



United Kingdom Taxation

THE FOLLOWING PARAGRAPHS, WHICH ARE INTENDED AS A GUIDE ONLY, ARE BASED ON THE UK LEGISLATION AND PUBLISHED INLAND REVENUE PRACTICE IN FORCE AT THE TIME B SHARES WERE ISSUED AND CONVERTED OR REDEEMED. THEY ONLY SUMMARISE CERTAIN LIMITED ASPECTS OF THE UK TAXATION TREATMENT OF THE ISSUE, REDEMPTION AND CONVERSION OF B SHARES. THEY RELATE ONLY TO THE POSITION OF SHAREHOLDERS WHO ARE RESIDENT OR ORDINARILY RESIDENT IN THE UK FOR TAX PURPOSES, WHO HELD THEIR B SHARES AS AN INVESTMENT AND WHO WERE 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 did 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 was treated as a reorganisation of its share capital. Accordingly:
 - (a) a Shareholder receiving an entitlement to B Shares was not 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 were 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") had the same aggregate base cost as the existing holding of shares in the Company immediately before the B Share issue; and
 - (c) on the 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 is 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 did 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 do not carry any entitlement to a tax credit and, in the hands of a corporate Shareholder, do not constitute franked investment income; and



- (b) a Shareholder who disposed of the whole or part of that Shareholder's holding of B Shares pursuant to the compulsory final redemption on 22 September 2008 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 is 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; subject to that
- (b) the position then depends on whether the Shareholder redeemed (or otherwise disposed) of his B Shares before, or on or after, 6 April 2008. For a disposal of all or any B Shares before that date, 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 prior to 6 April 2008 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.
- (c) if the Shareholder redeemed (or otherwise disposed) of all or any of his B Shares after 5 April 2008, no indexation allowance on taper relief will be available in respect of those Shares.

- 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 any available indexation or taper relief:

	Pence
Proceeds from redemption of fifty B Shares = (50×0.1)	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:

	Pence
Proceeds from redemption of fifty B Shares = (50×0.1)	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 elected to convert his B Shares into Ordinary Shares pursuant to the Conversion Option will not be treated as having made 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 became entitled to receive a further Ordinary Share pursuant to the Company's 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 paid 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.
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 arose 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, the Company was not required to withhold tax at source from dividend payments it makes on the B Shares and did not therefore 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 received a dividend from the Company on a B Share is 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 is 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 are not entitled to reclaim any part of the tax credit.

A UK resident shareholder who is liable to income tax at the starting rate, the savings rate, the starting rate for savings or the basic rate is entitled to set the tax credit against his liability to income tax in respect of the dividend and is not subject to any additional income tax on the dividend. A UK resident individual shareholder liable to income tax at the higher rate is subject to income tax on the gross dividend at the dividend upper rate of 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 is not normally subject to corporation tax on any dividend received from the Company on a B Share. Such corporate shareholders are not able to claim repayment of the tax credit attaching to any dividend.

(c) *Pension funds and charities*

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



Rolls-Royce

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

12. There is an anti-avoidance provision, section 703 ICTA (now re-enacted as section 684 of the Income Tax Act 2007 for individuals and trusts), 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 or its successor 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 or its successor should not apply to shareholders.