

Tax Representation



TAXREP 49/07

TAX LAW REWRITE: BILL 5: CORPORATION TAX

LOAN RELATIONSHIPS

Memorandum submitted in July 2007 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to Paper CC/SC(17)18 issued in May 2007 by HMRC Tax Law Rewrite Team

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The Tax Faculty of the Institute of Chartered Accountants in England and Wales

TAXREP 49/07

Tax Law Rewrite: Bill 5: corporation tax
Loan relationships

TAX LAW REWRITE: BILL 5: CORPORATION TAX

LOAN RELATIONSHIPS

INTRODUCTION

1. We welcome the opportunity to comment on Paper CC/SC(07)18 (Bill 5: Loan relationships) published on 2 May 2007 by HMRC's Tax Law Rewrite team at <http://www.hmrc.gov.uk/rewrite/exposure/menu.htm#1>
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are in Annex 1. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex 2.

GENERAL COMMENTS

3. The rewriting of FA 1996 Schedules 8, 9 and 10 in the form of clauses and the bringing together of those Schedules and Chapter II of Part IV of FA 1996 (Loan Relationships) with the various other relevant but currently scattered source material (in particular the alternative finance arrangements provisions in Chapter 5 of and Schedule 2 to FA 2005) improves the accessibility of this complex and important legislation. We support this approach of bringing together all the loan relationships provisions.
4. The decision to rewrite the source legislation in three separate Parts – Part 6 (Loan Relationships), 7 (Relationships treated as loan relationships, etc) and 16 (Exempt income) is appropriate, as further clarifying the legislation for the user.
5. We note that holdings by companies in open-ended investment companies (and relevant definitions) are temporarily excluded from Chapter 3 of Part 7 (Relationships treated as loan relationships etc).
6. We also note that only paragraph 7 of Schedule 2 to FA 2005 has been rewritten at this stage (in clause 179). Is it intended to rewrite any of the other paragraphs in that Schedule which affect companies and corporation tax?

ANSWERS TO QUESTIONS

7. **Q1** We are content with the retention of the term “loan relationships”.
8. **Q2** Having regard to the commentary in Change 2 in Annex 1, we are content with the proposal to rewrite “person” as applying only to a company.
9. **Q3** As indicated in the response to Q2, we are content with the proposal to rewrite ‘person’ in paragraph 4A(2)(d) of Schedule 9 to FA 1996 as applying only to a company in clause 71(1)(d).

10. **Q4** We support the proposal to carry Change 82 in ITTOIA across to corporation tax, and thereby bring income tax and corporation tax back into line.
11. **Q5** We agree that “the Board” should be rewritten as an officer of Revenue and Customs in clause 138(1)(b) (Time limits and procedure for claims under section 137(1)).
12. As indicated in the response to Q2, we are content with the proposal to rewrite ‘person’ in s 88(1) and (5) FA 1996 as applying only to a company in clause 144(1) and (4).
13. **Q7** As indicated in the response to Q2, we are content with the proposal to rewrite ‘person’ in s 88(2)(f) FA 1996 as applying only to a company in clause 145(5).
14. **Q8** Having regard to the commentary in Change 5 in Annex 1, we are content with the proposal to apply the definition of an offshore fund in s 756A of ICTA for all purposes of the qualifying investments test.
15. **Q9** As indicated in our response to Q8, we are content with the proposal.
16. **Q10** It is not easy to follow the analysis in Change 1 in Annex 1, but we support the proposal that dividends etc on shareholdings held in an industrial and provident society *for the purposes of a trade* should be treated as trading income as if the shareholding were a loan relationship held for the purposes of the trade. We agree that the drafting of clause 170(2) accommodates this, by ignoring the Schedule D Case III charge in s 486(4) ICTA and by assuming the existence of an underlying loan relationship that may be held for the purposes of a trade.
17. **Q11** We support the proposal to carry Change 112 in ITTOIA across to corporation tax.
18. **Q12** We agree the proposal to carry Change 149 in ITTOIA (as modified to reflect section 50 of the Commissioners for Revenue and Customs Act 2005) across to corporation tax, thereby bringing the income and corporation tax codes back into line.

SPECIFIC COMMENTS ON DRAFT LEGISLATION

19. **cl 10 Meaning of “money debt”**
(2) Why is the clause 10(2) reference to subsection (1)(a)(i) or (ii) only, and not also to subsection 10(1)(a)(iii)? Section 81(2) ICTA appears to direct a disregard at any other option exercisable by either party under subsection 81(2)(a), (b) or (c).
 20. **cl 16 Profits and expenses of trades from loan relationships: trading credits and debits**
(1) Would it be preferable to refer to ‘gains and losses’ of the trade rather than to ‘profits and expenses (also in the clause heading)? This would accord with the reference to ‘gains and losses’ in the introductory clause 13(1).
- cl 21 General principle for credits and debits: amounts fairly representing gains and losses.**

21. **(3)(c)** The distinction in the source s 84(3)(c) ICTA between making payments under any of the company's loan relationships and making payments in pursuance of any of the company's related transactions is not sufficiently made in clause 21(3)(c) as drafted.

cl 45 Company ceasing to be party to loan relationship

22. **(1)(b)** The source s 103(6)(b) FA 1996 refers to profits, gains or losses arising from the loan relationship *or a related transaction*. Having regard to the definition of 'related transaction' in clause 12, as referring to rights or liabilities under a loan relationship, is it now considered that the clause 45(1)(b) reference to gains or losses arising from the loan relationship includes such gains or losses from related transactions?

cl 58 Introduction: meaning of "connected companies relationship"

23. In Explanatory Notes paragraph 108, in the third sentence, should the reference to subsections (3) and (4) be to subsections (3) and (5)?

cl 75 Reduction of impairment loss debits exceeding group relief credits where group relief claimed

24. Is the explanation in Explanatory Notes paragraph 137 correct? Rather than group relief being reduced, doesn't clause 75 instead reduce the debits brought into account by the member company and/or a group member in respect of impairment losses and release debits?

cl 90 Debts owed by or to partnerships involving companies

25. **(1)** In clause 90(1)(a) should the reference to 'carried on by a partnership ("the firm")' be to 'carried on by persons in partnership ("the firm")', with 'the partners' in clause 90(1)(b) then being referred to as 'those persons'? This would accommodate the lack of a partnership's separate legal identity in England and Wales, as in the source legislation in paragraph 19(1), Schedule 9 FA 1996.

26. Similar comments apply to clause 143(1)(a) and clause 143(2) (Connections where partnerships are involved).

cl 119 Assumptions where options etc apply

27. **(2)(c)** In clause 119(2)(c) instead of the opening words 'how long' we suggest 'the time when', as the purpose of the source legislation in paragraph 3(1)(c) Schedule 9 FA 1996 is to identify the time when an amount becomes due after the end of a period rather than being concerned with the length of time after the period end to the due date.

28. **(4)** In clause 119(4) the reference should be to 'A or A's associate' rather than to 'A and A's associate'.

cl 137 Claims to set off loss against profits of loss period or earlier periods

29. Explanatory Notes paragraph 235 is not readily intelligible. In the penultimate sentence, the reference to 'clause 138' is presumably to 'clause 137', being the clause referred to in the final sentence? As clause 137 does not apply to a loss surrendered as group relief, clause 137(3) itself does not affect this; but simply prevents a company which is a charity from claiming the other types of loss relief (same period profits set off and carry-back against earlier periods' gains) provided for

in clause 137(1). It is not, therefore, clear how a company which is a charity is prevented from surrendering a non-trading deficit as group relief under s 403(2) ICTA, if that is the intention.

cl 161 Exclusion of exchange gains and losses in respect of tax debts etc

30. **(1)(b)** In clause 161(1)(b) delete 'not' before 'deductible'. Similarly in Explanatory Notes paragraph 281, delete 'not' in the first sentence.

cl 166 Meaning of "qualifying investments"

31. **(2)** In the definition of "derivative contract", should there be a reference to open-ended investment companies within the final brackets (having regard to Explanatory Notes paragraph 285)?
32. Why is a definition of "relevant accounting period" provided for the purposes of clause 166?
33. In Explanatory Notes paragraph 294, the reference to clause 166 providing for Treasury powers to add to or subtract from the list of "qualifying investments" is incorrect.
34. In Explanatory Notes paragraph 295, the reference in the first sentence to 'paragraph 8(a)(i)' should be to 'paragraph 8(2)(a)'.

cl 179 Treatment of alternative finance arrangements as loan relationships etc

35. **(6)** Why is 'this Part' applied rather than 'Part 6'?
36. In Explanatory Notes paragraph 317, in the final sentence, the reference to section 50 '(4A)' should be to section 50 '(4)' of FA 2005.

cl 185 Provision not at arm's length: non-deductibility of relevant return

37. **(2)** Is it considered unnecessary to rewrite s 52(6) FA 2005 (no group relief surrender of an amount if a deduction is prohibited)? Clause 185(2), however, does not itself provide this prohibition, as it relates only to a deduction for the person paying relevant return under the alternative finance arrangements.

cl 182 Meaning of "profit share return"

38. We note that s 54 FA 2005 (profit share return not to be treated as being a distribution) has not been rewritten. We assume that this will be covered by clause 7(3)(b), which refers to s 209(6A) ICTA as preventing profit share return under alternative finance arrangements from being a distribution.

cl 194 The redemption return condition

39. In view of clause 194(6) is it necessary to rewrite 'arrangements' in s 91D(2)(a) FA 1996 as 'agreements, arrangements or understandings'?

cl 205 Introduction: securities free of tax to residents abroad ("FOTRA securities")

40. In Explanatory Notes paragraph 353, in the quotation in the first sentence, should the reference be to persons *not* ordinarily resident in the UK?

cl 206 Exemption of profits from FOTRA securities

41. (1) Does the exemption also need to refer to 'any loan relationship represented by a FOTRA security' as does section 154(2) FA 1996 (FOTRA securities)?

cl 207 Income from savings certificates

42. (3)(c) In the case of savings certificates issued under Northern Ireland law, of the statutes listed in s 46(6) ICTA is s 12 of the National Loans Act 1968 the only relevant corresponding enactment?

DETAILED COMMENTS ON DRAFTING

cl 8 Exclusion of amounts relating to life assurance policies

43. (2) Would it be preferable to replace "amounts relating to such a policy" by "such amounts", as aligning with clause 7(2)?

cl 9 Meaning of "loan relationship", "creditor relationship", debtor relationship" etc

44. s the inclusion of 'etc' in the clause 9 heading appropriate?

cl 11 Meaning of payments, interest, rights and liabilities under a loan relationship

45. In Explanatory Notes paragraph 29, is it correct to attribute clause 11 to sections 84(5) and (6) of FA 1996 (as well as to its source s 81(5) FA 1996)?

cl 24 Generally accepted accounting practice and recognised amounts

46. (2) Should the reference in Explanatory Notes paragraph 55 be to "Generally accepted accounting practice"?
47. (4)(a) Should the reference to 'profit or loss account' be to 'profit and loss account'? Similarly, the reference in Explanatory Notes paragraph 54.

cl 28 Determination of credits and debits where amounts not fully recognised for accounting purposes

48. In Explanatory Notes paragraph 62, the second sentence is not readily intelligible.

cl 29 Basis of accounting: "amortised cost basis", "fair value accounting" and "fair value"

49. In Explanatory Notes paragraph 64, in the first line, "costs" should be "cost" (basis).

cl 56 Exception to section 55: transferor using fair value accounting

50. (6) Should clause 57(7) also refer to section 155(4) (when discount arises) as applying as it applies for the purposes of section 155, as aligning with clause 51(7)?

cl 61 Companies ceasing to be connected

51. (2) In clause 61(3), 'FVL' should be 'FVA'.

cl 63 Introduction

52. (1) Is there any reason for referring to 'companies with connections' rather than to 'connected companies'?

cl 77 Reduction corresponding to reduction under section 75 where related credits exceed impairment losses

53. In Explanatory Notes paragraph 139, at the end of the first sentence, 'under the preceding clause' should read 'under clause 75'.

cl 79 Carry forward of claims for group relief where there are no net consortium debits

54. In Explanatory Notes paragraph 142, 'debts' in the paragraph heading should read 'debits'.

cl 83 Late interest treated as not accruing until paid in some cases

55. In Explanatory Notes paragraph 147 should 'one of the following clauses applies' be more specifically drafted, as referring to clauses 84, 85, 87 and 88?

cl 84 Connection between debtor and person standing in position of creditor

56. Explanatory Notes paragraph 148 should presumably attribute clause 84 to paragraph 2(1A) only of Schedule 9 to FA 1996 (and not also to paragraph 2(1D) of that Schedule).

cl 86 Interpretation of section 85

57. (2) We assume that the relevant definition of "associate" and "collective investment scheme" will be located elsewhere in Bill 5.

Chapter 10 Special kinds of companies

58. In the Overview, the reference to 'certain non-resident companies holding War Loan' appears inappropriate and there is no reference to credit unions.

cl 103 Meaning of "strip"

59. In Explanatory Notes paragraph 184, in the second sentence, the reference to 'FA 1947' should be to 'section 47 FA 1942'.

cl 106 Non-UK resident bankers, insurers and security dealers with interest on 3½% War Loan 1952 Or After

60. (1)(a) Should 'in the United Kingdom' be inserted after 'carries on'?
61. (2) Can the Explanatory Notes give guidance as to how the average rate of interest is to be calculated for the purposes of Step 4? Is this a simple average or a weighted average?
62. (2) Similarly, can the Explanatory Notes give guidance as to how the average holding in the period ('AH') is to be calculated?

cl 110 Postponement until redemption of debits for close companies' deeply discounted securities

63. In Explanatory Notes paragraph 195, in the first sentence, insert 'be' after 'only'.

cl 111 Exceptions to section 110

64. In clause 111(1)(b) and in clause 111(3), 'closed' should be 'close'.

cl 114 Issue of funding bonds

65. In Change 3 in Annex 1, at the end of the first sentence in the final paragraph, 'change' should be 'charge'.
- cl 116 Loan relationships with embedded derivatives**
66. In view of the inclusion of the term in the clause heading, in clause 116(1)(b) should '("embedded derivatives")' be inserted after 'equity instruments'?
- cl 121 Loan relationships for unallowable purposes**
67. In Explanatory Notes paragraph 211, in the final sentence, the reference to '(2)' should be to '(1A)'.
- cl 122 Meaning of "unallowable purpose"**
68. In Explanatory Notes paragraph 212, in the second sentence, the reference to '13(3)' should be to '13(2)'.
- cl 123 Schemes and arrangements for obtaining relief for interest**
69. In Explanatory Notes paragraph 216, in the final sentence, the bracketed reference to section 337A(2)(a) of FA 1996 appears to be incorrect.
- cl 124 Transactions not at arm's length: general**
70. In Explanatory Notes paragraph 217, in the final sentence, insert 'and (2) to (3A)' after 'paragraph 11(1)'.
- cl 128 Exchange gains and losses: equity notes where holder associated with issuer**
71. For consistency with the drafting of clause 127, should 'debtor' be inserted before 'relationship' in clause 128(1)(b) and 'exchange' before 'gain' in clause 128(2)?
- cl 137 Claims to set off loss against profits of loss period or earlier periods (2)**
72. Insert 'a' before 'loss'.
- cl 162 Introduction**
73. In Explanatory Notes paragraph 286, in the second sentence, 'paragraph 5(1)' should be 'paragraph 4(1)'.
74. In Change 5 in Annex 1, in the heading and in paragraphs 363 and 366, 'investment' where it appears should read 'investments'.
- cl 167 Qualifying holdings**
75. In Explanatory Notes paragraph 298, the reference to 'Paragraph 10(6A) and (6B)' should be to 'Paragraph 8(6A) and (6B)'.
- cl 170 Industrial and provident society payments treated as interest under loan relationships**
76. In change 1 in Annex 1, in the second paragraph, the second reference to 'relationships' should be to 'relationship'.
- cl 180 Meaning of "alternative finance return": purchase and resale arrangements**
77. Sub-clause 180(2) also originates from s 47(4) FA 2005.

78. The origin of sub-clause 180(3) is s 47(7) FA 2005.
- cl 187 Introduction**
79. In Explanatory Notes paragraph 327, in the second sentence, 'and (1)' should be 'and (10)'.
- cl 190 Meaning of "interest-like investment"**
80. The origin of clause 190 is subsections 91A(7)-(9) of FA 1996.
- cl 195 The redemption return condition: excepted shares**
81. In Explanatory Notes paragraph 339, in the fourth sentence, 'Chapter 4 of Part 2' should be to 'Chapter 2 of Part 4'.
- cl 207 Income from savings certificates**
82. In Explanatory Notes paragraph 355, in the second sentence, the reference to section 46 '(7)' should be to '(6)' of ICTA.

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WHO WE ARE

1. The Institute of Chartered Accountants in England & Wales is a professional body representing some 128,000 members. The Institute operates under a Royal Charter with an obligation to act in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
2. The Tax Faculty is the centre for excellence and an authoritative voice for the Institute on taxation matters. It is responsible for tax representations on behalf of the Institute as a whole and it also provides services to more than 11,000 Faculty members who pay an additional subscription.
3. Further information is available on the ICAEW Tax Faculty website at www.icaew.com/taxfac or telephone 020 7920 8646.

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.