



Finance Act 1996

1996 CHAPTER 8

PART IV

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER II

LOAN RELATIONSHIPS

Computational provisions etc.

84 Debits and credits brought into account

- (1) The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, in accordance with an authorised accounting method and when taken together, fairly represent, for the accounting period in question—
 - (a) all profits, gains and losses of the company, including those of a capital nature, which (disregarding interest and any charges or expenses) arise to the company from its loan relationships and related transactions; and
 - (b) all interest under the company's loan relationship and all charges and expenses incurred by the company under or for the purposes of its loan relationships and related transactions.
- (2) The reference in subsection (1) above to the profits, gains and losses arising to a company—
 - (a) does not include a reference to any amounts required to be transferred to the company's share premium account; but
 - (b) does include a reference to any profits, gains or losses which, in accordance with normal accountancy practice, are carried to or sustained by any other reserve maintained by the company.

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- (3) The reference in subsection (1)(b) above to charges and expenses incurred for the purposes of a company's loan relationships and related transactions does not include a reference to any charges or expenses other than those incurred directly—
- (a) in bringing any of those relationships into existence;
 - (b) in entering into or giving effect to any of those transactions;
 - (c) in making payments under any of those relationships or in pursuance of any of those transactions; or
 - (d) in taking steps for ensuring the receipt of payments under any of those relationships or in accordance with any of those transactions.
- (4) Where—
- (a) any charges or expenses are incurred by a company for purposes connected—
 - (i) with entering into a loan relationship or related transaction, or
 - (ii) with giving effect to any obligation that might arise under a loan relationship or related transaction,
 - (b) at the time when the charges or expenses are incurred, the relationship or transaction is one into which the company may enter but has not entered, and
 - (c) if that relationship or transaction had been entered into by that company, the charges or expenses would be charges or expenses incurred as mentioned in subsection (3) above,
- those charges or expenses shall be treated for the purposes of this Chapter as charges or expenses in relation to which debits may be brought into account in accordance with subsection (1)(b) above to the same extent as if the relationship or transaction had been entered into.
- (5) In this section “related transaction”, in relation to a loan relationship, means any disposal or acquisition (in whole or in part) of rights or liabilities under that relationship.
- (6) The cases where there shall be taken for the purposes of this section to be a disposal and acquisition of rights or liabilities under a loan relationship shall include those where such rights or liabilities are transferred or extinguished by any sale, gift, exchange, surrender, redemption or release.
- (7) This section has effect subject to Schedule 9 to this Act (which contains provision disallowing certain debits and credits for the purposes of this Chapter and making assumptions about how an authorised accounting method is to be applied in certain cases).

85 Authorised accounting methods

- (1) Subject to the following provisions of this Chapter, the alternative accounting methods that are authorised for the purposes of this Chapter are—
- (a) an accruals basis of accounting; and
 - (b) a mark to market basis of accounting under which any loan relationship to which that basis is applied is brought into account in each accounting period at a fair value.
- (2) An accounting method applied in any case shall be treated as authorised for the purposes of this Chapter only if—

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- (a) it conforms (subject to paragraphs (b) and (c) below) to normal accountancy practice, as followed in cases where such practice allows the use of that method;
 - (b) it contains proper provision for allocating payments under a loan relationship to accounting periods; and
 - (c) where it is an accruals basis of accounting, it does not contain any provision (other than provision comprised in authorised arrangements for bad debt) that gives debits by reference to the valuation at different times of any asset representing a loan relationship.
- (3) In the case of an accruals basis of accounting, proper provision for allocating payments under a loan relationship to accounting periods is provision which—
- (a) allocates payments to the period to which they relate, without regard to the periods in which they are made or received or in which they become due and payable;
 - (b) includes provision which, where payments relate to two or more periods, apportions them on a just and reasonable basis between the different periods;
 - (c) assumes, subject to authorised arrangements for bad debt, that, so far as any company in the position of a creditor is concerned, every amount payable under the relationship will be paid in full as it becomes due;
 - (d) secures the making of the adjustments required in the case of the relationship by authorised arrangements for bad debt; and
 - (e) provides, subject to authorised arrangements for bad debt and for writing off government investments, that, where there is a release of any liability under the relationship, the appropriate amount in respect of the release is credited to the debtor in the accounting period in which the release takes place.
- (4) In the case of a mark to market basis of accounting, proper provision for allocating payments under a loan relationship to accounting periods is provision which allocates payments to the accounting period in which they become due and payable.
- (5) In this section—
- (a) the references to authorised arrangements for bad debt are references to accounting arrangements under which debits and credits are brought into account in conformity with the provisions of paragraph 5 of Schedule 9 to this Act; and
 - (b) the reference to authorised arrangements for writing off government investments is a reference to accounting arrangements that give effect to paragraph 7 of that Schedule.
- (6) In this section “fair value”, in relation to any loan relationship of a company, means the amount which, at the time as at which the value falls to be determined, is the amount that the company would obtain from or, as the case may be, would have to pay to an independent person for—
- (a) the transfer of all the company’s rights under the relationship in respect of amounts which at that time are not yet due and payable; and
 - (b) the release of all the company’s liabilities under the relationship in respect of amounts which at that time are not yet due and payable.

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86 Application of accounting methods

- (1) This section has effect, subject to the following provisions of this Chapter, for the determination of which of the alternative authorised accounting methods that are available by virtue of section 85 above is to be used as respects the loan relationships of a company.
- (2) Different methods may be used as respects different relationships or, as respects the same relationship, for different accounting periods or for different parts of the same accounting period.
- (3) If a basis of accounting which is or equates with an authorised accounting method is used as respects any loan relationship of a company in a company's statutory accounts, then the method which is to be used for the purposes of this Chapter as respects that relationship for the accounting period, or part of a period, for which that basis is used in those accounts shall be—
 - (a) where the basis used in those accounts is an authorised accounting method, that method; and
 - (b) where it is not, the authorised accounting method with which it equates.
- (4) For any period or part of a period for which the authorised accounting method to be used as respects a loan relationship of a company is not determined under subsection (3) above, an authorised accruals basis of accounting shall be used for the purposes of this Chapter as respects that loan relationship.
- (5) For the purposes of this section (but subject to subsection (6) below)—
 - (a) a basis of accounting equates with an authorised accruals basis of accounting if it purports to allocate payments under a loan relationship to accounting periods according to when they are taken to accrue; and
 - (b) a basis of accounting equates with an authorised mark to market basis of accounting if (without equating with an authorised accruals basis of accounting) it purports in respect of a loan relationship—
 - (i) to produce credits or debits computed by reference to the determination, as at different times in an accounting period, of a fair value; and
 - (ii) to produce credits or debits relating to payments under that relationship according to when they become due and payable.
- (6) An accounting method which purports to make any such allocation of payments under a loan relationship as is mentioned in subsection (5)(a) above shall be taken for the purposes of this section to equate with an authorised mark to market basis of accounting (rather than with an authorised accruals basis of accounting) if—
 - (a) it purports to bring that relationship into account in each accounting period at a value which would be a fair value if the valuation were made on the basis that interest under the relationship were to be disregarded to the extent that it has already accrued; and
 - (b) the credits and debits produced in the case of that relationship by that method (when it is properly applied) correspond, for all practical purposes, to the credits and debits produced in the case of that relationship, and for the same accounting period, by an authorised mark to market basis of accounting.
- (7) In this section “fair value” has the same meaning as in section 85 above.
- (8) In this section “statutory accounts”, in relation to a company, means—

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- (a) any accounts relating to that company that are drawn up in accordance with any requirements of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 that apply in relation to that company;
 - (b) any accounts relating to that company that are drawn up in accordance with any requirements of regulations under section 70 of the Friendly Societies Act 1992 that apply in relation to that company;
 - (c) any accounts relating to that company which are accounts to which Part I of Schedule 21C to the Companies Act 1985 or Part I of Schedule 21D to that Act (companies with UK branches) applies;
 - (d) in the case of a company which—
 - (i) is not subject to any such requirements as are mentioned in paragraphs (a) or (b) above, and
 - (ii) is a company in whose case there are no accounts for the period in question that fall within paragraph (c) above,any accounts relating to the company drawn up in accordance with requirements imposed in relation to that company under the law of its home State; and
 - (e) in the case of a company which—
 - (i) is not subject to any such requirements as are mentioned in paragraphs (a), (b) or (d) above, and
 - (ii) is a company in whose case there are no accounts for the period in question that fall within paragraph (c) above,the accounts relating to the company that most closely correspond to the accounts which, in the case of a company formed and registered under the Companies Act 1985, are required under that Act.
- (9) For the purposes of subsection (8) above the home State of a company is the country or territory under whose law the company is incorporated.

87 Accounting method where parties have a connection

- (1) This section applies in the case of a loan relationship of a company where for any accounting period there is a connection between the company and—
 - (a) in the case of a debtor relationship of the company, a person standing in the position of a creditor as respects the debt in question; or
 - (b) in the case of a creditor relationship of the company, a person standing in the position of a debtor as respects that debt.
- (2) The only accounting method authorised for the purposes of this Chapter for use by the company as respects the loan relationship shall be an authorised accruals basis of accounting.
- (3) For the purposes of this section there is a connection between a company and another person for an accounting period if (subject to subsection (4) and section 88 below)—
 - (a) the other person is a company and there is a time in that period, or in the two years before the beginning of that period, when one of the companies has had control of the other;
 - (b) the other person is a company and there is a time in that period, or in those two years, when both the companies have been under the control of the same person; or

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- (c) there is a time in that accounting period, or in those two years, when the company was a close company and the other person was a participator in that company or the associate of a person who was such a participator at that time.
- (4) Two companies which have at any time been under the control of the same person shall not, by virtue of that fact, be taken for the purposes of this section to be companies between whom there is a connection if the person was the Crown, a Minister of the Crown, a government department, a Northern Ireland department, a foreign sovereign power or an international organisation.
- (5) The references in subsection (1) above to a person who stands in the position of a creditor or debtor as respects a loan relationship include references to a person who indirectly stands in that position by reference to a series of loan relationships.
- (6) Subsections (2) to (6) of section 416 of the Taxes Act 1988 (meaning of “control”) shall apply for the purposes of this section as they apply for the purposes of Part XI of that Act.
- (7) Subject to subsection (8) below, in this section “participator” and “associate” have the meanings given for the purposes of Part XI of the Taxes Act 1988 by section 417 of that Act.
- (8) A person shall not for the purposes of this section be regarded as a participator in relation to a company by reason only that he is a loan creditor of the company.

88 Exemption from section 87 in certain cases

- (1) Subject to subsection (5) below, where a creditor relationship of a company is one to which that company is a party in any accounting period in exempt circumstances, any connection for that accounting period between the company and a person who stands in the position of a debtor as respects the debt shall be disregarded for the purposes of section 87 above.
- (2) A company having a creditor relationship in any accounting period shall, for that period, be taken for the purposes of this section to be a party to that relationship in exempt circumstances if—
 - (a) the company, in the course of carrying on any activities forming an integral part of a trade carried on by that company in that period, disposes of or acquires assets representing creditor relationships;
 - (b) that period is one for which the company uses an authorised mark to market basis of accounting as respects all the creditor relationships represented by assets acquired in the course of those activities;
 - (c) the asset representing the creditor relationship in question was acquired in the course of those activities;
 - (d) that asset is either—
 - (i) listed on a recognised stock exchange at the end of that period; or
 - (ii) a security the redemption of which must occur within twelve months of its issue;
 - (e) there is a time in that period when assets of the same kind as the asset representing the loan relationship in question are in the beneficial ownership of persons other than the company; and

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- (f) there is not more than three months, in aggregate, in that accounting period during which the equivalent of 30 per cent. or more of the assets of that kind is in the beneficial ownership of connected persons.
- (3) An insurance company carrying on basic life assurance and general annuity business and having a creditor relationship in any accounting period shall, for that period, be taken for the purposes of this section to be a party to that relationship in exempt circumstances if—
- (a) assets of the company representing any of its creditor relationships are linked for that period to its basic life assurance and general annuity business;
 - (b) that period is one for which the company uses an authorised mark to market basis of accounting as respects all the creditor relationships of the company represented by assets that are so linked;
 - (c) the asset representing the creditor relationship in question is so linked;
 - (d) that asset is either—
 - (i) listed on a recognised stock exchange at the end of that period; or
 - (ii) a security the redemption of which must occur within twelve months of its issue;
 - (e) there is a time in that period when assets of the same kind as the asset representing the creditor relationship in question are in the beneficial ownership of persons other than the company; and
 - (f) there is not more than three months, in aggregate, in that accounting period during which the equivalent of 30 per cent. or more of the assets of that kind is in the beneficial ownership of connected persons.
- (4) For the purposes of subsections (2) and (3) above—
- (a) assets shall be taken to be of the same kind where they are treated as being of the same kind by the practice of any recognised stock exchange, or would be so treated if dealt with on such a stock exchange; and
 - (b) a connected person has the beneficial ownership of an asset wherever there is, or (apart from this section) would be, a connection (within the meaning of section 87 above) between—
 - (i) the person who has the beneficial ownership of the asset, and
 - (ii) a person who stands in the position of a debtor as respects the money debt by reference to which any loan relationship represented by that asset subsists.
- (5) Where for any accounting period—
- (a) subsection (1) above has effect in the case of a creditor relationship of a company, and
 - (b) the person who stands in the position of a debtor as respects the debt in question is also a company,
- that subsection shall not apply for determining, for the purposes of so much of section 87 above as relates to the corresponding debtor relationship, whether there is a connection between the two companies.
- (6) Subsection (5) of section 87 above shall apply for the purposes of this section as it applies for the purposes of that section.
- (7) In this section “basic life assurance and general annuity business” and “insurance company” have the same meanings as in Chapter I of Part XII of the Taxes Act 1988,

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and section 432ZA of that Act (linked assets) shall apply for the purposes of this section as it applies for the purposes of that Chapter.

89 Inconsistent application of accounting methods

- (1) Where there is any inconsistency or other material difference between the way in which any authorised accounting method is applied as respects the same loan relationship in successive accounting periods, a balancing credit or balancing debit shall be brought into account in the second of those periods (“the second period”).
- (2) The amount of the balancing credit or debit shall be computed as respects the relationship in question by—
 - (a) taking the amount given by subsection (3) below and the amount given by subsection (4) below; and
 - (b) then aggregating those amounts (treating any debit as a negative amount) to produce a net credit or net debit.
- (3) The amount given by this subsection is whichever of the following is applicable—
 - (a) a debit equal to the amount (if any) by which the first of the following amounts exceeds the second, that is to say—
 - (i) the aggregate of the credits actually brought into account for all previous periods in which the accounting method was used; and
 - (ii) the aggregate of the credits that would have been brought into account if that method had been applied in those periods in the same way as it was applied in the second period;
 - (b) a credit equal to the amount (if any) by which the second aggregate mentioned in paragraph (a) above exceeds the first; or
 - (c) if both those aggregates are the same, nil.
- (4) The amount given by this subsection is whichever of the following is applicable—
 - (a) a credit equal to the amount (if any) by which the first of the following amounts exceeds the second, that is to say—
 - (i) the aggregate of the debits actually brought into account for all previous periods in which the accounting method was used; and
 - (ii) the aggregate of the debits that would have been brought into account if that method had been applied in those periods in the same way as it was applied in the second period;
 - (b) a debit equal to the amount (if any) by which the second aggregate mentioned in paragraph (a) above exceeds the first; or
 - (c) if both those aggregates are the same, nil.
- (5) In this section “previous period” means any accounting period before the second period.

90 Changes of accounting method

- (1) This section applies where different authorised accounting methods are used for the purposes of this Chapter as respects the same loan relationship for different parts of the same accounting period or for successive accounting periods.
- (2) Where, in the case of any loan relationship, the use of any authorised accounting method is superseded in the course of any accounting period by the use of another—

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- (a) the assumptions specified in subsection (4) below shall be made;
 - (b) each method shall be applied on those assumptions as respects the part of the period for which it is used; and
 - (c) the credits and debits given by the application of those methods on those assumptions shall be brought into account in the accounting period in which the change of method takes effect.
- (3) Where, in the case of any loan relationship, the use of any authorised accounting method is superseded as from the beginning of an accounting period by the use of another—
- (a) a net credit or debit shall be computed (treating any debit used in the computation as a negative amount) by—
 - (i) aggregating the credits and debits which, on the assumptions specified in subsection (4) below, would have been given in respect of that relationship for the successive accounting periods by the use for each period of the accounting method actually used for that period;
 - (ii) aggregating the credits and debits so given without the making of those assumptions; and
 - (iii) subtracting the second aggregate from the first;and
 - (b) the net credit or debit shall be brought into account for the purposes of this Chapter in the accounting period as from the beginning of which the change of method takes effect.
- (4) The assumptions mentioned in subsections (2) and (3) above are—
- (a) that the company ceased to be a party to the relationship immediately before the end of the period, or part of a period, for which the superseded method is used;
 - (b) that the company again became a party to that relationship as from the beginning of the period or, as the case may be, part of a period for which the other authorised accounting method is used;
 - (c) that the relationship to which the company is deemed to have become a party is separate and distinct from the one to which it is deemed to have ceased to be a party;
 - (d) that the amount payable under the transaction comprised in each of the assumptions specified in paragraphs (a) and (b) above was equal to the fair value of the relationship; and
 - (e) so far as relevant, that that amount became due at the time when the company is deemed to have ceased to be a party to the relationship or, as the case may be, to have again become a party to it.
- (5) Where—
- (a) a mark to market basis of accounting is superseded by an accruals basis of accounting in the case of any loan relationship, and
 - (b) the amount which would have accrued in respect of that relationship in the period or part of a period for which the accruals basis of accounting is used falls to be determined for the purposes of this section in accordance with the assumptions mentioned in subsection (4) above,
- that amount shall be taken for those purposes to be equal to the amount resulting from the subtraction of the amount given by subsection (6)(a) below from the amount given by subsection (6)(b) below.

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- (6) Those amounts are—
- (a) the amount which by virtue of the assumptions mentioned in subsection (4) above is given as an opening value for the period or part of a period; and
 - (b) the amount equal to whatever, in the computation in accordance with an authorised accruals basis of accounting of the amount accruing in that period or part of a period, would have been taken to be the closing value applicable as at the end of that period or part of a period if such a basis of accounting had always been used as respects the relationship.
- (7) In this section “fair value” has the same meaning as in section 85 above.

91 Payments subject to deduction of tax

- (1) This section applies where—
- (a) any company receives a payment of interest on which it bears income tax by deduction; and
 - (b) in the case of that company, a credit relating to that interest has been brought into account for the purposes of this Chapter for an accounting period ending more than two years before the receipt of the payment.
- (2) On a claim made by the company to an officer of the Board, section 7(2) or, as the case may be, 11(3) of the Taxes Act 1988 (deducted income tax to be set against liability to corporation tax) shall have effect in relation to the income tax on the payment as if the interest had fallen to be taken into account for the purposes of corporation tax in the accounting period in which the payment of that interest is received.
- (3) In determining for the purposes of this section which accounting period is the accounting period for which a credit relating to interest paid subsequently was brought into account, every payment of interest to a company under a loan relationship of that company shall be assumed to be a payment in discharge of the earliest outstanding liability to that company in respect of interest payable under the relationship.
- (4) For the purposes of this section, the earliest outstanding liability to interest payable under a loan relationship of a company shall be identified, in relation to any payment of such interest, according to the authorised accounting method most recently used as respects that relationship, so that—
- (a) if that method is an authorised accruals basis of accounting, it shall be determined by reference to the time when the interest accrued; and
 - (b) if that method is an authorised mark to market basis of accounting, it shall be determined by reference to the time when the interest became due and payable.
- (5) In subsection (4) above the reference, in relation to a payment of interest made to a company in any accounting period, to the authorised accounting method most recently used as respects that relationship is a reference to the authorised accounting method which, in the case of that company, has been used as respects that relationship for the accounting period which, when the payment is made, is the most recent for which amounts in respect of that relationship have been brought into account for the purposes of this Chapter.
- (6) A claim under this section shall not be made in respect of any payment of interest at any time after the later of the following, that is to say—
- (a) the time two years after the end of the accounting period in which the payment is received; and

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- (b) the time six years after the end of the accounting period for which the credit in respect of the interest was brought into account for the purposes of this Chapter.
- (7) Where—
- (a) there is a payment of interest to a company under a loan relationship of that company, and
 - (b) the company is prevented by virtue of subsection (6) above from making any claim under this section in respect of that payment,
- the company shall not be entitled to make any claim under paragraph 5 of Schedule 16 to the Taxes Act 1988 (set off of income tax borne against income tax payable) in respect of that payment.