



## **United Kingdom Taxation**

**The following paragraphs, which are intended as a guide only, are based on current UK legislation and published Inland Revenue practice at the date of this document and are therefore subject to change. They only summarise certain limited aspects of the UK taxation treatment of the proposed issue of B Shares. They relate only to the position of Shareholders who are resident or ordinarily resident in the UK for tax purposes, who will hold their B Shares as an investment and are the absolute beneficial owners of the B Shares. This section is not intended to be, and should not be construed to be, legal or taxation advice to any particular Shareholder. If you are in any doubt as to your taxation position, you are recommended to seek your own taxation advice immediately from an independent professional adviser.**

### **The issue of B Shares**

1. The allotment and issue of B Shares will not itself create any charge to UK income tax or UK taxation of chargeable gains.
2. For the purposes of UK taxation of chargeable gains, the allotment and issue of B Shares by the Company will be treated as a reorganisation of its share capital. Accordingly:
  - (a) a Shareholder receiving an entitlement to B Shares will not be treated as making a disposal of all or part of that Shareholder's existing holding of Ordinary Shares by reason thereof;
  - (b) the B Shares will be treated as the same asset as, and as having been acquired at the same time as, the Shareholder's existing holding of Ordinary Shares. Accordingly the new combined holding of B Shares and Ordinary Shares (together the "New Holding") will have the same aggregate base cost as the existing holding of shares in the Company immediately before this issue; and
  - (c) on a subsequent disposal (including a redemption) of the whole or part of the New Holding, the Shareholder's base cost in respect of the New Holding will be apportioned between the Ordinary Shares and the B Shares by reference to their respective market values on the first day after issue on which market values or prices are quoted or published for one or both classes of shares, as derived from the Official List.

### **Redemption of B Shares**

3. The payment by the Company of the nominal value of the B Shares on their redemption will not constitute an income distribution for UK tax purposes. Accordingly:
  - (a) no part of the proceeds received by a Shareholder pursuant to the redemption will be an income receipt in that Shareholder's hands for UK tax purposes. Those proceeds will not carry any entitlement to a tax credit and, in the hands of a corporate Shareholder, will not constitute franked investment income; and



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- (b) a Shareholder who disposes of the whole or part of that Shareholder's holding of B Shares pursuant to the Redemption Offer may, depending on that Shareholder's circumstances, be charged to capital gains tax or (in the case of a company) corporation tax on the amount of any chargeable gain realised. In computing such gain, the base cost of the B Shares is calculated in the manner described at paragraph (2)(c) above.

#### **4. Where the Shareholder is an individual:**

- (a) no tax will be payable on any gain realised on the redemption if the amount of the chargeable gain, when aggregated with any other chargeable gains realised by the Shareholder in the year of assessment in question, does not exceed the annual allowance of tax-free gains; and
- (b) if a Shareholder acquired his existing Ordinary Shares on June 23, 2003, as a result of the Company being introduced as the new holding company of the Group in place of the previous holding company Rolls-Royce plc, and that Shareholder had acquired the Ordinary Shares in Rolls-Royce plc (which were cancelled and replaced with his existing Ordinary Shares) prior to April 1, 1998, indexation allowance will be available in respect of part of the base cost in the existing Ordinary Shares (apportioned to the B Shares in the manner described in paragraph (2)(c) above) until the end of April 1998 (save to the extent that this creates or increases a capital loss). No indexation allowance will be available where an individual Shareholder acquired his Rolls-Royce plc shares after March 31, 1998 or acquired his existing Ordinary Shares after June 23, 2003. In either of these cases taper relief may apply so that the effective rate of capital gains tax on any gain on a redemption of B Shares by an individual will be reduced the longer existing Ordinary Shares (and any prior holding of shares in Rolls-Royce plc) and then the B Shares are held, up to a maximum of ten years.

5. Set out below are two examples of the capital gains tax computation on a redemption of B Shares by an individual. However, the actual calculation would depend on the tax position of each Shareholder and Shareholders should consult their professional advisers. The examples are for illustrative purposes only and the prices used are not intended to relate to the actual price of the Ordinary Shares.

In the examples, it is assumed that fifty B Shares (issued in respect of one Ordinary Share) are held. It is also assumed that the market quotation of the Ordinary Shares immediately after the bonus issue of B Shares is 350 pence each and that the market value of the B Shares at the same time is 0.1 pence each.



## Example 1

If the historic cost for capital gains tax purposes of the Ordinary Shares was 275 pence each, then ignoring indexation and taper relief:

	<b>Pence</b>
Proceeds from redemption of fifty B Shares = $(50 \times 0.1)$	5.00
Cost of fifty B Shares = $275 \times ((50 \times 0.1)/(350 + (50 \times 0.1)))$	3.87
Unindexed gain before any indexation allowance or taper relief	1.13

## Example 2

If the historic cost for capital gains tax purposes of the Ordinary Shares was 450 pence each, then:

	<b>Pence</b>
Proceeds from redemption of fifty B Shares = $(50 \times 0.1)$	5.00
Cost of fifty B Shares = $450 \times ((50 \times 0.1)/(350 + (50 \times 0.1)))$	6.34
Allowable loss	(1.34)

## Conversion of B Shares

6. A Shareholder who elects to convert his B Shares into Ordinary Shares pursuant to the Conversion Option will not be treated as making a disposal of his B Shares. Instead "roll-over" treatment should apply, which means the Ordinary Shares will be treated for the purposes of taxation on chargeable gains as the same asset as the B Shares and as having been acquired at the same time as the B Shares were treated as acquired.
7. If a Shareholder becomes entitled to receive a further Ordinary Share pursuant to the Company's proposed method of dealing with fractional entitlements to Ordinary Shares arising on conversion or carried forward under the Company's Scrip Dividend arrangements (i.e. the Shareholder has sufficient cash held by the Registrars to entitle him to an Ordinary Share), such additional share is likely, in practice, to be treated as receiving the "rollover" treatment discussed above, rather than being treated as a separate cash subscription for an Ordinary Share.
8. No charge to income tax should arise in relation to the conversion of B Shares pursuant to the Conversion Option. If, in relation to a Shareholder's entitlement in respect of fractions, the Registrars pay to him the cash held on his behalf (rather than issuing him with an Ordinary Share once he has a sufficient cash entitlement – as discussed above), in practice the amount of that cash is likely to be treated not as the proceeds of a part disposal but as reducing the base cost of the Shareholder's Ordinary Shares by an amount equal to the cash received.



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9. A Shareholder who subsequently disposes of Ordinary Shares may, depending on that Shareholder's circumstances, be charged to capital gains tax or (in the case of a company) corporation tax on the amount of any chargeable gain realised.

## **Stamp duty and stamp duty reserve tax**

10. No stamp duty or stamp duty reserve tax should arise on the issue, redemption or conversion of B Shares.

## **Dividends**

11. The United Kingdom tax treatment of dividends paid on the B Shares will be the same as the tax treatment of dividends paid on the Ordinary Shares. Accordingly under current tax law, the Company will not be required to withhold tax at source from dividend payments it makes on the B Shares and will therefore not assume responsibility for the withholding of tax at source.

### *(a) Individuals*

An individual shareholder who is resident in the UK for tax purposes and who receives a dividend from the Company on a B Share will be entitled to a tax credit which may be set off against his total income tax liability on the dividend. Such an individual shareholder's liability to income tax is calculated on the aggregate of the dividend and the tax credit (the "gross dividend") which will be regarded as the top slice of the individual's income. The tax credit will be equal to 10% of the "gross dividend" (i.e. the tax credit will be one-ninth of the amount of the dividend).

Shareholders who are not liable to income tax in respect of the gross dividend will not be entitled to reclaim any part of the tax credit.

A UK resident shareholder who is liable to income tax at the lower or basic rate will be subject to income tax on the dividend at the rate of 10% of the gross dividend so that the tax credit will satisfy in full such shareholder's liability to income tax on the dividend. A UK resident individual shareholder liable to income tax at the higher rate will be subject to income tax on the gross dividend at 32.5%. After taking into account the tax credit, such a shareholder will have to account for additional tax equal to 22.5% of the gross dividend (an effective tax rate of 25% of the net cash dividend received).

### *(b) Companies*

A corporate shareholder resident in the UK for tax purposes will not normally be subject to corporation tax on any dividend received from the Company on a B Share. Such corporate shareholders will not be able to claim repayment of the tax credit attaching to any dividend.

### *(c) Pension funds and charities*



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UK pension funds and charities will not be entitled to reclaim the tax credit attaching to any dividend paid by the Company on a B Share.

## **Section 703 of the Income and Corporation Taxes Act 1988 (ICTA)**

12. There is an anti-avoidance provision, section 703 ICTA, which the Inland Revenue may apply where they have reason to believe that a person obtains a tax advantage in consequence of certain transactions in securities. Were the Inland Revenue to seek to apply section 703 ICTA to the B Share proposals, one possible effect would be to tax the redemption proceeds as income. However, in the opinion of the Company and its taxation advisers, the B Share proposals are such that section 703 ICTA should not apply to Shareholders.