Rules on deemed releases of loan relationships - new corporate rescue reliefs and other changes

There are provisions which can result in a taxable profit where either the consideration paid to purchase a loan from a third party is less than face value and afterwards the new lender and borrower are connected, or where there is a loan between two companies which are not connected and they become connected.

These provisions have to be considered in the context of most acquisitions and refinancing and, typically, are relevant where the loan asset is impaired.

Various changes are being made to these provisions including the introduction of two new reliefs to facilitate corporate rescues and the repeal of two existing reliefs. The new reliefs are well targeted and will be useful in enabling companies in financial difficulty to be refinanced without a tax charge arising on irrecoverable debt. By way of contrast, the two reliefs which are being repealed were not widely used and so their repeal is unlikely to have significant impact. Taken together, the changes are welcome.

The changes apply with effect from Royal Assent to F(No. 2)A 2015 (expected in early Autumn).

Deemed release on purchase of debt at a discount to face value – new corporate rescue relief

There is a charging provision which applies, broadly, if a company purchases a loan from an unconnected party, the consideration paid is less than the face value (i.e. the loan is purchased at a discount to face value) and the purchaser and borrowing company are connected immediately after the acquisition. In these circumstances, there is a deemed taxable release of the discount which is chargeable on the borrowing company.

The charging provision is disapplied in the following circumstances (new section 361D CTA 2009).

- The acquisition of the debt is an arm's length transaction.
- The purchaser of the debt (or a company connected with the purchaser) releases the debt or part of the debt within 60 days of becoming a party to it.
- Immediately before the purchaser acquires the loan, it would have been reasonable to assume that, without the release and related arrangements, there would have been a material risk that 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.

If only part of the debt is released within 60 days of the purchase, the deemed taxable release is reduced by the amount of the actual release.

The new relief applies to purchases of debts taking place on or after Royal Assent to F(No. 2)A 2015.

Deemed release on unconnected loan relationship becoming connected – new corporate rescue relief

Another charging provision applies where a loan is owed between companies which are not connected, the loan asset has been impaired or purchased for consideration which is less than face value and the companies subsequently become connected. This can be relevant where a lender or purchaser of a loan ('the Lender') takes control of a borrower which is in financial difficulty. In these circumstances, there is a deemed taxable release of part of the loan, which is chargeable on the borrowing company.

The conditions are similar to that for the previous relief and are as follows (new section 362A CTA 2009).

- The companies which are a party to the loan became connected as a result of an arm's length transaction.
- The Lender releases the debt or part of the debt within 60 days of becoming connected with the borrower.
- Immediately before the Lender and the borrower become connected, it would have been reasonable to assume that, without the connection and related arrangements, there would have been a material risk that 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.

If only part of the loan is released within 60 days of the companies becoming connected, the deemed taxable release is reduced by the amount of the actual release.

Deemed release on purchase of debt at a discount to face value - repeal of two existing reliefs

In October 2009, three new exceptions were introduced to the first charging provision described above, where debt is acquired at a discount to face value. For two of these exceptions, known as the corporate rescue exception and the debt-for-debt exception, the amount which would have been deemed to be taxable on the purchase of the debt was held in suspense and, broadly, became taxable if the purchased debt is subsequently released, i.e. potentially, the effect was to defer recognition of a taxable profit.

These two reliefs are being repealed with effect from Royal Assent to F(No. 2)A 2015. Where either of these reliefs has applied prior to Royal Assent, the existing treatment is preserved such that a taxable profit can arise on a subsequent release of the purchased debt.

The third exception which applies, broadly, where the consideration for the debt purchased is the issue of ordinary shares, is being retained. If the conditions for the relief are satisfied, there is no taxable profit from a deemed release either when the debt is purchased or subsequently released, i.e. the effect is that no taxable profit arises from the debt purchase.

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