

*Corporation Tax: Bill 6
Leasing plant or machinery: tax avoidance
October 2008: Committee paper CC/SC (08) 46*

Chapter 1: Leasing plant or machinery: tax avoidance

Overview

1. This Chapter rewrites certain anti-avoidance provisions relating to leasing plant or machinery, namely:

- sections 785ZA and 785ZB of ICTA (restrictions on use of losses: leasing partnerships) introduced by section 83 of FA 2006 and
- sections 785B to 785E of ICTA (plant and machinery leases: capital receipts to be treated as income) introduced by paragraph 1 of Schedule 20 to FA 2008.

2. The commentary uses a number of abbreviations. They are listed below.

Bill 5 the draft Corporation Tax Bill published on 22 February 2008 (and references to numbered Parts, Chapters and clauses of, and Schedules to and paragraphs of Schedules to, Bill 5 are to the Parts, Chapters, clauses, Schedules and paragraphs so numbered in that draft)

CAA the Capital Allowances Act 2001

FA 2006 Finance Act 2006 (and similarly for other Finance Acts)

ICTA the Income and Corporation Taxes Act 1988

ITA the Income Tax Act 2007.

Clauses 1 and 2: Restrictions on use of losses in leasing partnerships

Overview

3. These two clauses rewrite provisions introduced by FA 2006 as an adjunct to the provisions of Schedule 10 to FA 2006 (Sale etc of lessor companies etc). Section 785ZA of ICTA addresses an alternative structure, which involves allocating profits and losses in a leasing business carried on in partnership to achieve a similar effect to a disposal of an interest in the leasing business. Section 785ZB of ICTA provides definitions and interpretation for the purposes of section 785ZA of ICTA.

4. The provisions of section 785ZA of ICTA have been divided into two clauses and the definitions in section 785ZB of ICTA incorporated within those clauses.

Clause 1: When restrictions on leasing partnership losses apply

5. This clause sets out the circumstances in which the restrictions on the use of losses in clause 2 apply. It is based on sections 785ZA(1) to (4) and 785ZB(1) to (6) of ICTA.

Corporation Tax: Bill 6
Leasing plant or machinery: tax avoidance
October 2008: Committee paper CC/SC (08) 46

6. The restrictions apply where a company carries on a “business of leasing plant or machinery” in partnership and the company’s profit sharing arrangements are unusual. *Subsection (1)(e)* achieves this by providing that the restrictions only apply if the profit sharing arrangements are not determined “on an allowable basis” as defined in *subsections (3) and (4)*.

7. “Business of leasing plant or machinery” has the same meaning as it has for the purposes of Part 3 (leasing business carried on by a company in partnership) of Schedule 10 to FA 2006 (Sale etc of lessor companies etc). See paragraph 25 for the definition applicable to Part 3 of that Schedule. Schedule 10 to FA 2006 is to be rewritten in this Bill. For the definition of “business of leasing plant or machinery” applicable to the Chapter rewriting Part 3 of that Schedule, see clause 26[j60610s6p] published on 14 October 2008 under committee paper CC/SC (08) 41: Leasing plant or machinery: the sales of lessors Chapters.

8. *Subsection (1)(d)* refers to “notional business” and *subsection (6)* defines this term by reference to section 114(2) of ICTA. Section 114(2) of ICTA has been rewritten in clause 1186[j190303] of Bill 5 in a way which dispenses with the concept of notional business. The references to notional business in sections 785ZA and 785ZB of ICTA are to be consequentially amended by Bill 5. This clause and clause 2 will then be amended accordingly.

9. Subsection (6) defines “lease” by cross-reference to section 785A of ICTA (rent factoring of leases of plant or machinery). That section of ICTA has not at this stage been rewritten, pending the outcome of the consultation on financial products: principles-based legislation which may result in its repeal.

Clause 2: Restrictions on leasing partnership losses

10. This clause restricts the use of losses incurred by a company in the partnership leasing business. It is based on sections 785ZA(5) to (9) and 785ZB(1), (7) and (8) of ICTA.

11. A loss which derives from capital allowances on the leased plant or machinery may only be set off against the company’s income from leases of plant or machinery entered into by the partnership no later than the end of the accounting period in which the loss is incurred. It can be carried forward, but only against such leasing income (see *subsection (2)*). It cannot be set sideways (see *subsection(3)*) or surrendered as group relief (see *subsection (4)*).

12. Section 393A(1) of ICTA referred to in subsection (3) is to be rewritten in this Bill. See clause 3[j4505rm](2) published on 8 November 2007 under committee paper CC/SC (07) 38: Losses.

13. The sections of ICTA referred to in the definition of “relevant loss relief provision” in *subsection (6)* are to be rewritten in this Bill. The relevant clauses as

Corporation Tax: Bill 6
Leasing plant or machinery: tax avoidance
October 2008: Committee paper CC/SC (08) 46

published on 8 November 2007 under committee paper CC/SC (07) 38: Losses are as follows:

Section of ICTA	Rewritten clause published on 8 November 2007 under committee paper CC/SC (07) 38
section 392A	clauses 25[j4101rm] and 26[j4101Arm]
section 392B	clause 29[j4102rm]
section 393	clause 15[j4513rm]
section 396	clause 31[j4551rm]

Clauses 3 to 7: Capital payments in respect of leases treated as income

Overview

14. These clauses rewrite sections 785B to 785E of ICTA introduced by FA 2008.

15. Only minor changes in language have been made but the provisions have been restructured to improve accessibility. In particular, section 785C (section 785B: interpretation) has been rewritten in two clauses. The first clause deals with the meaning of the primary terms “capital payment” and “relevant capital payment”, while the other defined terms are relegated to the second clause.

16. FA 2008 also introduced corresponding sections for income tax purposes: sections 809ZA to 809ZD of ITA. While we consider that the revised structure of the rewritten clauses is helpful to users, we are doubtful that it is imperative that the corresponding sections of ITA are rewritten or that the project will have the resources to do so. We do in any event propose to make one amendment to section 809ZC of ITA. See the commentary on clause 6.

Q1. We welcome comments on the restructuring of sections 785B to 785E of ICTA and on the necessity or desirability of restructuring sections 809ZA to 809ZD of ITA in the same manner.

Clause 3: Capital payments in respect of leases treated as income

17. This clause taxes certain capital receipts arising in connection with leases of plant or machinery (such as premiums and similar sums) as income of the lessor. It is based on section 785B of ICTA.

18. The accounting period in which the charge to tax arises depends upon whether or not an unconditional obligation to make a “relevant capital payment” (see clause 4) is entered into before the relevant capital payment is made. See *subsections (3) and (4)*.

Corporation Tax: Bill 6
Leasing plant or machinery: tax avoidance
October 2008: Committee paper CC/SC (08) 46

Clause 4: Meaning of “capital payment”, “relevant capital payment” etc

19. This clause defines “relevant capital payment” and related terms. It is based on section 785C(2) and (6) to (10) of ICTA.

20. *Subsection (2)* defines the term “capital payment” as any payment except one that would fall to be included in calculating the lessor’s income, or one that is not taken into account in the calculation of the lessor’s income because section 502B of ICTA applies. Section 502B, which is to be rewritten in this Bill, ensures that only the gross earnings from a long funding lease are taxed. *Subsection (2)*, therefore, ensures that no part of long funding lease rentals triggers clause 3.

21. Clause 3 is only triggered if the capital payment is “relevant” as defined in *subsections (3) to (5)*. But a capital payment which falls within those subsections is not relevant if it falls within *subsection (6)*.

22. Payment is given an extended meaning for the purposes of clauses 3, 6 and 7 and this clause (see *subsections (7) and (8)*).

Clause 5: Further interpretation of section 3 etc

23. This clause defines other terms used in clauses 3 to 7. It is based on section 785C(1) and (3) to (5).

24. The effect of *subsections (3) to (5)* is that a “lease of plant or machinery” includes:

- a lease of plant or machinery only;
- a lease of plant or machinery that is not a fixture where it is leased with land or other assets in circumstances where income attributable to the plant or machinery would not be taxed as property income (in which case see clause 6).

but does not include:

- a lease of land and buildings, including fixtures and other plant or machinery the income from which would be taxed as property income; or
- plant or machinery leased out under a long funding lease where the lessor would have been entitled to claim capital allowances but for section 34A of CAA.

Clause 6: Leases of plant or machinery and other property: apportionments for section 3

25. This clause ensures that clause 3 applies in a just and reasonable manner where the lease includes (but is not limited to) plant or machinery that is not a fixture. It is based on section 785D of ICTA.

Corporation Tax: Bill 6
Leasing plant or machinery: tax avoidance
October 2008: Committee paper CC/SC (08) 46

26. *Subsection (3)* ensures that where the capital payment refers to plant or machinery, any income from which would be charged as property income, it is treated as referring to “other property” for the purpose of arriving at an apportionment under *subsection (2)*. For example, if a lease of property includes furniture (and the income in respect of the furniture is taxed as property income) any element of the capital payment that refers to the furniture is outside the scope of clause 3.

27. The words “if the income (if any) ... is chargeable” in section 785D(3) of ICTA have been rewritten as “any income ... would be chargeable” in subsection (3), in order to remove any doubt that this treatment applies whether or not any income actually arises. This conforms the wording of subsection (3) with that of section 785C(4)(a) of ICTA rewritten in clause 5(4).

28. It is proposed that section 809ZC(3) of ITA is similarly amended by the substitution for “is chargeable” of “would be chargeable”.

Clause 7: Deduction where failure to make capital payment expected

29. This clause gives relief for bad debts, or debts which are expected to be bad. It is based on section 785E of ICTA.

30. As clause 3 may tax a relevant capital payment before it is received, relief is to be given at the time the lessor reasonably expects that some or all of the relevant capital payment will not be paid. This rule applies whether the payment was due to be made to the lessor or to someone on their behalf.