



Finance Act 2005

2005 CHAPTER 7

PART 2

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER 5

ALTERNATIVE FINANCE ARRANGEMENTS

Introductory

46 Alternative finance arrangements

- (1) In this Chapter “alternative finance arrangements” means arrangements falling within section 47 or 49.
- (2) In this Chapter “financial institution” means—
 - (a) a bank as defined by section 840A of ICTA,
 - (b) a building society within the meaning of the Building Societies Act 1986 (c. 53),
 - (c) a wholly-owned subsidiary of a bank within paragraph (a) or a building society within paragraph (b),
 - (d) a person authorised by a licence under Part 3 of the Consumer Credit Act 1974 (c. 39) to carry on a consumer credit business or consumer hire business within the meaning of that Act, or
 - (e) a person authorised in a jurisdiction outside the United Kingdom to receive deposits or other repayable funds from the public and to grant credits for its own account.
- (3) For the purposes of subsection (2)(c) a company is a wholly-owned subsidiary of a bank or building society (“the parent”) if it has no members except the parent and the

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parent's wholly-owned subsidiaries or persons acting on behalf of the parent or the parent's wholly-owned subsidiaries.

Arrangements giving rise to alternative finance return

47 Alternative finance arrangements: alternative finance return

- (1) Subject to subsection (3) and section 52, arrangements fall within this section if they are arrangements entered into between two persons under which—
 - (a) a person (“X”) purchases an asset and sells it, either immediately or in circumstances in which the conditions in subsection (2) are met, to the other person (“Y”),
 - (b) the amount payable by Y in respect of the sale (“the sale price”) is greater than the amount paid by X in respect of the purchase (“the purchase price”),
 - (c) all or part of the sale price is not required to be paid until a date later than that of the sale, and
 - (d) the difference between the sale price and the purchase price equates, in substance, to the return on an investment of money at interest.
- (2) The conditions referred to in subsection (1)(a) are—
 - (a) that X is a financial institution, and
 - (b) that the asset referred to in that provision was purchased by X for the purpose of entering into arrangements falling within this section.
- (3) Arrangements do not fall within this section unless at least one of the parties is a financial institution.
- (4) For the purposes of this section “the effective return” is so much of the sale price as exceeds the purchase price.
- (5) In this Chapter references to “alternative finance return” are to be read in accordance with subsections (6) and (7).
- (6) If under arrangements falling within this section the whole of the sale price is paid on one day, that sale price is to be taken to include alternative finance return equal to the effective return.
- (7) If under arrangements falling within this section the sale price is paid by instalments, each instalment is to be taken to include alternative finance return equal to the appropriate amount.
- (8) The appropriate amount, in relation to any instalment, is an amount equal to the interest that would have been included in the instalment if—
 - (a) the effective return were the total interest payable on a loan by X to Y of an amount equal to the purchase price,
 - (b) the instalment were a part repayment of the principal with interest, and
 - (c) the loan were made on arm's length terms and accounted for under generally accepted accounting practice.

48 Arrangements within section 47: foreign currency and non-residents

- (1) If alternative finance return is paid in a currency other than sterling—
 - (a) by or to a person other than a company, and

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- (b) otherwise than for the purposes of a trade, profession or vocation or a property business,
- then, as respects that person, the effective return for the purposes of section 47 and the appropriate amount for the purposes of subsection (7) of that section are to be calculated in the other currency and the amount of each payment of alternative finance return is to be translated into sterling at a spot rate of exchange for the day on which the payment is made.
- (2) In section 148 of FA 2003 (meaning of “permanent establishment”) after subsection (5) insert—
- “(5A) Where alternative finance return as defined by subsection (5) of section 47 of the Finance Act 2005 is paid to a company that is not resident in the United Kingdom, the company is not regarded as having a permanent establishment in the United Kingdom merely by virtue of anything done for the purposes of the arrangements falling within that section by the other party to the arrangements or by any other person acting for the company in relation to the arrangements.”
- (3) In section 127 of FA 1995 (persons not treated as UK representatives) in subsection (1), at the end of paragraph (c) but before the “and” insert—
- “(cc) where the income consists of alternative finance return, as defined by subsection (5) of section 47 of the Finance Act 2005, the other party to the arrangements falling within that section or any other person acting for the non-resident in relation to the arrangements;”.

Arrangements giving rise to profit share return

49 Alternative finance arrangements: profit share return

- (1) Subject to section 52, arrangements fall within this section if they are arrangements under which—
- (a) a person (“the depositor”) deposits money with a financial institution,
 - (b) the money, together with money deposited with the institution by other persons, is used by the institution with a view to producing a profit,
 - (c) from time to time the institution makes or credits a payment to the depositor, in proportion to the amount deposited by him, out of any profit resulting from the use of the money, and
 - (d) the payments so made or credited by the institution equate, in substance, to the return on an investment of money at interest.
- (2) In this Chapter references to “profit share return” are references to amounts paid or credited as mentioned in subsection (1)(c) by a financial institution under arrangements falling within this section.

Treatment of alternative finance arrangements

50 Treatment of alternative finance arrangements: companies

- (1) Where a company is a party to arrangements falling within section 47, Chapter 2 of Part 4 of FA 1996 (loan relationships) has effect in relation to the arrangements as if—
- (a) the arrangements were a loan relationship to which the company is a party,

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- (b) any amount which is the purchase price for the purposes of section 47(1)(b) were the amount of a loan made (as the case requires) to the company by, or by the company to, the other party to the arrangements, and
 - (c) alternative finance return payable to or by the company under the arrangements were interest payable under that loan relationship.
- (2) Where a company is a party to arrangements falling within section 49, Chapter 2 of Part 4 of FA 1996 (loan relationships) has effect in relation to the arrangements as if—
- (a) the arrangements were a loan relationship to which the company is a party,
 - (b) any amount deposited under the arrangements were—
 - (i) in relation to a company which is the depositor under the arrangements, the amount of a loan made by the company to the financial institution, and
 - (ii) in relation to a company which is the financial institution with which the depositor deposits money under the arrangements, the amount of a loan made to it by the depositor, and
 - (c) profit share return payable to or by the company under the arrangements were interest payable under that loan relationship.
- (3) Accordingly, references in the Corporation Tax Acts to a loan relationship include references to alternative finance arrangements.
- (4) In subsection (2)(b), “depositor” is to be read in accordance with section 49(1)(a).

51 Treatment of alternative finance arrangements: persons other than companies

- (1) Alternative finance return or profit share return is to be treated for the purposes of ITTOIA 2005 as if it were interest.
- (2) Sections 353 to 368 of ICTA (relief for payments of interest) have effect as if—
- (a) arrangements falling within section 47 involved the making of a loan, and
 - (b) alternative finance return were interest;
- and section 366 (information) shall have effect accordingly.
- (3) Subsections (4) and (5) apply to the extent that a person other than a company is a party to alternative finance arrangements for the purposes of a trade, profession or vocation carried on by him or for the purposes of a property business of his.
- (4) Alternative finance return or profit share return paid by him is to be treated as an expense of the trade, profession or vocation or of the property business.
- (5) Section 58 of ITTOIA 2005 (incidental costs of obtaining finance) has effect as if—
- (a) references to a loan included references to alternative finance arrangements, and
 - (b) references to interest included references to alternative finance return or profit share return.

52 Provision not at arm’s length

- (1) This section applies where—
- (a) arrangements would apart from this section fall within section 47 or section 49,

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- (b) paragraph 1(2) of Schedule 28AA to ICTA (provision not at arm's length) requires the profits and losses of any person who is a party to the arrangements to be computed for tax purposes as if the arm's length provision referred to in paragraph 1(2)(a) of that Schedule had been made or imposed instead of the arrangements, and
 - (c) any person who is for the purposes of that Schedule an affected person is entitled to—
 - (i) relevant return, or
 - (ii) an amount representing relevant return,
but is not subject to income tax or corporation tax, or any corresponding tax under the law of a territory outside the United Kingdom, on the relevant return or the amount representing it.
- (2) In this section “relevant return”, in relation to any arrangements, means any amount that would be alternative finance return or profit share return if the arrangements were alternative finance arrangements.
- (3) The arrangements are not to be regarded as falling within section 47 or section 49.
- (4) Where the arrangements would, but for subsection (3), fall within section 47, the person paying relevant return under the arrangements is not entitled—
- (a) to any deduction in computing profits or gains for the purposes of income tax or corporation tax, or
 - (b) to any deduction against total income or, as the case may be, total profits, in respect of the relevant return.
- (5) Where the arrangements would, but for subsection (3), fall within section 49, the person paying relevant return under the arrangements is not entitled—
- (a) to any deduction in computing profits or gains for the purposes of income tax or corporation tax, or
 - (b) to any deduction against total income or, as the case may be, total profits, in respect of the relevant return.
- (6) Where the person paying relevant return under the arrangements is a company, an amount may not be surrendered by way of group relief if a deduction in respect of it is prohibited by subsection (4) or (5).

53 Treatment of section 47 arrangements: sale and purchase of asset

- (1) Where under arrangements falling within section 47 an asset is sold by one party to the arrangements to the other party, the effective return shall be excluded in determining for the purposes of the Tax Acts (apart from that section) and of TCGA 1992 the consideration for the sale and purchase of the asset.
- (2) Subsection (1) does not affect the operation of any provision of the Tax Acts or TCGA 1992 which provides that the consideration for a sale or purchase is to be taken for any purpose to be an amount other than the actual consideration.

54 Section 49 arrangements: profit share return not to be treated as distribution

Profit share return is not to be treated by virtue of section 209(2)(e)(iii) of ICTA as being a distribution for the purposes of the Corporation Tax Acts.

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Supplementary

55 Further provisions

Schedule 2 (which contains further provision about the treatment of alternative finance arrangements for the purposes of income tax, corporation tax and capital gains tax) has effect.

56 Application of Chapter

- (1) This Chapter has effect in relation to alternative finance arrangements entered into on or after 6th April 2005.
- (2) To the extent provided by subsections (3) to (6), this Chapter also has effect in relation to alternative finance arrangements falling within section 49 entered into before 6th April 2005 under which profit share return is payable on or after that date (“existing profit share arrangements”).
- (3) For the purposes of income tax, this Chapter has effect in relation to payments of profit share return made on or after 6th April 2005 under existing profit share arrangements to a person other than a company.
- (4) Where a company is a party to existing profit share arrangements—
 - (a) this Chapter has effect in relation to the company in relation to those arrangements with effect from 6th April 2005, and
 - (b) for the purposes of Chapter 2 of Part 4 of FA 1996, the loan which is treated by section 50 as made by or to the company is a loan made on 6th April 2005 of an amount equal to the notional carrying value of the asset or liability representing the existing profit share arrangements.
- (5) For the purposes of subsection (4)(b) the notional carrying value is the amount which would have been the carrying value of the asset or liability in the accounts of the company (prepared in accordance with generally accepted accounting practice) if a period of accounts had ended immediately before 6th April 2005.
- (6) Section 54 has effect in relation to profit share return paid by a company on or after 6th April 2005 under existing profit share arrangements.

57 Interpretation of Chapter

In this Chapter—

- “alternative finance arrangements” has the meaning given by section 46(1);
- “alternative finance return” has the meaning given by section 47(5);
- “financial institution” has the meaning given by section 46(2);
- “profit share return” has the meaning given by section 49(2);
- “property business” has the meaning given by section 263(6) of ITTOIA 2005.