

FINANCE ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Section 44 Schedule 15: Connected Companies: Release of Debts

Summary

1. [Section 44](#) and Schedule 15 amend the corporation tax rules on loan relationships that apply to impaired debts between connected companies. Under the current rules, where a company (“C”) acquires debt owed by a connected company (“D”) to a third party, which has been written down in value (“impaired”), an amount is taxable on D in respect of a “deemed release”. This deemed release is equal to the discount to the face value of the debt at which D acquires the debt. There is an exemption from this deemed release in certain corporate rescue situations. The amendments to these rules change the conditions under which exemption from a deemed release is available, for transactions occurring on or after 14 October 2009. They also ensure that releases of debt bought back that benefited from the new corporate rescue and debt for debt exemption will result in the discount being taxed on the debtor. Where the subsequent release involves a debt equity swap there is a further amendment that applies to releases made on or after 9 November 2009 to ensure such releases under a debt equity swap will also result in the discount being taxed on the debtor.

Details of the Schedule

2. Paragraph 1 amends section 322(4) of the Corporation Tax Act 2009 (CTA), and inserts a new subsection (4A).
3. Section 322(4) of CTA ensures that loan relationship credits are not brought into account where a debt is released in consideration of the issue of ordinary shares by the debtor company. The effect of the amendment to section 322(4) and new section 322(4A) is to disapply this rule where the release in question is a “release of relevant rights”. The term “relevant rights” is defined in section 358 of CTA.
4. Paragraph 2 makes a number of changes to Chapter 6 of Part 5 of CTA, by amending sections 358 and 361 of CTA, and inserting new sections 361A, 361B and 361C of CTA.
5. Section 358 of CTA currently provides that a loan relationship credit arising from the release of a debt by a connected creditor company is only taxable if it is a “deemed release” within sections 361 and 362 of CTA. The section is amended so that a taxable credit also arises from a “release of relevant rights”.
6. New subsections (4) to (6) of section 358 define the term “relevant rights” as rights that would have been taxable as a “deemed release” but for the application of new sections 361A and 361B. The amount of the credit in such cases is the amount of any discount at which the connected creditor acquired the impaired debt from a third party, less any amounts in respect of which the connected creditor was taxed before the release.

Example

Company D owes 100 to unconnected company A. Company C, which is connected with company D acquires the debt for 80. A deemed release of 20 would have been taxable in company D but for the fact that one of the exemptions in sections 361A or 361B applied. If company C then releases D from the debt, a credit of 20 will be taxable on company in respect of the release of relevant rights.

7. [Section 361](#) CTA is amended to substitute new subsection 361(1)(f) and new subsection 361(2). These changes have the effect of replacing the current exemption from the charge on a “deemed release” under section 361 of CTA with three new exemptions – the “corporate rescue exception”, the “debt-for-debt” exception, and the “equity-for-debt” exception. These are set out in new sections 361A, 361B and 361C.
8. New section 361A provides the “corporate rescue exception”. No loan relationships credit will arise on a deemed release under section 361 where a connected company acquires the debt owed by a connected debtor company to a third party company provided:
 - the acquisition by the new creditor is at arm’s length;
 - there has been a change in ownership of the debtor company in the period beginning one year before and ending 60 days after the acquisition of the debt;
 - it is reasonable to assume that but for the change in ownership the debtor company would have met the insolvency conditions in section 322(6) of CTA; and
 - it is reasonable to assume that the new creditor would not have acquired the debt but for the change in ownership.
9. The term “change in ownership” takes its meaning from section 769 of the Income and Corporation Taxes Act 1988 (ICTA), subject to some specific rules for building societies.
10. New section 361B provides the “debt-for-debt” exception. No loan relationships credit will arise on a deemed release under section 361 where a connected company issues a new security in consideration of the acquisition of an old security or enters into an unsecured loan in consideration of the acquisition of an old unsecured loan of a connected debtor company provided certain conditions are met.
11. Where the consideration given for the old security is a new security, the acquisition by the new creditor must be at arm’s length and the new security must have the same nominal and substantially the same market value as the old security.
12. Where the consideration given for the old unsecured loan is a new unsecured loan, the acquisition by the new creditor must be at arm’s length and the terms of the new unsecured loan must be substantially the same as that of the old unsecured loan.
13. New section 361C provides the “equity-for-debt” exception. No loan relationships credit will arise on a deemed release under section 361 where a connected company acquires the debt owed by a connected debtor company to a third party company provided:
 - the acquisition by the new creditor is at arm’s length; and
 - the consideration given by the new creditor consists of its own ordinary shares or those of another connected company.
14. Paragraph 3 provides for the commencement of the new rules. The new conditions for the exemption from a credit on a deemed release under section 361 of CTA have effect for acquisitions of debt on or after 14 October 2009. The imposition of a credit on a “release of relevant rights” has effect only where it relates to a release of debt acquired on or after that date. Accordingly, where a creditor releases a connected debtor from a debt acquired before that date, no credit will arise under section 358 of CTA. Where the

“release of relevant rights” takes place under a debt equity swap the new condition in section 322(4A) has effect in relation to releases that take place on or after 9 November 2009.

15. Paragraphs 4 and 5 provide transitional rules. These changes do not have effect where there was an agreement to acquire the debt in question in place before 14 October, or where there was not actually an agreement in place provided one of the following conditions are met. The conditions are that:
- before 14 October there must have been a proposal (made either by the old creditor or new creditor (or persons acting on their behalf or persons who control them) that the new creditor will acquire the debt;
 - if the debt is in the form of securities, a proposal for the new creditor to acquire them must have been made to or by the holders of at least 50 per cent of the securities before 14 October; and
 - before 14 October the Financial Services Authority (FSA) gave its agreement to the acquisition of the debt by the new creditor, and where this agreement was subject to the agreement of any other party that agreement had also been given and not withdrawn before 14 October, and one of the two conditions in the previous bullets would have been met but for one or other of the parties complying with terms on which the FSA agreement was given.
16. For these conditions to apply, the acquisition must have been completed before 31 January 2010.

Background Note

17. The rules that apply to loan relationships work on the principle that amounts taxed and relieved as credits and debits under those rules are the profits and losses arising in accounts drawn up in accordance with generally accepted accounting practice. When a debt is impaired or written off by a creditor company its expense will normally be allowable as a loan relationships debit. When a debtor company is released from a debt it owes, its profit will be taxable as a loan relationships credit.
18. Where a debt exists between connected companies, such credits and debits are not normally brought into account for tax purposes. Exceptions to this approach prevent its exploitation when companies become connected. In particular, when debt that has been impaired by an unconnected company is then acquired by a company connected to the debtor, the tax rules impose a deemed release on the debtor. There is, in turn, an exemption from this deemed release to cater for “corporate rescues” where the debtor is in financial distress and a third party acquires the company and the debt it owes to unconnected companies.
19. This exemption has been used by companies to buy back publicly-issued debt that has been trading at a discount in the financial markets, in order to avoid the tax charge that would normally arise when debt is redeemed for less than the amount originally paid for it. The changes to these rules restricts the exemptions available to cases where there is a genuine corporate rescue, and to certain cases where a group engages in a self-rescue by way of issuing new debt or shares in exchange for old debt.