



Corporate rescue reliefs applying from Royal Assent

The Finance Bill includes two previously announced corporate rescue reliefs, applying with effect from Royal Assent, which are being introduced to help with the restructuring of borrowings, on a consensual basis, of companies which are in financial difficulty. The timing of when the reliefs become effective has been deferred and technical changes have been made to exclude certain profits.

These reliefs represent important changes which deal with problems that have already been faced by companies which have been applying new GAAP accounting standards and which are expected to be more common following the mandatory transition to such accounting standards for periods of account beginning on or after 1 January 2015. It had been intended that the reliefs would apply with effect from 1 January 2015 but the general election led to the commencement being deferred to Royal Assent of F(No.2)A 2015.

Going forward, for companies in financial distress, these new reliefs should facilitate the restructuring of borrowings where there is a real prospect that the borrower will be unable to repay its debts without the need to capitalise debt or use a formal insolvency procedure. However, claiming these reliefs will require an assessment to be made of the financial position of the borrower in the next 12 months.

The effect of the reliefs is as follows.

Releases of loans

With effect from Royal Assent, the release of a loan is not taxable for the borrower if, immediately before the release, it is reasonable to assume that there would be a material risk that, without the release and related arrangements, at some time in the next 12 months, the borrower would be unable to pay its debts as they fall due or the value of the company's assets would be less than the amount of its liabilities (new section 322(5B) CTA 2009).

Following the issue of the draft Finance Bill last December, changes have been made to narrow the scope of the relief so that it only applies to credits directly relating to an actual release of a debt and does not apply where there is a deemed release or release of relevant rights under the rules which apply when debt is purchased at a discount to face value and the purchaser and borrower are connected. However, the Finance Bill includes similar but more targeted corporate rescue reliefs for the rules on deemed releases of loan relationships (covered in a separate note).

Prior to the introduction of this relief, a taxable profit does not arise on the release of a borrowing owed by a company in a formal insolvency procedure and irrecoverable debt can be eliminated without triggering a taxable profit via a debt for equity swap. Going forward, the new relief should give more flexibility to companies in financial distress and their lenders to restructure borrowings on a consensual basis where there is a real prospect that the borrower will be unable to repay its debts.



Substantial modification to the terms of a borrowing

Also with effect from Royal Assent, provisions are being introduced to deal with the situation where a debt is modified or replaced, resulting in a 'substantial modification' for accounting purposes, giving rise to additional credits and debits with new GAAP accounting (new section 323A CTA 2009).

By way of background, with 'old' UK GAAP standards (excluding FRS 26), typically a substantial modification to the terms of a borrowing does not result in profits or losses being recognised. However, with new GAAP accounting standards, when the terms of a debt are substantially modified, the 'original' liability is derecognised or taken off the balance sheet and a 'new' replacement liability is recognised on the balance sheet at its fair value. Broadly, any excess of the carrying amount of the original liability over the fair value of the new liability is generally credited to the income statement. Subsequently, the debt is written back up to face value with debits going to the income statement.

For example, if a company amends the terms of a borrowing of 100 and the accounting is to derecognise the liability of 100 and recognise a 'new' liability at its fair value of 70, the borrower would immediately recognise a refinancing credit of 30, with debits of 30 subsequently being recognised over the remaining term of the debt.

If the refinancing credit is taxable, such that cash tax is payable, this would represent a significant downside for the borrower at a time when it is trying to secure new funding terms and managing cash-flows is crucial to its ability to remain solvent.

Going forward, if a substantial modification of a borrowing loan relationship takes place for accounting purposes, the borrower is not required to recognise a taxable profit in respect of the reduction in the carrying value of the liability if a condition is satisfied.

The condition for the relief to apply is very similar to that for the first relief; immediately before the modification or replacement, it is reasonable to assume that, without the modification and related arrangements, there would be a material risk that at some time within the next 12 months, the borrower would be unable to pay its debts as they fall due or the value of the company's assets will be less than the amount of its liabilities.

In these circumstances, debits representing the reversal of the non-taxable credit are not deductible.

Overall, the effect is to disregard, for tax purposes, the credit and debits arising from the modification of the borrowing terms i.e. to give the same tax treatment expected under old UK GAAP (without the adoption of FRS 26) accounting standards.

Relief on transition to new GAAP accounting

The relief for substantial modifications for accounting purposes is supplemented by some regulations made in December 2014 (SI 2014/3187) which provide for a transitional relief where there is a substantial modification of a company's debt in the comparative period to the adoption of new GAAP accounting standards. The effect of the regulations is that a transitional credit is not taxable and to treat the reversal of the credit as non-deductible if the conditions are met. The condition for the relief to apply is very similar to that outlined above. The transitional regulations apply to periods of account beginning on or after 1 January 2015.



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