Rolls-Royce

Your guide to C Shares

October 2008

What are C Shares?

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C Shares are non-cumulative redeemable preference shares of 0.1p each in the capital of Rolls-Royce Group plc (the Company) that can, during defined periods, be redeemed for cash. The Company will generally issue C Shares to ordinary shareholders twice a year in lieu of a cash dividend.

Why does the Company make payments in shares and will it ever return to paying dividends in cash?

The Company has previously identified the importance and relevance of making payments to shareholders in a form that does not generate additional shadow Advance Corporation Tax (ACT). This will accelerate the recovery of the Group's surplus ACT and improve future cash flow, to the benefit of all shareholders. Accordingly, all payments made to shareholders since June 2004 have been made in the form of B Shares (and with effect from January 2009, C Shares) rather than cash dividends. It is therefore unlikely that the Company will return to paying a cash dividend if it can make payments to shareholders in a form that does not generate shadow ACT.

Why is the Company issuing C Shares now instead of B Shares?

As a result of the Company's strategic financial review, the directors have concluded that the increase in the Company's issued share capital, which occurs when shareholders choose to convert B Shares into additional Ordinary Shares, is inconsistent with its strategy to maintain a more efficient balance sheet and limit Earnings Per Ordinary Share dilution. Therefore, from January 2009, payments to shareholders will be made in the form of C Shares, the only material difference being that, unlike B Shares, C Shares will not carry the right to convert directly into Ordinary Shares.

Will the C Shares be listed on the London Stock Exchange?

No. Although B Shares were listed there was actually a very limited market for them. The fact that C Shares are not listed should have little impact on shareholders as the market value of the shares is unlikely to change significantly from their nominal value of 0.1 pence per share.

What is a C Share worth?

The nominal value and the redemption price of each C Share is 0.1 pence. Therefore 1,000 C Shares are worth £1. In total, the C Shares issued to you will have a value equal to the cash dividend we would have paid to you under normal dividend arrangements. For example, instead of a cash dividend of £15 you would receive 15,000 C Shares (15,000 x 0.1p = £15).

Do C Shares carry a right to attend and vote at general meetings?

Generally no. Although you are entitled to one vote for every Ordinary Share you hold in the Company, C Shares do not carry the right to attend, speak and / or vote at any general meeting of the Company, with the sole exception of a meeting at which a resolution to wind up the Company is to be considered.

What is the tax position on the issue and redemption of C Shares?

The allotment and issue of C Shares does not itself create any charge to UK income tax. However, if any capital gain an individual realises on redemption, when aggregated with other chargeable gains in the same tax year (including on the compulsory redemption of B Shares), exceeds the annual exempt allowance (£9,600 for 2008/2009), the excess may be subject to capital gains tax, even if the redemption proceeds are used to purchase additional Ordinary Shares. A full discussion of the tax effects of C Shares can be found on pages 8 to 11 below.

Will I receive a dividend on any C Shares I hold?

Yes. C Shares are entitled to receive a dividend fixed at 75 per cent of the London Inter-Bank Offered Rate (LIBOR). LIBOR is widely used to set interest rates on the London wholesale money market.

What can I do with my C Shares?

You have three choices:

1. **redeem all C Shares for cash;**
2. **reinvest the redemption proceeds in additional Ordinary Shares; or**
3. **keep the C Shares.**

These three choices are considered in greater detail on the following pages.

I want to redeem all of my C Shares for cash

How do I make an evergreen election to redeem all of my C Shares for cash?

If you wish to redeem your C Shares for cash, simply complete the enclosed C Share Evergreen Mandate and return it to Computershare Investor Services PLC (the Registrar). You will need to do this before 5 December 2008 in order for your revised election to be in place in time for the first issue of C Shares in January 2009.

I currently redeem my B Shares for cash. Do I need to make another election?

No. If you currently have an instruction in place to redeem all B Shares issued to you for cash, unless you advise us to the contrary, the Company has made arrangements for this instruction to be carried forward to C Shares. Therefore, if you take no action, you will continue to receive cash twice a year from the Company. However, if you want to change your election, you will need to complete and submit the enclosed C Share Evergreen Mandate.

Can you pay the cash direct to my bank account?

Yes. If you enter your bank details on the C Share Evergreen Mandate, the Registrar will arrange to pay redemption monies direct to your account. If you already have a bank mandate in place and you have an instruction in place to redeem then you do not need to take any further action. The Registrar will pay the redemption monies direct to your nominated bank account.

How are the redemption proceeds calculated?

Example of redemption for a shareholder receiving 15,000 C Shares

IF:	You are issued with 15,000 C Shares,
AND:	You elect to redeem all your C Shares,
THEN:	You will receive £15 in cash because the nominal value of each C Share is 0.1p (15,000 x 0.1p = £15).

I want to redeem all of my C Shares for cash and use the proceeds to purchase more Ordinary Shares

What is the C Share Reinvestment Plan (the CRIP)?

The CRIP is a facility, offered by the Registrar, whereby the Registrar will use the cash proceeds arising on redemption of your C Shares to purchase additional Ordinary Shares in the Company on your behalf. Typically, this is a much more cost-effective way of purchasing shares than arranging your own purchase through a broker as there is no minimum charge. You will find enclosed a booklet containing the terms and conditions which apply to the operation of the CRIP.

How do I make an evergreen election to participate in the CRIP?

You can choose to participate in the CRIP by completing the enclosed C Share Evergreen Mandate and returning it to the Registrar. You will need to do this before 5 December 2008 in order for your revised election to be in place in time for the first issue of C Shares in January 2009.

I currently convert my B Shares into Ordinary Shares. Do I need to make another election?

No. If you currently have an election in place to convert all B Shares issued to you into additional Ordinary Shares, unless you advise us to the contrary, the Company has made arrangements for this election to be transferred so that any C Shares issued to you are redeemed for cash and the redemption proceeds used to purchase additional Ordinary Shares through the CRIP. Therefore, if you take no action you will continue to acquire additional Ordinary Shares in the Company twice a year. However, if you want to change your election you will need to complete and submit the enclosed C Share Evergreen Mandate.

Who can participate in the CRIP?

Generally any shareholder may choose to use their C Share redemption proceeds to acquire additional Ordinary Shares provided they make a valid election and return it by the deadline. However, the Registrar is unable to operate the CRIP for shareholders who live in, or are subject to the jurisdiction of, any country outside the United Kingdom that would require the Company or the Registrar to comply with local government or regulatory procedures or any similar formalities. More details can be found in the CRIP booklet.

How is the number of shares that I receive calculated?

The number of additional Ordinary Shares that you will receive is entirely dependent upon the prevailing market price as the example on the next page illustrates.

Example showing how the CRIP will operate:

IF: You are issued with 15,000 C Shares worth £15 in total,

AND: You elect to redeem all your C Shares and use the CRIP service,

AND: The market price of one Ordinary Share is £4.00*

THEN: The Registrar will purchase 3 additional Ordinary Shares on your behalf (3 x £4.00 = £12.00)

AND: The Registrar will deduct a dealing charge at 0.2% and stamp duty at 0.5% = 9p**

LEAVING: A residual cash balance of £2.91 which will be carried forward to the next issue of C Shares and will be added to any future redemption proceeds to be used to purchase additional Ordinary Shares in the future.

**The market price shown is an example, purely for the point of illustration. The actual purchase price will be the prevailing market rate on that day.*

***The calculations in this example have been rounded up to the nearest whole penny.*

I want to keep my C Shares

How do I make an evergreen election to retain the C Shares?

If you make no election at all then you will automatically receive C Shares. However, if you have previously made an election to redeem or convert B Shares, you can change that election by writing to the Registrar and informing them of your choice to retain C Shares.

What happens if I elect to retain my C Shares?

If you choose to retain your C Shares you will be sent a C Share certificate (or, if you are holding your shares in a dematerialised form, your CREST account will be credited with C Shares). You will receive cash dividends on the C Shares twice a year.

Can I sell my C Shares?

C Shares will not be listed on the London Stock Exchange and therefore there will be no ready market in which you can sell your C Shares. If you are issued with a C Share certificate and later want to redeem your C Shares, you will need to complete the form on the reverse of the certificate and return it to the Registrar. Provided the certificate is received by the relevant deadline for that redemption, the shares will be redeemed at 0.1 pence per share on the next redemption date.

What dividend will I receive on C Shares I hold?

C Shares are entitled to receive a dividend fixed at 75 per cent of LIBOR. The following example will give you an idea of the sort of return you can expect, should you decide to retain your C Shares.

Assuming the LIBOR rate for the C Share dividend was 6% per annum:

75% of LIBOR @ 6% = 4.5% per annum

The C Share dividend is paid twice a year and is calculated on a six monthly basis.

4.5% ÷ 2 = 2.25%

If you retained 20,000 C Shares @ 0.1p each they'd be worth £20.

2.25% return on £20 = 45p

You would receive a C Share dividend payment for 45p.

The dividend is non-cumulative which means it does not accrue if unpaid.

The tax effects of C Shares

United Kingdom Taxation

1 This information, which is intended as a guide only, is based on current UK legislation and published Inland Revenue practice at the date of this document and is therefore subject to change. It only summarises certain limited aspects of the UK taxation treatment of the issue of C Shares. The document only relates to the position of shareholders who are resident or ordinarily resident in the UK for tax purposes, who will hold their C Shares as an investment and are the absolute beneficial owners of the C Shares. It does not apply to shares held through Personal Equity Plans or Individual Savings Accounts.

2 This document 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.

3 The following summary only considers UK taxation. Overseas shareholders should seek tax advice in their jurisdiction of residency.

The issue of C Shares

4 The allotment and issue of C Shares will not itself create any charge to UK income tax or UK taxation of chargeable gains.

5 For the purposes of UK taxation of chargeable gains, the allotment and issue of C Shares by the Company will be treated as a reorganisation of its share capital.

Accordingly:

(a) a shareholder receiving an entitlement to C 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 C 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 C 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 C Shares by reference to their respective market values on the day of issue.

Redemption of C Shares

6 The payment by the Company of the nominal value of the C 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

(b) a shareholder who disposes of the whole or part of their holding of C Shares by electing to redeem their C Shares may, depending on their 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 C Shares is calculated in the manner described at paragraph 5(c).

7 Where the shareholder is an individual 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 (£9,600 in 2008/2009).

8 Set out below are two examples of the capital gains tax computation on a redemption of C 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 50 C 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 C Shares is 400 pence each and that the market value of the C 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 300 pence each, then:

Proceeds from redemption of fifty C Shares = (50 x 0.1)	5.00p
Cost of fifty C Shares = 300 x (50 x 0.1)/(400 + (50 x 0.1))	3.70p
Gain	1.30p

Example 2

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

Proceeds from redemption of fifty C Shares = (50 x 0.1)	5.00p
Cost of fifty C Shares = 450 x (50 x 0.1)/(400 + (50 x 0.1))	5.55p
Allowable loss	(0.55)p

The tax effects of C Shares

Reinvestment of proceeds from redemption of C Shares

9 A shareholder who elects to reinvest the proceeds of a redemption of the C Shares will be taxed on that redemption as set out in paragraphs 6 to 8 above.

10 The amount reinvested in new Ordinary Shares will form the base cost of those Ordinary Shares.

Stamp duty and stamp duty reserve tax

11 No stamp duty or stamp duty reserve tax should arise on the issue or redemption of C Shares.

12 Stamp duty or stamp duty reserve tax at 0.5 per cent will be payable on acquiring additional Ordinary Shares under the CRIP.

Dividends

13 Dividends payable on the C Shares will be subject to UK income tax.

(a) UK resident individual shareholders
Dividends paid on the C Shares will carry an associated tax credit of one-ninth of the cash dividend or 10 per cent of the aggregate of the cash dividend and associated tax credit. Individual shareholders resident in the UK receiving such dividends, other than those liable only to the starting rate for savings, will be liable to income tax on the aggregate of the dividend and associated tax credit at the dividend ordinary rate (10 per cent) or the dividend upper rate (32.5 per cent). The effect will be that taxpayers who are otherwise liable to pay tax at only the starting rate for savings or the basic rate of income tax will have no further liability to income tax in respect of such a dividend. Higher rate taxpayers will have an additional tax liability (after taking into account the 10 per cent tax credit) of 22.5 per cent of the aggregate of the dividend and associated tax credit. Individual shareholders whose income tax liability is less than the tax credit will not be entitled to claim a repayment of all or part of the tax credit associated with such dividends.

(b) Shareholders not resident in the UK
Persons who are not resident in the UK should consult their own tax advisers on the possible application of any relevant double tax treaty and on what relief or credit may be claimed in the jurisdiction in which they are resident for any tax credit associated with a dividend.

(c) UK resident corporate shareholders
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 C Share. Such corporate shareholders will not be able to claim repayment of the tax credit attaching to any dividend.

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

Section 684 Income Tax Act 2007 (ITA)

14 There is an anti-avoidance provision, section 684 ITA 2007, 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 684 ITA 2007 to C Shares, one possible effect would be to tax the redemption proceeds as income. However, in the opinion of the Company and its taxation advisers, the C Share arrangement is such that section 684 ITA 2007 should not apply to shareholders.

Rolls-Royce Group plc
65 Buckingham Gate
London SW1E 6AT

www.rolls-royce.com