



**Corporation Tax Treatment of Banks' Tier 2 Regulatory
Capital**

Technical Note
26 October 2012

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Introduction

This Technical Note sets out the detail of a legislative change clarifying the treatment of banks' regulatory Tier 2 capital in relation to section 1015(4) Corporation Tax Act 2010.

Responses

Comments on the proposed approach and the draft clause would be welcomed and should be addressed electronically to either:

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Or in writing to

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Chapter 1

Background

1. The Financial Secretary has today made a Written Ministerial Statement which sets out that the Government intends to provide banks and investors with the certainty that they need regarding the issuance of Tier 2 capital instruments that banks need to issue now and in the future to meet their regulatory requirements.
2. Banks must ensure compliance with the forthcoming Capital Requirements Directive IV (CRD 4). CRD 4 has not yet been enacted but Tier 2 capital instruments that banks want to issue to raise funding now need to include a reference to the fact that these instruments may be subject to the regulatory requirements of CRD 4, and make clear to investors that these instruments could be either written down or converted to share capital at the point at which a bank nears insolvency.
3. The principal technical difficulty applying to Tier 2 instruments issued in advance of the implementation of the CRD 4, but which are intended to comply with those requirements, is that they might be “special securities” within section 1015(4) Corporation Tax Act 2010. This would mean that the coupon on such instruments could be a distribution for corporation tax purposes, and therefore not deductible in computing the issuer’s profits.

Proposed Approach

4. To address this difficulty a provision will be included in Finance Bill 2013 which ensures that securities which are part of a bank’s regulatory Tier 2 capital for the purposes of the FSA Handbook are excluded from section 1015(4).
5. Section 221 Finance Act 2012 contains a power enabling Regulations to be made once CRD 4 is finalised. However, this power does not allow the Treasury to make Regulations which have retrospective effect, so any Regulations could not apply to change the tax treatment of capital instruments that are issued before the Regulations come into force. As a result, primary legislation is required in respect of the Tier 2 capital instruments which banks are currently issuing, as well as for existing Tier 2 instruments.
6. This clarification will ensure that the coupon on Tier 2 capital already in issue or yet to be issued will be deductible for the issuer in computing its profits for corporation tax purposes.
7. This provision will apply from today’s date, to instruments already in issue as well as instruments that are issued in the future. However section 1015(4) will continue to apply to any terms of a security that are not required for the instrument to qualify as Tier 2 capital for the purposes of the FSA Handbook.

8. A draft clause to achieve this is set out in Chapter 2.

Chapter 2

Draft Legislation.

Tier two capital

(1) *After section 1015 of CTA 2010 insert—*

“1015A Tier two capital

(1) *Section 1015(4) applies with the following modifications in relation to securities that form part of a bank’s tier two capital resources.*

(2) *The reference to consideration is to be read as a reference to consideration given under terms of the securities that fall within subsection (3).*

(3) *Terms fall within this subsection if they are not required for the securities to form part of the bank’s tier two capital resources.*

(4) *References in this section to securities that form part of the bank’s tier two capital resources are to be read in accordance with the FSA Handbook.*

(5) *In this section—*

“bank” has the meaning given by section 1120, and

“the FSA Handbook” means the Handbook of Rules and Guidance made by the Financial Services Authority (as that Handbook has effect from time to time).”

(2) *The amendment made by this section is treated as having come into force on 26 October 2012.*