

*Income Tax and Capital Gains Tax
the Taxation (International and Other Provisions) Bill
Leasing arrangements: finance leases and loans
June 2009: Committee Paper CC/SC (09) 13*

Clause 1 and Schedule 1: Leasing arrangements: finance leases and loans

Overview

1. This clause and Schedule provide for the rewriting of Schedule 12 to FA 1997.
2. Schedule 12 to FA 1997 has effect for both corporation tax purposes and income tax purposes. In accordance with the principle of splitting such provisions into separate corporation tax provisions in corporation tax rewrite Acts and income tax provisions in income tax rewrite Acts, clauses rewriting Schedule 12 for corporation tax purposes only were first issued for consultation in Part 10 of CTB2.
3. Part 1 of the Schedule inserts a new Part 11A of ITA to deal with the income tax aspects of the source legislation and Part 2 inserts a new section 37A of TCGA to deal with its chargeable gains aspects.
4. The structure and drafting of the new Part 11A of ITA is in line with that of Part 10 of CTB2, with certain exceptions. In particular the chargeable gains aspects of clauses 427 to 429 of CTB2 (based on paragraph 12 of Schedule 12 to FA 1997) have not been replicated in Part 11A. See the commentary on section 614BP of ITA and section 37A of TCGA.. We have also made some amendments to ensure that the split into separate corporation tax provisions and income tax provisions works as intended. As mentioned in the commentary, corresponding amendments will be made in Part 10 of CTB2.
5. We have recently received detailed and helpful comments on Part 10 of CTB2 from a respondent, for which we are grateful. Some of those comments highlight straightforward drafting errors, which we have corrected in the provisions now published and will correct in CTB2.
6. Other comments raise more substantive drafting queries. In one case, we have adopted the respondent's suggestion (see the commentary on section 614CD). We are considering the other comments and will reply to them in the Response Document to CTB2. The absence of any reference to them in this commentary and of any amendment in the provisions now published should not, therefore, be regarded as indicating whether or not an amendment is necessary or desirable.
7. Schedule 12 to FA 1997 was introduced to deal with two finance leasing arrangements. Schedule 12 achieves its aims by aligning the tax treatment of the return in respect of finance leases and loans more closely with the commercial accounting treatment.
8. Part 1 of Schedule 12 to FA 1997 (rewritten in Chapter 2 of the new Part 11A of ITA) counters tax avoidance by finance lessors trying to turn some of their lease rental income into capital receipts (taxed later and at lower effective rates, if at all). It ensures that any part of the capital receipt which is recognised as return on investment under GAAP is brought into account for tax purposes as income.

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9. Part 2 of Schedule 12 to FA 1997 (rewritten in Chapter 3 of the new Part 11A of ITA) deals with a possible deferral of tax liability by means of leases under which rentals are concentrated towards the end of the lease term. But for the provisions of Schedule 12, rental income in the case of such a finance lease could be recognised for tax purposes later than it is recognised in accordance with GAAP.

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

CAA	the Capital Allowances Act 2001
CTA 2009	the Corporation Tax Act 2009
CTB2	the draft Corporation Tax Bill published in March 2009 (and references to numbered Parts, Chapters and clauses of, and Schedules to and paragraphs of Schedules to, CTB2 are to the Parts, Chapters, clauses, Schedules and paragraphs so numbered in that draft)
FA 1997	Finance Act 1997 (and similarly for other Finance Acts)
GAAP	generally accepted accounting practice (see section 50(1) of FA 2004 and section 997 of ITA)
ICTA	the Income and Corporation Taxes Act 1988
ITA	the Income Tax Act 2007
ITTOIA	the Income Tax (Trading and Other Income) Act 2005
TCGA	the Taxation of Chargeable Gains Act 1992

Clause 1: Leasing arrangements: finance leases and loans

11. This clause introduces Schedule 1 (Leasing arrangements: finance leases and loans).

Schedule 1: Leasing arrangements: finance leases and loans

Overview

12. This Schedule is divided into two Parts containing respectively amendments to ITA and amendments to TCGA.

13. The following explanatory notes are written by reference to the Parts, Chapters and sections of ITA and TCGA proposed to be inserted or amended by the Schedule.

Part 1: New Part 11A of ITA 2007

Chapter 1: Introduction

Overview

14. This Chapter not only gives an overview of Part 11A but also brings to prominence the definitions of certain terms fundamental to its provisions.

Section 614A: Overview of Part

15. This section describes Part 11A and the contents of each Chapter. It is new.

16. The drafting of *subsection (3)* differs from that of clause 406(3) of CTB2 in response to comments received on that clause, which will be amended in similar manner.

Section 614AA: Normal rent

17. This section defines “normal rent”. It is based on paragraph 20 of Schedule 12 to FA 1997.

18. Normal rent is the amount which but for Part 11A a lessor would bring into account as rent from a lease for the purposes of income tax.

Section 614AB: Accountancy rental earnings

19. This section defines “accountancy rental earnings”. It is based on paragraph 21 of Schedule 12 to FA 1997.

20. Part 11A provides that the accountancy rental earnings of a lessor in relation to a lease are, in certain circumstances, to be brought into account for income tax purposes instead of the normal rent from the lease.

21. *Subsections (1)* and *(2)* provide that in relation to a lease “accountancy rental earnings” are the highest of the following three figures for a period of account:

- the rental earnings (see section 614AC) of the lessor in relation to the lease;
- the rental earnings of a connected person of the lessor in relation to the lease; or
- the rental earnings in relation to the lease for the purposes of consolidated accounts of the group of which the lessor is a member.

22. The purpose of taking the highest of the three figures is to ensure that the earnings fully reflecting the economic substance of the transaction are taxed. This is especially important when the capital sum which is an essential part of a leasing arrangement within Chapter 2 may be received not by the lessor but by a related party. In such a case it is only by considering the lessor’s position and that of the related party together that the true economic substance of the transaction can be appreciated. In the case of a lessor which is a company,

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that is likely to be in the consolidated accounts of the group as a whole, or possibly in the accounts of the related party, rather than in those of the lessor company itself.

23. Although most company lessors will be within the charge to corporation tax and thus fall within Part 10 of CTB2, these provisions apply to companies which are within the charge to income tax, including in particular non-UK resident companies that are lessors of land and buildings. Accordingly it is necessary for Part 11A of ITA to deal with lease accounting by a non-UK resident company and any group of which it is part.

Section 614AC: Rental earnings

24. This section defines “rental earnings”. It is based on paragraph 22 of Schedule 12 to FA 1997.

Chapter 2: Leases with return in capital form

Overview

25. This Chapter is concerned with finance leases intended to turn part of the associated rental income into capital receipts.

Section 614B: Arrangements to which this Chapter applies

26. This section describes the leasing arrangements that fall within Chapter 2. It is based on paragraphs 1(1) and 2(1) of Schedule 12 to FA 1997.

27. The arrangements fall within the Chapter if they involve the lease of any property or rights (see *subsection (1)* and the definition of “asset” in section 614DG).

28. The Chapter is only capable of applying if two conditions are met. First, the arrangements must fall to be treated under GAAP as a finance lease or loan (see *subsection (2)*). Second, it is necessary that some or all of the lessor’s return on investment in respect of the finance lease or loan is not in the form of rent and would not, apart from Part 11A or Part 10 of CTB2, be brought into account for tax purposes as rent (see *subsection (3)*).

29. Reference to Part 10 of CTB2 and to tax purposes (rather than only income tax purposes) has been included in subsection (3) to ensure that the division between that Part and Part 11A of ITA works as intended. Clause 410(3)(b) of CTB2 will be similarly amended to incorporate a reference to Part 11A of ITA and to refer to tax purposes instead of corporation tax purposes.

30. The Chapter is capable of applying to arrangements entered into before the commencement date of Schedule 12 to FA 1997 (see *subsection (4)(a)* and the commentary on section 614BX).

Section 614BA: Purposes of this Chapter

31. This section sets out the main purposes of Chapter 2. It is based on paragraph 1(2) of Schedule 12 to FA 1997.

32. The first purpose (in *subsections (2) to (4)*) is to substitute for the ordinary tax measure of income from the lease the amount recognised in accordance with GAAP where this is larger than the normal measure (see section 614BF).

33. Under GAAP, part of the sum mentioned in section 614B(3) is recognised as annual income over the course of the lease and thus taken into account in computing commercial profits. Income is recognised in this way because in substance the lease is tantamount to a loan, the interest on which needs to be matched with the lessor's own borrowing costs in order properly to reflect the lessor's profit.

34. The income recognised in accordance with GAAP may be that shown in consolidated accounts of the lessor's group or in those of a company which is a "connected person" of the lessor. The reason for looking wider than the lessor (see subsection (4)) is that the full earnings from the lease may only be shown in, say, the accounts of the parent or in the consolidated group results.

35. The second purpose of Chapter 2 (in *subsections (5) and (6)*) is to recover appropriately any tax reliefs for capital expenditure already given.

36. The drafting of subsection (4) differs from that of clause 411(4) of CTB2 in response to comments received on that clause, which will be amended in similar manner.

Clause 614BB: Application of this Chapter

37. This section, together with section 614BC, determines whether Chapter 2 applies to a particular lease. It is based on paragraph 2 of Schedule 12 to FA 1997.

38. For the Chapter to apply, the conditions in section 614BC must have been met in relation to the lease at some time in a period of account of the current lessor (see *subsection (1)(b)*). But once they have been met in relation to the lessor at the time, they are treated as continuing to be met as regards any subsequent lessor unless and until the lease is assigned to a wholly unrelated person (see *subsections (3) to (5)*).

39. *Subsection (2)* provides that Chapter 2 does not apply to long funding leases of plant or machinery in relation to which Part 2 of CAA gives capital allowances to the lessee instead of the lessor. Chapter 10A of Part 2 of ITTOIA sets out the basis of taxation of rental earnings under such leases.

40. *Subsection (6)* is a necessary consequence of the split into separate provisions for corporation tax purposes and income tax purposes.

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Section 614BC: The conditions referred to in section 614BB(1)

41. This section sets out the five conditions, A to E, all of which must be met if Chapter 2 is to apply to a specific lease. It is based on paragraph 3(1) to (5) of Schedule 12 to FA 1997.

42. Condition A in *subsections (2) to (4)* requires the lease to fall to be treated under GAAP as a finance lease or loan.

43. Condition B in *subsection (5)* requires a “major lump sum” which is not rent to be payable and for part of that sum to be treated under GAAP as return on investment in respect of the finance lease or loan.

44. Condition C in *subsection (6)* is that not all of that part of the major lump sum would apart from Chapter 2 be brought into account for income tax purposes as the “normal rent” (see sections 614AA and 614BD(3) and (4)) from the lease for tax years ending with “the relevant tax year” (see section 614BD(1)).

45. Condition D in *subsection (7)* is that for the period of account of the lessor in which “the relevant time” (see section 614BD(1)) falls or for an earlier period of account of the lessor, the “accountancy rental earnings” (see section 614AB) in respect of the lease exceed the normal rent for the period. The point of this condition is that, if a lessor is consistently being taxed on at least as much income as the commercial accounts show, then the terms of the lease are not ones which are designed to turn rental income into a capital receipt.

46. Condition E in *subsection (8)* is that at the relevant time there exist such arrangements or circumstances as are mentioned in section 614BE.

47. The arrangements and circumstances are set out in detail in section 614BE, but essentially there must be some likelihood that the lessee or a connected person of the lessee will buy out the lessor’s interest in the leased asset for a major lump sum.

48. Condition E is intended to ensure that a lease does not come within Chapter 2 solely because there is a possibility that the lessor may obtain a major capital sum otherwise than from the lessee or a connected person. This might happen for example on the unplanned sale of the leased asset to a third party or on a claim under an insurance policy on the destruction of the asset.

Section 614BD: Provisions supplementing section 614BC

49. This section provides the meanings of “the relevant tax year” and “the relevant time” and sets out how the normal rent is to be determined, for the purposes of section 614BC. It is based on paragraph 3(7) and (8) of Schedule 12 to FA 1997.

50. An incorrect reference to subsection (4)(b) in clause 414(5) of CTB2 has been corrected in *subsection (5)*.

Section 614BE: The arrangements and circumstances referred to in section 614BC(8)

51. This section sets out the arrangements and circumstances which constitute Condition E in section 614BC(8). It is based on paragraph 4 of Schedule 12 to FA 1997.

52. See the commentary on section 614BC.

Section 614BF: Current lessor taxed by reference to accountancy rental earnings

53. This section provides for the lessor to bring into account for income tax purposes the accountancy rental earnings in respect of the lease for a period of account if they exceed the normal rent for the period. It is based on paragraph 5 of Schedule 12 to FA 1997.

Sections 614BG to 614BK: Reduction of taxable rent by cumulative rental excesses

Overview

54. These sections ensure that the rule in section 614BF that the higher of the accountancy rental earnings and the normal rents (ordinary taxable rents) are taxed does not overall cause more rent to be taxed as income than is actually due to the lessor. They are based on paragraph 6 of Schedule 12 to FA 1997.

55. These sections achieve their purpose by requiring running totals to be kept of aggregate differences between accountancy rental earnings and the normal rents. Any aggregate excess of accountancy earnings over normal rents arising in past periods can then be set against any current excess of normal rents over accountancy earnings. Conversely, any aggregate excess of normal rents over accountancy rental earnings arising in past periods can be set against any current excess of accountancy rental earnings over normal rents.

56. The provisions of paragraph 6 of Schedule 12 to FA 1997 have been unpacked into five sections to provide greater clarity.

Section 614BG: Reduction of taxable rent by cumulative rental excesses: introduction

57. This section introduces sections 614BG to 614BK. It is based on paragraph 6(5) to (9) of Schedule 12 to FA 1997.

58. In response to the comments received on clause 417 of CTB2, the drafting of this section has been simplified by omitting the use of the term “the reduction sections” and its definition. The similar simplification will be made in clause 417 of CTB2.

Section 614BH: Meaning of “accountancy rental excess” and “cumulative accountancy rental excess”

59. This section defines the terms “accountancy rental excess” and “cumulative accountancy rental excess”. It is based on paragraph 6(3), (4) and (8) of Schedule 12 to FA 1997.

Section 614BI: Reduction of taxable rent by the cumulative accountancy rental excess

60. This section applies if in relation to a lease for a period of account the normal rent exceeds the accountancy rental earnings (so it is the normal rent that is taxed) and there is a cumulative accountancy rental excess. It is based on paragraph 6(5) and (6) of Schedule 12 to FA 1997.

61. The rent that is brought into account for income tax purposes is found by reducing normal rent by the cumulative accountancy rental excess but not so as to bring into account an amount less than the accountancy rental earnings for the period.

Section 614BJ: Meaning of “normal rental excess” and “cumulative normal rental excess”

62. This section defines the terms “normal rental excess” and “cumulative normal rental excess”. It is based on paragraph 6(1), (2) and (6) of Schedule 12 to FA 1997.

Section 614BK: Reduction of taxable rent by the cumulative normal rental excess

63. This section applies if in relation to a lease for a period of account the taxable rent under section 614BF would be the amount of the accountancy rental earnings and there is a cumulative normal rental excess. It is based on paragraph 6(7) and (8) of Schedule 12 to FA 1997.

64. Section 614BF only applies if the accountancy rental earnings exceed the normal rent. To avoid more rent being taxed as income for the period than is actually due to the lessor where there is a cumulative normal rental excess for the period, the rent that is brought into account for income tax purposes is found by reducing the accountancy rental earnings by the cumulative normal rental excess, but not so as to bring into account an amount less than the normal rent for the period.

Sections 614BL to 614BO: Relief for bad debts by reduction of cumulative rental excesses

Overview

65. These sections are concerned with bad debts. Broadly, the aim is to ensure that any bad debts are sensibly taken into account in calculating taxable profits and accountancy rental excesses and normal rental excesses. If the lease runs its course, the net rents taxed should equal the net rents payable after allowing for any bad debts.

Section 614BL: Relief for bad debts: reduction of cumulative accountancy rental excess

66. This section deals with a bad debt deduction in respect of rent under a lease for a period of account if there is a cumulative accountancy rental excess for the period. It is based on paragraph 9(1) to (4) and (7) of Schedule 12 to FA 1997.

67. *Subsection (2)* reduces the cumulative accountancy rental excess for a period where the accountancy rental earnings exceed normal rent by an amount equal to the excess of the bad debt deduction over the accountancy rental earnings.

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68. *Subsection (3)* deals with the converse situation if, for a period of account, normal rent is at least equal to accountancy rental earnings (so that it is the normal rent which is taxed). In those circumstances there are two restrictions.

69. *Subsection (4)* provides that relief otherwise available under section 614BI(2) in a period for any cumulative accountancy rental excess brought forward from previous periods is restricted to any excess of the normal rent over any bad debt deduction given in respect of rents from the lease. That is because only the normal rent net of bad debt relief is in effect being brought into account for tax.

70. *Subsection (5)* applies if the bad debt deduction exceeds the normal rent for a period of account. In such a case any cumulative accountancy rental excess brought forward from previous periods is reduced by the amount by which the bad debt deduction exceeds the normal rent. That is because the excess of the bad debt deduction over the normal rent for the period of account already represents relief for rents taxed in previous periods.

71. The definition of “bad debt deduction” in *subsection (6)* corrects a missed consequential in ITTOIA by substituting for the cross-reference to “sub-paragraph (i), (ii) or (iii) of section 74(1)(j) of the Taxes Act 1988” a cross-reference to “section 35(1)(a), (b) or (c) of ITTOIA 2005”.

Section 614BM: Recovery of bad debts following reduction under section 614BL

72. This section reinstates any relief for cumulative accountancy rental excess reduced under section 614BL if the bad deduction is subsequently reversed (because the debt is recovered or prospects for its recovery improve). It is based on paragraph 9(5) to (7) of Schedule 12 to FA 1997.

Section 614BN: Relief for bad debts: reduction of cumulative normal rental excess

73. This section deals with the interaction of bad debt deductions and relief for cumulative normal rental excess under section 614BK. It is based on paragraph 10(1) to (4) and (7) of Schedule 12 to FA 1997.

74. As with section 614BL, the rationale is that the relief should only represent an excess of normal rent over accountancy rental earnings which have effectively been brought into account for tax and that the relief should only be given against rents similarly brought into account.

75. The structure of the detailed rules is identical with that in section 614BL.

Section 614BO: Recovery of bad debts following reduction under section 614BN

76. This section reinstates any relief for cumulative normal rental excess reduced under section 614BN if the bad debt deduction is subsequently reversed (because the debt is recovered or prospects for its recovery improve). It is based on paragraph 10(5) to (7) of Schedule 12 to FA 1997.

Section 614BP: Effect of disposals of leases: general

77. This section treats a period of account as coming to an end for the purposes of Part 11A immediately before any disposal of the lessor's interest under the lease, the leased asset or an asset representing the leased asset. It is based on paragraph 12(5) to (7) of Schedule 12 to FA 1997.

78. The remaining sub-paragraphs of paragraph 12 of Schedule 12 to FA 1997 are rewritten by Part 2 of this Schedule in section 37A of TCGA. See the commentary on that section.

79. It is proposed that clauses 427 to 429 of CTB2 will be replaced by a clause corresponding to section 614BP to be placed before the current clause 426.

Section 614BQ: Assignments on which neither a gain nor a loss accrues

80. This section deals with the assignment of a lease in circumstances which are regarded for the purposes of capital gains tax as giving rise to neither a gain nor a loss. It is based on paragraph 7 of Schedule 12 to FA 1997.

81. In these circumstances the assignee takes over the assignor's "cumulative accountancy rental excess" or "cumulative normal rental excess" and can obtain relief for them against rental income or against any chargeable gain within section 37A of TCGA. The calculations are made as if the assignee had stepped into the assignor's shoes.

82. *Subsection (7)* has been included to ensure that the division between Part 11A of ITA and Part 10 of CTB2 works as intended. A corresponding subsection will be added to clause 426 of CTB2.

Sections 614BR to 614BW: Capital allowances: clawback of major lump sums

Overview

83. These sections unpack paragraph 11 of Schedule 12 to FA 1997 to improve its accessibility.

Section 614BR: Effect of capital allowances: introduction

84. This section introduces sections 614BS to 614BW and provides that they apply if a major lump sum (see section 614BC(5)) falls to be paid in relation to a lease. It is based on paragraph 11(1) and (2) of Schedule 12 to FA 1997.

Section 614BS: Cases where expenditure taken into account under Part 2, 5 or 8 of CAA 2001

85. This section deals with capital allowances in respect of plant or machinery, mineral extraction and patent rights. It is based on paragraph 11(3) to (7) of Schedule 12 to FA 1997.

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86. *Subsection (2)* brings into account as disposal value for the purposes of CAA an amount equal to the amount or value of the major lump sum. This is subject to adjustment under *subsections (3) to (6)* if the disposal value is limited in accordance with CAA.

Section 614BT: Cases where expenditure taken into account under other provisions of CAA 2001

87. This section deals with capital allowances given under any provision of CAA other than those mentioned in section 614BS. It is based on paragraph 11(8) and (14) of Schedule 12 to FA 1997.

88. In these cases, an amount equal to the allowances given or, if less, the amount or value of the major lump sum is treated as a balancing charge.

89. Following the repeal of section 532 of ICTA by CTA 2009, the extended definition of the Capital Allowances Act in paragraph 11(14) of Schedule 12 to FA 1997 is otiose and has not been rewritten. The provision rewriting that definition in clause 432(4) of CTB2 will also be omitted.

Section 614BU: Capital allowances deductions: waste disposal and cemeteries

90. This section deals with deductions for capital expenditure allowed under section 165, 168 or 170 of ITTOIA. It is based on paragraph 11(11) and (12) of Schedule 12 to FA 1997.

91. In these cases, an amount equal to the deductions allowed or, if less, the amount or value of the major lump sum is treated as a trading receipt.

Section 614BV: Capital allowances deductions: films and sound recordings

92. This section deals with deductions in respect of films and sound recordings allowed under section 135, 138, 138A, 139 or 140 of ITTOIA. It is based on paragraph 11(9) and (10) of Schedule 12 to FA 1997.

93. In these cases, if the amount or value of the major lump sum exceeds so much of that sum as was treated as a receipt of a revenue nature under section 134(2) of ITTOIA, the excess is also treated as a receipt of a revenue nature.

Section 614BW: Contributors to capital expenditure

94. This section deals with the case where capital allowances have been made to a person making contributions to capital expenditure on the provision of a leased asset under sections 537 to 542 of CAA. It is based on paragraph 11(13) of Schedule 12 to FA 1997.

95. *Subsection (2)* provides that sections 614BS and 614BT have the same effect in relation to the contributor and those allowances as they do in relation to the lessor and allowances given to the lessor for such expenditure by the lessor.

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Section 614BX: Pre-26 November 1996 schemes where this Chapter does not at first apply

96. This section makes provision for recognising income from some finance leases which form part of a “pre-26 November 1996 scheme” as defined in section 614D(1)(a). It is based on paragraph 13 of Schedule 12 to FA 1997.

97. A lease which forms part of a pre-26 November 1996 scheme only falls within Part 11A if it meets all the conditions in section 614BC. It does not fall within Chapter 3 as that Chapter only applies to leases which do not form part of a pre-26 November 1996 scheme (see section 614CB(1)(b) and the definition of a post-25 November 1996 scheme in section 614D(1)(b)).

98. If a lease forming part of a pre-26 November 1996 scheme met all the conditions in section 614BC on 26 November 1996, it falls within Chapter 2 for all periods of account beginning, or treated under section 614DB as beginning, on or after that date, subject to section 614BB(3).

99. But such a lease may not meet all those conditions until after 26 November 1996. In that case, this section effects a catching up exercise by taxing under section 614BF in the period when the lease is first subject to the rules in Chapter 2 the accumulated excess (if any) of the accountancy measure of income from the lease over the income actually taxed in earlier periods. No such excess relating to periods prior to 26 November 1996 can be taxed in this way nor are the assessments for earlier periods of account actually re-opened. The catching up is done in the period in which the conditions are met.

100. *Subsection (3)(b)* provides that for the purposes of Part 11A the time when the conditions are satisfied forms its own brief period of account. This ensures that the computational provisions in this section work correctly.

101. *Subsection (10)* provides for the case where for example there has been an assignment within section 614BQ and the lessor at an earlier time was within the charge to corporation tax. A corresponding subsection will be added in clause 436 of CTB2 to deal with cases where the prior lessor was within the charge to income tax.

Section 614BY: Post-25 November 1996 schemes to which Chapter 3 applied first

102. This section provides continuity of reliefs when a lease changes status. It is based on paragraph 14 of Schedule 12 to FA 1997.

103. It applies if a lease initially subject to the rules of Chapter 3 comes within those of Chapter 2. Any cumulative accountancy rental excess or any cumulative normal rental excess for the purposes of Chapter 3 counts for the purposes of Chapter 2.

104. *Subsection (4)* provides for the case where for example there has been an assignment within section 614BQ and the lessor at an earlier time was within the charge to corporation

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tax. A corresponding subsection will be added in clause 437 of CTB2 to deal with cases where the prior lessor was within the charge to income tax.

Chapter 3: Other finance leases

Overview

105. This Chapter is concerned with cases outside Chapter 2 where any assets are leased in such a way that they are in accordance with GAAP a finance lease or loan.

Section 614C: Introduction to Chapter

106. This section introduces the Chapter. It is based on paragraph 15(1) of Schedule 12 to FA 1997.

Section 614CA: Purpose of this Chapter

107. This section sets out the main purpose of the Chapter. It is based on paragraph 15(2) of Schedule 12 to FA 1997.

108. That purpose is to ensure that the taxable measure of earnings from the lease is not less than the accountancy measure. In effect, the rules take as the taxable earnings the amount which, but for Part 11A, the lessor would bring into account as rent from the lease for the purposes of income tax or the amount of the return on investment from the lease in accordance with GAAP, whichever is the higher. Unlike Chapter 2, this Chapter contains no special rules relating to reliefs for capital expenditure.

Section 614CB: Leases to which this Chapter applies

109. This section determines whether Chapter 3 applies to a particular lease. It is based on paragraph 16 of Schedule 12 to FA 1997.

110. The Chapter only applies to leases granted on or after 26 November 1996 and then only if they form part of a post-25 November 1996 scheme as defined in section 614D(1)(b) (see *subsection (1)(a)* and *(b)*).

111. The lease may be of any property or rights (see *subsection (1)(a)* and the definition of “asset” in section 614DG).

112. In addition, for the Chapter to apply, condition A, but not all of conditions B to E, in section 614BC must have been met in relation to the lease at some time on or after 26 November 1996 in a period of account of the current lessor (see *subsection (1)(c)* and *(d)*). But once condition A has been met in relation to the lessor at the time, it is treated as continuing to be met as regards any subsequent lessor unless and until the lease is assigned to a wholly unrelated person (see *subsections (4)* to *(6)*).

113. *Subsection (3)* provides that Chapter 2 does not apply to long funding leases of plant or machinery in relation to which Part 2 of CAA gives capital allowances to the lessee instead

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of the lessor. Chapter 10A of Part 2 of ITTOIA sets out the basis of taxation of rental earnings under such leases.

114. *Subsection (7)* is a necessary consequence of the split into separate provisions for corporation tax purposes and income tax purposes. Compared with clause 440(7) of CTB2, subsection (7) extends the provisions on which it operates to include subsection (1)(d). The extent of the operation of clause 440(7) of CTB2 will be similarly extended.

Section 614CD: Current lessor taxed by reference to accountancy rental earnings

115. This section provides for the lessor to bring into account for income tax purposes the accountancy rental earnings in respect of the lease for a period of account if they exceed the normal rent for the period. It is based on paragraph 17 of Schedule 12 to FA 1997.

116. Paragraph 17 applies paragraph 5 of Schedule 12 to FA 1997 for the purposes of Part 2 of that Schedule by cross-reference.

117. A respondent has commented in relation to clause 441 of CTB2 which is based on paragraph 17 of Schedule 12 to FA 1997:

Given that the rewrite has usually been at pains to specify precisely and explicitly who is the person charged and on how much, it is rather unsatisfactory that the only charging provision for this Chapter is in the form of the cross-reference in this clause to clause 416.

118. In response to that comment, this section restates section 614BF (based on paragraph 5 of Schedule 12 to FA 1997) in full for the purposes of Chapter 3. A similar clause restating clause 416 of CTB2 in full will be included in Chapter 3 of Part 10 of CTB2.

Section 614CE: Application of provisions of Chapter 2 for purposes of this Chapter

119. This section applies the provisions of sections 614BG to 614BQ for the purposes of this Chapter. It is based on paragraph 17 of Schedule 12 to FA 1997.

120. Clause 441 of CTB2 will be amended to conform with this section.

Chapter 4: Supplementary provisions

Overview

121. This Chapter contains supplementary and interpretative provisions.

Section 614D: Pre-26 November 1996 schemes and post-25 November 1996 schemes

122. This section defines a “pre-26 November 1996 scheme” and a “post-25 November 1996 scheme”. It is based on paragraph 27 of Schedule 12 to FA 1997.

123. For the significance of these terms see the commentary on sections 614BX and 614CB.

Section 614DA: Time apportionment where periods of account do not coincide

124. This section deals with situations where the measure of the accountancy rental earnings taxed under Part 11A on the lessor is that shown in the accounts of a connected person or a group of companies as a whole and the period for which those accounts are drawn up is different from the period for which the lessor's accounts are drawn up. It is based on paragraph 24 of Schedule 12 to FA 1997.

125. In these circumstances the figures are time-apportioned as necessary to arrive at the measure of accountancy rental earnings for the lessor's period of account.

Section 614DB: Periods of account and related periods of account and tax years

126. This section sets out the definition of "period of account". It is based on paragraphs 23 and 30 of Schedule 12 to FA 1997.

Section 614DC: Connected persons

127. This section provides that persons are regarded as connected throughout the period beginning at the time the leasing arrangements are made and ending with the termination of the current lessor's interest, if they are connected at some point during that period. It is based on paragraph 25(1) of Schedule 12 to FA 1997.

128. Section 1021(1) of ITA provides that section 932 of that Act (meaning of "connected" persons) applies for the purposes of ITA unless otherwise indicated (whether expressly or by implication). Accordingly it is unnecessary to rewrite paragraph 25(2) of Schedule 12 to FA 1997 here.

Section 614DD: Assets which represent the leased asset

129. This section defines assets which represent leased assets. It is based on paragraph 26 of Schedule 12 to FA 1997.

130. The purpose is to identify assets which in economic terms are essentially the same asset, in whole or in part, as the leased asset. Part 11A provides broadly that transactions in such assets are treated as transactions involving the leased asset itself.

Section 614DE: Parent undertakings and consolidated group accounts

131. This section sets out an assumption about consolidated accounts of companies which would count as "parent undertakings" for the purposes of the Companies Act 2006 but are not required for accounting purposes to prepare consolidated accounts in accordance with GAAP. It is based on paragraph 28 of Schedule 12 to FA 1997.

132. Such companies are regarded for the purposes of Part 11A as having to draw up consolidated accounts whether or not they are actually required to do so for accounting purposes. So parent companies incorporated outside the United Kingdom are treated, for the purpose of identifying leases within Part 11A and calculating the rental income from them, as

having to draw up consolidated accounts if they would not be so required for accounting purposes.

Section 614DF: Assessments and adjustments

133. This section ensures that all assessments and adjustments necessary to give effect to the provisions of Part 11A may be made. It is based on paragraph 29 of Schedule 12 to FA 1997.

134. This is principally relevant to the provisions dealing with capital allowances.

Section 614DG: Interpretation

135. This section provides definitions and interpretative rules. It is based on paragraph 30 of Schedule 12 to FA 1997.

Part 2: New section 37A of TCGA 1992

Overview

136. This new section moves to TCGA the provisions of paragraph 12 of Schedule 12 to FA 1997 relating to the calculation of the amount of any chargeable gain on a disposal of the lessor's interest in a lease, the leased asset or an asset representing the leased asset.

Section 37A: Consideration on disposal of certain leases

137. This section deals with the calculation of the amount of any chargeable gain on a disposal within section 614BP of ITA (including that section as applied by section 614CE of that Act) or within clause [j6971212c] of CTB2 (see currently clause 427(2)) (including that clause as applied by clause 441 of CTB2) if there is any cumulative accountancy rental excess. It is based on paragraph 12(1) to (4) and (6) of Schedule 12 to FA 1997.

138. In such cases any unused part of the cumulative accountancy rental excess is set against the disposal proceeds in calculating the chargeable gains position on the disposal. This is to ensure that the same sum is not taxed twice, once as income and again as a chargeable gain. The charge to income tax or to corporation tax on income takes priority because the cumulative accountancy rental excess represents that part of the proceeds on the disposal which is in substance of an income nature.

139. Section 614BP(2) of ITA and clause [j6971212c](2) of CTB2 (see currently clause 427(2)) treat a period of account as coming to an end immediately before any disposal. This ensures that the amount of cumulative accountancy rental excess available for set off against the disposal proceeds under this section can be properly calculated.

140. The cumulative accountancy rental excess for any period of account is, in effect, the aggregate accountancy rental excess for periods *before* the current period of account (see section 614BH(5) of ITA and clause 418(5) of CTB2). By treating a period of account as ending immediately before the disposal, the accountancy rental excess for that period can be

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included in the cumulative accountancy rental excess available to be used in calculating the chargeable gain.

141. If the disposal mentioned in *subsection (1) or (2)* is a part disposal, *subsections (6) to (9)* provide that the amount of the cumulative accountancy rental excess to be set against the disposal proceeds in accordance with *subsection (3)* is an apportioned part only of the full amount.

142. If two or more of the disposals mentioned in *subsection (1) or (2)* are made at the same time, *subsection (10)* provides that a just and reasonable proportion of the full cumulative accountancy rental excess is to be set against the proceeds of each disposal in accordance with *subsection (3)*.