HMRC - CFM45090 - Shares With Guaranteed Returns: Outstanding Third Party Obligations: Comparison With Commercial Rate Of Interest

Interest-like investment: substantial deviation from commercial rate of interest

This guidance applies to companies that hold shares up to 21 April 2009

The rule provides that an investment is ‘interest-like’ where the fair value is likely to increase at a rate which represents a return on an investment of money at a commercial rate of interest, and is unlikely to deviate substantially from that rate of increase. In turn, the definition of commercial rate of interest allows latitude by referring to a rate which is ‘reasonably comparable’.

These two provisions are designed to prevent companies getting round the rules by slightly tweaking a likely rate of increase in the fair value of a share, and should be operated as explained by the following example.

Company A invests in shares in an SPV which are intended to increase in value using outstanding third party obligations. The arrangement is to last a year and it is agreed that the correct comparative deposit rate between the parties would be 5%. The ‘reasonably comparable’ test prevents the parties escaping from FA96/S91A by using a slightly different rate such as 5.1% or 4.9%.

It would also be possible for the rate of increase in fair value to be varied during the term of the arrangement but in such a way that that the overall increase over the term was 5%. For instance, it would be possible to build in a rate of 5.5% for the first 6 months and 4.5% for the second 6 months. The ‘unlikely to deviate substantially’ rule prevents such manipulation from taking the shares outside S524.

From 12 March 2008, the special tax definition of ‘commercial rate of interest’ is repealed. In practice, this will not result in any change in HMRC’s approach to determining whether a rate of interest is ‘commercial’.

Previous page

Next page