HMRC - CFM50740 - Share-Based Contracts Always Within Part 7

Contracts to which the exclusions cannot apply

Shares treated as debt for tax purposes

Shares may, for the holder, be treated as creditor loan relationships if

they are shares in an open-ended investment company coming within CTA09/S488, or

they come within CTA09/S524 (shares subject to outstanding third party obligations) or CTA09/S526 (non-qualifying shares).

Where profits and losses on the shares themselves are taxed as income, it is appropriate for derivatives over such shares to also come within an income regime. So CTA09/S589(3) ensures that these shares are not an ‘excluded property’.

Contracts over shares that give an interest-like return

For accounting periods ending on or after 12 March 2008, any derivative over shares is not excluded from the derivative contracts rules if it produces a return which equates to interest. This ensures that the exclusions in CTA09/S589 cannot be exploited to prevent a profit which is, in substance, interest from being taxed as income.

Example

X Ltd pays a premium of £20 million that allows it to purchase 100% of the share capital of another company in the same group for £5 million in 12 months’ time. When it exercises the option, the target company is worth £26 million. It immediately sells the shares at market value, thus realising a cash profit of £21 million.

X Ltd might be seen as having invested £20 million and got back £21 million after a year, a return of 5% per annum on its capital. Generally, however, the company takes a genuine risk: the target company might be worth only £4 million (so the company does not exercise the option and loses the premium that it has paid), or the company may achieve a return considerably more (or less) than 5%. It cannot be said in such cases that the contract was designed to produce an interest-like return. If the shares acquired represent a substantial shareholding, the exclusion at CTA09/S591(5) will apply (CFM50800).

But suppose the net asset value of the target company is manipulated so that, when the option is exercised, it will always have a value of £26 million. The contract is designed so that, in substance, it equates to a deposit at a commercial rate of interest. CTA09/S589(5) provides that the exemptions in S590 cannot apply. The overall £5 million profit on the contract is taxed as income.

Where a company was, immediately before 12 March 2008, party to a relevant contract that becomes a derivative contract because of this change, the derivative contract is treated as having been entered into by the company on 12 March 2008 for a consideration equal to its ‘notional carrying value’ within the meaning of CTA09/S622(4).

Previous page

Next page