



# Finance Act 1989

## 1989 CHAPTER 26

### PART II

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

### CHAPTER III

#### CAPITAL GAINS

##### *Value shifting and groups of companies*

#### **135 Value shifting.**

- (1) In section 26 of the Capital Gains Tax Act 1979 (value shifting: further provisions) in subsection (1)(a) (schemes whereby value of the asset disposed of is materially reduced) after the words “the asset” there shall be inserted the words “or a relevant asset” and at the end of that subsection there shall be inserted—

“(1A) For the purposes of this section, where the asset disposed of by a company (“the disposing company”) consists of shares in, or securities of, another company, another asset is a relevant asset if, at the time of the disposal, it is owned by a company associated with the disposing company; but no account shall be taken of any reduction in the value of a relevant asset except in a case where—

- (a) during the period beginning with the reduction in value and ending immediately before the disposal by the disposing company, there is no disposal of the asset to any person, other than a disposal falling within section 273(1) of the Taxes Act 1970 (transfers within a group: no gain/no loss),
- (b) no disposal of the asset is treated as having occurred during that period by virtue of section 278 of the Taxes Act 1970 (company ceasing to be member of group), and

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- (c) if the reduction had not taken place but any consideration given for the relevant asset and any other material circumstances (including any consideration given before the disposal for the asset disposed of) were unchanged, the value of the asset disposed of would, at the time of the disposal, have been materially greater;  
 and in this subsection “securities” has the same meaning as in section 82 below.”
- (2) For subsection (7) of that section there shall be substituted—
- “(7) References in this section, in relation to any disposal, to a reduction in the value of an asset, where the asset consists of shares owned by a company in another company, shall be interpreted in accordance with sections 26A to 26C below and, in those sections, the disposal, the asset and those companies are referred to respectively as “the section 26 disposal”, “the principal asset”, “the first company” and “the second company”.”
- (3) In subsection (8) of that section for the words “reference in subsection (1)(a)” there shall be substituted the words “references in subsections (1)(a) and (1A)”.
- (4) This section shall have effect in respect of any disposal of an asset on or after 14th March 1989.

### **136 Value shifting: reductions attributable to distributions within a group**

- (1) After section 26 of the Capital Gains Tax Act 1979 there shall be inserted—
- “26A Value shifting: distributions within a group followed by a disposal of shares**
- (1) The references in section 26 above to a reduction in the value of an asset, in the case mentioned in subsection (7) of that section, do not include a reduction attributable to the payment of a dividend by the second company at a time when it and the first company are associated, except to the extent (if any) that the dividend is attributable to chargeable profits of the second company and, in such a case, the tax-free benefit shall be ascertained without regard to any part of the dividend that is not attributable to such profits.
- (2) Subsections (3) to (11) below apply for the interpretation of subsection (1) above.
- (3) Chargeable profits shall be ascertained as follows—
- (a) the distributable profits of any company are chargeable profits of that company to the extent that they are profits arising on a transaction caught by this section, and
- (b) where any company makes a distribution attributable wholly or partly to chargeable profits (including any profits that are chargeable profits by virtue of this paragraph) to another company, the distributable profits of the other company, so far as they represent that distribution or so much of it as was attributable to chargeable profits, are chargeable profits of the other company,
- and for this purpose any loss or other amount to be set against the profits of a company in determining the distributable profits shall be set first against

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profits other than the profits so arising or, as the case may be, representing so much of the distribution as was attributable to chargeable profits.

- (4) The distributable profits of a company are such profits computed on a commercial basis as, after allowing for any provision properly made for tax, the company is empowered, assuming sufficient funds, to distribute to persons entitled to participate in the profits of the company.
- (5) Profits of a company (“company A”) are profits arising on a transaction caught by this section where each of the following three conditions is satisfied.
- (6) The first condition is that the transaction is—
  - (a) a disposal of an asset by company A to another company in circumstances such that company A and the other company are treated as mentioned in section 273(1) of the Taxes Act 1970 (transfers within a group: no gain/no loss), or
  - (b) an exchange, or a transaction treated for the purposes of section 85(2) and (3) below as an exchange, of shares in or debentures of a company held by company A for shares in or debentures of another company, being a company associated with company A immediately after the transaction, and is treated by virtue of section 85(3) below as a reorganisation of share capital, or
  - (c) a revaluation of an asset in the accounting records of company A.

In the following conditions the “asset with enhanced value” means (subject to section 26C below), in the paragraph (a) case, the asset acquired by the person to whom the disposal is made, in the paragraph (b) case, the shares in or debentures of the other company and, in the paragraph (c) case, the revalued asset.
- (7) The second condition is that—
  - (a) during the period beginning with the transaction referred to in subsection (6) above and ending immediately before the section 26 disposal, there is no disposal of the asset with enhanced value to any person, other than a disposal falling within section 273(1) of the Taxes Act 1970, and
  - (b) no disposal of the asset with enhanced value is treated as having occurred during that period by virtue of section 278 of the Taxes Act 1970 (company ceasing to be member of group).
- (8) The third condition is that, immediately after the section 26 disposal, the asset with enhanced value is owned by a person other than the company making that disposal or a company associated with it.
- (9) The conditions in subsections (6) to (8) above are not satisfied if—
  - (a) at the time of the transaction referred to in subsection (6) above, company A carries on a trade and a profit on a disposal of the asset with enhanced value would form part of the trading profits, or
  - (b) by reason of the nature of the asset with enhanced value, a disposal of it could give rise neither to a chargeable gain nor to an allowable loss, or
  - (c) immediately before the section 26 disposal, the company owning the asset with enhanced value carries on a trade and a profit on a disposal of the asset would form part of the trading profits.

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- (10) The amount of chargeable profits of a company to be attributed to any distribution made by the company at any time in respect of any class of shares, securities or rights shall be ascertained by—
- (a) determining the total of distributable profits, and the total of chargeable profits, that remains after allowing for earlier distributions made in respect of that or any other class of shares, securities or rights, and for distributions made at or to be made after that time in respect of other classes of shares, securities or rights, and
  - (b) attributing first to that distribution distributable profits other than chargeable profits.
- (11) The amount of chargeable profits of a company to be attributed to any part of a distribution made at any time to which a person is entitled by virtue of any part of his holding of any class of shares, securities or rights, shall be such proportion of the chargeable profits as are attributable under subsection (10) above to the distributions made at that time in respect of that class as corresponds to that part of his holding.

**26B Value shifting: disposals within a group followed by a disposal of shares**

- (1) The references in section 26 above to a reduction in the value of an asset, in the case mentioned in subsection (7) of that section, do not include a reduction attributable to the disposal of any asset (“the underlying asset”) by the second company at a time when it and the first company are associated, being a disposal falling within section 273(1) of the Taxes Act 1970 (transfers within group: no gain/no loss), except in a case within subsection (2) below.
- (2) A case is within this subsection if the amount or value of the actual consideration for the disposal of the underlying asset—
- (a) is less than the market value of the underlying asset, and
  - (b) is less than the cost of the underlying asset,
- unless the disposal is effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to corporation tax.
- (3) For the purposes of subsection (2) above, the cost of an asset owned by a company is the aggregate of—
- (a) any capital expenditure incurred by the company in acquiring or providing the asset, and
  - (b) any other capital expenditure incurred by the company in respect of the asset while owned by that company.
- (4) For the purposes of this section, where the disposal of the underlying asset is a part disposal, the reference in subsection (2)(a) above to the market value of the underlying asset is to the market value of the asset acquired by the person to whom the disposal is made and the amounts to be attributed to the underlying asset under paragraphs (a) and (b) of subsection (3) above shall be reduced to the appropriate proportion of those amounts, that is—
- (a) the proportion of capital expenditure in respect of the underlying asset properly attributed in the accounting records of the company to the asset acquired by the person to whom the disposal is made, or

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- (b) where paragraph (a) above does not apply, such proportion as appears to the inspector, or on appeal the Commissioners concerned, to be just and reasonable.
- (5) Where by virtue of a distribution in the course of dissolving or winding up the second company the first company is treated as disposing of an interest in the principal asset, the exception mentioned in subsection (1) above does not apply.

### **26C Value shifting: supplementary**

- (1) For the purposes of sections 26(1A) and 26A(7) to (9) above, subsections (2) to (6) below apply for the purpose of determining in the case of any asset (“the original asset”) whether it is subsequently disposed of or treated as disposed of or owned or any other condition is satisfied in respect of it.
- (2) References in sections 26(1A)(a) and (b) and 26A(7) to a disposal are to a disposal other than a part disposal.
- (3) References to an asset are to the original asset or, where at a later time one or more assets are treated by virtue of subsections (5) or (6) below as the same as the original asset—
- (a) if no disposal falling within paragraph (a) or (b) of section 26(1A) or, as the case may be, of 26A(7) has occurred, those references are to the asset so treated or, as the case may be, all the assets so treated, and
  - (b) in any other case, those references are to an asset or, as the case may be, all the assets representing that part of the value of the original asset that remains after allowing for earlier disposals falling within the paragraphs concerned,
- references in this subsection to a disposal including a disposal which would fall within the paragraphs concerned but for subsection (2) above.
- (4) Where by virtue of subsection (3) above those references are to two or more assets—
- (a) those assets shall be treated as if they were a single asset,
  - (b) any disposal of any one of them is to be treated as a part disposal, and
  - (c) the reference in section 26(1A) to the asset owned at the time of the disposal by a company associated with the disposing company and the reference in section 26A(8) to the asset with enhanced value is to all or any of those assets.
- (5) Where there is a part disposal of an asset, that asset and the asset acquired by the person to whom the disposal is made are to be treated as the same.
- (6) Where the value of an asset is derived from any other asset in the ownership of the same or an associated company, in a case where assets have been merged or divided or have changed their nature or rights or interests in or over assets have been created or extinguished, the first asset is to be treated as the same as the second.
- (7) For the purposes of section 26(1A) above, where account is to be taken under that subsection of a reduction in the value of a relevant asset and at the time of the disposal by the disposing company referred to in that subsection—

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- (a) references to the relevant asset are by virtue of this section references to two or more assets treated as a single asset, and
- (b) one or more but not all of those assets are owned by a company associated with the disposing company,

the amount of the reduction in the value of the relevant asset to be taken into account by virtue of that subsection shall be reduced to such amount as appears to the inspector, or on appeal to the Commissioners concerned, to be just and reasonable.

- (8) For the purposes of section 26A above, where—
  - (a) a dividend paid by the second company is attributable to chargeable profits of that company, and
  - (b) the condition in subsection (7), (8) or (9)(c) of that section is satisfied by reference to an asset, or assets treated as a single asset, treated by virtue of subsection (3)(b) above as the same as the asset with enhanced value,

the amount of the reduction in value of the principal asset shall be reduced to such amount as appears to the inspector, or on appeal to the Commissioners concerned, to be just and reasonable.

- (9) For the purposes of sections 26 to 26B above and this section, companies are associated if they are members of the same group.
- (10) Section 272(1) to (4) of the Taxes Act 1970 (groups of companies: definitions) applies for the purposes of sections 26 to 26B above and this section as it applies for the purposes of that section.”

- (2) This section shall have effect in respect of any disposal of an asset on or after 14th March 1989, but—
  - (a) no account shall be taken by virtue of section 26A of the Capital Gains Tax Act 1979 of any reduction in the value of an asset attributable to the payment of a dividend unless it is paid on or after that date, and
  - (b) no account shall be taken by virtue of section 26B of that Act of a reduction in the value of an asset attributable to the disposal of another asset unless the disposal took place on or after that date.

### **137 Value shifting: transactions treated as a reorganisation of share capital.**

- (1) After section 26C of the Capital Gains Tax Act 1979 there shall be inserted—

#### **“26D Value shifting: transactions treated as a reorganisation of share capital.**

- (1) Where—
  - (a) but for sections 78 and 85(3) below, section 26 above would have effect as respects the disposal by a company (“the disposing company”) of an asset consisting of shares in or debentures of another company (“the original holding”) in exchange for shares in or debentures of a further company which, immediately after the disposal, is not a member of the same group as the disposing company, and

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- (b) if section 26 above had effect as respects that disposal, any allowable loss or chargeable gain accruing on the disposal would be calculated as if the consideration for the disposal were increased by an amount, the disposing company shall be treated for the purposes of section 79(2) below as receiving, on the reorganisation of share capital that is treated as occurring by virtue of section 85(3) below, that amount for the disposal of the original holding.
- (2) For the purposes of subsection (1) above it shall be assumed that section 86 below has effect generally for the purposes of this Act, and in that subsection “group” has the same meaning as in sections 26 to 26C above.”
- (2) This section shall have effect where the reduction in value, by reason of which the amount referred to in section 26D(1)(b) of the Capital Gains Tax Act 1979 falls to be calculated, occurred on or after 14th March 1989.

### **138 Groups of companies.**

- (1) In section 272 of the Taxes Act 1970 (groups of companies: definitions) in subsection (1), for paragraphs (b) and (c) there shall be substituted—
  - “(b) subsections (1A) to (1D) below apply to determine whether companies form a group and, where they do, which is the principal company of the group;”.
- (2) After that subsection there shall be inserted—
  - “(1A) Subject to subsections (1B) to (1D) below—
    - (a) a company (referred to below in this Chapter as the “principal company of the group”) and all its 75 per cent. subsidiaries form a group and, if any of those subsidiaries have 75 per cent. subsidiaries, the group includes them and their 75 per cent. subsidiaries, and so on, but
    - (b) a group does not include any company (other than the principal company of the group) that is not an effective 51 per cent. subsidiary of the principal company of the group.
  - (1B) A company cannot be the principal company of a group if it is itself a 75 per cent. subsidiary of another company.
  - (1C) Where a company (“the subsidiary”) is a 75 per cent. subsidiary of another company but those companies are prevented from being members of the same group by subsection (1A)(b) above, the subsidiary may, where the requirements of subsection (1A) above are satisfied, itself be the principal company of another group notwithstanding subsection (1B) above unless this subsection enables a further company to be the principal company of a group of which the subsidiary would be a member.
  - (1D) A company cannot be a member of more than one group; but where, apart from this subsection, a company would be a member of two or more groups (the principal company of each group being referred to below as the “head of a group”), it is a member only of that group, if any, of which it would be a member under one of the following tests (applying earlier tests in preference to later tests)—

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- (a) it is a member of the group it would be a member of if, in applying subsection (1A)(b) above, there were left out of account any amount to which a head of a group is or would be beneficially entitled of any profits available for distribution to equity holders of a head of another group or of any assets of a head of another group available for distribution to its equity holders on a winding-up,
  - (b) it is a member of the group the head of which is beneficially entitled to a percentage of profits available for distribution to equity holders of the company that is greater than the percentage of those profits to which any other head of a group is so entitled,
  - (c) it is a member of the group the head of which would be beneficially entitled to a percentage of any assets of the company available for distribution to its equity holders on a winding-up that is greater than the percentage of those assets to which any other head of a group would be so entitled,
  - (d) it is a member of the group the head of which owns directly or indirectly a percentage of the company's ordinary share capital that is greater than the percentage of that capital owned directly or indirectly by any other head of a group (interpreting this paragraph as if it were included in section 838(1)(a) of the Taxes Act 1988).
- (1E) For the purposes referred to in subsection (1) above, a company ("the subsidiary") is an effective 51 per cent. subsidiary of another company ("the parent") at any time if and only if—
- (a) the parent is beneficially entitled to more than 50 per cent. of any profits available for distribution to equity holders of the subsidiary; and
  - (b) the parent would be beneficially entitled to more than 50 per cent. of any assets of the subsidiary available for distribution to its equity holders on a winding-up.
- (1F) Schedule 18 to the Taxes Act 1988 (group relief: equity holders and profits or assets available for distribution) shall apply for the purposes of subsections (1D) and (1E) above as if the references to subsection (7), or subsections (7) to (9), of section 413 of that Act were references to subsections (1D) and (1E) above and as if, in paragraph 1(4), the words from "but" to the end and paragraph 7(1)(b) were omitted."
- (3) In subsection (3) of that section for the words from "75 per cent. subsidiary of another company" to "is the principal company" there shall be substituted the words "member of another group, the first group and the other group shall be regarded as the same".
- (4) In subsection (4) of that section—
- (a) for the words "a company" there shall be substituted the words "a member of a group of companies", and
  - (b) for the words from "that company, or" to the end there shall be substituted the words "that or any other company ceasing to be a member of the group".
- (5) In section 278 of that Act (deemed disposal of certain assets held by company leaving group) after subsection (3A) there shall be inserted—
- "(3B) Where, apart from subsection (3C) below, a company ceasing to be a member of a group by reason only of the fact that the principal company of the



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group becomes a member of another group would be treated by virtue of subsection (3) above as selling an asset at any time, subsections (3C) to (3E) below shall apply.

(3C) The company in question shall not be treated as selling the asset at that time; but if—

- (a) within six years of that time the company in question ceases at any time (“the relevant time”) to satisfy the following conditions, and
- (b) at the relevant time, the company in question, or a company in the same group as that company, owns otherwise than as trading stock the asset or property to which a chargeable gain has been carried forward from the asset on a replacement of business assets,

the company in question shall be treated for all the purposes of the Capital Gains Tax Act 1979 as if, immediately after its acquisition of the asset, it had sold and immediately reacquired the asset at the value that, at the time of acquisition, was its market value.

(3D) Those conditions are—

- (a) that the company is a 75 per cent. subsidiary of one or more members of the other group referred to in subsection (3B) above, and
- (b) that the company is an effective 51 per cent. subsidiary of one or more of those members.

(3E) Any chargeable gain or allowable loss accruing to the company on that sale shall be treated as accruing at the relevant time.

(3F) Where—

- (a) by virtue of this section a company is treated as having sold an asset at any time, and
- (b) if at that time the company had in fact sold the asset at market value at that time, then, by virtue of section 26 of that Act, any allowable loss or chargeable gain accruing on the disposal would have been calculated as if the consideration for the disposal were increased by an amount,

subsections (3) and (3C) above shall have effect as if the market value at that time had been that amount greater.”

(6) In section 97 of the Inheritance Tax Act 1984 (transfers within group etc.)—

- (a) for the words “principal member” and “principal member's”, wherever appearing, there shall be substituted “principal company” and “principal company's” respectively,
- (b) for subsection (2)(a) there shall be substituted—
  - “(a) section 272 of the Taxes Act 1970 (groups of companies: definitions) applies as for the purposes of sections 273 to 281 of that Act”, and
- (c) the words from “and in this section” in subsection (2) to the end shall be omitted.

(7) Subject to the following provisions, this section shall be deemed to have come into force on 14th March 1989; but section 278(3E) of the Taxes Act 1970 shall have effect where the accounting period in which the company referred to in subsection (3B) of that section ceases to be a member of a group ends after the day appointed for the purposes of paragraph 4 of Schedule 6 to the Finance (No. 2) Act 1987.

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(8) Where—

- (a) at the beginning of the commencement day a company ceases for the purposes of the group provisions to be a member of a group by reason only of the substitution for the old definition of the new definition, and
- (b) in consequence of ceasing to be such a member the company would, apart from this subsection, be treated by virtue of section 278(3) of the Taxes Act 1970 as selling an asset at any time,

the company in question shall not be treated as selling that asset at that time unless the conditions in subsection (9) below become satisfied, assuming for that purpose that the old definition applies.

(9) Those conditions are—

- (a) that for the purposes of section 278 of that Act the company in question ceases at any time (“the relevant time”) to be a member of the group referred to in subsection (8)(a) above,
- (b) that, at the relevant time, the company in question, or an associated company also leaving that group at that time, owns otherwise than as trading stock the asset or property to which a chargeable gain has been carried forward from the asset on a replacement of business assets, and
- (c) that the time of acquisition referred to in section 278(1) of that Act fell within the period of six years ending with the relevant time.

(10) Where, under any compromise or arrangement agreed to on any date before 14th March 1989 in pursuance of section 425 of the Companies Act 1985 and sanctioned by the court, one company acquires at any time, directly or indirectly, an interest in ordinary share capital of another company and immediately after that time—

- (a) under the old definition the two companies are, by virtue of that acquisition, members of a group for the purposes of the group provisions, but
- (b) the second company is not an effective 51 per cent. subsidiary of the first company,

subsection (11) below applies; and in that subsection those companies and any other members of the group are referred to as “relevant companies”.

(11) In respect of the period beginning with the time of acquisition and ending with—

- (a) the expiry of the six months beginning with the date of the agreement, or
- (b) if earlier, the date when, under the old definition, the other company ceases for the purposes of the group provisions to be a member of the group referred to in subsection (10)(a) above,

the old definition shall apply in relation to the relevant companies for the purposes of the group provisions and the commencement day in relation to those companies is the day following the end of that period.

(12) In subsections (8) to (11) above—

“arrangement” has the same meaning as in section 425 of the Companies Act 1985,

“commencement day”, subject to subsection (11) above, is 14th March 1989,

“effective 51 per cent. subsidiary” has the meaning given by section 272(1E) of the Taxes Act 1970,

“group provisions” means sections 273 to 281 of that Act, and

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“the new definition” means section 272 of that Act as amended by this section and “the old definition” means that section as it had effect on 13th March 1989,  
and section 278(4) of that Act shall apply for the purposes of those subsections.