or profits: deductions) –
- (a) in subsection (1), for “the lessee’s” substitute “S’s”,
 - (b) in subsection (2), for the words from “the total” to the end substitute “the amount of the finance charges shown in the accounts”,

- (c) in subsection (4), in the definition of “Original Consideration”, for “entering into the relevant transaction” substitute “granting B rights over the plant or machinery”, and
- (d) the heading accordingly becomes “**S’s income or profits: deductions**”.
- (4) In section 228C (lessee’s income or profits: termination of leaseback) –
- (a) in subsection (2), for “the lessee” substitute “S”,
- (b) in subsection (3), in the formula, for “Net” substitute “Original” and for the definition of “Net Consideration” substitute –
- ““Original Consideration” means the consideration payable to S for granting B rights over the plant or machinery,”
- (c) in subsection (6), for “the lessee’s” substitute “S’s” and for “the lessor” substitute “B (or, where appropriate, an assignee of B)”, and
- (d) the heading accordingly becomes “**S’s income or profits: termination of leaseback**”.
- (5) Omit –
- (a) section 228D (lessor’s income or profits),
- (b) section 228E (lessor’s income or profits: termination of leaseback), and
- (c) section 228F (lease and finance leaseback).
- (6) In section 228G (leaseback not accounted for as finance lease in accounts of lessee) –
- (a) in subsection (1), for “the lessee” substitute “S”,
- (b) in subsection (2), for “the lessee” (in both places) substitute “S”,
- (c) in subsection (3), for “the lessee’s” substitute “S’s”,
- (d) in subsection (4), for “the lessee” substitute “S”,
- (e) in subsection (6), for “the lessee” substitute “S” and for the words from “increased by –” to the end substitute “increased by the consideration payable to S for granting B rights over the plant or machinery.”, and
- (f) the heading accordingly becomes “**Leaseback not accounted for as finance lease in S’s accounts**”.
- (7) In section 228H(1) (sections 228A to 228G: supplementary) –
- (a) omit the definition of “lessee”,
- (b) in the definition of “net book value”, for “the lessee’s” substitute “S’s”,
- (c) omit the definition of “restricted disposal value”,
- (d) before the definition of “termination” insert –
- ““S” does not include an assignee of S;”, and
- (e) in the definition of “termination”, omit “(except in section 228E)”, for “the lessee’s” (in both places) substitute “S’s” and for “the lessee” substitute “S”.
- (8) In section 228J(8) (plant or machinery subject to further operating lease), in the definition of “lease and finance leaseback”, for “section 228F” substitute “section 228A”.
- (9) In section 774E(5)(b) of ICTA (structured finance arrangements: exceptions), omit “with the modifications contained in section 228F of that Act”.

- (10) The amendments made by this paragraph have effect in relation to transactions referred to in section 228A(2)(a) of CAA 2001 (as substituted by this paragraph) which are entered into on or after 9 October 2007.

Lessors under long funding leases of plant or machinery

- 3 (1) In Chapter 5A of Part 12 of ICTA (special rules for long funding leases of plant or machinery: corporation tax), after section 502G insert –

“Lessors under long funding finance or operating leases: avoidance etc

502GA Cases where ss. 502B to 502G do not apply: plant or machinery held as trading stock

- (1) Sections 502B to 502G do not apply in the case of a company which is or has been the lessor of any plant or machinery under a long funding lease if the following condition is met.
 - (2) The condition is that any part of the expenditure incurred by the company on the provision of the plant or machinery for leasing under the lease is (apart from those sections) allowable as a deduction in calculating the profits or losses of the company for the purposes of corporation tax.
 - (3) For the purposes of this section the cases in which expenditure incurred by a company on the provision of any plant or machinery for leasing under a lease is allowable as such a deduction include any case where –
 - (a) the company becomes entitled to the deduction at any time after the expenditure is incurred, and
 - (b) the deduction arises as a result of the plant or machinery forming part of its trading stock at that time.
 - (4) The references in this section to expenditure incurred on the provision of any plant or machinery for leasing under a lease have the same meaning as in Part 2 of the Capital Allowances Act.
 - (5) If –
 - (a) at any time any of sections 502B to 502G has applied for determining the amounts to be taken into account in calculating the profits or losses of the company for the purposes of corporation tax, and
 - (b) the condition in subsection (2) is met at any subsequent time, those amounts, and any other amounts which (as a result of this section) are to be so taken into account, are subject to such adjustments as are just and reasonable.
 - (6) All such assessments and adjustments of assessments are to be made as are necessary to give effect to subsection (5).”
- (2) After section 502GA of ICTA (as inserted by sub-paragraph (1)) insert –

“502GB Cases where ss. 502B to 502G do not apply: other avoidance

- (1) Sections 502B to 502G do not apply in the case of a company which is or has been the lessor of any plant or machinery under a long funding lease if conditions A to C are met.

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- (2) Condition A is that the long funding lease forms part of any arrangement entered into by the company which includes one or more other transactions (whether the arrangement is entered into before or after or at the inception of the lease).
 - (3) Condition B is that the main purpose, or one of the main purposes, of the arrangement is to secure that, over the relevant period, there is a substantial difference between –
 - (a) the total amount of the amounts under the arrangement which are, in accordance with generally accepted accounting practice, recognised in determining the company's profit or loss for any period or taken into account in calculating the amounts which are so recognised, and
 - (b) the total amount of the amounts under the arrangement which are taken into account in calculating the profits or losses of the company for the purposes of corporation tax.
 - (4) For the purposes of condition B “the relevant period” means the period which begins with the inception of the lease and ends with the end of the term of the lease.
 - (5) Condition C is that the difference is attributable (wholly or partly) to the application of any of sections 502B to 502G in relation to the company by reference to the plant or machinery under the lease.
 - (6) The reference in this section to an amount being recognised in determining a company's profit or loss for a period is to an amount being recognised for accounting purposes –
 - (a) in the company's profit and loss account or income statement,
 - (b) in the company's statement of recognised gains and losses or statement of changes in equity, or
 - (c) in any other statement of items brought into account in calculating the company's profits and losses for that period.
 - (7) For the purposes of this section it does not matter whether the parties to any transaction which forms part of the arrangement differ from the parties to any of the other transactions.
 - (8) For the purposes of this section the cases in which two or more transactions are to be taken as forming part of an arrangement include any case in which it would be reasonable to assume that one or more of them –
 - (a) would not have been entered into independently of the other or others, or
 - (b) if entered into independently of the other or others, would not have taken the same form or been on the same terms.
 - (9) If –
 - (a) at any time any of sections 502B to 502G has applied for determining the amounts to be taken into account in calculating the profits or losses of the company for the purposes of corporation tax, and
 - (b) conditions A to C are met at any subsequent time,

those amounts, and any other amounts which (as a result of this section) are to be so taken into account, are subject to such adjustments as are just and reasonable.

- (10) All such assessments and adjustments of assessments are to be made as are necessary to give effect to subsection (9).”
- (3) The amendment made by sub-paragraph (1) has effect where –
- (a) expenditure is incurred on or after 9 October 2007, or
 - (b) a company becomes entitled to a deduction in calculating its profits or losses for the purposes of corporation tax as a result of any plant or machinery forming part of its trading stock on or after that date.
- (4) The amendment made by sub-paragraph (2) has effect in relation to arrangements entered into on or after that date.
- 4 (1) In Chapter 10A of Part 2 of ITTOIA 2005 (corresponding income tax rules), after section 148F insert –

“Lessors under long funding finance or operating leases: avoidance etc

148FA Cases where ss. 148A to 148F do not apply: plant or machinery held as trading stock

- (1) Sections 148A to 148F do not apply in the case of a person carrying on a trade who is or has been the lessor of any plant or machinery under a long funding lease if the following condition is met.
- (2) The condition is that any part of the expenditure incurred by the person on the provision of the plant or machinery for leasing under the lease is (apart from those sections) allowable as a deduction in calculating the profits or losses of the trade.
- (3) For the purposes of this section the cases in which expenditure incurred by a person carrying on a trade on the provision of any plant or machinery for leasing under a lease is allowable as such a deduction include any case where –
- (a) the person becomes entitled to the deduction at any time after the expenditure is incurred, and
 - (b) the deduction arises as a result of the plant or machinery forming part of the trading stock of the trade at that time.
- (4) The references in this section to expenditure incurred on the provision of any plant or machinery for leasing under a lease have the same meaning as in Part 2 of CAA 2001.
- (5) If –
- (a) at any time any of sections 148A to 148F has applied for determining the amounts to be taken into account in calculating the profits or losses of the trade, and
 - (b) the condition in subsection (2) is met at any subsequent time,
- those amounts, and any other amounts which (as a result of this section) are to be so taken into account, are subject to such adjustments as are just and reasonable.
- (6) All such assessments and adjustments of assessments are to be made as are necessary to give effect to subsection (5).”

- (2) After section 148FA of ITTOIA 2005 (as inserted by sub-paragraph (1)) insert –

“148FB Cases where ss. 148A to 148F do not apply: other avoidance

- (1) Sections 148A to 148F do not apply in the case of a person carrying on a trade who is or has been the lessor of any plant or machinery under a long funding lease if conditions A to C are met.
- (2) Condition A is that the long funding lease forms part of any arrangement entered into by the person which includes one or more other transactions (whether the arrangement is entered into before or after or at the inception of the lease).
- (3) Condition B is that the main purpose, or one of the main purposes, of the arrangement is to secure that, over the relevant period, there is a substantial difference between –
 - (a) the total amount of the amounts under the arrangement which are, in accordance with generally accepted accounting practice, recognised in determining the profit or loss of the trade for any period or taken into account in calculating the amounts which are so recognised, and
 - (b) the total amount of the amounts under the arrangement which are taken into account in calculating the profits or losses of the trade.
- (4) For the purposes of condition B “the relevant period” means the period which begins with the inception of the lease and ends with the end of the term of the lease.
- (5) Condition C is that the difference is attributable (wholly or partly) to the application of any of sections 148A to 148F in relation to the person by reference to the plant or machinery under the lease.
- (6) The reference in this section to an amount being recognised in determining the profit or loss of a trade for a period is to an amount being recognised for accounting purposes –
 - (a) in the profit and loss account or income statement relating to the trade,
 - (b) in the statement of recognised gains and losses or statement of changes in equity relating to the trade, or
 - (c) in any other statement of items brought into account in calculating the profits and losses of the trade for that period.
- (7) For the purposes of this section it does not matter whether the parties to any transaction which forms part of the arrangement differ from the parties to any of the other transactions.
- (8) For the purposes of this section the cases in which two or more transactions are to be taken as forming part of an arrangement include any case in which it would be reasonable to assume that one or more of them –
 - (a) would not have been entered into independently of the other or others, or
 - (b) if entered into independently of the other or others, would not have taken the same form or been on the same terms.

- (9) If—
 - (a) at any time any of sections 148A to 148F has applied for determining the amounts to be taken into account in calculating the profits or losses of the trade, and
 - (b) conditions A to C are met at any subsequent time, those amounts, and any other amounts which (as a result of this section) are to be so taken into account, are subject to such adjustments as are just and reasonable.
- (10) All such assessments and adjustments of assessments are to be made as are necessary to give effect to subsection (9).”
- (3) The amendment made by sub-paragraph (1) has effect where—
 - (a) expenditure is incurred on or after 9 October 2007, or
 - (b) a person carrying on a trade becomes entitled to a deduction in calculating the profits or losses of the trade as a result of any plant or machinery forming part of the trading stock of the trade on or after that date.
- (4) The amendment made by sub-paragraph (2) has effect in relation to arrangements entered into on or after that date.