



# Finance (No.2) Act 1987

## 1987 CHAPTER 51

### PART I

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

### CHAPTER III

#### GENERAL

##### *Provisions having an overseas element*

#### **62 United Kingdom members of partnerships controlled abroad.**

(1) At the end of section 153 of the Taxes Act (partnerships controlled abroad) there shall be added the following subsections—

“(4) In any case where—

- (a) a person resident in the United Kingdom (in this subsection and subsection (5) below referred to as “the resident partner”) is a member of a partnership which resides or is deemed to reside outside the United Kingdom, and
- (b) by virtue of any arrangements falling within section 497 of this Act (double taxation relief) any of the income or capital gains of the partnership is relieved from tax in the United Kingdom,

the arrangements referred to in paragraph (b) above shall not affect any liability to tax in respect of the resident partner’s share of any income or capital gains of the partnership.

(5) If, in a case where subsection (4) above applies, the resident partner’s share of the income of the partnership consists of or includes a share in a qualifying distribution, within the meaning of Part V of the Finance Act 1972, made by a company resident in the United Kingdom, then, notwithstanding anything in the arrangements, the resident partner (and not the partnership as a whole)

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shall be regarded as entitled to that share of the tax credit in respect of the distribution which corresponds to his share of the distribution.”

- (2) Nothing in subsection (1) above affects—
- (a) the determination of any Commissioners or the judgment of any court made or given before 17th March 1987, or
  - (b) the law to be applied in proceedings on appeal to the Court of Appeal or the House of Lords where the judgment of the High Court or the Court of Session which is in issue was given before that date,
- but, subject to that, the amendment made by subsection (1) above shall be deemed always to have been made.

### **63 Limitation of group relief in relation to certain dual resident companies.**

- (1) Notwithstanding anything in the enactments relating to group relief, no loss or other amount shall be available for set off by way of group relief in accordance with section 259 of the Taxes Act if, in the material accounting period of the company which would otherwise be the surrendering company, that company is for the purposes of this section a dual resident investing company.
- (2) In this section “the material accounting period” means, according to the kind of group relief which would be appropriate, the accounting period—
  - (a) in which the loss is incurred; or
  - (b) for which the capital allowances fall to be made; or
  - (c) for which the expenses of management are disbursed; or
  - (d) for which the amount is paid by way of charges on income;

but subsection (1) above does not have effect unless the material accounting period is an accounting period which begins on or after 1st April 1987.
- (3) In Schedule 4 to this Act,—
  - (a) Part I has effect where an accounting period of a company in which it is a dual resident investing company begins before and ends on or after 1st April 1987 and references in subsections (1) and (2) above to the material accounting period shall be construed accordingly; and
  - (b) Part II has effect with respect to the time at which certain interest and other payments are to be treated as paid.
- (4) A company is for the purposes of this section a dual resident company in any accounting period in which—
  - (a) it is resident in the United Kingdom; and
  - (b) it is also within a charge to tax under the laws of a territory outside the United Kingdom,—
    - (i) because it derives its status as a company from those laws; or
    - (ii) because its place of management is in that territory; or
    - (iii) because, under those laws, it is for any other reason regarded as resident in that territory for the purposes of that charge.
- (5) In any accounting period throughout which it is not a trading company, a dual resident company is for the purposes of this section an investing company.
- (6) In any accounting period of a dual resident company in which it is a trading company, the company is nevertheless for the purposes of this section an investing company if—

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- (a) in that period it carries on a trade of such a description that its main function or one of its main functions consists of all or any of the following, namely,—
    - (i) acquiring and holding, directly or indirectly, shares, securities or investments of any other description, including interests in companies (resident outside, as well as in, the United Kingdom) with which the dual resident company is connected, within the terms of section 533 of the Taxes Act;
    - (ii) making payments which, by virtue of any enactment, are charges on income for the purposes of corporation tax;
    - (iii) making payments (of interest or other sums) which are similar to those referred to in sub-paragraph (ii) above but which are deductible in computing the profits of the company for the purposes of corporation tax;
    - (iv) obtaining funds (by borrowing or in any other manner whatsoever) for the purpose of, or otherwise in connection with, any of the activities referred to in sub-paragraphs (i) to (iii) above; or
  - (b) it does not fall within paragraph (a) above, but in that accounting period it carries on all or any of the activities referred to in sub-paragraphs (i) to (iv) of that paragraph and does so—
    - (i) to an extent which does not appear to be justified by any trade which it does carry on; or
    - (ii) for a purpose which does not appear to be appropriate to any such trade; or
  - (c) in that period—
    - (i) the amount paid by the company by way of charges on income exceeds its profits of the period, determined as mentioned in section 259(7) of the Taxes Act (group relief); and
    - (ii) those charges include an amount which falls to be treated as a charge on income by virtue of section 42(2) of the Finance Act 1984 (discounts on bills of exchange) or paragraph 3(2) of Schedule 9 to that Act (deep discount securities); and
    - (iii) the paying of those charges by the company is its main activity or one of its main activities.
- (7) In this section and Schedule 4 to this Act “the enactments relating to group relief” means sections 258 onwards of Chapter I of Part XI of the Taxes Act; and, except where the context otherwise requires, any expression to which a meaning is assigned for the purposes of those enactments has the same meaning in this section and that Schedule.

#### **64 Limitation of other reliefs in dealings involving dual resident investing companies.**

- (1) In Schedule 7 to the Capital Allowances Act 1968 (special rules for sales of property between connected persons etc.) at the end of sub-paragraph (3) of paragraph 4 (which in certain cases excludes the right to elect to substitute a sale price or other sum for market value for the purposes of Parts I and II of that Act) there shall be added the words “nor may such an election be made if the buyer is a dual resident investing company, within the meaning of section 63 of the Finance (No. 2) Act 1987”.

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- (2) In section 252 of the Taxes Act (company reconstructions without change of ownership) at the beginning of subsection (2) (which, in relation to capital allowances, provides for continuity as between the successor and the predecessor) there shall be inserted the words “Subject to subsection (2A) below” and at the end of that subsection there shall be inserted the following subsection—
- “(2A) Subsection (2) above does not apply if the successor is a dual resident investing company, within the meaning of section 63 of the Finance (No. 2) Act 1987.”
- (3) In section 273 of the Taxes Act (disposals of assets within a group of companies to be on a no-gain/no-loss basis) in subsection (2) (exclusions) at the end of paragraph (c) there shall be inserted the words “or
- (d) a disposal to a dual resident investing company, within the meaning of section 63 of the Finance (No. 2) Act 1987”.
- (4) In section 276 of the Taxes Act (replacement of business assets by members of a group) at the beginning of subsection (1) there shall be inserted the words “Subject to subsection (1A) below” and at the end of that subsection there shall be inserted the following subsection—
- “(1A) Subsection (1) above does not apply where so much of the consideration for the disposal of the old assets as is applied in acquiring the new assets or the interest in them is so applied by a member of the group which is a dual resident investing company; and in this subsection—
- (a) “the old assets” and “the new assets” have the same meaning as in section 115 of the Capital Gains Tax Act 1979; and
- (b) “dual resident investing company” has the same meaning as in section 63 of the Finance (No. 2) Act 1987.”
- (5) In subsection (6) of section 44 of the Finance Act 1971 (disposal value of machinery or plant in relation to capital allowances) in paragraph (b) (if sale is at an undervalue, disposal value is equal to market value except where, among other matters, the buyer’s expenditure qualifies for capital allowances) in sub-paragraph (i) after the words “(scientific research allowances)” there shall be inserted “and the buyer is not a dual resident investing company, within the meaning of section 63 of the Finance (No. 2) Act 1987, which is connected with the seller within the terms of section 533 of the Taxes Act”.
- (6) In paragraph 13 of Schedule 8 to the Finance Act 1971 (right of connected persons to elect, in relation to capital allowances, for continuity as between the successor and the predecessor) after the words “Taxes Act” there shall be inserted “and the successor is not a dual resident investing company, within the meaning of section 63 of the Finance (No. 2) Act 1987”.
- (7) In this section—
- (a) subsections (1) and (5) above apply in relation to sales on or after 1st April 1987;
- (b) subsections (2) and (6) above apply where the successor in question begins to carry on the trade on or after that date;
- (c) subsection (3) above applies in relation to disposals on or after that date; and

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- (d) subsection (4) above applies where the new assets (within the meaning of section 115 of the Capital Gains Tax Act 1979) are acquired on or after that date.

## **65 Controlled foreign companies: acceptable distribution policy.**

- (1) In Schedule 17 to the Finance Act 1984 (controlled foreign companies: cases excluded from direction-making powers) Part I (acceptable distribution policy) shall be amended in accordance with this section.
- (2) In sub-paragraph (1) of paragraph 2 (payment of dividend for accounting period of controlled foreign company) after paragraph (b) there shall be inserted the following paragraph—
- “(bb) the dividend is paid at a time when the company is not resident in the United Kingdom (whether or not it is at that time a controlled foreign company); and”.
- (3) In sub-paragraph (1) of paragraph 4 (payment of dividend by a third company) after paragraph (b) there shall be inserted the following paragraph—
- “(bb) the subsequent dividend is paid at a time when the company paying it is not resident in the United Kingdom, and”.
- (4) This section applies in any case where the dividend concerned is paid on or after 17th March 1987.

## **66 Offshore funds.**

- (1) In paragraph 1 of Schedule 19 to the Finance Act 1984 (the distribution test for offshore funds) in sub-paragraph (1)(c) (distribution for an account period to be made during that period or not more than six months after its expiry) after the words “six months” there shall be inserted “or such longer period as the Board may in any particular case allow”.
- (2) At the end of Part II of the said Schedule 19 (modifications of conditions for certification in certain cases) there shall be inserted the following paragraph—

*“Power of Board to disregard certain breaches of conditions.*

12B If, in the case of any account period of an offshore fund, it appears to the Board that there has been a failure to comply with any of the conditions in paragraphs (a) to (c) of subsection (3) of section 95 of this Act (as modified, where appropriate, by the preceding provisions of this Part of this Schedule) but the Board are satisfied—

- (a) that the failure occurred inadvertently, and  
(b) that the failure was remedied without unreasonable delay,

the Board may disregard the failure in determining whether to certify the fund as a distributing fund in respect of that account period.”

- (3) This section has effect with respect to periods which—
- (a) for the purposes of Chapter VII of Part II of the Finance Act 1984 are account periods of offshore funds; and
- (b) end after the passing of this Act.

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**67 Double taxation relief: interest on certain overseas loans.**

- (1) Section 65 of the Finance Act 1982 (restriction of double taxation relief in relation to interest on certain overseas loans) shall be amended in accordance with this section.
- (2) In subsection (1), in paragraph (a) the words “in a territory” shall be omitted and at the end of that subsection there shall be added “and for the purpose only of determining whether the condition in paragraph (b) above is fulfilled in a case where the lender has in fact incurred no expenditure related to the earning of the foreign loan interest, it shall be assumed that he has incurred such expenditure”.
- (3) After subsection (1) there shall be inserted the following subsection—
- “(1A) In subsection (1) above “interest”, in relation to a loan, includes any introductory or other fee or charge which is payable in accordance with the terms on which the loan is made or is otherwise payable in connection with the making of the loan; and any reference in this section to foreign loan interest shall be construed accordingly.”
- (4) In subsection (4) for paragraph (b) there shall be substituted—
- “(b) the amount of tax exceeds—
- (i) the amount of credit which, by virtue of Chapter II of Part XVIII of the Taxes Act (but disregarding subsection (5) below), is allowed for that foreign tax against income tax or corporation tax, or
- (ii) if it is less, 15 per cent. of the foreign loan interest, computed without regard to any increase or reduction under this section”.
- (5) For subsection (5) there shall be substituted the following subsections—
- “(5) Where this section applies, the amount of the credit for foreign tax referred to in subsection (1)(c) above which, in accordance with Chapter II of Part XVIII of the Taxes Act, is to be allowed against income tax or corporation tax—
- (a) shall be limited by treating the amount of the foreign loan interest (as increased or reduced under subsection (2) or subsection (4) above) as reduced (or further reduced) for the purposes of that Chapter by an amount equal to so much of the lender’s financial expenditure in relation to the loan concerned as is properly attributable to the period for which the interest is paid; and
- (b) shall not exceed 15 per cent. of the foreign loan interest, computed without regard to paragraph (a) above or to any increase under subsection (2) or any reduction under subsection (4) above.
- (5A) For the purposes of this section the lender’s financial expenditure in relation to a loan is the aggregate of—
- (a) the financial expenses (consisting of interest or similar sums) incurred by the lender in or in connection with the provision of the loan, so far as those expenses consist of payments which either are charges on income for the purposes of corporation tax or are deductible in computing profits of the lender which are brought into charge to income tax or corporation tax; and
- (b) where the loan is financed by the issue of securities at a discount by the lender, so much of the amount of the discount as either constitutes

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- such a charge as is mentioned in paragraph (a) above or is deductible as mentioned in that paragraph; and
- (c) so much as it is just and reasonable to attribute to the loan of any interest or other return forgone by a person connected or associated with the lender in connection with the provision of funds to the lender, either interest free or in other circumstances more favourable to the lender than if the parties were at arm's length; and
- (d) any other sum, whether paid by way of refund of tax or interest or by way of commission, which—
- (i) is paid by the lender or a person connected or associated with him;
  - (ii) is paid directly or indirectly to the borrower or a person connected or associated with him;
  - (iii) is deductible as mentioned in paragraph (a) above;
  - (iv) would not, apart from this paragraph, be taken into account in determining the amount of the foreign loan interest; and
  - (v) it is reasonable to regard as referable to the loan or the foreign loan interest (or both).
- (5B) In a case where the amount of the lender's financial expenditure in relation to a loan is not readily ascertainable, that amount shall be taken, subject to subsection (5C) below, to be such sum as it is just and reasonable to attribute to the financing of the loan, having regard, in particular, to any market rates of interest by reference to which the rate of interest on the loan is determined.
- (5C) The Board may by regulations supplement subsection (5B) above—
- (a) by specifying matters to be taken into account in determining such a just and reasonable attribution as is referred to in that subsection; and
  - (b) by making provision with respect to the determination of market rates of interest for the purposes of that subsection;
- and any such regulations may make different provision for different cases.
- (5D) Regulations under subsection (5C) above shall be made by statutory instrument which shall be subject to annulment in pursuance of a resolution of the House of Commons.
- (5E) For the purposes of this section—
- (a) section 533 of the Taxes Act (connected persons) applies; and
  - (b) subsection (10) of section 494 of that Act (associated persons) applies as it applies for the purposes of that section."
- (6) Where the loan on which the foreign loan interest is payable was made pursuant to an agreement entered into before 1st April 1987, this section does not apply in relation to interest payable before 1st April 1989 but, subject thereto, this section (including the power to make regulations conferred by subsection (5) above) applies in relation to interest payable on or after 1st April 1987.

## **68 Double taxation relief: underlying tax reflecting interest on loans.**

- (1) Section 66 of the Finance Act 1982 (restriction of double taxation relief in respect of underlying tax on certain dividends) shall be amended in accordance with this section.
- (2) After subsection (1) there shall be inserted the following subsections—

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- “(1A) In a case where this section applies, the amount of the credit for that part of the foreign tax which consists of the tax referred to in subsection (1)(c) above shall not exceed an amount determined under subsection (1B) below.
- (1B) The amount referred to in subsection (1A) above is a sum equal to corporation tax, at the rate in force at the time the foreign tax referred to in paragraph (c) of subsection (1) above was chargeable, on so much of the interest on the loan as exceeds the amount of the lender’s relevant expenditure which is properly attributable to the period for which that interest is paid.
- (1C) In subsection (1B) above—
- (a) “interest”, subject to subsection (1D) below, has the meaning assigned to it by section 65(1A) above; and
  - (b) “the lender’s relevant expenditure” means the amount which, if the company referred to in subsection (1)(d) above were resident in the United Kingdom (and liable to tax accordingly) would be its financial expenditure in relation to the loan, as determined in accordance with subsections (5) to (5E) of section 65 above.
- (1D) If, in accordance with subsection (2) or subsection (4) below, the amount of the dividend would be treated for the purposes of corporation tax as increased or reduced by any amount, then the amount which, apart from this subsection, would be the amount of the interest referred to in subsection (1B) above shall be taken to be increased or reduced by the same amount as the dividend is so treated as increased or reduced.”
- (3) Where the loan referred to in paragraph (c) of subsection (1) of section 66 of the Finance Act 1982 was made pursuant to an agreement entered into before 1st April 1987, this section does not apply in relation to tax payable as mentioned in that paragraph by reference to interest payable before 1st April 1989 but, subject thereto, this section applies in relation to tax so payable by reference to interest payable on or after 1st April 1987.