



# Finance Act 2002

## 2002 CHAPTER 23

### PART 3

#### INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

### CHAPTER 2

#### OTHER PROVISIONS

#### *Miscellaneous*

#### **102 Distributions: reasonable commercial return for use of principal secured**

- (1) In section 209 of the Taxes Act 1988 (meaning of “distribution”) after subsection (3A) insert—

“(3AA) If, in the case of any security issued by a company, the amount of new consideration received by the company for the issue of the security exceeds the amount of the principal secured by the security—

- (a) the amount of the principal so secured shall be treated for the purposes of paragraph (d) of subsection (2) above as increased to the amount of the new consideration so received; and
- (b) subsection (3A) above, so far as relating to that paragraph, shall not have effect in relation to the security;

but this subsection is subject to sections 209A and 209B.”.

- (2) After that section insert—

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**“209A Section 209(3AA): link to shares of company or associated company**

- (1) Subsection (3AA) of section 209 does not apply in relation to a security issued by a company (the “issuing company”) if the security is one which to a significant extent reflects dividends or other distributions in respect of, or fluctuations in the value of, shares in one or more companies each of which is—
- (a) the issuing company; or
  - (b) an associated company of the issuing company;
- but this subsection is subject to the following provisions of this section.
- (2) Subsection (1) above does not prevent subsection (3AA) of section 209 above from applying in relation to a security if—
- (a) the issuing company is a bank or securities house;
  - (b) the security is issued by the issuing company in the ordinary course of its business; and
  - (c) the security reflects dividends or other distributions in respect of, or fluctuations in the value of, shares in companies falling within paragraph (a) or (b) of subsection (1) above by reason only that the security reflects fluctuations in a qualifying index.
- (3) In subsection (2)(c) above “qualifying index” means an index whose underlying subject matter includes both—
- (a) shares in one or more companies falling within paragraph (a) or (b) of subsection (1) above, and
  - (b) shares in one or more companies falling within neither of those paragraphs,
- and which is an index such that the shares falling within paragraph (b) above represent a significant proportion of the market value of the underlying subject matter of the index.
- (4) In this section—
- “bank” has the meaning given by section 840A;
- “securities house” means any person—
- (a) who is authorised for the purposes of the Financial Services and Markets Act 2000; and
  - (b) whose business consists wholly or mainly of dealing in financial instruments as principal;
- and in paragraph (b) above “financial instrument” has the meaning given by section 349(5) and (6).
- (5) For the purposes of this section a company is an “associated company” of another at any time if at that time one has control of the other or both are under the control of the same person or persons.
- (6) For the purposes of subsection (5) above, “control”, in relation to a company, means the power of a person to secure—
- (a) by means of the holding of shares or the possession of voting power in or in relation to the company or any other company, or

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(b) by virtue of any powers conferred by the articles of association or other document regulating the company or any other company, that the affairs of the company are conducted in accordance with his wishes.

- (7) There shall be left out of account for the purposes of subsection (6) above—
- (a) any shares held by a company, and
  - (b) any voting power or other powers arising from shares held by a company,

if a profit on a sale of the shares would be treated as a trading receipt of a trade carried on by the company and the shares are not, within the meaning of Chapter 1 of Part 12, assets of an insurance company's long-term insurance fund (see section 431(2)).

### **209B Section 209(3AA): hedging arrangements**

- (1) Subsection (3AA) of section 209 does not at any time apply in relation to a security issued by a company (the “issuing company”) if at that time, or any earlier time on or after 17th April 2002, there are or have been any hedging arrangements that relate to some or all of the company's liabilities under the security.
- (2) Subsection (1) above does not prevent subsection (3AA) of section 209 from applying in relation to a security at any time if—
- (a) conditions 1 to 4 below are satisfied in relation to any such hedging arrangements at that time; and
  - (b) at all earlier times on or after 17th April 2002 when there have been hedging arrangements that relate to some or all of the company's liabilities under the security, conditions 1 to 4 below were satisfied in relation to those hedging arrangements.
- (3) Where subsection (3AA) of section 209 at any time ceases to apply in relation to a security by virtue of this section, subsection (2)(d) of that section shall have effect in relation to the security as from that time as it would have had effect if subsection (3AA) had never applied in relation to the security.
- (4) Condition 1 is that the hedging arrangements do not constitute, include, or form part of, any scheme or arrangement the purpose or one of the main purposes of which is the avoidance of tax or stamp duty.
- (5) Condition 2 is that the hedging arrangements are such that, where for the purposes of corporation tax a deduction in respect of the security falls to be made at any time by the issuing company, then at that time, or within a reasonable time before or after it, any amounts intended under the hedging arrangements to offset some or all of that deduction arise—
- (a) to the issuing company; or
  - (b) to a company which is a member of the same group of companies as the issuing company.
- (6) Condition 3 is that the whole of every amount arising as mentioned in subsection (5) above is brought into charge to corporation tax—
- (a) by a company falling within paragraph (a) or (b) of that subsection, or
  - (b) by two or more companies, taken together, each of which falls within paragraph (a) or (b) of that subsection.

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- (7) Condition 4 is that for the purposes of corporation tax any deductions in respect of expenses of establishing or administering the hedging arrangements are reasonable, in proportion to the amounts required to be brought into charge to corporation tax by subsection (6) above.
- (8) For the purposes of this section “hedging arrangements”, in relation to a security, means any scheme or arrangement for the purpose, or for purposes which include the purpose, of securing that an amount of income or gain accrues, or is received or receivable, whether directly or indirectly, which is intended to offset some or all of the amounts which fall to be brought into account, in accordance with generally accepted accounting practice, in respect of amounts accruing or falling to be paid in accordance with the terms of the security.
- (9) Any reference in this section to two companies being members of the same group of companies is a reference to their being members of the same group of companies for the purposes of Chapter 4 of Part 10 of this Act (group relief).”.
- (3) This section has effect in relation to interest and other distributions out of assets of a company in respect of securities of the company where the interest is paid, or the distribution is made, on or after 17th April 2002.

### **103 References to accounting practice and periods of account**

- (1) In section 832(1) of the Taxes Act 1988 (interpretation of the Tax Acts), at the appropriate places insert—

““generally accepted accounting practice” has the meaning given by section 836A;”;

““for accounting purposes” means for the purposes of accounts drawn up in accordance with generally accepted accounting practice;”;

and

““period of account”—

- (a) in relation to a person, means any period for which the person draws up accounts, and
- (b) in relation to a trade, profession, vocation or other business means any period for which accounts of the business are drawn up;”.

- (2) After section 836 of that Act insert—

#### **“836A Generally accepted accounting practice**

- (1) In the Tax Acts, unless the context otherwise requires, “generally accepted accounting practice”—
- (a) means generally accepted accounting practice with respect to accounts of UK companies that are intended to give a true and fair view, and
- (b) has the same meaning in relation to—
- (i) individuals,
- (ii) entities other than companies, and

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- (iii) companies that are not UK companies,  
as it has in relation to UK companies.
- (2) In subsection (1) “UK companies” means companies incorporated or formed under the law of a part of the United Kingdom.”
- (3) In section 288(1) of the Taxation of Chargeable Gains Act 1992 (interpretation), at the appropriate place insert—
- ““period of account” has the meaning given by section 832(1) of the Taxes Act;”.
- (4) In the following provisions for “normal accounting practice” or “normal accountancy practice”, wherever occurring, substitute “generally accepted accounting practice”
- (a) in the Taxes Act 1988, sections 43A(1), 297(5B), 494AA(2), 798B(1) and 837A(2), and in Schedule 28B, paragraph 4(6B);
  - (b) in the Finance Act 1993 (c. 34), sections 93(2), 150(6)(c) and (11)(c), 154(11)(c), (12)(d), (13)(b), (13A)(d) and (13B)(d), 155(7), (11)(d) and (12)(b), 156(2)(e) and (4)(b) and 159(1)(b);
  - (c) in the Finance Act 1994 (c. 9), section 156(3)(a) and (4)(a);
  - (d) in the Finance Act 1996 (c. 8), sections 84(2)(b) and 85(2)(a), in Schedule 9, paragraph 14(1) and (2) and in Schedule 10, paragraph 1(3)(a) and (4);
  - (e) in the Finance Act 1997 (c. 16), in Schedule 12, paragraphs 1(1)(c) and (2)(a), 3(1) and (2), 4(5), 6(1)(a), 15(1)(c) and (2), 22, 28(5) and 30(1);
  - (f) in the Finance Act 2000 (c. 17), in Schedule 14, paragraph 22(4), in Schedule 15, paragraph 29(4), in Schedule 20, paragraphs 6(1), 10(1)(b) and (2)(b)(ii) and 25(1), and in Schedule 23, paragraphs 2(1), 3(1) and (3) and 5;
  - (g) in the Capital Allowances Act 2001 (c. 2), sections 179(1)(f), 219(1) and 437;
  - (h) in the Finance Act 2001 (c. 9), in Schedule 22, paragraphs 10(1)(b) and (2)(b)(ii).
- (5) In section 42(1) of the Finance Act 1998 (c. 36) (computation of profits of trade, profession or vocation), for “on an accounting basis which gives a true and fair view” substitute “in accordance with generally accepted accounting practice”.
- (6) The amendments made by subsections (1) to (3) above have effect for the purposes of provisions of this Act using the expressions mentioned (including provisions inserted by amendment in other enactments) whenever those provisions are expressed to have effect or to come, or to have come, into force.

This is without prejudice to the general effect of those amendments.

#### **104 Discounted securities etc**

- (1) Schedule 13 to the Finance Act 1996 (discounted securities: income tax provisions) is amended as follows.
- (2) After paragraph 3 (meaning of “relevant discounted security”) insert—

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**3A “Issue price etc of securities issued in accordance with qualifying earn-out right**

- (1) This paragraph applies where a security is issued to a person in accordance with the terms of a qualifying earn-out right.
- (2) In any such case the issue price of the security shall be taken for the purposes of this Schedule to be the sum of—
  - (a) the market value, immediately before the issue of the security, of the right to be issued with the security in accordance with the terms of the qualifying earn-out right, and
  - (b) any amount payable for the issue of the security in accordance with those terms,

and any reference in this Schedule to the amount paid by the person in respect of his acquisition of the security shall be taken as a reference to that sum.

- (3) For the purposes of this paragraph a “qualifying earn-out right” is so much of any right conferred on a person as—
  - (a) constitutes the whole or any part of the consideration for the transfer by him of shares in or debentures of a company or for the transfer of the whole or part of a business or interest in a business carried on by him or by him and others in partnership;
  - (b) consists in either a right to be issued with securities of another company or a right which is capable of being discharged in accordance with its terms by the issue of such securities; and
  - (c) is such that the value of the consideration mentioned in paragraph (a) above is unascertainable at the time when the right is conferred.”.

- (3) After paragraph 9 (other transactions deemed to be at market value) insert—

**9A “Securities issued to connected person etc at price in excess of market value: transfer to connected person**

- (1) Where a relevant discounted security is transferred by a person (“the relevant person”) to a person connected with him and—
  - (a) the occasion of the relevant person’s acquisition of the security was its issue to him,
  - (b) the relevant person was, at the time of issue, connected with the issuer or the conditions in sub-paragraph (2) below are satisfied, and
  - (c) the amount paid by the relevant person in respect of his acquisition of the security exceeds the market value of the security at the time of issue,

the relevant person shall be taken for the purposes of this Schedule not to sustain a loss from the discount on the relevant discounted security.

- (2) The conditions mentioned in sub-paragraph (1)(b) above are that—
  - (a) the security is a security issued by a close company;
  - (b) at the time of issue, the relevant person was not connected with the company;

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- (c) securities of the same kind as that issued to him were also issued to other persons; and
  - (d) he and some or all of those other persons, taken together, controlled the company.
- (3) In sub-paragraph (2)(d) above, “control” shall be construed in accordance with section 416 of the Taxes Act 1988.
- (4) For the purposes of this section, section 414 of the Taxes Act 1988 (meaning of “close company” in the Tax Acts) shall have effect with the omission of subsection (1)(a) (exclusion of companies not resident in the United Kingdom).
- (5) Section 839 of the Taxes Act 1988 (connected persons) shall apply for the purposes of this paragraph.”.
- (4) Schedule 13 to the Finance Act 1996 (c. 8) shall have effect, and be deemed always to have had effect, with the amendment made by subsection (2).
- (5) The amendment made by subsection (3) has effect in relation to transfers on and after 26th March 2002.

## **105 Financial trading stock**

- (1) In section 100 of the Taxes Act 1988 (valuation of trading stock at discontinuance of trade) in subsection (1B), omit paragraph (a) (which relates to stock consisting of certain debts and is superseded by Chapter 2 of Part 4 of the Finance Act 1996 (c. 8) (loan relationships)).
- (2) In Schedule 12 to the Finance Act 1988 (c. 39) (building societies: change of status)—
  - (a) in paragraph 1 (which provides that paragraphs 2 to 7 apply where there is a transfer of the whole of a building society’s business to a successor company in accordance with section 97 etc of the Building Societies Act 1986 (c. 53)) for “2” substitute “ 3 ”; and
  - (b) omit paragraph 2 (which relates to gilt-edged securities and other financial trading stock and is superseded by Chapter 2 of Part 4 of the Finance Act 1996).

## **106 Valuation of trading stock on transfer of trade**

- (1) In section 100 of the Taxes Act 1988 (valuation of trading stock at discontinuance of trade), after subsection (2) insert—
  - “(3) Where trading stock falling to be valued under paragraph (a) of subsection (1) above is sold or transferred together with other assets, so much of the amount realised on the sale or, as the case may be, of the value of the consideration given for the transfer as on a just and reasonable apportionment is properly attributable to each asset shall be treated for the purposes of this section as the amount realised on the sale or, as the case may be, the value of the consideration given for the transfer, of that asset.”.
- (2) Subsection (1) applies where the sale or transfer in question takes place after the passing of this Act.

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## **107 Banks etc in compulsory liquidation**

- (1) Schedule 12 to the Finance (No. 2) Act 1992 (c. 48) is amended as follows.
- (2) In paragraph 3 (taxation of certain receipts under Case VI of Schedule D) omit paragraph (c) of sub-paragraph (3) (which has become unnecessary because no interest or dividends any longer fall within it).
- (3) At the end of paragraph 3, insert—
  - “(5) This paragraph and paragraph 4 below have effect for the purposes of corporation tax notwithstanding anything in section 80(5) of the Finance Act 1996 (matters to be brought into account in the case of loan relationships only under Chapter 2 of Part 4 of that Act).”.
- (4) In paragraph 4 (relief from tax) omit sub-paragraph (3) (which provides for deductions from sums excluded from paragraph 3(2) by paragraph 3(3)(c)).
- (5) The amendments made by this section have effect in relation to accounting periods beginning on or after 1st October 2002.

## **108 Manufactured dividends and interest**

- (1) Schedule 23A to the Taxes Act 1988 (manufactured dividends and interest) is amended as follows.
- (2) In paragraph 2A (manufactured dividends on UK equities: deductibility of manufactured payment in case of manufacturer) at the end of sub-paragraph (1) (amount paid to be deductible against total income) insert “ , subject to sub-paragraph (1A) below ”.
- (3) After that sub-paragraph insert—
  - “(1A) An amount shall be allowable under sub-paragraph (1) above as a deduction against total income only to the extent that—
    - (a) the dividend manufacturer receives the dividend on the equities which is represented by the manufactured dividend, or receives a payment which is representative of that dividend, and is chargeable to income tax on the dividend or other payment so received;
    - (b) the dividend manufacturer is treated under section 730A (repos) as receiving a payment of interest in respect of the equities and is chargeable to income tax on that payment; or
    - (c) a chargeable gain accrues to the dividend manufacturer as a result of a transaction whose nature is such as to give rise to the payment of a manufactured dividend by him,
 but the amount allowable by virtue of paragraph (c) above is limited to so much of the chargeable gain as does not exceed the manufactured dividend paid as a result of the transaction.
  - (1B) Where an amount is allowable under sub-paragraph (1) above by reference to the whole or any part of—
    - (a) a dividend or other payment falling within paragraph (a) of sub-paragraph (1A) above,
    - (b) a payment of interest which a person is treated as receiving, as mentioned in paragraph (b) of that sub-paragraph, or



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- (c) a chargeable gain falling within paragraph (c) of that sub-paragraph, (the “utilised portion” of the dividend, other payment or chargeable gain) no other amount shall be allowable under sub-paragraph (1) above by reference to all or any of the utilised portion of the dividend, other payment or chargeable gain.”.
- (4) In paragraph 3 (manufactured interest on UK securities) in sub-paragraph (2) (tax treatment of interest manufacturer) in paragraph (c) (amount allowable as a deduction) at the end add “, but only to the extent that—
- (i) it would be so allowable if it were interest, or
  - (ii) so far as not falling within sub-paragraph (i) above, it falls within sub-paragraph (2A) below”.
- (5) After that sub-paragraph insert—
- “(2A) An amount of manufactured interest falls within this sub-paragraph if and to the extent that the interest manufacturer—
- (a) receives the periodical payment of interest on the securities which is represented by the manufactured interest, or receives a payment which is representative of that periodical payment of interest, and is chargeable to income tax on the periodical payment or representative payment so received;
  - (b) is treated under section 713(2)(a) or (3)(b) (accrued income scheme) as entitled to a sum in respect of a transfer of the securities and is chargeable to income tax on that sum; or
  - (c) is treated under section 730A (repos) as receiving a payment of interest in respect of the securities and is chargeable to income tax on that payment.
- (2B) Where an amount is allowable under sub-paragraph (2)(c) above by reference to the whole or any part of—
- (a) a periodical payment of interest, or a payment representative of such a payment, falling within paragraph (a) of sub-paragraph (2A) above,
  - (b) a sum falling within paragraph (b) of that sub-paragraph, or
  - (c) a payment of interest which a person is treated as receiving, as mentioned in paragraph (c) of that sub-paragraph,
- (the “utilised portion” of the interest, sum or other payment) no other amount shall be allowable under sub-paragraph (2)(c) above by reference to all or any of the utilised portion of the interest, sum or other payment.”.
- (6) The amendments made by subsections (2) and (3) have effect in relation to manufactured dividends paid on or after 17th April 2002.
- (7) The amendments made by subsections (4) and (5) have effect in relation to manufactured interest paid on or after 17th April 2002.

## **109 Venture capital trusts**

- (1) Schedule 33 to this Act has effect.
- (2) In that Schedule—
- Part 1 enables regulations to make provision for cases where a venture capital trust is being wound up,

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Part 2 enables regulations to make provision for cases where there is a merger of two or more venture capital trusts,

Part 3 enables regulations to make provision about the time allowed for venture capital trusts to invest money raised from issues (other than initial issues) of ordinary share capital, and

Part 4 contains supplementary provisions.

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