HMRC - CFM39040 - Reset Bonds: Introduction

Reset bonds: overview

CTA09/S454 stops avoidance schemes that use ‘reset’ bonds.

Such bonds are issued on what are initially commercial terms, but contain a clause to the effect that, on a prescribed date shortly after issue, those terms will vary depending on a pre-set trigger event. Trigger events usually involve the value of a financial index on a particular date, such as the three-month sterling LIBOR interest rate.

As a result of the trigger, the bond is suddenly worth much more or much less than its value on issue, and companies aim to use this change in value to their advantage by creating tax-free profit.

An investor is gambling on whether the return will be substantially above or below current market rates. No ordinary investor would enter into such uncertain arrangements on a commercial basis, so there are likely to be other reasons for the bonds’ issue.

There are essentially two types of reset bond scheme:

mirror bond scheme (

change of ownership scheme (

Typically both schemes involve the purchase or disposal of reset bonds at shareholder level rather than directly. There will be other scheme participants besides the bond issuer and the company obtaining the tax advantage. For instance, both schemes involve a sponsor, and a change of ownership scheme also involves a loss-making entity to which the avoider disposes of the bond.

Tax advantage

Companies using the amortised cost basis of accounting (see CFM21640) use these bonds in different ways to obtain a tax advantage. For example, they can be used to

convert income to capital

enable a profitable group to share relief for another group’s tax losses.

Effect of S454

When S454 applies, the company must account for the bond on a fair value basis, so that the change in value is brought into account.

S454 does not apply to normal commercial bonds, which may also reset, for example, interest rates in line with LIBOR. The difference is that, for normal commercial bonds,

the changes are known from the outset

the changes do not cause a significant change in the bond’s value.

Nor does S454 apply to intra-group loans where interest is newly charged or not charged on an informal basis, unless it is done to secure a tax advantage.

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